



# Investment in Germany

**A practical Investor Guide to the Tax and  
Regulatory Landscape in Germany**

2016

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International Business



# Preface

Germany is one of the most attractive places for foreign direct investment. The reasons are abundant: A large market in the middle of Europe, well-connected to its neighbors and markets around the world, top-notch research institutions, a high level of industrial production, world leading manufacturing companies, full employment, economic and political stability.

However, doing business in Germany is no simple task. The World Bank's "ease of doing business" ranking puts Germany in 15th place overall, but as low as 107th place when it comes to starting a business and 72nd place in terms of paying taxes. The confusing mixture of competences of regional, federal, and European authorities adds to the German gift for bureaucracy.

Numerous legislative changes have taken effect since we last issued this guide in 2011. Particularly noteworthy are the Act on the Modification and Simplification of Business Taxation and of the Tax Law on Travel Expenses (Gesetz zur Änderung und Vereinfachung der Unternehmensbesteuerung und des steuerlichen Reisekostenrechts), the 2015 Tax Amendment Act (Steueränderungsgesetz 2015), and the Accounting Directive Implementation Act (Bilanzrichtlinie-Umsetzungsgesetz).

The remake of Investment in Germany provides you with the most up-to-date guide on the German business and legal environment.\* You will be equipped with a comprehensive overview of issues concerning your investment decision and business activities including economic facts, legal forms, subsidies, tariffs, accounting principles, and taxation. For a more detailed elaboration on the investment potential, please also see our publication Business Destination Germany on our website.

Please contact us for further information. We will be happy to advise you.

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\* based on published legal status as of January 1 2016.

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# Germany - an outline

## Chapter 01

## 1.1 Geography and climate

The Federal Republic of Germany is located in the center of Europe. It is one of the largest countries in Europe, covering an area of approximately 357,000 square kilometers (138,000 square miles) and measuring 885 kilometers (550 miles) from north to south and 595 kilometers (370 miles) from east to west. Germany's neighboring countries are Poland, the Czech Republic, Austria, Switzerland, France, Luxembourg, Belgium, the Netherlands, and Denmark (clockwise). Germany's ideal location in the heart of Europe, with major international airports in Frankfurt/Main, Munich, Duesseldorf, Cologne, Hamburg and Berlin, as well as access to the North and Baltic Seas, creates a multitude of opportunities for European and international business.

The climate in Germany is mild, with moderate rainfall throughout the year. In the lower-altitude regions, winter temperatures are usually above freezing with rare snowfalls, and summers are occasionally hot. Regions above 500 meters generally have mild summers and moderate amounts of snow in the winter.

## 1.2 Population and language

The population of Germany is currently around 80.78 million. Table 1 shows the population of Germany in comparison with that of other EU countries. The size of its population makes Germany the largest consumer market within the EU. Most German citizens speak one or two foreign languages, of which English, French, Spanish, and Russian are the most common.

## 1.3 Political system

Under the German constitution, the Federal Republic of Germany is a parliamentary democracy with currently 16 federal states (*Länder*). The capital of Germany is Berlin. At the federal level, the executive branch consists of the Federal President (*Bundespräsident*) and the Federal Government (headed by the Federal Chancellor and the Cabinet). The bicameral legislature consists of the Federal Parliament (*Bundestag*), the delegates of which are elected in part directly and in part under a party list proportional system, and the Federal Council of States (*Bundesrat*), consisting of representatives from the governments of the federal states (*Länder*).

**Table 1: German population in relation to the EU**

Country	Population (inhabitants, millions)	Federal State (Land)	Population (inhabitants, millions)
Germany	81.2	Baden-Wuerttemberg	10.7
Austria	8.6	Bavaria	12.7
Belgium	11.3	Berlin	3.5
Bulgaria	7.2	Brandenburg	2.5
Croatia	4.2	Bremen	0.7
Cyprus	0.9	Hamburg	1.8
Czech Republic	10.5	Hesse	6.1
Denmark	5.7	Mecklenburg-Western Pomerania	1.6
Estonia	1.3	Lower Saxony	7.8
Finland	5.5	North Rhine-Westphalia	17.6
France	66.4	Rhineland-Palatinate	4.0
Greece	10.8	Saarland	1.0
Hungary	9.9	Saxony	4.1
Ireland	4.6	Saxony-Anhalt	2.2
Italy	60.8	Schleswig-Holstein	2.8
Latvia	2.0	Thuringia	2.2
Lithuania	2.9	<b>Germany total</b>	<b>81.2</b>
Luxembourg	0.6		
Malta	0.4		
Netherlands	16.9		
Poland	38.0		
Portugal	10.4		
Romania	19.9		
Slovak Republic	5.4		
Slovenia	2.1		
Spain	46.4		
Sweden	9.8		
United Kingdom	64.8		
<b>EU total</b>	<b>508.2</b>		

Source: Statista/German Federal Statistical Office, 2016

## 1.4 Legal system

The origin of Germany's civil law is Roman law. Important legislation is mainly federal and is usually embodied in general codes. The judicial system is generally three-tiered (federal, regional and local courts), except for tax courts, which are two-tiered. The Federal Constitutional Court (Bundesverfassungsgericht) is the court of last resort if constitutional issues are involved. The European Court of Justice (ECJ) is the supreme decision-making body for issues relating to the fundamental freedoms guaranteed by the EC treaty and to other questions of EU law.

## 1.5 Economy and currency

### 1.5.1 General European background

The Federal Republic of Germany, one of the world's major industrialized nations, is a founding member of what is now called the EU, which was created in 1957 under the Treaty of Rome. The signatories to the treaty agreed to form a common market by abolishing all customs barriers within the Union. This involved creating common external tariffs for imports from non-member countries, allowing freedom of movement of capital and labor within the Union, as well as harmonizing economic policies, legal and taxation systems, and social conditions. In recent years, the EU has been increasingly active in the area of company law harmonization, including requirements for the format of financial statements, and has issued directives on consumer protection, fair-trade practices, antitrust regulations, and specific taxes. In 1993 the single European market came into existence. The Maastricht Treaty, which established the EU, also entered into force in 1993. This treaty between the 15 (at the time) Member States of the EU defines the following three fundamental objectives:

- Economic and monetary union
- Common foreign and security policy
- Close cooperation in legal and internal matters

The Amsterdam Treaty entered into force on 1 May 1999 and was followed by the Treaty of Nice on 1 February 2003. Both treaties seek to achieve more effective political cooperation and improvements in the rights of individual EU citizens. The Treaty Establishing a Constitution for Europe, commonly referred to as the European Constitution, was an international treaty

intended to create a constitution for the EU. Its main aims were to replace the overlapping set of existing treaties that comprise the EU's current constitution, to codify uniform basic rights and democratic principles throughout the EU, and to streamline decision-making processes. It was signed in 2004 by representatives of the Member States of the EU and subject to ratification by all Member States. This proved impossible to achieve, since several Member States declined to ratify the Constitution. Following the failure of the constitutional treaty, it was decided at a European Council meeting in June 2007 to start negotiations on a treaty of reform as a replacement. This treaty (the Treaty of Lisbon) was signed in December 2007 at a summit in Lisbon, Portugal. It amends the existing treaties of the EU. The Lisbon Treaty was ratified by all EU Member States and entered into force on December 1 2009.

### ***1.5.2 Monetary policy in the European Union***

Of the present 28 EU Member States, 19 are now part of the Eurozone (Belgium, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal, Finland, Greece, Slovenia, Malta, Cyprus, Slovakia, Estonia, Latvia, Lithuania). Bulgaria, Croatia, Czech Republic, Denmark, Hungary, Poland, Romania, Sweden, and the United Kingdom are EU Member States but do not use the single European currency at present.

The participating countries were deemed by the European Council to have satisfied the convergence criteria, in particular

- Price stability (low inflation)
- No excessive government deficits
- No excessive government debt

The fulfillment of these criteria is also used to determine which countries will be allowed to join the European Monetary Union (EMU).

Monetary policy in the participating countries is managed by the European System of Central Banks, which consists of the European Central Bank (ECB) and the national central banks. The ECB is based in Frankfurt/Main. It started work in 1999 and is an independent institution committed to maintaining stable prices.

The Stability and Growth Pact is an important part of the EMU. Under this Pact, governments are committed to "reach a budgetary position of 'close to balance or in surplus' in the coming years". The Stability and Growth Pact also sets up procedures on how to handle excessive deficits, which are deemed to begin at a rate above 3% of gross domestic product (GDP), except in extreme economic conditions. Furthermore, the ratio of gross government indebtedness to GDP is not permitted to exceed 60% at the end of any fiscal year. In January 2012, the heads of state and government of the Member States decided to tighten the Stability and Growth Pact in response to the European debt crisis. This "Fiscal Compact" came into effect in January 2013. Among other aspects, it includes an obligation for the individual countries to implement a balanced budget amendment in national legislation by 2018. In addition, the European Stability Mechanism (ESM) was established to prevent heavily indebted Eurozone countries from becoming insolvent.

### 1.5.3 General economic data

In 2015, Germany's GDP was € 3,026,6 billion. Over the past few years, Germany's GDP has changed as follows:

**Table 2: Development of gross domestic product**

Year	GDP in billion €	(price-adjusted)
2012	2,749.9	0.4%
2013	2,809.5	0.1%
2014	2,903.8	1.6%
2015	3,026.6	1.7%

Source: German Federal Statistical Office, 2012–2015

**Table 3: Average exchange rate of the Euro**

Country	Currency	Exchange Rate
United Kingdom	Pounds sterling	0.72584
Japan	Yen	134.31
Switzerland	Swiss francs	1.0679
USA	US dollars	1.1095

Source: European Central Bank, 2015

In 2015, the annual inflation rate was around 0.3%.

The prime interest rate of the European Central Bank (ECB) (main refinancing operations – fixed rate) is 0.05%, effective September 4 2014. This interest rate, which applies in the European Monetary Union (EMU), influences the exchange rate of the euro against other currencies. The value of the euro in other major currencies in 2015 is shown in table 3.

#### ***1.5.4 German exports to foreign countries***

In 2013, Germany was third behind China and the USA on the list of the world's 20 largest exporting countries. German manufacturers of machines, cars, chemical and electronic products, and optical products traditionally have a strong foothold on the global market. In 2014, Germany exported goods worth € 1,123,746 billion. Exports declined by 18.4% in the calendar year 2009 due to the global economic crisis, but have increased steadily since then.

#### ***1.5.5 Consumer prices***

The cost of living in Germany varies greatly and depends mainly on the place of residence. The cost of living and housing in Munich in southern Germany, for instance, is likely to be higher than in Rostock – a city in the northeastern part of Germany. The Federal Statistical Office identifies retail price movements by using various consumer categories, and documents its findings in the form of a consumer price index.

**Table 4: Development of gross domestic product**

<b>Total index/category</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
Food/non-alcoholic beverages	100.0	102.8	106.3	110.4	111.5
Alcoholic beverages, tobacco products	100.0	101.8	104.8	107.0	110.3
Clothing and shoes	100.0	101.2	103.3	104.4	105.5
Accommodation, water, gas, electricity, etc.	100.0	103.1	105.4	107.5	108.4
Furnishings, household goods	100.0	100.4	101.1	102.1	102.5
Health care	100.0	100.7	103.2	99.4	101.4
Transport	100.0	104.5	107.7	107.5	107.3
Communications	100.0	96.5	94.8	93.4	92.3
Leisure, entertainment, etc.	100.0	99.7	100.6	103.1	104.4
Education	100.0	99.6	94.0	95.1	93.1
Restaurant services	100.0	101.5	103.6	106.0	108.2
Other goods and services	100.0	101.6	102.6	104.3	106.1
<b>Total index</b>	<b>100.0</b>	<b>102.1</b>	<b>104.1</b>	<b>105.7</b>	<b>106.6</b>

Source: German Federal Statistical Office, 2010–2014

### 1.5.6 Currency and exchange controls

The euro is the official currency in Germany and the other Eurozone member countries. The euro was launched in 1999. The euro is freely convertible into other currencies, and the import and export of capital is free, subject only to reporting requirements.

### 1.6 Banking system and regulations

Germany has a universal banking system, i.e. German banks are typically engaged in a full range of banking activities rather than being specialized or restricted to certain activities. Despite all the differences in their legal form, size, organization and business structure, the vast majority of banks provide virtually every type of banking services. Large parts of the banking sector are publicly owned or controlled, or are cooperatives. These banks play an important role in the development of local communities.

### ***1.6.1 The German Central Bank and the European Central Bank***

The German Central Bank (Deutsche Bundesbank) is the central bank of Germany. Its central office is in Frankfurt/Main. It has nine regional offices (Hauptverwaltungen, formerly known as State Central Banks, Landeszentralbanken) located in Berlin, Duesseldorf, Frankfurt/Main, Hamburg, Hanover, Leipzig, Mainz, Munich, Stuttgart.

The duties of the German Central Bank include country-specific tasks within the framework of European monetary policy, such as joint decision-making and the implementation of a common European monetary policy, and the management of currency reserves. The German Central Bank is also involved in monitoring banks and financial services institutions and is a member of the International Monetary Fund (IMF) and International Clearing Bank.

The European Central Bank (ECB) was established in June 1998 and is located in Frankfurt/Main. Under the European Treaty, the European System of Central Banks (ESCB) consists of the ECB and the national central banks of the EU Member States. The key tasks of the ECB are to issue banknotes within the eurozone and to formulate monetary policy for the eurozone – in particular to determine the prime interest rate.

The ECB is independent not only of the governments of the EU Member States, but also of the national central banks in the euro system. Furthermore, the ECB has its own budget and is thus financially independent.

### ***1.6.2 German banking institutions***

Germany has a system of “universal” banks which are engaged in the full range of banking activities. In addition, there are some banks which specialize in particular services (e.g. mortgage banks and home loan banks). Most banks conduct both corporate and private customer business, although there is a trend towards big corporations increasingly being handled by major banks, while small and medium-sized enterprises are handled by smaller, regionally based banks (e.g. savings and loan banks, credit cooperatives for trade, and agricultural credit cooperatives). Meanwhile, many non-banking firms, such as insurers,

department stores, mail-order firms, and car manufacturers have become financial services providers.

In the past few years, the German banking sector has undergone significant consolidation. The takeover of Dresdner Bank by Commerzbank and the takeover of Postbank and Sal. Oppenheim by Deutsche Bank are the most striking examples of this development. Even in the case of cooperatives there have been numerous mergers between branches. The strong increase in consolidations has led to a shrinking banking branch network in Germany. Nevertheless, Germany is still at the European forefront in this respect.

Commercial banks, which account for the largest percentage of the volume of banking business, engage in most types of banking operations. They grant short-term loans, lines of credit, and medium and long-term loans; they also place issues and trade in securities for customers and for their own account. They are also allowed to own shares and participations in other industries. The range of services offered by banks is becoming increasingly diversified and includes activities such as online banking and investment banking. Moreover, the number of direct banks with no branch network has been increasing.

Savings and loan banks (Sparkassen) are mostly municipal and regional banks. They are coordinated through central institutions and serve as regional clearing houses. Savings and loan banks are also engaged in commercial banking activities.

Credit cooperatives for trade (Volksbanken) and for agriculture (Raiffeisenkassen) generally extend lines of credit and long-term loans to their members – typically smaller businesses – but also to individuals. Regional and federal central institutions serve as clearing houses and sources of refinancing.

Mortgage banks (Hypothekenbanken) specialize in long-term mortgage loans and long-term loans to federal, state, and local governments. They issue bonds secured by mortgage loans and loans to public authorities.

In addition, a number of private and public banks provide highly specialized services and special forms of financing. Insurance

banks and leasing companies also play an important role in the financing of industrial business.

### **1.6.3 Banking regulations**

The German Banking Act (Kreditwesengesetz – KWG) governs the business activities of banks, financial services institutes, and other legal forms that are active in the finance sector. The Banking Act pursues three goals:

- Ensuring structured business transactions in the financial sector under state supervision
- Ensuring a functioning banking industry
- Protecting bank creditors against losses

Banks, financial services institutions, and insurers in Germany are governed by a state regulator, the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin). BaFin functions under the auspices of the German Federal Ministry of Finance (Bundesministerium der Finanzen – BMF). Its main objectives are as follows:

- To ensure proper functioning, stability, and integrity of the German financial system (the prime objective),
- to ensure that banks, financial services institutions, and insurers are able to meet their payment obligations, and
- to enforce standards of professional conduct which preserve investors' confidence in the financial markets.

The tasks of the BaFin directorate for Banking Supervision include, *inter alia*, constant monitoring of banks to ensure that they are complying with capital adequacy requirements, maintaining sufficient liquid funds, and complying with statutory risk limits (e.g. large exposure limits). It also ensures that the banks' bad debt provisions are in line with their risk exposure. The BaFin directorate for Insurance Supervision is responsible, *inter alia*, for granting the regulatory authorization required by enterprises in order to carry out insurance business. The BaFin directorate for Securities Supervision/Asset Management is responsible for ensuring, *inter alia*, that insider trading prohibited by the German Securities Trading Act (Wertpapierhandelsgesetz – WpHG) does not occur.

The Deutsche Bundesbank participates in ongoing banking supervision. Its participation is governed by § 7 of the German

Banking Act (Kreditwesengesetz – KWG). Among other things, the Bundesbank analyzes the reports and returns that institutions have to submit on a regular basis and assesses whether their capital and risk management procedures are adequate.

The Basel Committee on Banking Supervision is exerting an increasing influence on banking supervision. Germany has implemented the recommendations of the Basel Committee on Banking Supervision (e.g. Basel II) via German Banking Act (KWG), Regulation Governing Solvency (SolvV), and Minimum Requirements for Risk Management (MaRisk). Other recommendations (e.g. Basel III) and EU standards (e.g. Solvency II) will be implemented in the near future.

### **1.7 Stock exchanges**

In Germany there are stock exchanges in Berlin, Duesseldorf, Frankfurt/Main, Hamburg, Hanover, Munich, and Stuttgart. The most important stock exchange is the Frankfurt Stock Exchange (Frankfurter Wertpapierbörse). The institution operating the Frankfurt Stock Exchange is Deutsche Börse AG. The Frankfurt Stock Exchange accounts for over 85% of trading in the German market. The most important trading indices in Frankfurt are DAX, MDAX, TecDAX, SDAX, and DJ Euro Stoxx 50.

The German Exchange Supervisory Authority, an institution of the German federal states (Länder), monitors the setting up, closing down, and operations of stock exchanges, and ensures that trading is properly conducted.

### **1.8 Foreign investment in Germany**

In the not too distant past, foreign direct investment (FDI) in Germany was rather slow, and international companies claimed that the German economy had lost its attractiveness for foreign investors. However, there has been a turnaround in FDI over the last couple of years. Current trends towards tax reform have improved opportunities for foreign investors.

Foreign investment is welcome in Germany. There are no substantial restrictions on new foreign investments, permanent currency controls, or administrative controls on such investments. Attitudes towards foreign takeovers of German businesses are much more positive today than they were just a few years ago.

Foreign investors are subject to the same conditions as German investors when obtaining licenses or building permits, or applying for and receiving investment incentives.

Where restrictions exist with respect to a particular business activity, such as licensing and notification requirements (see below), such restrictions apply to both German and foreign businesses.

The July 2006 Takeover Directive Implementation Act amended the Securities Acquisition and Takeover Act (Wertpapiererwerbs- und Übernahmegesetz – WpÜG) to bring it into line with the 2004 EU Takeover Directive. The WpÜG now also applies to cross-border takeovers.

As the German Federal Cartel Office (Bundeskartellamt) aims to prevent the establishment of dominant market positions, large firms must register proposed takeover bids in advance, based on certain criteria. The applicable criteria pertain to global markets.

## 1.9 Business regulations

### 1.9.1 *Notification requirements*

While freedom of enterprise is a valid principle under Section 1 of the Business Practice Act (Gewerbeordnung – GewO), any business, factory, trade, or industrial establishment, whether German or foreign, must notify the respective local administration and tax authorities of its business prior to commencing activities.

### 1.9.2 *Regulated industries*

In order to protect the general public from risky business practices, special licenses are necessary for certain businesses, including the following:

- Insurance business
- Commercial banking
- Brokers and agents for real estate, housing, investment, and mutual funds
- Asset-custody and security businesses
- Pawnbroking and auction sales
- Gambling

### **1.9.3 Special business permits**

Germany has strict environmental regulations. Business activities which are inherently dangerous, polluting, or otherwise clearly harmful to the environment require special authorization. The Federal Pollution Control Act (Bundesimmissionsschutzgesetz – BImSchG) is at the center of such legislation. Industrial facilities and their modifications must comply with strict standards, which are defined in "Technical Directives". The licensing procedure for such special business permits is very formal. Investors often complain about the complexity of the licensing procedure. This, in turn, has led to a review of the procedure by governmental and legislative bodies in Germany with the aim of reducing the complexity and burden for the investor.

### **1.10 Intellectual property**

German law offers several options to protect the economic value of intellectual work. The object, product, or idea to be protected determines the type of property right to be applied.

#### **1.10.1 Patents**

Patents are granted for technical inventions that are novel throughout the world, involve an inventive step, and are susceptible of industrial application.

The patent gives the proprietor of the patent the exclusive right to use the patent for a period of 20 years from the day following the filing of the application. The invention may be used only subject to the consent of the patent proprietor.

Patents may be granted for inventions in all technical fields. No patents will be granted in Germany for simple discoveries, scientific theories, mathematical methods, schemes, rules and methods for performing mental acts, playing games, or doing business, e.g. organization models.

The invention must be registered with the German Patent and Trade Mark Office (Deutsches Patent- und Markenamt – DPMA) to obtain patent protection. In Germany the DPMA is the central industrial property authority.

The applicant has to file a request for examination with the DPMA that is subject to a fee. The request must contain a detailed description of the invention. The DPMA website [www.dpma.de](http://www.dpma.de)

provides further information on filing the application and applicable fees.

Foreigners may also file applications for patents in Germany. Under certain circumstances, however, a patent attorney has to be appointed as representative in Germany.

European patents are granted under the European Patent Convention (EPC). More information is available at the website of the European Patent Organization [www.epo.org/patents.html](http://www.epo.org/patents.html).

### ***1.10.2 Utility models***

Similar to a patent, a utility model gives its owner the exclusive right to use a technical invention for a duration of 10 years from the day following the filing of the application.

Contrary to patent applications, the DPMA does not verify during the application process whether the subject matter of a utility model is novel, involves an inventive step, or is susceptible of industrial application. A review will be conducted only if a third party challenges the utility model by filing a request for cancellation.

While a patent application might take several years to be granted, the utility model can be entered into the Register already a few weeks after the application was filed.

### ***1.10.3 Trademarks***

Trademark law entitles the proprietor to put a product or service on the market and to use the trademark as protection against competitors.

Trademarks are signs which are used to distinguish goods or services of one company from those of other companies. Words, images (e.g. company name or logo), sounds, colors, three-dimensional shapes, or combinations thereof may be registered as trademarks.

A trademark is protected by registering it with the DPMA. As with patents, the owner must file an application with the DPMA. In addition, trademark protection shall also accrue without registration (i) through the pure use of the sign in the course of trade insofar as the sign has acquired a secondary meaning as a

trademark within the affected trade circles or (ii) by notoriety as a trademark within the meaning of Article 6bis Paris Convention of the Protection of Industrial Property.

It is not possible to register signs or indications which are merely descriptive of the kind, quality, or other properties and features of the goods or services applied for.

The proprietor of a trademark has the exclusive right of use for the mark in question. He can prohibit third parties from using a similar mark for similar goods or services. If any action arises that is in violation of his right, the proprietor may claim damages and demand the destruction of infringing articles.

The term of protection for a mark is 10 years. It can be renewed indefinitely.

#### ***1.10.4 Registered designs***

A registered design carries the exclusive right to manufacture and distribute designs and models of aesthetic value. Registered designs protect the outward appearance of two-dimensional or three-dimensional items (e.g. shapes or colors).

The design must be entered in the Designs Register of the DPMA to obtain protection. The DPMA does not verify whether the design is novel or has individual character when it is entered in the Register. Civil Courts will clarify this matter in the event of disputes.

Protection is valid up to 25 years from the date of filing.

#### ***1.10.5 Copyright and competition law***

German copyright law protects in particular literary works, scientific work, and works of applied art against copying. A registration is not necessary. The owner automatically holds an exclusive right of use and exploitation. Such right expires automatically 70 years from the death of the author.

The Unfair Competition Act (Gesetz gegen unlauteren Wettbewerb – UWG) protects competitors and participants in the market against unfair business practices that distort competition, e.g. the distribution of counterfeits.

### **1.10.6 Licenses**

License agreements play an important role in industry and commerce. They grant third parties a right of use and enjoyment of intellectual property rights (patents, registered designs, registered trademarks, and copyrights).

If granted such a license the licensee can use such right without having to be the owner.

The licensor may decide at his discretion whether to grant an exclusive license to one licensee, or simultaneously to multiple licensees within the same territory.

For further information on the taxation of licenses see chapters 6.1.1 and 6.2.3.

## **1.11 Residence and work permits**

### **1.11.1 Residence permits**

The Residence Act (Aufenthaltsgesetz – AufenthG) regulates entry and residence of foreign nationals. Most foreign nationals from outside the EU need a residence title (Aufenthaltstitel) to enter or reside in Germany. This can be a visa (Visum), a residence permit (Aufenthaltserlaubnis), or a permission of settlement (Niederlassungserlaubnis). Persons wishing to enter Germany must normally obtain a residence title in advance in the form of a visa from an official representative of the Federal Republic of Germany in their home country. A short-term visa is sufficient for a stay of up to three months within a six-month period without taking up paid work. Furthermore, citizens of many countries do not need a visa for private or business trips of up to three months' duration. Individuals intending to stay for more than three months or to take up paid work must obtain a national visa (nationales Visum). Such a national visa must be approved by the immigration office (Ausländerbehörde) of the place where the foreign person intends to settle. The Federal Employment Office (Bundesagentur für Arbeit) also needs to approve the issuance of the visa if an individual intends to take up employment. Nationals from EU Member States do not need a visa or any other residence title to enter or reside in Germany. Nevertheless, they must register with the proper authorities (Eingewohnermeldeamt) in the same manner as German citizens. They have the right to be automatically granted a residence permit

where this right exists under the EU treaty (freedom of movement of workers, etc). Citizens of Australia, Israel, Japan, Canada, South Korea, the United States, and New Zealand may also travel to Germany without a visa and apply for the necessary residence permit upon entry.

### **1.11.2 Work permits**

Nationals from EU Member States do not require a work permit due to the EU rights of freedom of movement.

Foreign nationals from outside the EU who are not self-employed and intend to work in Germany need a work permit in addition to a residence permit. This work permit can be granted by law (for instance, permission of settlement carries automatic entitlement to work). Otherwise, any gainful employment must be specifically authorized in the residence title (visa or residence permit). Before granting permission to work, the immigration office must obtain the approval of the employment office. Certain persons, including members of the management board of corporations, are exempt from the requirement of a work permit. Various other employees (e.g. employees on short-term foreign assignment for special construction jobs) may be exempt from the requirement of a work permit upon official notification towards the employment office.

Highly qualified employees can be granted work and residence permits of indefinite duration. There are two groups of highly qualified employees:

- Scientists with extraordinary qualifications
- High-level teachers/professors or high-level research assistants

# How to invest in Germany

## Chapter 02

## 2.1 Investment options

Germany offers different types of investment options which need to be assessed with a view to the intended business activity and the objectives of the potential investor. Generally, investors can opt for so-called direct transactions or direct investments, make investments through a permanent establishment or the engagement of a permanent representative, take up business activities as a sole proprietor in Germany, or set up a company. When deciding between these options, investors should consider the type and duration of their intended activities, the business risk associated with such activities, and the tax consequences.

### 2.1.1 *Direct transactions/direct investments*

For investors who, for instance, only intend to sell their products in Germany and thus develop a new market, the direct transaction option seems to offer some advantages, especially when considering that such projects are usually not free from risks and often lead to success only after a startup phase.

Direct transactions are the easiest option when it comes to conducting business in Germany. In direct transactions in the classical meaning, the foreign business supplies goods or renders services to a domestic recipient without giving rise to taxation in Germany (e.g. a foreign business supplies merchandise from abroad to a German customer). In such a case, the German-source income is not subject to income taxation in Germany. Nevertheless, the impact of Value Added Tax Law and Customs Law has to be considered (for further information see chapters 3 and 7). The number of transactions carried out by the business is irrelevant. Should domestic assistance be required to distribute the products, direct transactions may also be conducted with the help of an independent representative (not subject to substantive instructions) (for further information see chapter 2.1.2).

Real estate, for instance, that is situated in Germany and which a foreign investor acquires for the purpose of letting said property, is deemed a direct investment. The foreign investor engages in ongoing business activities in Germany but maintains neither a fixed place of business operating as a permanent establishment nor a commercial partnership or corporation in Germany. In such case, the German-source income generated by foreign investors is typically subject to non-resident (limited) tax liability in Ger-

many. Such activities are not subject to resident (unlimited) tax liability, as the investor does not reside in Germany. The amount of direct investments carried out is of no relevance.

Investing through direct transactions or direct investments in Germany typically results in the lowest administrative burden, requires no or only a very short lead time, and allows for the greatest flexibility (for further information see chapter 6.1.1). This type of investment is thus particularly appropriate for the initial phase of business activities to be conducted in Germany, if business activities in Germany are not intended to be conducted on a permanent basis, or only on a small scale.

### ***2.1.2 Investment through a permanent establishment (permanent – dependent – representative)***

Oftentimes, however, a stronger presence will be required in Germany after a while so as to meet market demands and increasing administrative requirements. In many cases, fulfilling these requirements is only possible by establishing a fixed place of business or facility in Germany that serves the business of the enterprise. Typically, this leads to the formation of a permanent establishment in Germany. There are no conditions under company law that permanent establishments would have to meet. The only condition to be met is to inform the municipality, in which the permanent establishment is opened, which in turn will share this information with the local tax office. Establishing and liquidating a permanent establishment is thus considerably easier than setting up or liquidating a company, which means that setting up a permanent establishment may be profitable even after a short period of engagement. Any German-source income derived from a permanent establishment is qualified as commercial income and subject to non-resident tax liability in Germany (for further information see chapter 6.1.2). The economic risk will be assumed solely by the foreign head office because a permanent establishment has no legal personality.

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In many cases, a representative rather than a fixed place of residence or facility will, after a certain period of time, become necessary to successfully conduct business. If the representative is a so-called permanent (dependent) representative who transacts business for an enterprise on an ongoing basis (enters into or procures contracts, obtains new business, or keeps and ships stocks of goods/products) and is subject to substantive instructions of the enterprise, the tax consequences will be the same as when setting up a permanent establishment (excluding trade tax). The income derived from a permanent (dependent) representative in Germany is subject to non-resident tax liability, as is the case with permanent establishment income (for further information see chapter 6.1.2).

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### ***2.1.3 Doing business as a sole proprietor in Germany***

Typically, engaging in business as a sole proprietor in Germany will only be interesting for foreigners intending to relocate to Germany to operate a small business there (for further information see chapter 5.3.4).

### ***2.1.4 Investments through a company***

#### ***2.1.4.1 Legal forms***

If foreign investors plan to conduct business on an ongoing basis in Germany, it might make sense to set up a company in Germany with a view to intended business activities. Foreign investors can choose between different legal forms which are typically divided into corporations (Kapitalgesellschaften) and partnerships (Personengesellschaften). Liability and allocation of profit are vital parameters influencing investors' decisions.

Establishing a corporation gives investors the opportunity to limit liability to the so-called liable equity capital (registered share capital – Grund-/Stammkapital) in order to limit their business risk (for further information see chapter 5.1.2). It is only with corporations that contractual relationships between the company and its shareholders are recognized for tax purposes, provided that said relationships comply with the arm's length principle (for further information see chapter 6.1.4). Furthermore, corporations with registered office or management in Germany are deemed separate legal persons and are thus subject to resident tax liability and must pay corporate income tax (plus solidarity surcharge) and trade tax, irrespective of their shareholders. In tax terms, a clear line has to be drawn between the level of the corporation and the level of its shareholders. Being separate legal persons,

corporations may retain earnings, thus ensuring that the shareholder's country of residence is unable to tax said earnings. Typically, only corporations are entitled to treaty benefits (for further information see chapter 6.2.5). There are several types of German corporations: the limited liability company (Gesellschaft mit beschränkter Haftung – GmbH), the business company (Unternehmergesellschaft – GmbH UG), the stock corporation (Aktiengesellschaft – AG), and the limited partnership with share capital (Kommanditgesellschaft auf Aktien – KGaA).

A typical feature of partnerships is that one or more of the partners are general partners with personal (unlimited) liability. Hence, contrary to corporations, there will always be at least one partner whose business risk is not fully limited (for further information see chapter 5.3.1). The principle of transparency applies to partnerships, which means that the result of the partnership's business activities, i.e. the profit or loss generated, is allocated directly to the partners. Direct allocation of profits and losses can be particularly interesting with regard to initial losses. As a general rule, partnerships are subject to trade tax depending on their business activities. As a consequence of the principle of transparency, however, income tax is levied at the level of the partners in accordance with their personal circumstances (for further information see chapter 6.1.3). Typically, a partnership is generally unable to enjoy treaty benefits as it has no legal person. Partnerships include general partnerships (Offene Handelsgesellschaft – OHG), limited partnerships (Kommanditgesellschaft – KG), and civil law associations (Gesellschaft des bürgerlichen Rechts – GbR).

German company law also allows for combinations between partnerships and corporations. The GmbH&Co. KG is a typical combination allowing for direct profit allocation at the level of the partners while avoiding the required unlimited personal liability of a partner (for further information see chapter 5.3.1). There is also the option to hold a participation in an existing company through a silent partnership or participation (stille Gesellschaft) (for further information see chapter 5.3.2).

In addition to the legal forms under German law it is also possible to establish a Societas Europaea (SE) (for further information see chapter 5.2.1). Legal forms of other EU Member States are

also recognized in Germany (for further information see chapter 5.5).

According to a decree of the German Finance Ministry the following criteria could be used in order to determine whether a foreign entity qualifies as a corporation or as a partnership from a German perspective.

**Table 5: List of possible criteria determining a corporation or partnership**

Criteria	Corporation	Partnership
Centralized management and representation	Yes	No
Limited liability – none of the members is personal liable	Yes	No
Free transferability of interests	Yes (in general)	No
Provision of capital	Requirement to provide the company with capital	No statutory requirement
Profit distribution	Determined by the par value of the stock	Proportionate to contributions
Formal requirements for organization	Entry in the Commercial Register is required	Entry in the Commercial Register is not required

### Types of investments

Basically, foreign investors can set up a new domestic company or acquire a domestic company. This decision depends on a number of geographical, financial and industrial factors, all of which need to be considered. A cost-benefit analysis or reference analysis always has to take into account all circumstances with regard to the individual case.

The requirements to be met when starting a business depend on the legal form chosen. When establishing a corporation (for further information see chapter 5.1.1), formal requirements are comparatively more exacting than the requirements to be met when setting up a partnership (for further information see chapter 5.3.1).

The timeline that has been set for entering the domestic market should not be neglected either. Given this situation, it can often make sense to acquire a business, as this would allow a

comparatively fast market penetration through the already established organization of the acquired business. Investors may acquire a domestic business by purchasing shares in a company (share deal – for further information see chapter 6.3.2), or by purchasing assets by way of singular succession (asset deal – individual transfer of assets and liabilities – for further information see chapter 6.3.1). In most cases, potential gains resulting from the sale, subsequent measures, and the deductibility of refinancing expenses will determine which type of business acquisition will be the best in tax terms.

In addition to the acquisition types described above, there is also the option to enter or expand into the domestic market by virtue of corporate reorganization (e.g. a merger with a domestic business – for further information see chapter 6.5).

### ***2.1.5 Types of cooperation***

It may be the case that there is no attractive option to acquire a domestic business at the intended point in time and that setting up a domestic business is also out of the question under the given circumstances. In such cases it might make sense to cooperate with domestic businesses through joint ventures and strategic alliances. Cooperating with strong, domestic partners will help investors tap into new markets, resources, and technologies, reach a critical mass to generate more growth, or share the risks of equity or technology-intensive projects.

Strictly speaking, a joint venture is based on a contractual agreement between two or more parties undertaking to pursue economic activity together. A joint venture is also a company in its own right where different partners join forces and share in the control, risk and profit of the company. The purpose is to pursue the agreed project in the common interest of all parties involved. Unlike in a merger, the parties generally maintain their independence and collaborate only when pursuing the goals of the joint project. Strategic alliances, on the other hand, are Joint Ventures based on a contractual relationship without forming a legal entity.

A joint venture created under company law is taxed according to the chosen legal form, the companies involved, and the regulations of the countries of residence concerned.

### **2.1.6 Going public**

Businesses in Germany may also use the option of an Initial Public Offering or IPO, i.e. the initial offer of shares on the organized capital market (for detailed information concerning stock corporations see chapter 5.1). Usually, a syndicate carries out the IPO which requires extensive financial, legal, and tax advice prior to offering the stock. IPOs enable businesses to raise new funding to expand their business, or to strengthen their equity capital base, thus reducing their cost of debt and safeguarding their credit worthiness. Employees can be given the option to participate in the company. An IPO can increase the visibility and competitiveness of a business. Also, IPOs can be used for business succession planning and spin-offs.

## **2.2 Opportunities for international investors**

Many federal, regional and EU programs exist to promote investment in Germany.

### **2.2.1 Federal and regional subsidies**

The Federal Government and the governments of the federal states (Länder) support Germany's economy by providing subsidies. Financial aid and tax reliefs are regarded as subsidies.

- Tax reliefs always have a legal basis and are intended to reduce the tax burden. Important tax relief measures were introduced recently to defuse the financial and economic crisis, with the aim to quickly and efficiently remove obstacles to growth in Germany. The German Growth Acceleration Act (Wachstumsbeschleunigungsgesetz) introduced reliefs pertaining to limitations on loss utilization as specified in § 8c Corporate Income Tax Law (KStG) and earnings stripping rules (§ 4h Income Tax Law (EStG), § 8a KStG), which makes it more interesting to acquire companies in Germany that are in need of reorganization in order to "rescue" the company.

Financial aid is granted in addition to tax reliefs and is available as a subsidy, loan, or debt service assistance, with subsidies accounting for the lion's share. The Federal Government grants loans through financial institutions such as the Kreditanstalt für Wiederaufbau – KfW.

Subsidy policy in Germany is currently affected to a large extent by the goals of the energy transition. The aim is to ensure a climate-friendly and environmentally compatible energy supply without putting the competitiveness of German companies at risk. To this end, research projects relating to the environment, the climate, and the energy supply system, as well as to the efficient use of renewable energy are being promoted by means of various measures. Meanwhile, there are tax breaks, for energy-intensive economic sectors, for example, to ensure that they remain internationally competitive as energy prices increase.

The following chapters give an overview of the main types of financial aid extended by the German Federal Government and the governments of the Länder.

*2.2.1.1 "Joint Task Improving the Regional Economic Structure" ("Gemeinschaftsaufgabe – Verbesserung der regionalen Wirtschaftsstruktur" – GRW)*

The framework of the "Joint Task Improving the Regional Economic Structure" ("Gemeinschaftsaufgabe – Verbesserung der regionalen Wirtschaftsstruktur") or Joint Task Program (Gemeinschaftsaufgabe – GRW) regulates the distribution of non-repayable cash incentives, loans, and guarantees. Typically, these incentives are earmarked for commercial investments and investments in local economic infrastructures. Joint Task incentives are limited to distinct, economically weak regions and are intended to create and maintain competitive, permanent jobs in the respective region.

The Joint Task Program grants non-repayable cash payments which are based on either investment costs or assumed wage costs.

As a general rule, investment projects qualify for the Joint Task Program if they are both suited to induce a permanent, significant and immediate increase of the total income (primary effect) and suited to create new, permanent jobs or safeguard existing jobs in the so-called Development Areas. The investor is required to provide an appropriate portion of the costs that are subject to this program (at least 25%), and the project has to be completed within 36 months. Also, as a general rule, after the completion of the investment project, the assets subsidized by

the program must remain in the subsidized permanent establishment for at least five years and/or the jobs created with such subsidies have to be maintained over a period of at least five years. Otherwise, the cash payments may be recalled.

The amount of the cash payment depends on the incentive rate level, which varies from region to region. The different regions are classified based on their economic development level. The Joint Task Program thus distinguishes between two different grades of Development Areas:

- Development Area C (regions located mainly in the eastern part of Germany),
- Development Area D

In the Development Areas the investment subsidies disbursed from Joint Task funds and other public funds may be granted only up to the specified maximum incentive rate level. The following table summarizes the maximum incentive rate level for the Development Areas.

**Table 6: Summary of maximum incentive rates**

Development Areas	Small enterprises	Medium-sized enterprises	Other
C	35%*	25%*	15%*
D	20%	10%	€ 200,000

\*local variances possible (from 30/20/10% to 40/30/20%)

Medium-sized enterprises are defined as enterprises:

- with fewer than 250 employees, and
- with either turnover not exceeding € 50 million or a balance sheet total not exceeding € 43 million.

Small enterprises are defined as enterprises:

- with fewer than 50 employees, and
- with turnover or a balance sheet total not exceeding € 10 million.

Applications regarding the Joint Task Program have to be addressed to the appropriate office before commencing the project. A claim cannot be enforced at law as a legal right even if all requirements are met.

#### *2.2.1.2 Loan programs*

Investors can access publicly subsidized loan programs in Germany. Loans at concessionary interest rates are granted by various public credit institutions, such as the Kreditanstalt für Wiederaufbau – KfW (i.e. KfW Mittelstandsbank). A private credit institution has to file the application for funds. The loans granted by KfW are generally long-term loans with maturities of up to 20 years and often have a grace period at the beginning. The maximum loan amount granted in the programs shown below is between € 100,000 and € 25 million:

- KfW Startgeld: Loans for business start-ups, freelancers, and small enterprises that have been doing business for less than three years,
- KfW Entrepreneur Loan: Loans for business start-ups, medium-sized enterprises, and freelancers investing in Germany,
- ERP Regional Promotion Program: Long-term financing of investments for economically weak areas,
- KfW Energy Efficiency Program: Low-interest financing to help small and medium-sized enterprises to improve their energy efficiency,
- KfW Renewable Energies Program: For investors wishing to generate energy with biomass, biogas, or geothermal power plants.

#### *2.2.2 European subsidies*

For the 2007 to 2013 grant period, Germany had approximately € 26.3 billion in EU funding available. The financial framework for 2014 to 2020 granted Germany approximately € 19.3 billion for structural measures.

There are a number of ways to obtain grants from EU institutions. However, support for enterprises is usually given indirectly through the provision of federal and regional grants funded by EU capital.

Sometimes, it is possible to apply directly to international institutions for funding. Public invitations to apply for this type of funding may be found in the Official Journal of the EU. Assistance from European funds may be given in the form of subsidies, loans at concessionary rates of interest, equity investments, or the provision of venture capital.

The EU provides all kinds of assistance especially for SMEs from Member States, e.g. grants, loans and, in some cases, guarantees. Support is available either directly or indirectly through the EU's Structural Funds, which are managed at the national level. SMEs can also benefit from a host of non-financial assistance activities in the form of programs and business support services.

# Importing to Germany

## Chapter 03

Germany is a Member State of the EU. Goods can circulate freely within the EU, but must be cleared through customs when imported into the EU customs territory from a non-EU country. This can be achieved either by importing the goods under special customs procedures (in which case customs duties often do not arise), or by clearing the goods for free circulation (as defined for customs purposes).

Clearance for free circulation generally triggers import duties. These duties include in particular customs duty, import value added tax and, where applicable, excise duties.

The level of the customs duties depends on the classification of the imported goods within the customs tariff and on the customs value that is placed on the goods. In many cases, the European Union grants tariff preferences to goods from certain non-EU countries in the form of preferential customs duties.

In contrast to these customs duties, protective customs duties are becoming increasingly important. Trade policy instruments in the form of import permits, quantitative restrictions, and anti-dumping duties are used to direct the flow of goods and to protect local economies. Customs duties are used as a control measure particularly in the agricultural sector.

In addition to the above-mentioned provisions, an important security-related update of the Community Customs Code has been introduced. This affects anyone involved in international trade with the EU. With effect from January 2008, the Authorized Economic Operator (AEO) concept has been introduced, under which approved importers/exporters who meet certain criteria will be encouraged to apply for registration as AEO as a part of the EU's continuing anti-terrorism program. Registered AEOs may qualify for a wide range of simplified customs procedures and fewer physical and document-based controls.

Mutual recognition of AEO status is a key element to strengthen and assist the end-to-end security of the supply chain and to multiply benefits to traders.

At present, mutual recognition agreements are in force with the following countries:

- Switzerland
- Norway
- Japan
- USA
- China

The following section deals with goods cleared for free circulation on which customs duties and import value added tax arise. This applies only to tangible items; intangible items, such as the utilization of foreign patents, production processes, and other intellectual services are not subject to customs clearance.

A discussion of customs duty exemptions and tariff reductions follows the section on duties and import value added tax.

### **3.1 Customs duties**

#### ***3.1.1 Customs tariff***

Germany, like the other EU Member States, applies the “Common Customs Tariff of the EU” (CCT), which is the basic law for the classification of goods. The first six digits of the classification code numbers are based on the Harmonized System (so far adopted by approximately 200 countries) to which further EU sub-headings of the Combined Nomenclature (CN) are added and which determines the duty rates applied. The general rules for the interpretation of the Harmonized System (HS) are an integral part of the CCT.

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Upon application by an importer, the appropriate customs authorities must issue binding tariff information (BTI). Any BTI issued by a Member State binds the customs authorities of all Member States if the holder requests its application and the imported goods are identical in every respect with those described in the BTI.

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#### ***3.1.2 Customs value – transaction value***

Customs duties are calculated as a percentage of the value of the product (ad valorem duties). Thus, a common definition of the applicable customs value is necessary to ensure that duties are imposed uniformly within the Customs Union.

There are different methods of determining the value of imported goods. Normally, the customs value will be the “transaction value”, which as a rule is the actual price paid or payable for the goods when sold for export to the EU if this price is not subject to certain restrictions in use (substantially affecting the value), or to certain conditions not affecting the value and not influenced by the relationship between seller and buyer.

Additionally, costs or values incidental to the production and the sale of the goods or associated with the transportation of the goods must be added if not included in the price already.

This applies to:

- Commissions and brokerage (except buying commissions)
- Costs of containers and packing
- Royalties and license fees
- Resale proceeds
- Cost of transportation

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While these costs must be added, certain other costs are not deemed to be a component of the customs value, provided they are distinguishable from the price actually paid or payable for the imported goods. Financing costs and buying commissions are examples of this.

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### ***3.1.3 Origin of goods and preferences***

The origin of goods is defined differently depending on the purpose, and may affect the treatment of goods under customs law, foreign trade law, and also under commercial aspects. Under the Customs Code there are different rules of origin for non-preferential purposes and for customs preference purposes.

The non-preferential origin of goods imported into Germany, as certified by a “certificate of origin”, may be relevant for

- Foreign trade purposes (import restrictions, i.e. licenses, quantity restrictions)
- Statistical purposes
- Anti-dumping proceedings.

Goods have their non-preferential origin in the country in which they are wholly obtained or produced. However, if more than one country is involved in the production, goods have their non-preferential origin in the country where they underwent their last substantial, economically justified processing or re-working in an undertaking equipped for that purpose and resulting in the manufacture of a new product or representing an important stage in the manufacturing of the goods.

Various duty-preference agreements between the EU and other countries exist, which grant exemption from customs duties or lower duty rates for goods originating from certain countries (e.g. EEA/EFTA countries, Maghreb countries, or developing countries). The principles of all agreements are the same, but details of the definition of origin and other conditions may differ for certain products.

Products wholly obtained in the beneficiary country are considered to originate in that country. This corresponds largely to the non-preferential origin. For other products, the re-working or processing required on non-originating materials used in manufacturing is generally set out in a list covering the different chapters of the CCT.

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The origin must be certified by a "certificate of origin". Preferential treatment will only be granted at the request of an importer.

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### ***3.1.4 Customs regimes to avoid, reduce, or defer duty payment***

In principle, goods may at any time be assigned any customs-approved treatment or use, irrespective of their nature or quantity, or their country of origin or destination. It is important for an importer to file the request and make the declaration that results in the customs procedure that minimizes duties or costs.

- Customs warehousing: Under the customs warehousing procedure, imported goods can be stored indefinitely in a customs warehouse, without as yet being subject to payment of import duties, import value added tax duties, or excise duties, or to the application of commercial policy measures.

- Inward processing: This customs procedure applies to goods imported temporarily into Germany from non-EU countries for processing and subsequent re-export in the form of compensating products.
- Temporary use: This customs procedure allows goods to be imported into Germany for a short period without triggering duties and taxes, and subsequently re-exported (e.g. goods temporarily imported in conjunction with a fair or exhibition or for testing and educational purposes).
- End-use relief: The customs tariff provides a customs duty exemption for certain goods if the goods are used in Germany for a specifically described purpose.
- Transit procedure: Under the transit procedure, goods can be moved from one point to another within the EU without incurring liability for customs duties, import value added tax or excise duty, and without being subject to commercial policy measures.
- Tariff suspensions: If goods are not available in the EU (either at all or in the same or a similar form) in sufficient quantity or quality, the shortfall can be offset by imports from non-EU countries. In this case, the suspension of tariff serves as an incentive to import such products.
- Non-tariff customs duty exemptions: These exemptions are generally linked to the use the goods serve or the purpose for which the goods are used. This includes personal and household items imported in connection with the relocation of residence to the EU, as well as materials used in teaching, education, and research.

### **3.2 Anti-dumping and countervailing duties**

The EU Anti-Dumping and Anti-Subsidies Regulation provides for the imposition of anti-dumping or countervailing duties in line with the GATT Anti-Dumping Code when a formal investigation has found that:

- dumping or subsidization is taking or has taken place,
- such dumping or subsidization is causing or threatening material damage to an industry segment in the EU, and
- the imposition of such duties is in the interest of the EU.

If all of these requirements are fulfilled, the EU Commission may impose duties equivalent to the value of the dumping margin or the subsidy in question. Alternatively, it may accept a voluntary declaration by the private party or the country involved that the dumping or subsidization will be discontinued.

### **3.3 Special import duties**

#### ***3.3.1 Other excise duties***

Germany's main excise duties are at present energy tax, alcohol tax, and tobacco tax (see chapters 7.2.2 and 7.2.4). These excise duties are levied as a general matter when the goods are imported into Germany.

Relief from excise duties is available under certain circumstances in the form of reduced tax rates or exemption from tax.

#### ***3.3.2 Import value added tax***

The import of goods into Germany from non-EU countries is subject to German import value added tax (Einfuhrumsatzsteuer), which is part of the German value added tax system (see chapter 7.1).

The standard tax rate of 19% is subject to reduction for privileged goods (e.g. food and books). Importers who are taxable persons for VAT purposes may recover the import value added tax from the tax authorities.

### **3.4 Outlook**

On October 9 2013, the Union Customs Code (UCC) was adopted, which establishes new EU customs rules. Implementing rules (UCC-DA "delegated acts" and UCC-IA "implementing acts") were published in the Official Journal of the EU (ABI L 343) on December 29 2015. The UCC is applicable from May 1 2016. The UCC will serve as the new framework regulation on the rules and procedures for customs throughout the EU.

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**The UCC and its related decisions and implementation measures shall**

- streamline customs legislation and procedures,
- offer greater legal certainty and uniformity to businesses,
- increase clarity for customs officials throughout the EU,
- simplify customs rules and procedures and facilitate more efficient customs transactions in line with modern-day needs,
- complete the shift by customs to a paperless and fully electronic environment, and
- reinforce swifter customs procedures for compliant and trustworthy economic operators (Authorized Economic Operators).

# Accounting and reporting

## Chapter 04

## 4.1 German accounting principles

### 4.1.1 Financial statements

Financial statements have to be prepared under the German Commercial Code (Handelsgesetzbuch – HGB). Most of the provisions can be found in the third book (§ 238 – 342e) of the German Commercial Code, which contains regulations to be complied with by all businesses as well as supplementary regulations for incorporated companies, banks, and insurance companies. The supplementary regulations designed for incorporated companies (Aktiengesellschaften – AG) also apply to general partnerships (Offene Handelsgesellschaften – OHG) and to limited partnerships (Kommanditgesellschaften – KG) where no individual is personally liable (known as “KapCoGesellschaften”). In Germany, this applies particularly to the form of limited partnership known as the “GmbH&Co. KG”, which has a limited liability company (Gesellschaft mit beschränkter Haftung – GmbH) as general partner and individuals – typically the members of the GmbH – as limited partners.

The current rules are fundamentally based on the German Accounting and Reporting Act (Bilanzrichtliniengesetz – BiRiLiG), which was enacted in December 1985 to implement the 4th, 7th, and 8th EU Directives into German law.

In 2004, an amendment to the German Commercial Code (Accounting Law Reform Act, Bilanzrechtsreformgesetz – BilReG) accompanied the introduction of the EU IAS Regulation, implementing several EU Directives (Modernization Directive, Threshold Directive, and Fair Value Directive). The BilReG led to a further alignment of German accounting law to EU legal standards and addressed such matters as size criteria, the management report, and the information to be presented in the notes. On May 25 2009, the German Accounting Law Modernization Act (Bilanzrechtsmodernisierungsgesetz – BilMoG) was enacted with the objective to make German accounting law a fully adequate, yet more economical and simpler alternative to International Financial Reporting Standards (IFRS).

The elimination of various tax elections with regard to capitalization, recognition, and valuation brings German accounting law closer to IFRS while retaining the existing accounting principles of the German Commercial Code. To enhance the informational con-

tent of the financial statements, the so-called principle of reverse linkage (umgekehrte Maßgeblichkeit), which means that elections exercised for tax purposes must also be reflected by the commercial balance sheet to become tax-effective, was abandoned. Therefore, future tax elections can be exercised independently of the commercial balance sheet. Nonetheless, the balance sheet according to German Commercial Code remains the basis for determining the limits of permissible dividend distributions as well as for determining taxable income.

The HGB provides for the exemption of sole proprietors from the requirement of keeping books and preparing financial statements if net income does not exceed € 60,000 and sales revenues do not exceed € 600,000 on the balance sheet dates of two consecutive fiscal years.

For incorporated companies (Aktiengesellschaft – AG, Kommanditgesellschaft auf Aktien – KGaA, Gesellschaft mit beschränkter Haftung – GmbH, Societas Europaea – SE) and for “KapCoGesellschaften”, which are treated in the same manner as incorporated companies, the German Commercial Code contains four reporting categories based on the respective company's size: “micro entities” as well as small, medium and large companies. Three criteria are used to determine the category to which a company belongs: balance sheet total, sales revenue, and number of employees (see table 8). A company is included in a particular size class if it meets two out of the three criteria on two successive balance sheet dates.

**Table 8: Classification of company size (accounting obligations)**

		Balance sheet total € million	Sales revenue € million	Number of employees (average per year)
Micro-entity	up to	0.35	0.70	10
Small	above	0.35	0.70	10
	up to	6.0	12.0	50
Medium-sized	above	6.0	12.0	50
	up to	20.0	40.0	250
Large	above	20.0	40.0	250

The initial classification of newly established companies depends on the company's characteristics on the first balance sheet date. However, publicly traded companies are always deemed to be large companies.

The classification of companies by size is significant because the disclosures required by the German Commercial Code vary according to the size of the company. Large companies must prepare a balance sheet, an income statement, notes to the financial statements (comments and supplementary disclosures about items in the balance sheet and income statement, as well as additional information about such matters as accounting policies, affiliated companies, and the remuneration of management and of the supervisory board), and a management report (containing a description of business trends and future prospects for the company), each in the complete format prescribed by law. The legal representatives of a publicly traded company which is not obligated to prepare consolidated financial statements have to prepare a cash flow statement and a statement of stockholders' equity in accordance with the balance sheet, the income statement, and the notes to the financial statements as well. In addition, segment information may be provided together with the financial statements.

As of 2007, documents must be filed in electronic form with the German Federal Gazette (Bundesanzeiger) for publication on its homepage (see [www.bundesanzeiger.de](http://www.bundesanzeiger.de) and [www.unternehmensregister.de](http://www.unternehmensregister.de)). Companies are not distinguished by size in this respect: small and medium-sized companies must also file with the German Federal Gazette. However, small companies and micro-entities must submit only the balance sheet and the notes to the financial statements. Micro-entities also have the option of applying for "filing" with the German Federal Gazette instead of publication.

Simplifications based on size are available for small and medium-sized companies as well as for micro-entities with respect to the disclosure documents. Medium-sized companies need only to prepare a simplified income statement (including exemption from the requirement to analyze the gross profit figure) and simplified notes to the financial statements (including exemptions from the requirement to analyze sales by areas of activity and by geographical markets).

Small companies are not required to prepare a management report, and the notes to the financial statements are largely simplified. The balance sheet may be presented in an abbreviated format. The balance sheets of micro-entities are even more condensed. Furthermore, micro-entities may prepare a condensed income statement and may forgo notes to the financial statements under certain conditions.

Enterprises that are neither corporations (Kapitalgesellschaften) nor "KapCoGesellschaften" are not required to disclose their financial statements. There are exceptions, however, under the Disclosure Act (Publizitätsgesetz – PublG) for large enterprises that exceed two of the three size criteria (balance sheet total: € 65,000,000; sales revenue: € 130,000,000; number of employees: 5,000). Special disclosure requirements also apply to enterprises in specific industry sectors (e.g. banking, insurance).

Corporations and "KapCoGesellschaften" must prepare their balance sheets in the accounting format prescribed by law for their respective size category. This method of presentation is followed by many other types of enterprises.

The income statement must be prepared by corporations and "KapCoGesellschaften" in vertical form using either the nature of expense method or the cost of sales method. For each of these two methods, the form in which the income statement needs to be structured is prescribed by law. When selecting the form of presentation of the income statement, enterprises other than corporations and "KapCoGesellschaften" are only required to comply with the principle that financial statements must be clear and understandable; in practice, the form of presentation used for corporations is usually followed.

The German Commercial Code provides for extensive relief for subsidiaries that are included in the consolidated financial statements of a parent company domiciled in the EU or in an EEA state. Provided the individual requirements are met, these companies are not obliged to prepare notes to the financial statements or a management report. In addition, they are not required to follow the regulations of the German Commercial Code that apply to corporations, but are rather subject only to the general accounting regulations (particularly classification regulations in the balance sheet and income statement). They also are not

required to have the annual financial statement audited and published.

Irrespective of the legal form of the enterprise, every business is required to maintain accounts that reflect its business transactions and its financial position in accordance with German principles of proper accounting. These principles are derived from a variety of sources and are frequently amended.

Specifically, German accounting principles require that entries be complete, correct, and chronological, that annual financial statements be prepared, that all computations be made on a euro currency basis, and that books and records be maintained in a living language and retained for a certain period of time. "Loose-leaf" accounting (Loseblattbuchführung), "open item accounting" (Offene-Posten-Buchhaltung), and IT-based accounting systems are acceptable if they meet certain requirements. Inventories of goods must generally be compiled, valued, and recorded in the accounts at the balance sheet date. Reliance on perpetual inventory records is permissible if they are in conformity with the legal requirements and show the inventory on the balance sheet date. Additionally, a physical inventory of movable fixed assets must be taken at each balance sheet date, unless perpetual inventory records are maintained. Such records are also sufficient for tax purposes, provided certain requirements regarding detailed information on the respective assets are met.

Furthermore, commercial law requires that the accounting system be set up in such a way that an independent professional is able, within a reasonable amount of time, to obtain an overview over the assets, liabilities, and operations of the company. The provisions, however, focus on accounting and reporting by companies. The objective is to ensure that companies present a true and fair view of their net assets, financial position, and operational results. If this is not accomplished by the balance sheet and income statement alone, additional information must be provided in the notes to the financial statements.

In principle, tax law incorporates by reference the requirements under commercial law and relies on the financial statements prepared for commercial purposes. In other words, the commercial financial statements form an authoritative basis for tax accounting purposes (so-called principle of linkage – Maßgeblichkeit).

However, there are also certain specific tax accounting rules (see chapter 6). Differences commonly arise, therefore, between the commercial financial statements and the tax accounts.

One unavoidable difference between the commercial financial statements and the tax accounts results from provisions for anticipated losses on transactions in the course of completion (pending transactions). Such provisions are mandatory under commercial law, but generally not permitted in the tax accounts.

In principle, German accounting regulations require the application of the historical cost principle under both commercial and tax law. If the value of an asset at a later date exceeds its historical cost, the increase may not be recognized in the balance sheet until a realization event occurs (e.g. the sale of the asset). The principle of the lower cost or market value applies in a different form for fixed and current assets.

Fixed assets must be stated in the balance sheet at their purchase or manufacturing costs less accumulated amortization or depreciation. Depending on the type of asset involved, assets are generally amortized or depreciated over their estimated useful lives using the straight-line method, the declining-balance method, the declining-balance combined with the straight-line method, or an output-related method. Regardless of the legal form of the company, an exceptional write-down for fixed assets must be carried out in cases of a decrease in value deemed to be permanent. For financial assets, an option for exceptional depreciation exists for decreases in value deemed to be non-permanent. For tax purposes, exceptional write-downs can be exercised if the decrease in value is deemed to be permanent. When an asset recovers in value subsequent to an exceptional write-down, the reversal of the write-down is mandatory for all business entities. For commercial accounting purposes, by way of exception no reversal of a prior write-down will be permitted for goodwill acquired for consideration.

Current assets must be stated at purchase or manufacturing cost and written down to the lower of cost or market value. A write-down is only permissible for tax purposes where the diminution in the value of the asset is deemed to be permanent. If the value of the asset subsequently increases, write-ups are in general mandatory in the tax and commercial accounts.

For commercial accounting purposes, provisions must be created for liabilities of an uncertain nature and for anticipated losses on transactions in the course of completion.

#### **4.1.2 *Consolidated financial statements***

For companies that are not publicly traded, the requirements for the preparation of consolidated financial statements and the consolidation and valuation principles to be applied in consolidation accounting are set out in the German Commercial Code (Handelsgesetzbuch – HGB). In addition, the German Federal Ministry of Justice (Bundesjustizministerium) issues supplementary recommendations for the application of group accounting principles. These recommendations are drawn up by the German Accounting Standards Committee. For publicly traded parent companies, the application of the IAS Regulation is mandatory (see chapter 4.2).

Under the German Commercial Code, a corporation (i.e. AG, KGaA, GmbH, and SE) and “KapCoGesellschaft” (see chapter 4.1.1) that is the parent company of a group of companies and resident in Germany must prepare worldwide consolidated financial statements. All companies controlled by a domestic parent company (either directly or indirectly) are deemed to be members of the group (so-called potential control concept). Companies are always controlled where the parent company holds a majority of their voting rights or is entitled to appoint the majority of members of their boards of management or supervisory boards, as well as where the parent company controls the other companies by virtue of a management control agreement. Furthermore, a company is deemed to be controlled when such company only serves a special purpose of the parent company (so-called special purpose entity) and the parent company is the recipient of the majority of the risks and rewards. Whether the parent company holds any ownership interest in the enterprise in question is no longer relevant.

In general, both domestic and foreign companies must be included in the consolidated financial statements. Group financial statements comprise a consolidated balance sheet, a consolidated income statement, and notes to the financial statements, as well as a report on the business trends and outlook of the group (management report). The consolidated financial statements must include a cash flow statement showing the cash flows of

the period and a statement of changes in equity showing the changes in consolidated equity and comprehensive income. Optionally, segment reporting may be provided together with the consolidated financial statements.

Consolidated financial statements must be prepared if at least two of the criteria exhibited below have been met on both the reporting balance sheet date and the preceding balance sheet date. The financial statements that are included in the consolidated financial statements must be prepared using the same accounting and valuation policies as those of the parent company.

**Table 9: Criteria for mandatory preparation of consolidated financial statements (if two out of three criteria are met on two successive balance sheet dates).**

	Balance sheet total € m	Sales revenue € m	No. of employees (average per year)
Pre-elimination figure exceeds	24,000	48,000	250
or consolidated figure exceeds	20,000	40,000	250

The consolidation of shareholders' equity follows the purchase method under which the difference between the book value of the investment (cost) and the portion of the shareholders' equity to be consolidated at the time of the acquisition is allocated to the assets and liabilities of the acquired company to the extent possible (fair value accounting), with the remainder, if any, being presented as goodwill. In accordance with German Accounting Standard 4, the share of the assets and liabilities attributable to the minority shareholders must be stated at fair value (total revaluation).

An interest in a joint venture with outsiders or other non-consolidated parties should be included in the consolidation, usually by using the proportionate consolidation method or, alternatively, the equity accounting method (German Accounting Standard 9). The proportionate consolidation method means that all assets and liabilities, income, and expenses are included in the group

accounts pro-rata to the interest in the joint venture, so that no minority interest arises.

For group reporting purposes, the equity accounting method is mandatory for certain investments (associated enterprises) that are included in the group financial statements. An associated enterprise is one over which the group exercises significant influence and which is neither a subsidiary nor a joint venture (German Accounting Standard 8). This is deemed to be the case when the reporting company holds more than 20% of the voting rights in a company. Under the equity accounting method, the interest in the associated enterprise is accounted for at book value in the records of the parent company at the primary appraisal. The difference between the book value and the pro-rata equity of the associated enterprise must be disclosed in the notes to the consolidated financial statements. The effects of updating the disclosed differences and the proportional movements in the associated company's equity in the following years are either debited or credited to the investment account in the books of the parent company.

Generally, inter-company profits and losses must be eliminated. However, this rule may be waived if sales or services were made or rendered on customary market terms and the calculation of inter-company profits or losses would cause unreasonable expense. If this exception is relied on, this must be disclosed in the notes to the consolidated financial statements.

The obligation to prepare consolidated financial statements in accordance with German accounting regulations exists even if the German parent company is itself the subsidiary of a foreign group of companies (sub-group financial statement). However, there are significant exceptions to this rule. The German parent company is exempt from the requirement to prepare German (sub-group) consolidated financial statements if the foreign parent company prepares consolidated financial statements (exempting consolidated financial statements) which include the German sub-group, provided these exempting consolidated financial statements comply with EU-Directive 83/349/EEC of June 13 1983, and fulfill a number of other requirements (e.g. examination of the exempting consolidated financial statements by qualified auditors). In such cases it is irrelevant whether the parent company is established in the EU, in the European Eco-

nomic Area (EEA), or in a non-member country. This exemption does not, however, apply if the German parent company is a stock corporation (Aktiengesellschaft – AG) whose shares are listed and traded on a recognized stock exchange. Any shareholders other than the foreign parent company that hold at least 10% of the shares (in the case of an AG, KGaA, or SE) or at least 20% of the shares (in the case of a GmbH) in the German parent company may block the exemption as well.

## 4.2 International Financial Reporting Standards (IFRS)

### 4.2.1 *Consolidated financial statements*

On 19 July 2002, the European Parliament and the European Council issued a regulation on the application of International Accounting Standards (IAS Regulation). The objective of the IAS Regulation is to harmonize the financial information presented by companies in order to achieve a high level of transparency and comparability in the financial statements, thereby ensuring the efficient functioning of the capital market in the EU. The IAS Regulation stipulates that, from 2005 onwards, publicly traded companies must prepare consolidated financial statements in accordance with IAS, renamed as International Financial Reporting Standards (IFRS), that have been endorsed by the EU. Furthermore, the IAS Regulation permits Member States to decide whether the application of IFRS to the consolidated financial statements of non-publicly traded companies and/or to individual company financial statements shall be optional or mandatory.

## Recognition of IFRS in the EU

The International Financial Reporting Standards are developed by the International Accounting Standards Board (IASB), which is a private sector organization and as such lacks democratic legitimacy. To retain legislative competence, the EU Commission reserves the right to review the IFRS for compliance prior to their transformation into Community law. To this end, the European Commission has developed an endorsement mechanism: In particular, all newly developed or revised standards and interpretations have to undergo an endorsement process before they become binding law in the EU. Such standards and interpretations are then incorporated into Community law through adoption by the European Commission of a Regulation on the application of IFRS in the EU. As a consequence, it is not necessary for the relevant provisions to be transposed into national law in a legislative procedure by the Member States, as would be the case with a directive. Instead, they take legal effect in each single Member State of the EU. The relevant standards enter into force with the publication of the Regulation and are then applicable across the EU.

As mentioned in chapter 4.1.1, the Accounting Law Reform Act (Bilanzrechtsreformgesetz – BilReG) governs the transition to IFRS accounting. It mainly addresses publicly traded parent companies (kapitalmarktorientierte Unternehmen) – i.e. companies whose securities are traded on a regulated market in any Member State of the EU. The obligation of publicly traded companies to prepare their consolidated financial statements in accordance with IFRS starting in 2005 is not, however, explicit under the German Commercial Code (Handelsgesetzbuch – HGB). It is instead based on the IAS Regulation. Section 315a (2) HGB goes beyond the obligatory requirements of the IAS Regulation in that it requires parent companies to prepare their consolidated financial statements in accordance with IFRS if they have filed an application for admission of their securities to trading on a regulated market. Non-publicly traded parent companies may now meet their legal requirements by preparing their consolidated financial statements in accordance with IFRS. Since 2007, the application of IFRS has been obligatory for all EU/EEA parent companies publicly traded on a regulated market in the EU/EEA.

### 4.2.2 Financial statements

In order to fulfill certain requirements for publication and reporting, companies may replace their regular annual financial statements

with annual financial statements prepared in accordance with IFRS. This will allow these companies to compete on an equal footing for financial resources on international capital markets. For the assessment of dividends and for tax filing purposes, annual financial statements must, however, continue to be prepared in accordance with the principles of German commercial law.

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### **IFRS for SMEs**

In July 2009 an International Financial Reporting Standard (IFRS) designed for use by small and medium-sized enterprises (SME) was published. In May 2015, the IASB completed a comprehensive review of the standard and made limited amendments to the standard. The self-contained standard is much simpler than the full IFRSs and is designed to meet the needs and capabilities of smaller businesses. Many of the principles in full IFRSs for recognizing and measuring assets, liabilities, income, and expenses have been simplified, topics not relevant to SMEs have been omitted, and the number of required disclosures has been reduced. However, the new standard has not yet been endorsed by the EU and its implementation in German accounting law is still not accepted by Germany. With the implementation of the BilMoG, Germany has developed adequate and simpler regulations for SMEs compared to IFRS for SMEs.

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### **Enforcement**

The Accounting Control Act (Bilanzkontrollgesetz – BilKoG) of December 13 2004 introduced a two-stage enforcement procedure into German law. In the first stage, an independent financial reporting enforcement panel audits the financial statements of publicly traded companies at the request of the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin). Requests are made if there are indications of violations of financial reporting requirements and for general sampling purposes.

The findings are disclosed to the audited company and to the Federal Financial Supervisory Authority. Errors identified by the panel are published and must be corrected by the company. If the company fails to cooperate with the auditor, the Federal Financial Supervisory Authority may order a second audit.



# Company law

## Chapter 05

German law offers a broad variety of legal forms for conducting business. Foreign investors can select between several types of corporations (Kapitalgesellschaften) and partnerships (Personengesellschaften). Alternatively, operating through a branch of a foreign legal entity or – in the case of an individual – a sole proprietorship, may also be considered.

## 5.1 Limited liability companies and stock corporations

German law provides two major types of corporations: the limited liability company (Gesellschaft mit beschränkter Haftung – GmbH) and the stock corporation (Aktiengesellschaft – AG).

Both are separate legal entities with shareholders' liability restricted to the value of the corporation's assets (including outstanding contributions). The GmbH is the most common form of incorporated company under German commercial law. The GmbH is generally preferred as a vehicle for closely held companies (no IPO possible) and subsidiaries of foreign corporations due principally to the flexibility it offers. Among the special features of the law governing the GmbH that are important for the choice of entity consideration are: firstly, the ability to tailor the articles of association to the needs of the enterprise and, secondly, the right of the shareholders at the shareholders' meeting not only to formulate general guidelines for management, but also to stipulate specific instructions for particular areas of business in which the shareholders wish to exert their influence. By contrast, the AG is the corporate form adopted by many of Germany's largest corporations. The principal advantage of an AG is that its shares, unlike those in a GmbH, may be transferred with relative ease and can be listed on a stock exchange.

### 5.1.1 Formation

A GmbH or AG can be formed by one or more persons, who may be individuals or companies and need not be German nationals or domiciled in Germany.

The existence of corporate founders and the authority of their agent must be proven by certified extracts from the commercial register or other official documents.

The formation of a GmbH or AG starts with a deed, certified by a German public notary, in which the founders (or single founder) issue a declaration of formation, undertake to pay in the registered share capital (Stammkapital or Grundkapital), and stipulate the articles of association of the GmbH (Gesellschaftsvertrag) or the articles of incorporation of the AG (Satzung). The articles must include, *inter alia*, the company's name and registered office (Sitz), the purpose of the enterprise, the amount of the registered share capital and – in case of a GmbH – the amount each shareholder must contribute to the registered share capital (original contribution, Stammeinlage). In the case of an AG, the articles must include the par value or number of shares, the issue price and, if more than one class of shares exists, the class of shares subscribed by each founder. In contrast to a GmbH, the articles of an AG may deviate from statutory provisions only where this is expressly allowed by the German Stock Corporation Law (Aktiengesetz – AktG). Generally there is little leeway to amend the articles in view of the many mandatory provisions contained in the AktG. Since the laws governing GmbHs and AGs are federal laws, the location of the registered office does not affect the rules governing a GmbH or AG. The registered office of a GmbH or an AG must be in Germany. The place of management can be outside Germany.

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A "business company" (Unternehmergeellschaft – GmbH UG) can be formed with a lower initial registered share capital and less formal requirements for its formation than is the case for the usual GmbH. The GmbH UG is no specific legal form; it is a version of the GmbH that can be formed with a minimum of € 1 registered share capital. A GmbH UG is not allowed to distribute its profits completely; the minimum stated capital of such entities has to be saved up over the years. Model articles of association (Musterprotokoll) are provided for incorporating a GmbH UG. Notarial charges can be reduced when using these model articles.

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In order to make it easier to take legal action against a corporation, GmbHs and AGs have to enter their domestic postal address in the commercial register. Hence, creditors can find out easily against whom to assert their claims.

For a GmbH, one or more managing directors (Geschäftsführer) must be appointed as provided for in the articles. This is usually

stipulated in the articles, but can also be changed at a later date. Managing directors are allowed to hold an interest in the GmbH.

They must be individuals, but need not be citizens or residents of Germany. The managing director(s) appointed must submit an application to register the GmbH in the commercial register (Handelsregister) maintained by the local court where the GmbH has its registered office. The GmbH comes into legal existence only upon registration.

In the case of an AG, the founders appoint the auditors for the AG's first full or partial fiscal year and appoint the initial supervisory board (Aufsichtsrat), which in turn appoints the first board of management (Vorstand). The appointment of the auditors and the supervisory board must be certified by a public notary. The members of the boards (management and supervisory) must be individuals but need not be citizens or residents of Germany. They can be shareholders, but cannot simultaneously be members of both the management and supervisory boards. The founders must also prepare a formation report (Gründungsbericht), in which they are required to describe the transactions leading up to the formation, the initial acquisition of assets, capital contributions in kind, and special advantages or remuneration granted to the members of the management or supervisory boards. In addition, the formation of an AG must be examined by the members of both boards and, under certain circumstances, the auditors may be required to issue an examination report. The founders and members of the management and supervisory boards must submit the application to register the AG in the commercial register maintained by the local court where the AG has its registered office. The AG comes into legal existence upon registration.

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## Example

Businessman A would like to form a GmbH. He has to deliver the necessary documents to his notary to initiate the required registration in the commercial register.

If the application form and deeds are available in hard copy only, the notary will convert them into an electronic format. The notary thereafter notarizes the documents and sends them in electronic form to the appropriate local court. Upon receipt, the local court will process the documents and enter the GmbH in the electronic commercial register. The GmbH then comes into legal existence. Registration entails simultaneous electronic publication, so anyone can view the data online at the homepage: [www.unternehmensregister.de](http://www.unternehmensregister.de) (see chapter 5.1.7).

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The necessary documents for entity formation have to be filed in electronic format. The local court then rules promptly on the registration and thereafter the documents are entered in the electronic commercial register.

If the founders delegate their powers to authorized representatives, they need not appear in person before the acting notary for the formation deed. Any power of attorney must be notarized or at least "authenticated" by a public notary. In the case of notarization or authentication by a foreign public notary, the certificate of the foreign public notary will only be recognized by German courts if it has been "legitimized" by the German Consulate in the country in which the power of attorney was notarized or authenticated. There are, however, numerous provisions in international conventions stipulating that a so-called apostille certificate (i.e. additional attestation by a foreign authority) is sufficient or, indeed, that neither legalization nor attestation is necessary.

Some time may elapse between the date of notarization of the articles and the registration of the GmbH or AG. During this period, the GmbH or AG is referred to as a "company in formation" (Vorgesellschaft). Such company is considered to be a separate entity, which is entitled to act through its representatives, commence business, enter into transactions, and assume liabilities.

### **5.1.2 Registered share capital**

The statutory minimum registered share capital, which must be subscribed in full, is € 25,000 for a GmbH and up to € 50,000 for an AG. If contributed in cash, only one quarter of the registered

share capital of a GmbH (but not less than € 12,500) must be paid in by the date of the application for registration in the commercial register. In the case of an AG, one quarter of the registered share capital and the entire premium, if any, must be paid in. The capital of a GmbH or AG must be paid in full or security must be given in respect of outstanding capital if the GmbH or AG is established by a single shareholder. Contributions in kind must be fully contributed in such a way that the assets are permanently at the free disposition of the managing directors/ board of management.

The legislation governing GmbHs and AGs is designed to ensure that registered share capital is paid up and maintained. The rules applicable to an AG are stricter in this respect. In particular, an AG is not permitted to repay share capital contributions to its shareholders regardless of whether such payment would reduce the AG's net assets to a level below its registered share capital. A GmbH, on the other hand, is prohibited only from making payments to shareholders to the extent that such payments are not covered by a valid claim against the shareholder concerned.

The AG may issue share certificates either with a par value (Nennbetragsaktien) of at least € 1 per share or multiples thereof or without par value (Stückaktien). Both common shares (Stammaktien) and preferred shares (Vorzugsaktien) may be issued, either as bearer shares (Inhaberaktien) or registered shares (i.e. where the name of the owner is registered in the AG's share register, Namensaktien). Bearer shares are freely transferable; the corporation is not allowed to restrict their transfer. For registered shares, the articles may provide that a transfer requires the consent of the company. In general, each share confers one vote, although preferred shares may be non-voting. Multiple voting rights are not permissible.

By contrast, the capital of a GmbH is not issued in the form of certificates. Shareholders can acquire several shares, the par value of the shares (with the exception of the minimum amount of € 1) and the number of shares can be determined at liberty. The share in a GmbH may be transferred by assignment or upon inheritance. Any contractual transfer of ownership must be notarized and can be made conditional upon the consent of the GmbH or other holders of shares or any other restriction stipulated in the articles of association. Any changes in the composition

of shareholders holding shares or in the number of shares they hold are effective for the corporation only after they have been added to the list of shareholders in the commercial register.

### **5.1.3 Management**

A GmbH is managed and represented by its managing director(s) (Geschäftsführer) in and out of court. Unless otherwise provided by the articles, the principle of collective management and representation applies, meaning that all managing directors must act jointly.

The power of representation (Vertretungsmacht) cannot be restricted vis-à-vis third parties. The management authority (Geschäftsführungsbefugnis), however, can be restricted internally, and the shareholders may exercise their right to give the managing directors instructions regarding any particular matter on which they wish to exert their influence. A GmbH must have at least one managing director and can have in total as many as the shareholders wish. The managing directors must be individuals, but need not be citizens or residents of Germany, and are allowed to hold an interest in the GmbH. The managing directors are appointed at a shareholders' meeting as provided in the articles. A majority shareholder can appoint himself managing director by virtue of his majority vote. The appointment can be revoked at any time, without prejudice to any contractual indemnification claims. The articles can restrict the right of revocation to the reasons set forth in the articles.

The AG is managed and represented in and out of court by a board of management (Vorstand). Unless otherwise specified in the articles, all members of the board of management must act jointly in both managing the corporation and representing the corporation vis-à-vis third parties. The board of management may have internal rules, which may provide for committees and may stipulate the transactions requiring board of management consent. A limitation on the statutory authority of the board of management to represent and bind the AG is not effective against third parties. Internally, however, the management may be subject to certain restrictions, e.g. specific transactions may require the approval of the supervisory board. Board members are appointed, removed, and supervised by the supervisory board. They are appointed for a term not to exceed five years and can only be dismissed for cause during their term of office.

Neither the shareholders nor the supervisory board may issue instructions to the board of management.

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On 5 August 2009 the Act on the Appropriateness of Management Board Remuneration (Gesetz zur Angemessenheit der Vorstandsvergütung) entered into force with the purpose to place a greater focus on sustainable and long-term corporate leadership when granting incentives as part of management board remuneration schemes. When fixing the total remuneration for individual board members, the supervisory board of an AG must ensure that such remuneration appropriately reflects both the responsibilities and performance of the board member and the situation of the company, and it should not exceed the common remuneration, unless there are specific reasons to do so. Furthermore, variable remuneration components should be determined on the basis of several years. The supervisory board must agree on capping mechanisms in the event of extraordinary developments. The supervisory board is to limit executive remuneration to an appropriate amount if the situation of the AG deteriorates.

Since September 2013, a special regulation has applied to financial institutions, which stipulates that the variable remuneration must not be higher than the fixed remuneration or, under certain conditions, must not be more than twice as high as the fixed remuneration.

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The so-called business judgment rule creates a strong presumption in favor of the board of management of an AG, shielding the board members from liability for decisions that result in unforeseeable harm to the corporation. Since the managers of a GmbH are directly responsible to its shareholders, no statutory business judgment rule has as yet been enacted with regard to GmbHs.

#### **5.1.4 Supervisory board**

The supervisory board (Aufsichtsrat) is mandatory for an AG. It controls and supervises the board of management, but may not participate in the corporation's day-to-day management. It may, however, determine that certain categories of transactions are subject to its approval. If the approval is denied, the board of management may appeal the decision to the shareholders. The supervisory board consists of a minimum of three members with a total number of members that must be divisible by three. In an AG with a registered share capital of more than € 10 million, the maximum number is 21 members. Except for employee

representatives, whose appointment is governed by special provisions, the members of the supervisory board are elected by shareholder resolution for a term not to exceed five years as set forth in the articles or in the resolution of appointment. A right to appoint members to the supervisory board (Entsenderecht) may be granted by the articles of association to specific shareholders or to the holders of specific shares. Members can be dismissed only by court order, by a 75% majority of votes cast in a general meeting of shareholders, or by a shareholder with the right to appoint the member in question. Members may also be recalled by a simple majority of shareholder votes if they cease to meet the requirements specified in the articles. The main functions of the supervisory board are:

- Appointment and dismissal of the members of the board of management, including agreeing to the terms and conditions of the employment contracts of the members of the board of management
- Supervision of the board of management, including the examination of both legal and commercial aspects of management board actions
- Representation of the AG in its dealings with the board of management
- Representation of the AG (together with the board of management) in litigation relating to the validity of shareholder resolutions
- Authorization of business decisions of the board of management where required by the articles or by the supervisory board itself
- Appointment of the statutory auditor, review and approval of the annual financial statements

In the case of a GmbH, a supervisory board is mandatory only if the GmbH has more than 500 employees. In all other cases, shareholders are entitled to form a supervisory or advisory board (Beirat) and to define the functions of said board in the articles.

### **5.1.5 Shareholder or general meetings**

Shareholders' decisions are made by way of shareholder resolutions taken at shareholder meetings (Gesellschafterversammlung) in the case of a GmbH and at the general meeting of shareholders (Hauptversammlung) in the case of an AG.

For a GmbH, shareholder meetings are normally called by the managing directors (or the supervisory board, if applicable), or by holders of at least 10% of the share capital. The meetings need not be held in Germany. Votes can be cast by telex, fax, e-mail, etc. Unless otherwise provided in the articles of association, the statutory rights of shareholders at shareholder meetings include decisions on: appointment of managing directors, review of the activities of the managing directors, approval of the financial statements, appropriation of profits, and amendments to the articles of association. Unless otherwise stipulated in the articles, each € 1 participation entitles the owner to one vote. Decisions are made by a simple majority of votes (more than 50%), unless the articles provide otherwise. In some cases a 75% majority is required by law.

For an AG, a general meeting must be held each year within eight months of the end of the fiscal year and is convened by the board of management. The meeting is normally held in Germany at the place where the AG has its registered office. In addition, the board of management, the supervisory board, or shareholders holding at least one twentieth of the registered share capital have the right to call an extraordinary general meeting. The statutory rights of the general meeting include decisions regarding the appointment of members of the supervisory board, the appropriation of profits, formal approval of the board members (management and supervisory) with respect to their activities during the preceding financial year, the appointment of auditors, amendments to the articles of incorporation, reorganizations, and the liquidation of the AG. Decisions are made by a simple majority of votes (more than 50%) unless:

- the law mandates a greater majority, e.g. 75% to amend the articles or to increase or decrease share capital;
- the law requires the consent of certain shareholders, e.g. the consent of preferred shareholders whenever their rights are affected;
- the articles provide otherwise.

#### **5.1.6 German Corporate Governance Code**

The German Corporate Governance Code contains major statutory provisions for running and monitoring German corporations, including nationally and internationally accepted standards

for good and responsible corporate governance. The Code is intended to make corporate governance rules more transparent for national and international investors and to strengthen the confidence of shareholders, associates, customers, and the public in the management of corporations. The Code describes the general legal framework for a company and the functionality of the board of management and the supervisory board of German corporations.

The German Corporate Governance Code contains three types of terms: recapitulations, proposals, and recommendations. The recapitulative terms are informational. They reiterate statutory rules already in effect, thus giving foreign investors an overview of important German corporate governance provisions. The terms in the second category – the proposals – are recognizable by “should” or “can” phrases. While the proposals are not mandatory, they help potential investors focus attention on specific areas of management action. In the final category, the recommendations constitute accepted standards of corporate governance and are identified by “shall” phrases. Their application is also not mandatory, but corporations that decline to adhere to the recommendations must state their reasons for failing to do so. Depending on context, the recommendations relate either to the board of management or to the supervisory board, or to both boards.

Under § 161 of the Stock Corporation Law (Aktiengesetz – AktG), the board of management and the supervisory board of corporations with publicly traded shares must on an annual basis declare whether the corporate management complies with the terms of the German Corporate Governance Code and identify any proposals and recommendations that are not adhered to. This so-called declaration of compliance must be available to the shareholders at all times.

The German Corporate Governance Code is intended primarily for public corporations, but it is recommended that non-public corporations follow the code as well.

The German Corporate Governance Code is published by the Federal Ministry of Justice in the German Federal Gazette. The Code is monitored by the Commission of the German Corporate Governance Code (Regierungskommission Deutscher Corporate

Governance Kodex) which was formed by the Federal Ministry of Justice. As a rule, the code is reviewed at least once a year, and is amended if necessary.

### **5.1.7 *Business register (Unternehmensregister)***

The business register shows the records in the commercial register. Documents that must be on record in the commercial register must be filed in electronic form. The announcement of entry in the commercial register takes place online only. In addition, the business register contains all essential business data subject to publication requirements, e.g. financial statements. They are published on the website as well. Anyone may view the information online on the website: [www.unternehmensregister.de](http://www.unternehmensregister.de).

### **5.1.8 *Insolvency***

GmbHs and AGs are considered insolvent when they cannot pay their debts as they fall due (illiquidity), or when, on the company's balance sheet or interim statement, liabilities exceed the value of the assets, measured at their going-concern value. This deficiency of assets is known as "over-indebtedness" (Überschuldung). Over-indebtedness, however, does not cause insolvency of the corporation if there is a predominant probability that the business can be continued.

If a situation of over-indebtedness or illiquidity is identified, the managers of the corporation must file a petition for the commencement of insolvency proceedings with the local district court without culpable delay, at the latest after three weeks. Otherwise, they may be held personally liable and subject to criminal penalties. A petition for the commencement of insolvency proceedings may also be filed against the company by any creditor.

### **5.1.9 *Liquidation***

An AG and a GmbH may be dissolved on expiration of a period provided in the articles, by resolution of three quarters of the shareholders, upon commencement of insolvency proceedings, or by court order. Subsequent to the dissolution, the corporation is to be liquidated unless bankruptcy proceedings have begun. An AG is liquidated by the board of management and a GmbH by the managing director(s), unless otherwise provided for in the articles or decided upon by a shareholder resolution. In certain

cases, liquidators may be appointed by a court order requested by a certain percentage of shareholders, or by the supervisory board in the case of an AG.

The liquidation must be entered in the commercial register. Financial statements must be prepared as of the date of the opening of the liquidation proceedings and for every year-end thereafter.

The creditors of the company must be notified of the liquidation and requested, through three consecutive public notifications in the German Federal Gazette (Bundesanzeiger), to submit their claims. Upon discharge of the liabilities, the remaining assets are distributed among the shareholders in liquidation, but not earlier than one year after the third public notification to the creditors.

## 5.2 Other forms of corporations

### 5.2.1 *Societas Europaea (SE)*

On October 8 2001, the European Council adopted a regulation establishing a statute for a European stock corporation (Societas Europaea – SE). The SE regulation was accompanied by a directive on the involvement of employees in the SE. The SE regulation adopts the place of management rule: Once incorporated, the SE can change its place of management to another Member State without giving up its legal status. The registered office and place of management must always be identical for the SE. The SE can move freely within the EU and the EEA (Norway, Iceland, and Liechtenstein) Member States.

An SE can be set up by two or more stock corporations from at least two different EU Member States. Operating throughout the EU on the basis of a single set of core regulations, the SE is an alternative for corporate reorganizations on a European level. The SE is designed as a publicly held corporation comparable to a German AG with a registered share capital of at least € 120,000. Depending on the form adopted in its articles of incorporation, the

SE can be governed by either a supervisory body and a management body (two-tier system) or by a single administrative body (one-tier system).

### 5.2.2 *Societas Unius Personae (SUP)*

A proposal for a directive by the European Commission dated April 9 2014 provides for the introduction of a European legal form for single-member limited liability companies with a single shareholder (Societas Unius Personae – SUP). This proposal replaces the abandoned proposal to introduce a Societas Privata Europae (SPE) dated June 25 2008. Under the draft directive, the EU Member States would be obliged to provide for a national form of company in their legal systems for which the same regulations and the EU-wide abbreviation SUP would apply in all Member States. This is intended to make it easier for companies (particularly SMEs) to perform cross-border activities (particularly founding companies in foreign countries). On May 28 2015, the European Council provided a general approach for its position on the draft of the European Commission. Although there is a substantial consensus, the European Council proposes some changes. Because the discussions regarding the draft are still in progress, it remains to be seen when the SUP will be available as a legal form.

Under the directive, an SUP must have its registered office and either its administrative center or its headquarters in the European Union. The SUP distinguishes itself from other legal forms, for instance, because it requires a minimum registered share capital of only € 1. Standard articles of association and an online foundation procedure are also provided for.

### 5.2.3 *Limited partnership with share capital (KGaA)*

The Stock Corporation Law contains provisions on limited partnerships with share capital (Kommanditgesellschaft auf Aktien – KGaA). These companies are similar to stock corporations, except that one or more general partners are personally liable for the company's debts. This business form is not frequently used in Germany.

## 5.3 Other business associations

### 5.3.1 *Partnerships*

Besides GmbHs and AGs, commercial partnerships (as defined by the German Commercial Code) play an important role in Germany's business life. Such partnerships include general partnerships (Offene Handelsgesellschaft – OHG) and limited partnerships (Kommanditgesellschaft – KG). The only major

difference between the two forms is the liability of partners. In an OHG, all partners are jointly and severally liable for all of the partnership's debts. In a KG, at least one general partner (Komplementär) is personally liable, whereas the liability of the limited partners (Kommanditisten) is limited to their registered contribution to the partnership. For this reason, foreign investors usually choose a KG when setting up a partnership structure for their investment in Germany.

To set up a partnership, at least two partners are required to execute a partnership agreement; in principle, the partners may freely agree upon their rights and obligations. The partners (general as well as limited partners) of a German partnership may be either individuals, German or foreign corporations, or other partnerships. No special form must be observed, unless the agreement includes certain obligations, e.g. the transfer of real estate (in this case the agreement must be executed in a deed certified by a public notary). The partnership must be registered with the relevant commercial register. All partners are obligated to apply for registration. In order to achieve the liability protection for the limited partners, the liable contribution (Haftsumme) must be properly registered; otherwise, it is not legally effective. In the event that the partnership commences business prior to registration, each limited partner who has agreed to the commencement of the business is liable in the same manner as a general partner for any debts arising from the commencement of business prior to registration, unless that partner's status as a limited partner was known to the creditor. The transfer of any ownership interest (as limited or general partner) requires an agreement between the transferor and the transferee together with the consent of all other partners, unless the partnership agreement provides otherwise.

The partnership is managed and represented in and out of court by the general partners. The limited partners may only participate in the management if the partnership agreement so provides. The limited partners are also unable to act on behalf of the partnership, unless the partnership agreement confers representation authority on them.

The partners determine the affairs of the partnership through partnership resolutions, which generally must be passed unanimously, unless otherwise agreed in the partnership agreement.

Although an OHG or KG is not an entity entirely separate from its partners, the partnership may carry on business, acquire, hold and dispose of property, and sue and be sued in its own name. All partnership property is owned by the partners in joint tenancy.

The reasons why a partnership might be preferred over a corporation include, firstly, the great flexibility in tailoring the partnership's internal affairs to the individual needs of the partners and, secondly, less extensive publication requirements (unlike the articles of a GmbH or AG, the partnership agreement need not be filed with the commercial register).

Other factors are the greater ease of dissolution and distribution of the capital to the partners and direct management and representation by the general partner.

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German company law does not restrict the mixing of corporate forms. A very common form of a commercial partnership is the GmbH & Co. KG, a limited partnership with a limited liability company acting as general partner. The GmbH & Co. KG combines certain advantages of partnerships with the liability limitations of corporations. Based on a large number of court decisions, the GmbH & Co. KG has emerged as a business association in its own right.

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### 5.3.2 *Silent partnerships*

A silent partnership or participation (stille Gesellschaft) exists when a person contributes to the capital of an existing business and shares in its profits (possibly also in its losses) without incurring any liabilities towards creditors. Silent partnerships have no entity or quasi-entity status, but are mere financial participations in another business on a contractual basis. Aside from their tax planning uses, silent partnerships are used especially to allow third parties to share profits and risks of a business without acquiring any rights or assuming any obligations not specifically covered in the silent partnership agreement. Silent partnerships also permit the silent partner to avoid disclosing its investment, since silent partnerships are generally not registered in the commercial register. However, various higher regional courts have held that silent partnerships must be registered in the commercial register if the business in which the silent partner participates is an AG, because the creation of a silent partnership

is effectively an agreement to transfer a portion of the profit, which affects the distribution of total profit to the shareholders.

### **5.3.3 Civil law associations**

A civil law association (Gesellschaft bürgerlichen Rechts – GbR) is a partnership which has no registered business name and does not constitute an entity entirely separate from its partners.

However, the GbR as such may generally conclude contracts and bear the rights and obligations thereof, and can sue and be sued in its own name. All property acquired by the association in its name is owned by the partners in joint tenancy. All partners are jointly and severally liable for all debts incurred by the GbR unless a liability limitation is agreed with each single creditor for each transaction.

To set up a civil law association, at least two partners are required to execute an association agreement. No registration is required. Possible partners can be either individuals, German or foreign corporations, or commercial partnerships or other civil law associations.

The legal relationship between the different partners is determined by the rights and obligations agreed upon in the association agreement. Unless otherwise agreed, the GbR is managed and represented in and out of court by all partners, and each transaction requires the consent of all partners.

A civil law association is typically used for non-commercial purposes (e.g. associations of professionals) and for individual transactions or contracts (e.g. construction projects), in most cases for a limited period of time.

### **5.3.4 Sole proprietorship**

In a sole proprietorship (Einzelkaufmann), the owner is engaged in a typical commercial business. He is personally liable for all debts and must register the business with the commercial register.

## **5.4 Branches**

A foreign individual entrepreneur, corporation or partnership may establish a branch (Zweigniederlassung) in Germany, especially when it is set up with the purpose to act as an independent en-

ity. No branches are necessary in Germany, for instance, when goods are manufactured without distribution, warehousing, shipping or receiving activities, or for retail shops and points of sale that do not pursue any purchasing activities. The branch must be registered in the commercial register with the local court where it has

its registered office, and it must notify the local municipality when starting business operations. A branch is not a separate legal entity even though contracts may be concluded in its name.

To register a branch, the court will request evidence of the legal existence of the foreign company, copies of the articles of association/incorporation, the names of all managing directors or members of management boards and their power of representation, the amount of registered share capital, the location of the registered office, its organization, as well as the names of the persons who will act for it in Germany. This information and all subsequent changes must be registered in the electronic commercial register and published on the homepage of the German Federal Gazette (Bundesanzeiger).

Depending on the type of business the branch intends to conduct, it may be necessary – as in case of banking and insurance – to produce evidence of proper qualifications and obtain special permits. The licensing procedures have been relaxed recently as part of developments within the EU.

Branches are subject to non-resident tax liability in Germany as soon as they meet the requirements for a permanent establishment (see chapter 6.1.2).

## **5.5 Companies organized under the law of a foreign jurisdiction**

Companies organized under the laws of a foreign jurisdiction can be an attractive alternative. Following a series of decisions by the Court of Justice of the European Union (CJEU) (Centros, Überseering, Inspire Art Ltd.), it is now possible for companies organized under the law of another European jurisdiction to move their place of management to Germany if their foreign jurisdiction permits such a move. German business associations (GmbH, AG formed in Germany) can also select a place of management that is outside of Germany.

According to the CJEU, Germany is required to respect the legal capacity of companies duly formed in accordance with the law of another EU Member State, even if the foreign company has moved its actual place of management to Germany. The requirements of CJEU rulings apply to corporations as well as to other business associations.

A substantial presence in their home jurisdiction is not required. Even if the foreign company lacks any material connection with the country in which it was formed and only has a token presence in its nominal home jurisdiction, Germany may not refuse to recognize the foreign company.

All business organizations formed under the law of a Member State that follows the place-of-incorporation rule – e.g. UK, Ireland, and the Netherlands – must be recognized by the German authorities and German courts.

Under a bilateral agreement (1954 German-American Treaty of Friendship, Commerce and Navigation), US companies (e.g. Delaware LLC) are recognized as well.

The formation of a foreign corporation – e.g. a UK Ltd. – might involve fewer formalities and entail less expense compared with forming an AG or a GmbH in Germany. However, the operating costs of a foreign company that conducts its business in Germany often exceed the costs their German counterparts would incur. In addition, there are legal uncertainties and implications concerning the taxation of such entities which often render corporations organized under the law of a foreign jurisdiction less attractive.



# Business Taxation

## Chapter 06

## 6.1 Taxation of non-residents investing in Germany

A foreign investor planning to set up a business in Germany has a wide range of options. If the activities on the German market are only intended to be short-term, the investor may choose not to establish a physical presence, but might instead prefer direct transactions with his business partners. If, however, business activities are intended to be of a longer-term nature and require a physical presence in Germany, the foreign investor may establish:

- a permanent establishment,
- a partnership,
- a corporation.

Income taxation in Germany for non-residents differs depending on the form of investment chosen.

### 6.1.1 *Investment by direct cross-border transactions/ direct investments*

When direct transactions take place between foreign investors and domestic customers, it is not required to establish a permanent basis in Germany such as domestic permanent establishments and/or permanent representatives, partnerships or corporations. The income derived from such direct transactions/investments by foreign investors, whether individuals or legal entities, might be subject to non-resident tax liability (beschränkte Steuerpflicht, see chapter 6.2.1) in Germany. The following examples provide an overview of major forms of direct transactions and direct investments as well as of their tax treatment.

Imports: In principle, no income tax accrues when a foreign investor has neither a permanent establishment, a permanent representative, nor a business entity (company or partnership) in Germany. Imports from other countries to Germany are in themselves not taxable events under German income tax law. Imports of goods are not considered as investments in the strict sense of the word, because no real or monetary capital remains for the foreign investor to support any economic activity in the domestic territory.

Granting of loans to borrowers residing in Germany and debentures of German issuers: Interest on debentures (e.g. corporate bonds) are generally not subject to non-resident tax liability. For interest derived from loans to borrowers residing in Germany, non-resident tax liability can also be avoided if

- the capital is not directly or indirectly secured by domestic real property, by domestic rights subject to provisions of the civil law regarding land, or by ships entered in a domestic ship register or
- the interest derived is interest on deposits with banks and the loan does not constitute an over-the-counter transaction.

If, however, the interest derived from loans is subject to non-resident tax liability in Germany, tax is levied by withholding tax at the source. There are the following exceptions to this rule:

- Interest derived from private loans
- Interest derived from shareholder loans

When withholding tax is withheld on interest (25% of the gross amount plus solidarity surcharge, 5.5% of 25%) derived from loans, such tax is, as a general rule, final for non-resident taxpayers.

Many double tax treaties allocate the right to tax interest exclusively to the country of residence of the lender. Hence, despite the fact that the interest is taxable under national law, Germany may not retain its right to levy (withholding) tax. Those double tax treaties that grant Germany the right to withhold tax provide for a withholding tax rate of up to 15% (see Appendix I – Table of withholding tax rates).

Granting of licenses by foreign licensors to licensees residing in Germany: Royalty payments are subject to non-resident tax liability and are to be taxed with a final withholding tax rate of 15% of gross royalty revenue. When the provisions implementing the EU Interest and Royalty Directive apply (EU Directive 2003/49/EC; § 50g EStG (Income Tax Law)), relief from withholding for payments of royalties is possible. Under German double tax treaties, the exclusive right to tax royalties is in most cases allocated to the country of residence of the licensor. However, when Germany retains the right to withhold tax, a withholding tax rate

of up to 25% may be provided for by the relevant double tax treaty (see Appendix I – Table of withholding tax rates).

Rental and sale of real estate situated in Germany: Income from rental of real estate located in Germany is subject to non-resident tax liability. The same applies to income from the sale of real estate located in Germany. As a rule, the rental of real estate does not give rise to the formation of a permanent establishment. It has been practice under tax treaty law in Germany to allocate the right to tax income from the rental of real estate and gains arising from the sale of real estate, in most cases, to the country in which the property is situated, i.e. Germany.

Sale of shares in domestic corporations: As a general rule, gains realized by a non-resident shareholder from the sale of shares in a corporation that has its registered office or place of management in Germany are not subject to tax liability in Germany. However, if during the past five years the non-resident shareholder has had a direct or indirect holding of at least one percent in such corporation, the gain on sale is subject to non-resident tax liability, regardless of whether the shares are held as a foreign private asset or as part of foreign business property. In most cases, the German double tax treaties allocate the right to tax gains on the sale of shares in domestic corporations to the taxpayer's country of residence, i.e. the German domestic right of taxation has no effect.

## **6.1.2 *Investment through a domestic permanent establishment/permanent representative***

### **6.1.2.1 *General principles***

If a permanent establishment situated in Germany is used for investments by a foreign investor, the profit derived from such permanent establishment is deemed to be income from trade or business and is thus subject to non-resident tax liability. The same applies to income derived from a permanent representative in Germany.

A permanent establishment is defined as a fixed place of business or facility that serves the business of an enterprise and over which the entrepreneur (here: the foreign investor) exercises control. This definition does not require human intervention, so that, for example, the presence of an Internet server or an

oil pipeline on German territory may constitute a permanent establishment.

A permanent representative is defined as an individual that transacts business for an enterprise on an ongoing basis and, in so doing, is subject to its substantive instructions. The existence of a permanent establishment or a permanent representative in Germany exposes the investor to German tax liability.

An applicable tax treaty may modify the concept of a permanent establishment or a permanent representative.

The (positive or negative) assets that are intended for a permanent establishment's exclusive use and exploitation are to be allocated to such permanent establishment. According to the tax authorities, funds that serve the company as a whole and holdings in other companies are allocable to the head office, unless the business assets exclusively support the activities carried out by the permanent establishment. For details regarding the allocation of assets and profits to permanent establishments, please refer to chapter 6.2.2.3.

#### *6.1.2.2 Current taxation*

If the foreign head office is a corporation, it is assessed under non-resident tax liability for its permanent establishment income arising in Germany. The same rules apply to a foreign individual maintaining a permanent establishment in Germany. When the foreign head office is a partnership, the individuals or corporations that are its partners are subject to non-resident tax liability with regard to the German profits of the permanent establishment.

The profits generated by a non-resident corporation's permanent establishment are subject to a corporate income tax rate of 15% plus trade tax (Gewerbesteuer) and solidarity surcharge.

The profits of permanent establishments owned by an individual non-resident taxpayer must be taxed according to such taxpayer's personal income tax rate (disregarding a zero-bracket amount) plus trade tax and solidarity surcharge. The trade tax that is allocable to the German permanent establishment and that has actually been paid may be considered for tax purposes by providing for a trade tax credit (§ 35 EStG). Profits that are

generated by a permanent representative are not subject to trade tax in general.

If the permanent establishment derives dividends from shares in corporations, their tax treatment depends on the legal form of the head office.

If the head office is a corporation, the dividends attributable to such corporation are effectively tax-free for 95% of the gross dividends (§ 8b (1), (5) KStG – Corporate Income Tax Law. The tax exemption applies to dividends received after February 28 2013, but not if the direct shareholding at the start of the calendar year amounts to less than 10% of the share capital. In the case of individuals, 40% of dividends are tax-exempt (§ 3 no. 40d EStG). In the assessment procedure for the head office – whether a corporation or an individual – any dividend withholding tax withheld is creditable in its entire amount.

It is generally possible to offset losses arising from permanent establishments against other positive domestic income. Losses that are not offset may generally be carried back (up to an amount of € 1,000,000) for one year and forward for an unlimited time. However, the offset of losses carried forward is restricted by the so called minimum taxation (§ 10d EStG, see chapter 6.2.2.7).<sup>6</sup>

Double taxation can be prevented or its effects reduced by double tax treaties which contain permanent establishment rules (cf. Art. 7 OECD Model Tax Convention), or by taking unilateral measures in the foreign country.

#### *6.1.2.3 Exit taxation*

The transfer of any of the permanent establishment's assets to a foreign head office or a foreign permanent establishment of the same taxpayer generally results in the immediate taxation of such asset's hidden reserves. If the assets are transferred to another EU Member State, non-resident taxpayers, in contrast to resident taxpayers, may not spread out their tax payments for such hidden reserves over a period of five years.

Gains on the sale of a permanent establishment are deemed to be current profit and are thus subject to non-resident tax liability.

Germany's tax treaties generally permit the taxation of gains on the sale of a permanent establishment.

### ***6.1.3 Investment through a domestic partnership***

#### ***6.1.3.1 General principles***

Under international tax law, the ownership interest in a domestic partnership held by a foreign partner is generally considered as a foreign enterprise with a German permanent establishment. A partnership is not itself a taxable entity for income tax purposes. Its income is determined at the level of the partnership, but taxed in the hands of the partners. However, a partnership is a taxable entity for trade tax purposes (Gewerbesteuer) if its business activity or its legal form constitutes a commercial activity. A number of different forms of partnership are available (see chapter 5.3.1 for further details).

#### ***6.1.3.2 Current taxation***

When business is carried out through a German partnership, the foreign investor is subject to income tax on the German-source income attributable to the German partnership. The profits are determined on the level of the partnership and allocated to the partners in proportion to their respective ownership and subject to tax in their hands. The profits derived from the partnership by a non-resident individual are taxed according to such taxpayer's personal income tax rate (disregarding a zero-bracket amount) plus solidarity surcharge. If the foreign investor is a corporation, the foreign corporation is subject to corporate income tax (15%) plus solidarity surcharge.

The German partnership as such is liable to trade tax if its business activity qualifies as a trading activity. However, the trade tax may be considered for income tax purposes of the partners by providing a trade tax credit (§ 35 EStG).

Loan agreements between a foreign partner and its German partnership are in principle recognized for tax purposes. However, interest deducted at the level of the partnership is added back at the level of the respective partner to determine the income of the partnership as such and the profit share of the individual partner. Hence, loan agreements between a foreign partner and a domestic partnership are only relevant for the profit allocation between the partners. For further details regarding the treat-

ment of cross-border payments from the German partnership to its foreign partner, see chapter 6.4.

When a partnership is financed with debt capital, the earnings stripping rules must be observed, which can limit the deductibility of net interest expense. For further details on the German earnings stripping rules, please refer to chapter 6.2.2.4.

The tax treatment of a partnership that has shares in a corporation and receives dividends from such shares depends on the legal form of the partners of such partnership. When a partner of the partnership is a corporation, the dividends attributable to such corporation are effectively tax-free for 95% of the gross dividends (§ 8b (6) KStG) if the co-entrepreneur's notional share in the corporation amounts to more than 10% (see chapter 6.1.2.2 for further details). The minimum notional share of 10% applies to dividends received after February 28 2013. When a partner of the partnership is an individual, 40% of the dividends are tax-exempt (§ 3 no. 40d EStG). Any dividend withholding tax levied either on the corporation or the non-resident taxpayer is creditable in the assessment procedure.

Should the partnership generate losses, special regulations must be observed at the level of the partners if such losses are to be claimed for tax purposes (see chapter 6.2.2.7 for further details).

#### *6.1.3.3 Exit taxation*

The tax treatment of the transfer of assets from a domestic partnership to a foreign investor's business property as well as the taxation of gains on the sale of a partner's ownership interests in the domestic partnership is similar to the tax treatment of a domestic permanent establishment in such cases (see chapter 6.1.2.3). Germany's tax treaties generally permit the taxation of gains on the sale of an interest in a partnership.

### ***6.1.4 Investment through a domestic corporation***

#### *6.1.4.1 General principles*

A (domestic) corporation is subject to both trade tax and corporate income tax plus solidarity surcharge. Shareholders, whether individuals or corporations, are taxable on the profits distributed to them. A number of different forms of corporations are available (see chapters 5.1 and 5.2 for further details).

The choice of the most appropriate legal form depends on a number of factors, including employee co-determination rights, the structure of the management and supervisory bodies, equity funding requirements, credit rating, reporting and audit requirements, incorporation costs, etc.

#### *6.1.4.2 Current taxation*

For the tax treatment of the profits derived from a domestic corporation by a foreign investor, it is necessary to distinguish between the level of the corporation and the level of the shareholders.

The corporation itself is an independent taxable entity and hence subject to corporate income tax on its entire worldwide income (resident tax liability). A uniform corporate income tax rate applies whether profits are retained or distributed. The corporate income tax rate is 15%. Apart from corporate income tax, German businesses are generally subject to trade tax (see chapter 6.2.3 for further details) and the solidarity surcharge (5.5% of corporate income tax).

At the level of shareholders, when dividends and constructive dividends are distributed to foreign shareholders, such shareholders are subject to non-resident income tax if they are individuals and subject to non-resident corporate income tax if they are corporations. The distribution of profits triggers withholding tax (Kapitalertragsteuer), normally 25% of the gross dividend. If the non-resident recipient of the dividend is a corporation, the withholding tax can be reduced to 15% via refund (unilateral deduction). Furthermore, the withholding tax rate is often reduced by a tax treaty. A summary of the withholding tax rates in tax treaties between Germany and other industrial countries is included in Appendix I. When the requirements of the EU Parent-Subsidiary Directive are met, withholding tax on dividends paid to a corporation resident in another EU country is reduced to zero. The reduction of withholding tax (unilateral, tax treaty, or EU Directive) is subject to the condition that the recipient fulfills the activity requirements under the anti-treaty/-directive shopping provision (§ 50d (3) EStG, see chapter 6.2.2.5). The withholding tax liability on the gross amount of the dividends and constructive dividends is discharged by the amount withheld. Due to the discharging effect, the tax exemptions under the partial income system are denied to non-resident individuals.

and the effective tax exemption of 95% (§ 8b (1) and (5) KStG) is denied to non-resident corporations.

Corporations may enter into contractual relationships with their shareholders, e.g. by concluding service contracts, rental contracts, licensing agreements, or consulting agreements. Expenses and revenues related to such contractual relationships with shareholders must generally be recognized for tax purposes if the performance obligations meet the requirements of the arm's length principle. If this is not the case, corrections or adjustments may be necessary, especially through constructive dividends, constructive contributions, or income adjustments within the meaning of § 1 AStG (Foreign Transactions Tax Law).

The tax treatment of the contractual relationships between a corporation and its shareholders is particularly important regarding the financing of the corporation. Chapter 6.4.2 lists various options of financing German corporate subsidiaries and their tax consequences. If debt financing is the option chosen, the earnings stripping rules must be observed regardless of whether shareholders or other persons finance the corporation (see chapter 6.2.2.4).

It is possible for domestic corporations to carry back and forward losses under a minimum taxation rule (see chapter 6.2.2.7 for further details). However, losses incurred by the domestic corporation may not be transferred to non-resident shareholders. A non-resident parent company and its resident subsidiary may not in principle form a German tax group (Organschaft) that generally provides for the possibility of transferring losses to the parent company (see chapter 6.2.4 for further details regarding German tax group rules).

#### *6.1.4.3 Exit taxation*

If the seller of shares in a corporation is not a resident in Germany, the gains on the sale are subject to non-resident tax liability only if the shareholding is substantial (i.e. a direct or indirect holding of at least 1% within a five-year period before the sale at any point in time). No tax liability arises in Germany for the sale of shares in a domestic corporation if the non-resident seller holds less than 1% of such corporation, regardless of whether the shareholder is an individual or a corporation. A foreign corporate shareholder whose gain on the sale of shares in a

German corporation is taxable will benefit from the capital gains exemption, as the sale of shares in a corporation by another corporation is exempt from corporate income tax. However, since 5% of capital gains qualify as non-deductible expenses for corporate income tax purposes, effectively 95% of the capital gain is tax-exempt (§ 8b (2), (3) KStG).

When the foreign seller is an individual or a partnership with individuals as partners, the gain on the sale is subject to the partial-income rule, whereby 60% of the gain is subject to income tax. Germany's tax treaties typically allocate the right to tax capital gains on the sale of shares to the seller's country of residence.

## 6.2 Basic principles of business taxation

### 6.2.1 Principles of income taxation

A company's tax status depends primarily on the legal form chosen by its organizers. Corporations are taxable entities subject to corporate income tax, trade tax, and the solidarity surcharge.

Partnerships are not taxable entities for corporate or income tax purposes. The income determined at the level of the partnership is allocated to the partners. The partnership prepares returns for informational purposes, and the partners declare their respective shares of partnership profits or losses on personal tax returns. The partnership itself is subject only to trade tax. The determination of income at the level of a partnership is generally similar to that of a corporation. However, the income of a non-commercial partnership can also be determined under a different method. The main aspects of income determination are explained below. Specific issues affecting the taxation of partnerships are highlighted in chapter 6.2.2.

A permanent establishment is not a legal form (for the taxation of permanent establishments see chapter 6.2.2.3).

Corporations residing in Germany are subject to tax on their worldwide income (resident tax liability, unbeschränkte Steuerpflicht). Corporations not residing in Germany are subject to tax on their income from sources in Germany (non-resident tax liability, beschränkte Steuerpflicht), which includes income derived from

a permanent establishment (Betriebsstätte) or a permanent representative in Germany, gains from the sale of shares in a German corporation (if specific conditions are fulfilled), income from agriculture and forestry, rental income, investment income, and certain categories of income subject to withholding tax. No differentiation is made between publicly and closely held corporations. Capital gains on the sale of real estate located in Germany are also subject to German corporate income tax.

A corporation is considered resident in Germany if it maintains either its registered office (as determined by its articles of incorporation) or its principal place of management in Germany. The principal place of management is where key decisions are regularly made and the place from which day-to-day business operations are managed. Corporations lacking either of these nexuses are considered non-resident. Residence determines whether a corporation is subject to tax in Germany on its worldwide income or only on its German-source income.

Resident corporations are classified as commercial businesses (Gewerbebetriebe) by virtue of their legal form under civil law and therefore all of their income constitutes commercial business income (gewerbliche Einkünfte), irrespective of its source.

Profits are subject to a corporate income tax rate of 15% at the level of the corporation plus a solidarity surcharge (Solidaritätszuschlag) of 5.5%. The tax rate for corporations of 15% is therefore increased by the solidarity surcharge to 15.825% (15% plus 5.5% of 15%). The solidarity surcharge is levied on, among other things, the assessed amount of corporate income taxes, corporate income tax prepayments, and withholding taxes.

Furthermore, profits from commercial business activity are subject to trade tax. Trade tax (Gewerbesteuer) is based on federal law but is levied by local municipalities on a corporation's trade income. The trade income is multiplied by a basic tax rate (Steuermesszahl) of 3.5% to arrive at the so-called base amount (Steuermessbetrag). The relevant multiplier (Hebesatz) for each local municipality is then applied to the base amount. These multipliers typically range between 300 – 490%, i.e. a factor of 3.0 to 4.9, yielding a tax rate of 10.5 – 17.15%. For further information regarding trade tax see chapter 6.2.3.

For non-resident corporations, the tax treatment of certain types of income depends on whether the tax is levied via a filing and assessment procedure (the case e.g. for business income derived through a permanent establishment, income from agriculture and forestry, rental income from movable assets and immovable property, and interest income secured by real property located in Germany), or by means of a withholding tax procedure (in the case of dividends, interest, and royalties). The standard 15% corporate income tax rate generally applies in assessment procedures. Withholding tax rates vary depending on the kind of income.

In 2007, the German legislature created the Real Estate Investment Trust (REIT) as a new asset class. The introduction of the REIT has opened up significant opportunities for real estate companies, investors in real estate, and companies with substantial real estate holdings in Germany, in particular by providing the opportunity to transfer assets to the capital market. REITs help companies to unlock hidden reserves and to invest the proceeds in their core business.

REITs are stock corporations (Aktiengesellschaft) organized under German law having their registered office and principal place of management in Germany. The shares in a REIT must be registered for trading on a public exchange in a Member State of the European Union or the European Economic Area. Their minimum stated capital is € 15m. In addition, several other requirements have to be fulfilled. If a REIT meets these requirements, it is exempt from German corporate income tax, trade tax, and solidarity surcharge. The tax exemption at the level of the REIT corresponds to full taxation at the shareholder level.

## **6.2.2 Determination of taxable income**

### **6.2.2.1 General principles**

There is an underlying principle in Germany that tax accounting is based on commercial accounting (so-called principle of linkage – Maßgeblichkeitsprinzip). Accordingly, the determination of taxable income is based on the results shown in the annual accounts (see chapter 4), as adjusted to comply with pertinent tax provisions. If the books of account are not kept in a lawful manner, the tax authorities are entitled to estimate the taxable income.

All assets and liabilities must be valued as of the balance sheet date, i.e. the end of the fiscal year. Unrealized losses must be recognized (subject, however to certain conditions and to a restriction for provisions for anticipated losses on pending transactions – see below), whereas unrealized profits are not recognized. Assets are carried at cost, less depreciation if applicable, or at their lower going concern value (Teilwert). Going concern value is defined as the amount or fraction of the total purchase price which a purchaser of the entire business would allot to a specific asset assuming the purchaser intends to continue the business. This lower going concern value may only be recognized if the impairment in value is considered to be of lasting nature. The write-down to a lower going concern value is optional for tax purposes. If the reason for the impairment in value no longer exists, the write-down must be reversed. In general, all assets with a useful life in excess of one year must be capitalized on the balance sheet. An exception applies for depreciable movable assets whose acquisition or production costs are € 410 or less – so-called assets of minor value (geringwertige Wirtschaftsgüter). These assets can be expensed in the year of the acquisition or production. Alternatively, assets purchased at prices from € 150.01 to € 1,000 can be aggregated for each assessment period (so-called pool items) and depreciated over five years. In addition, assets purchased at prices of € 150 or less can be expensed in the year of acquisition or production. Intangible assets must be reflected on the balance sheet if acquired for consideration, in which case they are amortized over their useful life. Capitalization is prohibited for self-created intangible assets and intangible assets acquired gratuitously.

Depreciation is, in general, allowed on tangible or intangible fixed assets with a useful life of more than one year. Land and investments in other corporations cannot be depreciated, but may be written down to a lower going-concern value. Please note that write-downs of shares in other corporations are not deductible for corporate income tax purposes (§ 8b (3) KStG). The 2008 Tax Act expanded this rule to cover shareholder loans. Therefore, deductions for reductions in profits are denied if these result from loans made by substantial shareholders (direct or indirect holding of at least 25% of the shares), persons related to the substantial shareholder under § 1 (2) AStG, and third parties with a right of recourse against the aforementioned persons. The denial does not apply if the lender can prove that an unrelated party would

have made the loan on the same terms. Goodwill acquired for consideration can be amortized on a straight-line basis over 15 years.

Depreciation is based on the acquisition or production cost of an asset. In general, the straight-line and units-of-production methods can be used. The declining balance method is applicable only for fixed assets acquired or produced after December 31 2008 and before January 1 2011.

A taxpayer may change from the declining-balance to the straight-line method, but not vice versa. Except for buildings, depreciation rates are not fixed by statute; however, the Federal Ministry of Finance publishes guidelines on useful asset lives in officially recommended tables.

A write-down to a lower going-concern value to reflect technical or economic obsolescence is possible for tax purposes.

Inventories must be valued at cost. However, write-downs to lower market prices are possible. For essentially similar goods, a weighted average is allowed. The German Income Tax Law (Einkommensteuergesetz – EStG) explicitly permits the use of the last-in-first-out method (LIFO) if this is in accordance with generally accepted accounting principles.

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### Typically accepted straight-line rates

- Buildings: 2%, if the building was completed after December 31 1924
- Office buildings and factories: 3%, if the building permit was applied for later than March 31 1985
- Commercial and residential buildings: under certain circumstances eligible for higher rates
- Plant equipment: 5% to 20%
- Office equipment and furniture: 10% to 20%
- Motor vehicles: 16.67%
- EDP equipment: 33.33%

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Provisions (Rückstellungen) must be established for contingent liabilities if there is a reasonable expectation that a liability will materialize in the future. In particular, provisions are required for anticipated guarantee and warranty costs. General and specific allowances (Wertberichtigungen) may be recognized for the general risk of non-collection and for specific doubtful debts. A pension provision must be recognized if the employer's obligation to make pension payments is documented in a written promise and the employee has a legal right to one-time or periodic pension benefits. Pension claims are generally vested and not contingent on the employee's continuing in the service of the employer if the employee is more than 30 years old and the pension promise has been in existence for at least five years. The pension provision must be actuarially calculated annually for each employee using an interest rate of 6.0%.

Provisions for anticipated losses from pending transactions must be recognized when applicable for financial reporting purposes. For tax purposes, however, it has not been possible to recognize such provisions since 1 January 1997. Tax rules also stipulate stricter recognition criteria for a number of provisions, including provisions for infringement of patents, copyrights or similar industrial rights, and provisions for long-term service awards. Provisions (and liabilities) must be discounted for tax purposes using an interest rate of 5.5% (except pension provisions, see above). Only short-term provisions and liabilities (maturing within 12 months of the balance sheet date) or interest-bearing amounts are excepted from this requirement.

Some of the major items in determining taxable income are considered below:

- Capital gains are, in general, treated as ordinary income and taxed at ordinary rates (except gains from the sale of shares, see above). 100% of gains realized on the sale of real estate and buildings may be offset against the cost of similar assets acquired in the year of sale, the preceding year, or the following 4 years (6 years for buildings – roll-over relief).
- Non-taxable income includes declared and constructive contributions to capital.
- Organizational expenses incurred as a result of forming a corporation or increasing its capital may not be capitalized. They must instead be deducted in the year incurred. Organizational

expenses include accountant and attorney fees and registration fees, among other things.

- Salaries and other compensation paid for the services of shareholder-employees are deductible. The compensation must be at arm's length; otherwise, a constructive dividend may be imputed.
- Rental expense in connection with the business may be deducted as incurred.
- Interest expenses are generally deductible unless they relate to tax-exempt income (other than dividends and capital gains from the sale of shares). But the deduction of interest expenses is restricted due to the earnings stripping rules (see chapter 6.2.2.4).
- Repair and maintenance expenses are deductible in the period incurred.
- Charges by a foreign parent for providing certain assets or services to its German subsidiary are deductible if at arm's length. To the extent that they exceed an arm's length price, they are treated as constructive dividends.
- Excise tax and real estate tax are all deductible for corporate income tax purposes.
- Corporate income tax and trade tax are non-deductible expenses, however.
- Other non-deductible expenses include expenses relating to tax-exempt income; in addition, as a general rule, expenses for hunting rights, yachts or guest houses not located on business premises, and 50% of fees paid to members of the supervisory board are not deductible.
- Business gifts worth up to € 35 per recipient per year are deductible if they are accounted for separately.
- Only 70% of reasonable business entertainment expenses are deductible.

Deductions for charitable contributions are limited to 20% of income or 0.4% of the sum of sales and payroll.

**Table 10: Taxation of partnerships: retained vs. distributed profits (For simplification purposes the solidarity surcharge is not considered in the example)**

Partnership		Retention	Distribution
	Income before taxes	100.0	100.0
-	Trade tax (e.g. 14%)	14.0	14.0
=	Income after trade tax	86.0	86.0
	Tax base	86.0	100.0
-	Tax on retained profits (28.25%)	24.3	0.0
-	Tax on distributed profits (45%)	6.3 <sup>1</sup>	45.0 <sup>1</sup>
+	(Trade) tax credit 2)	13.3	13.3
=	Income after tax	68.7	54.3
	Subsequent distribution	86.0	
	Tax base distributed profits	61.7 <sup>3</sup>	
-	Subsequent taxation (25%)	15.4	
=	Net cash flow	53.3 <sup>4</sup>	54.3

<sup>1</sup> At the level of the partners, trade tax is treated as distributed profits for income tax purposes.

<sup>2</sup> See detailed information of the (trade) tax credit in chapter 6.2.3.

<sup>3</sup> Tax base (86.0) minus tax on retained profits (24.3).

#### 6.2.2.2 Specifics of taxation of partnerships

For income/corporate income tax purposes, the profits of a partnership are allocated to the partners in proportion to their interest in the business (transparency principle). The partners' income from the partnership is then subject to income tax (in the case of an individual) or corporate income tax (in the case of a corporation) at the appropriate tax rate, unless the taxpayer elects flat-rate taxation. Flat-rate taxation may only be elected by individuals. The flat rate of 28.25% (plus solidarity surcharge) is applicable to retained profits. Later distribution of these profits triggers an additional tax of 25% (plus solidarity surcharge).

The nature of the income allocated to the partners is based on how the income is classified at the level of the partnership. A

partnership generates income from commercial business activity (Einkünfte aus Gewerbebetrieb) if it is a commercial business (Gewerbebetrieb). To qualify as a commercial business it has to operate autonomously on a continuing basis, generate profits, and participate in general commerce. Activities relating to agriculture, forestry, and self-employed work are excluded. The scope of the activities must constitute more than the mere management of private assets. A typical GmbH & Co. KG qualifies by virtue of its legal form as a commercial business with trade income.

Since the determination of income and the allocation of that income to the partners are separate processes, income of a commercial partnership must be determined in two stages:

Step 1 – Determination of income at the level of the partnership:  
In general, the determination of income at the level of the partnership follows the same rules as the determination of income for corporations. However, some specific features must be considered:

### Example

A and B are business partners, each holding a 50% interest in A&B OHG, a general partnership. In the 2014 assessment period, the OHG generates a profit from commercial business activity in the amount of 100. The profit from commercial business activity includes a remuneration of 30 for A's work as managing director and interest expense in the amount of 20 in connection with a shareholder loan provided by B.

Profit allocation	Partnership	Business partner A (50%)	Business partner B (50%)
Step 1			
Joint profit	100	50	50
Step 2			
Special partner Business property			
Remuneration for managing director	30	30	
Interest on loan	20		20
Profit from commercial business activity	150	80	70

For example, if the acquisition costs exceed the carrying amount of equity attributable to the partner, it is necessary to recognize the excess amount in a supplementary tax balance sheet (Ergänzungsbilanz).

Special partner remuneration (Sondervergütungen) paid by the partnership to its partner for services (e.g. directors' remuneration), loans (interest), and the use of assets (rental expenses) are deductible in determining the income of the partnership.

The income is allocated to the partner in accordance with the applicable profit allocation key.

Step 2 – Special partner remuneration: In a second step the special partner remuneration is added back to the profit/loss of the partnership and allocated to the partner who received them as special business income (Sonderbetriebseinnahmen) or special business expense (Sonderbetriebsausgaben). Hence, special partner remuneration does not reduce the taxable profit (or increase the losses) of the partnership.

#### *6.2.2.3 Specifics of taxation of permanent establishments*

Under German tax law, permanent establishments are any fixed place of business or facility which serves the business of an enterprise (§ 12 AO – Tax Procedure Law). In particular the place of management, branches, offices, factories, and warehouses are permanent establishments. Under German tax law, a permanent representative (§ 13 AO) is similar to a permanent establishment (§ 12 AO). A permanent representative does not need to be an employee of the corporation. A permanent representative within the meaning of § 13 AO conducts business on behalf of a company on an ongoing basis and is subject to the company's instructions.

Germany's right of taxation of a permanent establishment or permanent representative maintained by a foreign resident in Germany may be modified by a tax treaty.

Under typical German tax treaties, which follow the OECD Model Tax Convention, permanent establishments are any fixed place of business in which the business of the enterprise is wholly or partly carried on. In particular the place of management, branches, offices, and factories are permanent establishments. Unlike

under German tax law, warehouses are not deemed permanent establishments. A person acting in Germany on behalf of a foreign enterprise is deemed to be a permanent establishment in Germany if the person has, and habitually exercises in Germany, an authority to conclude contracts in the name of the enterprise. This does not apply when the activities of the person are limited to the purchase of goods or merchandise for the enterprise. Furthermore, a foreign enterprise is not deemed to have a permanent establishment in Germany merely because it carries out business in Germany through a broker, general commission agent, or any other agent of an independent status, if such persons are acting in the ordinary course of their business.

Germany's tax treaties typically provide that the income and the assets of a permanent establishment may be taxed in the country in which the permanent establishment is located. Hence, foreign investors are subject to tax in Germany with respect to their German-source income attributable to a permanent establishment.

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As part of the OECD BEPS project, the definition of "permanent establishment" within the scope of the OECD Model Convention will be extended.

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The investor's tax status is relevant for determining the level of taxation of the income attributable to the permanent establishment. If the investor is a corporation (from a German tax perspective), the investor is subject to corporate income tax and to the solidarity surcharge. If the investor is an individual, the investor is subject to income tax and to the solidarity surcharge. If a partnership owns the permanent establishment, the profits are allocated to the partners in proportion to their respective ownership interests and taxed at the level of the partners. Partners are accordingly liable to personal or corporate income taxes and to the solidarity surcharge.

A domestic permanent establishment earning commercial business income is subject to trade tax.

The permanent establishment may be financed with debt capital raised by the permanent establishment itself by borrowing from a third party (not the head office). Alternatively, the head office

may raise debt capital and provide such capital to the permanent establishment.

Because a permanent establishment is merely a part of the overall enterprise, only a portion of the overall profits of the enterprise is

allocable to the permanent establishment. The required allocation of business profits between head office and permanent establishment is made using the Functionally Separate Entity Approach. This so called Authorized OECD Approach was transposed into domestic law with effect as of 2013 (Sec. 1 (5) AStG), and the Federal Ministry of Finance (BMF) published its decree on the Attribution of Profits to Permanent Establishments with effect as of 2015.

The treatment of the permanent establishment as a separate and independent enterprise ("Functionally Separate Entity Approach") requires a two-step procedure for the determination of profits and the attribution of profits to permanent establishments:

*1st step: function and risk analysis of the business activity of the permanent establishment*

- Determination of the (relevant) personnel functions are to be attributed to the permanent establishment.
- On the basis of the (relevant) personnel functions, the assets, the opportunities and risks, the dotation capital as well as the remaining liabilities are to be attributed to the permanent establishment.
- Business transactions of the enterprise with third parties and with closely related persons within the meaning of § 1 (2) AStG are to be attributed to the permanent establishment.
- Determination of the deemed contractual relationships ("dealings"), maintained by the permanent establishment with the rest of the enterprise. Dealings are defined as economic processes that either require a change in the attribution of assets, opportunities and risks, or business transactions, or that would be regulated by an agreement under the law of obligations, assuming that the permanent establishment and the rest of the company are legally independent, or lead to the assertion of legal positions.

## *2nd step: comparability analysis of the business activity of the permanent establishment*

On the basis of a comparability analysis, transfer prices are to be determined in consideration of the arm's length principle for the business relationships of the permanent establishment within the meaning of § 1 (4) AStG. An auxiliary or ancillary account has to be set up, which contains all components that are to be attributed to the permanent establishment on the basis of its personnel functions. These include the assets, if an independent enterprise had to consider them in the determination of taxable income, the dotation capital, the liabilities, as well as the related business revenue and expenses (including deemed business revenue and expenses based on the dealings). The auxiliary and ancillary account must be set up at the beginning of the fiscal year, continuously updated, and closed by the end of the fiscal year. The closing of the auxiliary and ancillary account shall show the operating profit of the permanent establishment. The auxiliary and ancillary account must be completed at the latest on the date of submission of a tax statement, which is a requirement for the enterprise pursuant to § 149 AO (Tax Procedure Law) and which has to take the income of the permanent establishment into account. Enterprises that are not required to maintain books, neither under domestic nor under international law, and that de facto do not maintain books must prepare the auxiliary and ancillary account on the basis of the cash method of accounting within the meaning of § 4 (3) EStG – Income Tax Law.

### *6.2.2.4 Earnings stripping rules*

The earnings stripping rules replaced existing thin capitalization rules with general effect as of January 1 2008.

The earnings stripping rules apply in general to all types of debt financing of sole proprietorships, partnerships, and corporations. The scope of the new rules is far broader than the previous thin capitalization rules as all third-party debt financing is included. Interest expense is completely deductible from the tax base only to the extent the taxpayer earns positive interest income in the same financial year. Interest expense in excess of interest income (net interest expense) is deductible only up to 30% of tax EBITDA (so-called 30% rule). Tax EBITDA is defined as taxable profit before application of the earnings stripping rules, increased

by interest expenses and by fiscal depreciation and reduced by interest earnings.

**De-minimis threshold (Freigrenze):** The earnings stripping rules do not apply where interest expense exceeds positive interest income by less than € 3m (tax threshold). Thus, small and medium-sized business enterprises are in many cases unaffected by the new earnings stripping rules.

**Non-group businesses (Konzernklausel):** The earnings stripping rules also do not apply to businesses that are not part of a controlled group. An enterprise is regarded as part of a controlled group if it is or could be included in consolidated financial statements in accordance with IFRS, German GAAP, or US GAAP.

The exemption for non-controlled corporations applies only if the corporation proves that remuneration on shareholder debt accounts for at most 10% of net interest expense. Shareholder debt is defined as debt capital received from a substantial shareholder (more than 25%), a related person, or a third party having recourse against a substantial shareholder or a related person.

**Example of the application of the earnings stripping rules:**

<b>Year 2015</b>	<b>€</b>
EBITDA in 2015	20.0
Interest expense	8.0
Interest income	4.0
Net interest expense	4.0
Directly deductible interest expense	4.0
30% x EBITDA	6.0
Deductible net interest expense	4.0
Remaining EBITDA (EBITDA carryforward)	2.0
EBITDA in 2016	5.0
Interest expense	4.0
Interest income	0
Net interest expense	4.0
30% x EBITDA	1.5
+ EBITDA carryforward of year 2015	2.0
Deductible net interest expense	3.5
Non-deductible interest expense (interest carryforward)	0.5

Escape clause: For businesses which are part of a controlled group, a so-called escape clause applies. If the equity ratio of the entity in question is equal to or greater than the equity ratio of the controlled group, the earnings stripping rules will not apply. There is a one percentage point safety cushion for the equity ratio of the business in question. As of assessment period 2010, the threshold was increased to two percentage points. As a consequence, the escape clause is still met when the equity ratio of the entity is 48% and the equity ratio of the controlled group is 50%. The escape clause applies only if the corporation proves that remuneration on shareholder debt (see above) accounts for at most 10% of net interest expense.

Interest carryforward: Interest expense that is not deductible in the period in which it arose has to be carried forward. It increases interest expense in the following year, but is not taken into account to determine tax EBITDA. Interest expense carried forward will, however, be erased in reorganizations and where the change-of-control rules (see chapter 6.2.2.7) apply.

EBITDA carryforward: In 2010, the possibility to carry forward unused tax EBITDA was introduced, i.e. if 30% of EBITDA exceeds the net interest expenses. Net interest expenses which cannot be deducted according to the 30%-rule in a given business year may be deducted up to the amount of the EBITDA carryforward of former business years. Such tax EBITDA carry-forward is limited to a maximum period of five years.

Tax groups (Organschaft): For purposes of the earnings stripping rules, the controlling entity and controlled companies of a tax group are treated as a single entity.

#### *6.2.2.5 Dividends*

When profits are distributed to a corporation, these profits are generally exempt from corporate taxation at the shareholder level. However, an amount equivalent to 5% of a corporation's dividend income is treated as a non-deductible business expense. Thus, only 95% of the dividend income received is effectively tax-exempt. Costs actually incurred are deductible without limit. This rule applies to dividends which are paid by domestic or foreign corporations. The above-mentioned tax exemption applies to dividends received after February 28 2013, but not if the direct shareholding at the start of the calendar year amounts to less than 10% of the share capital. Furthermore, the tax exemption does not apply to credit institutions and insurance companies if special requirements are met. As a consequence, these dividends are completely subject to tax.

The corporation paying the dividend must deduct withholding tax (Kapitalertragsteuer) on the dividend, generally at a rate of 25% (plus a solidarity surcharge of 5.5% of 25%), and remit such tax to the tax authorities. In principle the shareholder can offset the amount so withheld against its ultimate tax liability. In general, the withholding tax is final for non-resident corporations.

As the EU Parent-Subsidiary Directive has been transposed into domestic law, dividends paid by a resident subsidiary corporation to a parent company that is based in another EU Member State are generally exempted from withholding tax. This requires that the parent company has a direct holding of 10% in the subsidiary, which it has held for twelve months without interruption, and that the parent company has filed the relevant application with the German Federal Central Tax Office (Bundeszentralamt für Steuern).

Dividends paid by a German subsidiary to a non-German permanent establishment in the EU which is maintained by a qualifying EU parent company are also exempt from withholding taxes. The same applies if such a permanent establishment is maintained by a German parent company, provided the relevant shares are effectively connected with the German company's EU permanent establishment.

Non-EU based parent companies may therefore benefit by establishing a holding company in the EU. However, the German tax authorities may disallow the reduction of the withholding tax rate for dividends paid by a German subsidiary to, for example, an EU based holding company, (i) to the extent the foreign company is owned by persons who would not be entitled to the reduction if they derived the income directly, and (ii) to the extent the foreign company's gross earnings for the respective fiscal year are not derived from its own business activities and (iii) any one of the following additional conditions is met (anti-treaty/directive-shopping provision (§ 50d (3) EStG):

- With regard to the above mentioned earnings, there are no economic or other valid reasons for the interposition of the foreign company, or
- the foreign company does not participate in general commerce by means of a business organization with resources appropriate to its business purpose.

Whether the elements of this provision are fulfilled is determined solely with reference to the situation of the foreign company. The provision aims to counter abuse of the EU Parent-Subsidiary Directive or the tax treaties by interposition of foreign companies without economic function for the purpose of obtaining benefits under the directive (so-called treaty/directive-shopping).

Withholding tax may be partially or totally reduced due to a tax treaty between Germany and the shareholder's country of residence. Upon application to the German Federal Central Tax Office withholding tax may be (partially) reduced or refunded. For further information regarding tax treaties see chapter 6.2.5.2.

In case the withholding tax is not reduced by the EU Parent-Subsidiary Directive or a tax treaty, non-resident corporations may also apply for a reduction of withholding tax. Upon application to

the German Federal Central Tax Office, 40% of the withholding tax may be refunded, provided the recipient is a corporation from a German tax perspective and fulfills the activity requirements under the anti-treaty/directive shopping provision. As a consequence the corporation pays tax at the final rate of 15%, which reflects the corporate income tax rate.

If the shareholder of the distributing corporation is a partnership, the dividends are taxed for corporate or income tax purposes at the level of the partners and not at the level of the partnership.

When dividends are distributed to an individual, the distributing corporation must withhold 25% withholding tax (plus solidarity surcharge). Where shares in the corporation are held as private assets by a resident taxpayer, the tax withheld on the income from capital is generally final when withholding tax has been deducted (so-called final withholding tax), regardless of the taxpayer's personal income tax rate. Upon request, the taxpayer's personal income tax rate can be used as a basis for taxation if it is beneficial for the taxpayer.

If shares in corporations are held as business property, the final withholding tax is not applicable. In such cases 40% of the received income is tax-exempt and 60% of the related expenses are deductible as business expenses (partial income system). The withholding tax on the dividends (25% of the gross amount plus solidarity surcharge) that is withheld by the debtor of the dividends and remitted to the tax authority is credited against the income tax liability of the recipient of the dividends. For non-resident individuals, the withholding of tax is generally final.

The required calculations can be illustrated as follows:

**Table 11: Computation of income/corporate income tax rates on payment of dividends**

	Individual: final withholding tax	Individual: partial income system	Resident corporation with not less than 10% of shares	Non- resident corporation
Income of corporation	100.0	100.0	100.0	100.0
– Corporate income tax (15%)	15.0	15.0	15.0	15.0
<b>= Income after trade tax</b>	<b>85.0</b>	<b>85.0</b>	<b>85.0</b>	<b>85.0</b>
Dividend	85.0	85.0	85.0	85.0
– WHT (25%)		21.3	21.3	
<b>= Cash dividend</b>		<b>63.7</b>	<b>63.7</b>	
Final WHT (25%/15%)	21.3			12.8
Taxable income of shareholder (60%/5%)		51.0	4.3	
– Income tax (45%)		23.0		
– Corporate income tax			0.6	
+ Creditable withholding tax	0.0	21.3	21.3	0
<b>Income after taxation</b>	<b>63.7</b>	<b>62.0</b>	<b>84.4</b>	<b>72.2</b>

Constructive dividends (verdeckte Gewinnausschüttungen) occur when a corporation confers a benefit on its shareholders or on persons related to shareholders which it would not normally confer on unrelated third parties. Constructive dividends result in increased taxable income either through the disallowance of a tax deduction claimed (e.g. excessive service fees paid to a related person) or an increase in an income item (e.g. below-market interest rate charged on a loan to a related person).

Constructive dividends are, in general, taxed the same way as declared distributions. Hence, constructive dividends received by a corporation are in effect 95% tax-exempt. An exception to this basic rule – the congruency principle – was introduced into German tax law in 2007. Under the congruency principle, the 95% tax exemption on dividends received is limited to dividends that have not reduced the taxable income of the distributing

corporation. This means that a constructive dividend that is deducted as a business expense at the level of the distributing corporation will not be tax-exempt in the hands of a recipient corporation.

#### *6.2.2.6 Capital gains*

Capital gains arising on the sale of shares held by a corporation are also exempt from corporate income tax. Similar to the treatment of dividends, 5% of the capital gain is treated as a non-deductible business expense. Costs incurred in connection with the sale reduce the net amount of the capital gain and are thus not separately deductible as business expenses, but do reduce the base on which deemed non-deductible business expenses are calculated. Losses on the sale of shares and write-downs due to impaired value are likewise not tax-deductible.

If the shareholder of the corporation is a partnership, the capital gains are taxed for corporate or income tax purposes at the level of the partners and not at the level of the partnership.

When an individual resident in Germany sells shares in a corporation and such shares are held as private assets, 25% of the capital gain is liable to tax (plus solidarity surcharge). If the shares are held for safekeeping by a so-called domestic paying agent (a bank, securities trading bank, etc.), which is often the case especially with shares in listed companies, the domestic paying agent must withhold 25% withholding tax plus solidarity surcharge. In such a case, withholding tax is generally final (so-called final withholding tax), regardless of the taxpayer's personal income tax rate. If it is beneficial for the taxpayer, his personal income tax rate can be used upon request as a basis for taxation. However, if the shares are not held for safekeeping by a domestic paying agent, no withholding tax is levied. The taxpayer is then required to file a tax return for the capital gains in question.

When an individual holds shares in a corporation as business property and sells such shares, 40% of the gain on the sale are tax-exempt (partial income system). Shares in corporations that are held as private assets also qualify for the partial-income system, provided that the shareholding is substantial (i.e. a direct or indirect holding of at least 1% within a five-year period at any point in time).

If the seller is not a resident in Germany, the gains on the sale are subject to non-resident tax liability only if the shareholding is substantial (i.e. a direct or indirect holding of at least 1% within a five-year period at any point in time) or if the shares are held through a domestic permanent establishment. No tax liability arises in Germany for the sale of shares in a domestic corporation if the seller does not have a substantial shareholding (as described above) in such a corporation, regardless of whether the shareholder is an individual or a corporation.

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In most cases, German double tax treaties allocate the right to tax gains on the sale of shares in domestic corporations to the taxpayer's country of residence; i.e. the German domestic right of taxation has no effect.

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#### *6.2.2.7 Loss deduction*

The approach to loss deduction is different for corporations and partnerships. According to the principle of separation, a corporation's losses are recognized at the level of the corporation and may not be allocated to the shareholders. Profits and losses generated by a partnership are directly allocated to the partners. Hence, losses from commercial business activity may generally be offset against the respective partner's other income. If the partner generates an overall negative income, such income may either be carried back to the previous year or carried forward; in such case the same ceilings apply as set out below for corporations.

Special loss deduction rules apply to partners in specific partnership forms. Thus, limited partners and other partners with comparable liability are subject to a separate restriction regarding tax losses. Under these rules, losses from a partnership (negative commercial income) can only be offset against profits of the same partnership if the limited partner's capital account is negative or becomes negative as a result of the loss allocation. In effect, the amount of losses which can be offset is limited to the amount of the partner's capital account.

Tax losses which cannot be offset in the current year may be carried back one year up to an amount of € 1,000,000 for corporate income tax purposes. To the extent that the losses exceed € 1,000,000 or cannot be fully offset against the previous year's

income, they may be carried forward indefinitely. However losses carried forward may be offset without restriction against profits only up to an amount of € 1m. Losses carried forward in excess of this amount may be offset against no more than 60% of taxable income in the current period (so called "minimum taxation"). The taxpayer can elect whether to carry back the losses or not and may also decide, within the limits described above, the amount to be carried back.

There is, however, an additional restriction on loss deduction for corporations. Changes in the ownership of corporations can cause forfeiture of losses for tax purposes under the so-called change-of-control rules. The restriction proceeds in two steps. Acquisitions of more than 25% and up to 50% of a corporation's shares or voting rights within a five-year period by a person or parties related thereto triggers pro rata forfeiture of losses. The forfeiture of losses is total when more than 50% of the shares or voting rights are transferred. The statute covers both direct and indirect transfers. The rules also operate when shares are transferred to a group of purchasers with convergent interests. The change-of-control rules were introduced into German tax law with effect from 2008 and apply to transfers of shares on or after 1 January 2008.

A detrimental change in ownership does not exist if 100% of the shares in the transferee and transferor are held directly or indirectly by the same person (top management of the group) (so-called group exemption provision). By the 2015 Tax Amendment Act, the group exemption provision was extended to group internal acquisitions with participation of the group's parent company (top management). In addition, individuals, legal entities, as well as commercial partnerships can be regarded as the top management of the group. In addition, the rules provide that unused tax losses of a corporation are not forfeited upon a share transfer up to the amount of hidden reserves taxable in Germany of the corporation's fully taxable business property.

#### *6.2.2.8 CFC rules*

If a German corporation, partnership, or permanent establishment (in this section referred to as a German entity) holds an investment in a foreign corporation, Germany's CFC rules (controlled foreign company rules, *Hinzurechnungsbesteuerung*)

under the German Foreign Transactions Tax Law (Außensteuergesetz – AStG) must be considered.

Taxation in accordance with the CFC rules will apply at the level of the German entity if the foreign corporation is deemed to be an intermediary company (Zwischengesellschaft). Particular care must be exercised in the case of a German holding company.

CFC rules apply where the following conditions are cumulatively met:

- In general, shareholders who are tax resident in Germany hold (alone or jointly, directly or indirectly) more than 50% of the shares or more than 50% of the voting rights in the foreign corporation.
- Passive income of the foreign corporation
- Low rate of taxation at the level of the foreign corporation which is where the effective income tax rate is lower than 25% (claims for tax refund or tax credits raised by the shareholders against the state or territory of the foreign corporation are included in the calculation of the foreign corporation's tax burden).
- Foreign corporations whose headquarters or management is located within the EU/EEA may provide evidence that the foreign company pursues genuine economic activities ("motive test"). If this is proven successfully, the foreign corporation is then not subject to controlled foreign company taxation.

#### *6.2.2.9 Transfer pricing*

When an investor decides to carry out business activities in Germany via a German subsidiary, the transactions between the German corporation and its foreign affiliates may give rise to issues of how income should be allocated for tax purposes.

Based on the "separate entity concept", the arm's length principle has become the accepted approach in dealing with intra-group transactions on an international level. Prices as well as terms and conditions agreed on for transactions between related parties will be accepted for tax purposes only when the terms and conditions of the transaction do not differ from those on which unrelated parties would have agreed. The same approach must be used to determine the acceptable level of profit mark-up

under cost-plus arrangements. The inter-company prices agreed on for the exchange of goods or services are referred to as transfer prices (Verrechnungspreise).

The authorized OECD approach (AOA) under German law must be observed for business years starting after December 31 2012. Under the AOA, the functionally separate entity approach applies to cross-border profit ascertainment for permanent establishments. The allocation of profits between a German company and a foreign permanent establishment, and between a foreign company and a German permanent establishment, is therefore performed in the same way as between independent companies. In 2014, the Federal Ministry of Finance issued a statutory regulation to specify the application of the arm's length principle in cross-border cases of permanent establishments (Decree on the Attribution of Profits to Permanent Establishments, Betriebsstättengewinnaufteilungsverordnung), which is to be applied to business years beginning after December 31 2014.

The standard transfer pricing methods confirmed by the legislature are the comparable uncontrolled price method, the resale price method, and the cost-plus method. The transactional net margin method and the profit split method are also accepted transfer pricing methods, subject to certain conditions. In the event that only a range of arm's length transfer prices can be determined, the resulting range is narrowed in accordance with applicable regulations. If the transfer price chosen by the taxpayer is outside of the narrowed range, a correction is generally made to the median value in the range. A hypothetical arm's length test is applied when it is not possible to determine arm's length transfer prices on the basis of an accepted transfer pricing method.

Special rules apply for so-called base shifting (Funktionsverlagerungen), which involves the transfer of business functions, including opportunities, risks, and assets. It is possible to determine individual transfer prices for all components of the transfer package, provided that at least one substantial intangible asset is transferred and specifically identified by the taxpayer. This provision is applicable retroactively as of the assessment period 2008. The Federal Ministry of Finance issued the Administrative

Principles for the Transfer of Functions, which explain and clarify numerous potentially uncertain cases.

It is necessary to document the legal and commercial bases of transfer price arrangements and any other business relationships subject to the arm's length principle. At the request of the tax authorities, documentation must be presented within 60 days. Although a request will generally be made only in the context of a tax audit, requests in other circumstances are possible. If no documentation is presented, the tax authorities are entitled by law to assume that the profits of the German entity have been reduced because of inappropriate transfer prices, and can as a result make appropriate adjustments to taxable income by way of an estimate. Furthermore, the tax authorities have the option of levying additional payments and reversing the burden of proof, placing it on the taxpayer. The taxpayer may avoid such sanctions by filing proper transfer pricing documentation in a timely manner and by basing its transfer pricing arrangements on the relevant parameters.

With regard to extraordinary business events (such as reorganizations, significant changes in functions and risks, relevant changes to business strategies, the conclusion or modification of major long-term contracts), documentation must be created within six months of the event (contemporaneous documentation).

Careful structuring of transfer price arrangements is particularly important for optimizing the effective tax rate of a group and avoiding double taxation as a result of transfer price adjustments. The selection of tried and tested options (such as the resale price method vs. the cost-plus, licensing model, or cost allocation method) may help in this respect. It is also possible to structure the organization of the group in terms of the various functions to be performed, or by redistributing the risks and rewards within the group. This may also be achieved, for example, by changing the sales system to a commission basis or by establishing shared administrative service centers.

The conclusion of advance pricing agreements (APA) is possible under German tax laws and should be considered. APAs are

possible pursuant to bilateral and multilateral mutual agreement procedures.

### 6.2.3 Trade tax

Trade tax (Gewerbesteuer) is based on federal law but is levied by local municipalities on a corporation's "trade income" (Gewerbeertrag).

The trade income is multiplied by a basic tax rate (Steuermesszahl) of 3.5% to arrive at the so-called base amount (Steuermessbetrag).

**Table 12: Range of trade tax rates**

Location of business	Multiplier	Trade tax rate
Munich	490%	17.15%
Frankfurt/Main	460%	16.10%
Conurbation	400%	14.00%

The relevant multiplier (Hebesatz) for each local municipality is then applied to the base amount. These multipliers typically range between 300 – 490%, i.e. a factor of 3.0 to 4.9, yielding a tax rate of 10.5 – 17.15%. In order to eliminate so-called trade tax havens, municipalities must set their multipliers at or above 200%. The typical multiplier for conurbations is approx. 400%; in adjoining areas it can be as low as 200%.

If a company has permanent establishments in different municipalities, the base amount is apportioned among the municipalities based on the proportion of payroll expenses of the respective permanent establishments.

With certain exceptions (public enterprises acting in the public interest, farmers, architects, engineers, lawyers, medics, accountants, and other professionals), the trade tax applies to all businesses. The mere administration of property, on the other hand, is not a "commercial business" and is therefore not subject to trade tax, provided certain requirements are met. The business of a corporation is always treated as a commercial business activity.

Trade income is determined based on the taxable income for income tax or corporate income tax purposes modified by certain additions and deductions.

The additions include one-fourth of the sum of the following items, which must be added back when computing income for trade tax purposes:

- Loan remuneration (e. g. interest)
- Recurring payments
- Profit shares of a silent partner
- 20% of rental and leasing payments for movable fixed assets
- 50% of rental and leasing payments for immovable fixed assets
- 25% of payments to obtain license rights for a limited time period, except for licenses that merely confer entitlement to license to third parties the rights derived thereunder

The addbacks apply only to the extent that payments exceed an exemption amount of € 100,000.

Additionally, the following items must be added back when computing income for trade tax purposes:

- Dividends that are not included in the computation of income for corporate income tax purposes, when the requirements of exemption for trade tax purposes are not fulfilled (see below)
- Distributive share of the losses of domestic or foreign partnerships

The additional deductions (Kürzungen) include:

- 1.2% of 140% of the assessed value (Einheitswert) of real property
- Distributive share of profits from an interest in a domestic or foreign partnership
- Dividends from a domestic corporation in which the taxpayer has a shareholding of at least 15% as of the beginning of the calendar year, to the extent this income was included in the computation of the profit
- Dividends from a non-resident corporation in which the taxpayer has a shareholding of at least 15% (10% in case the EU Parent-Subsidiary Directive is applicable), provided this corporation has little or no passive income. This also applies

to indirect holdings in a second-tier subsidiary. Taxable income is only reduced to the extent this income was included in the computation of the profit. However, the active business requirement is not applicable with respect to companies resident in the EU.

– Charitable contributions

As a result of the various additions and reductions relating to dividends, dividend income is generally effectively 95% exempt from trade tax at the level of a corporation if the receiving corporation has a shareholding of at least 15% in the corporation paying the dividend. If the holding is less than 15% (10% in case the EU Parent-Subsidiary Directive is applicable), the dividend (less the expenses relating to the dividend which were non-deductible for corporate income tax purposes) must be added back for trade tax purposes. Since this threshold must be met at the beginning of the calendar year, dividend income arising in the year the shareholding is acquired is subject to trade tax. Gains on the sale of shares in a corporation are also de facto 95% exempt from trade tax.

Commercial business losses (Gewerbeverlust) can be carried forward from preceding years and may be offset against future trade income. No loss carryback is available. The minimum taxation rules also apply mutatis mutandis to trade tax: Up to a limit of € 1m, loss carryforwards may be fully set off against earnings in the tax assessment period in which such earnings are generated. Beyond this limit, loss carryforwards may be offset against no more than 60% of the commercial business income in the current period. There is no time limit to the use of loss carryforwards. When shares in a company are transferred, the so-called change of control rules are applied mutatis mutandis under certain circumstances so as to deny said company the trade tax carryforward (for more information on the change of control rules please refer to chapter 6.2.2.7).

The German partnership is subject to trade tax if its business activity qualifies as a trading activity. Thus, commercial business losses can be carried forward on the level of the partnership and may be offset against future trade income of the partnership. For income tax purposes, losses generated by the partnership are directly allocated to the partners and carried forward and backward on the level of the partners (see chapter 6.2.2.7).

Prepayments are due 15 February, 15 May, 15 August, and 15 November. Any balance due upon final assessment is payable within one month.

An amount equal to 3.8 times the trade tax base amount (see above) is credited as lump sum trade tax against the income tax levied on commercial income in order to grant resident and non-resident commercial partnerships and sole proprietorships a significant trade tax relief. The deduction is limited to the trade tax actually to be paid.

The German tax group (Organschaft) also applies to the trade tax. The requirements are the same as described for corporate income tax purposes (see detailed information in chapter 6.2.4).

The controlled company is treated as a permanent establishment of the controlling entity. The commercial business income of controlled and controlling entities is combined. The trade tax is assessed at the level of the controlling entity and levied by the relevant municipalities.

This treatment does not apply to a non-resident controlling entity unless it has a permanent establishment in Germany.

#### **Sample tax calculation**

Assumption: The multiplier is 400%. The effective tax rate for trade tax on income can be calculated using the following formula: Effective tax rate = Multiplier  $\times$  assessment rate = 400%  $\times$  0.035 = 14%

**Table 13: Taxation of a corporation and dividends paid to individuals and corporations (assessment period 2016)**

	Individual partial income rule	Corporation shareholding < 15%	Type of shareholder < 15%
Income before taxes	100.0	100.0	100.0
= Income subject to corporate	100.0	100.0	100.0
– Trade tax (e.g., 14%)	14.0	14.0	14.0
– Corporate income tax	15.0	15.0	15.0
<b>= Income after tax</b>	<b>71.0</b>	<b>71.0</b>	<b>71.0</b>
Dividend	71.0	71.0	71.0
– Withholding tax (25%)	17.8	17.8	17.8
<b>= Cash dividend</b>	<b>53.2</b>	<b>53.2</b>	<b>53.2</b>
+ Credit for withholding tax	17.8	17.8	17.8
<b>= Net cash-flow</b>	<b>71.0</b>	<b>71.0</b>	<b>71.0</b>
Taxable dividend	42.6 <sup>1</sup>	3.6	3.6
– Trade tax (14%)		9.9 <sup>2</sup>	0.5 <sup>3</sup>
Income/corporate income tax base	42.6	3.6	3.6
– Income tax (e.g., 45%)	19.2		
– Corporate income tax (15%)		0.5	0.5
<b>= Net cash-flow</b>	<b>51.8</b>	<b>60.6</b>	<b>70.0</b>

Please note that for simplification purposes the solidarity surcharge has not been considered in the above example.

<sup>1</sup> 40% tax exemption by partial income rule    <sup>2</sup> 14% × 71.0    <sup>3</sup> 14% × 3.6

#### 6.2.4 Tax group

Although consolidated tax returns are not allowed under German tax law per se, the rules governing tax groups (Organschaft) provide similar relief. Under the Organschaft system for corporate income tax purposes, the income or loss of a controlled company (Organgesellschaft) is attributed to a controlling entity (Organträger). In order to qualify, the controlling entity and the controlled company must enter into a profit and loss pooling agreement (Ergebnisabführungsvertrag), and the controlled company must be financially integrated into the controlling entity. This requires that the controlling entity holds a majority of the voting rights in the controlled company. Financial integration can

be achieved through direct or indirect shareholdings. The profit and loss pooling agreement must be entered into for a minimum period of five years.

A profit and loss pooling agreement only becomes effective after the shareholders of both the parent and subsidiary company approve the contract by a three-fourths majority of the votes cast and after the contract has been entered in the commercial register of the subsidiary company. The relevant shareholder resolutions must be notarized. This applies not only to stock corporations (Aktiengesellschaft – AG), for which the above requirements are stipulated by the Stock Corporation Law (Aktiengesetz – AktG), but also to limited liability companies (Gesellschaft mit beschränkter Haftung – GmbH), for which the case law of the Federal Court of Justice (Bundesgerichtshof – BGH) establishes comparable requirements in the absence of explicit statutory provisions.

The Stock Corporation Law contains specific provisions for any “enterprise agreement” (Unternehmensvertrag) entered into by a stock corporation (AG) or a limited partnership with share capital (KGaA). Enterprise agreements (which include *inter alia* profit and loss pooling agreements) only become effective after the relevant resolution has been approved at a general meeting of shareholders. The management board of the AG or KGaA is required by law to submit a comprehensive written report, which must describe the nature of the enterprise agreement, the individual terms of such agreement and, in particular, the type and extent of compensation and consideration paid to minority shareholders. The report must substantiate the various aspects of the agreements from a legal and financial perspective. It must also draw attention to any special difficulties in valuing the businesses of the contracting parties and the potential consequences for the interests of the shareholders. The enterprise agreement must be audited by qualified independent auditors unless all of the shares of the controlled company are held by the controlling entity.

For Organschaft purposes, the controlling entity can be a corporation or a partnership if it engages in trading activities. Neither the registered office nor the management headquarters of the controlling company must be in Germany. For this purpose, the controlling company must have a German permanent establish-

ment to which the holding in the controlled company is to be allocated throughout the entire duration of the fiscal entity. A German permanent establishment for the purposes of the fiscal entity exists only if the income attributable to this permanent establishment is subject to domestic taxation under both German tax law and an applicable double tax treaty. The controlled companies must be corporations with their registered office in a Member State of the EU or in a contracting state of the EEA Agreement and with their principal place of management within Germany. If the controlled company is a limited liability company (GmbH), then the recognition of the fiscal entity is also subject to the requirement that a loss transfer must be agreed by reference to the provisions of § 302 AktG in its currently applicable version ("dynamic reference").

The Organschaft system also applies to the trade tax. The requirements are the same as described above for corporate income tax purposes. The controlled company is treated as a permanent establishment of the controlling entity. The trade income of controlled and controlling entities is combined. The trade tax is assessed at the level of the controlling entity and levied by the relevant municipalities. This treatment does not apply to a non-resident controlling entity unless it has a permanent establishment in Germany.

### **6.2.5 Double tax treaties and relief for foreign taxes**

#### **6.2.5.1 Methods of relief**

In the absence of a tax treaty, a corporation residing in Germany is also subject to tax on its income from foreign sources. However, the foreign income taxes paid on that income may be credited against its German tax liability. The foreign tax credit must be determined separately for each foreign country and may not exceed the German tax attributable to the income from the respective country (per country limitation). For this purpose, foreign source income is defined by the German Income Tax Law and includes income generated in a foreign country from agriculture and forestry activities, other trading activities, the sale of certain assets and shares, income from certain investments, and income from the lease of real estate. Only foreign taxes equivalent to German corporate/income taxes can be credited against the German tax liability. Taxpayers may elect either an offset (if creditable) or a deduction (if not creditable) of the foreign taxes.

No carryforward is available for foreign taxes which cannot be offset or deducted in the period for which they accrued.

#### *6.2.5.2 Tax treaties*

For corporations resident in Germany, tax relief may also be available under the tax treaties that Germany has concluded with approximately 90 countries (as of 1 January 2016). Typically, these treaties grant the right of taxation either to the country where income has its source (country of source) or to the country where the recipient is resident (country of residence), while exempting the income from taxation in the other country. In some cases, alternatively, they provide relief from double taxation by allowing a foreign tax credit.

In most treaties, the treatment of certain categories of income follows the OECD Model Tax Convention, as outlined below – assuming Germany to be the country of residence:

- Business profits derived through a permanent establishment in the other treaty country are, in general, exempt from tax in Germany. Some German tax treaties provide for the credit method, if the profits of the permanent establishment are not derived exclusively or almost exclusively by active income.
- Dividends paid to a German corporation may be subject to a reduced withholding tax rate of up to 15% in the other country and are taxable in Germany (subject to the tax exemption rules stated above). Normally, the withholding tax would be creditable against the German tax liability. However, due to the tax exemption for dividend income at the level of the recipient corporation, the withholding tax is not creditable.
- Under most tax treaties with developed countries, interest income is tax-exempt in the country of source and taxable in Germany, unless it is attributable to a permanent establishment.
- Royalties paid to a German corporation are usually subject to withholding tax in the country of source and taxable in Germany.
- Capital gains are, in most cases, taxed only in Germany unless the property sold is attributable to a permanent establishment in the other contracting state.
- Income from immovable property (including capital gains on the sale of such property) may be taxed in the country of location (situs). Income from foreign real property is therefore, in most cases, exempt from tax in Germany.

### 6.2.5.3 *Subject-to-tax clause*

Germany's avoidance of double taxation by the exemption method under the terms of its tax treaties can, in some cases, cause the income in question to escape taxation altogether (so-called white income). This is the case if the other treaty country fails to tax the income that Germany has exempted, for instance because the two countries classify the income differently for treaty purposes (qualification conflict) or have different interpretations of a particular treaty provision.

Under the subject-to-tax clause, Germany does not avoid double taxation by the exemption method under its tax treaties to the extent the other treaty state

- classifies the income under a different treaty provision, causing it to be exempt in, or to be taxed at a reduced rate by, the other treaty state, or
- fails to tax the income because it is derived by a person that is not subject to tax in the other state by reason of the person's domicile, residence, place of management, registered office, or other similar criterion.

The subject-to-tax clause, does not apply to dividends that are excluded from the German tax base under a tax treaty. But the subject-to-tax clause does apply if the dividends in question reduce the income of the distributing corporation.

### 6.2.6 *Tax assessment procedure and withholding procedure*

With respect to non-resident taxpayers, tax is levied either by means of an assessment procedure or by withholding tax at the source.

In principle, both non-resident and resident taxpayers have to follow the same rules in the assessment procedure. However, for non-resident taxpayers only German-source income is subject to tax. Consequently, costs of earning non-business income and business expenses may only be deducted to the extent they are economically related to the German-source income.

Under the withholding procedure, the debtor of the remuneration withholds tax for the account of the taxpayer and remits it to the tax office. As a general rule, withholding tax accrues upon pay-

ment of the corresponding remuneration. Withholding tax at the source is final. Due to numerous exceptions, assessment tends to be obligatory, however.

Corporations, partnerships and individuals, whether subject to resident or non-resident tax liability in Germany, are required to withhold taxes at the source on the following types of payments and to remit such taxes to the tax authorities:

- Wage tax (Lohnsteuer) must be withheld by the employer and remitted to the tax authorities.
- Dividends, other profit distributions, and income from a silent partnership or profit participating loan are subject to withholding tax (Kapitalertragsteuer) at a rate of 25%. The tax rate that is generally applicable to non-resident corporations is 15% and reflects the corporate income tax rate. Withholding tax may be reduced, for example, according to the EU Parent-Subsidiary Directive or to a tax treaty (see chapter 6.2.2.5).

In addition, payments to non-residents are subject to taxation in the following cases (unless modified by a tax treaty):

- Royalty income is subject to withholding tax at a rate of 15%.
- Supervisory board fees paid to non-residents are subject to withholding tax at a rate of 30%.
- The income from artistic, athletic, acrobatic or similar performances performed in Germany and the income from utilization of such performances is subject to withholding tax at a rate of 15%.
- With certain exceptions, interest paid to non-residents is generally not subject to withholding tax.

Non-resident taxpayers who are citizens and residents of EU/EEA countries are able to elect taxation on a net basis with respect to income from artistic, athletic, acrobatic or similar performances, income from utilization of such performances, or income from service on a supervisory board. This permits the deduction of expenses that are directly related to the receipts. Based on a recent announcement of the Federal Ministry of Finance, these principles also apply to royalty income. Where tax is withheld on the net amount, a standard tax rate of 30% applies for individuals. The tax rate for non-resident corporate entities is 15%.

Payments of interest, royalties, and licensing fees are generally exempt from withholding tax pursuant to EU Interest and Royalties Directive (2003/49/EC), provided the payments are made between certain associated enterprises within the European Community (minimum shareholding of 25%). This rule also applies to royalty payments between permanent establishments of affiliated enterprises within the EU. Generally, the entire tax amount is withheld and remitted to the tax authorities. Taxpayers may then apply for a refund. It is, however, also possible to obtain an exemption certificate from the German Federal Central Tax Office (Bundeszentralamt für Steuern). A payment is only exempt from withholding taxes if, at the time of payment, the payer has a valid exemption certificate.

### ***6.2.7 Tax assessment procedure and withholding procedure***

Income tax returns (Einkommensteuererklärungen) and corporate income tax returns (Körperschaftsteuererklärungen) must be filed annually for the calendar year based on the sole proprietorship's, partnership's or corporation's fiscal year ending with or within the calendar year. The returns must be filed by May 31, with an automatic extension until December 31 if the return is prepared by a professional tax advisor. Further extensions may be granted on application. Corporate income tax returns and income tax returns of taxpayers with profit income types (income from agriculture and forestry, business operations, self-employment) must be sent to the tax office in electronic form. Income tax returns of taxpayers with surplus income types (income from employment, capital assets, rental and lease income, other income) can currently still be submitted to the tax office in paper form.

For corporations, additional documents to be filed with the return include: the corporation's financial statements, a copy of the auditor's report, a copy of the resolution of the supervisory board approving the financial statements, or, alternatively, a copy of the shareholder resolution to this effect, and a copy of the shareholder resolution on the distribution of the profit for the year.

For fiscal years beginning after December 31 2011 financial statements must be transmitted electronically in accordance with the official data set requirements (e-balance sheet – eBilanz).

The accounts of the individual accounting system must therefore be allocated to a very detailed taxonomy, which is published by the German Federal Ministry of Finance. By contrast, the other specified additional documents to be submitted with the tax returns are generally sent in paper form.

After receipt of the annual tax return, the tax office will issue a notice of assessment (Steuerbescheid), possibly “subject to re-examination” (“unter Vorbehalt der Nachprüfung”). Administrative appeals (Einspruch) against assessments must be lodged within one month.

Taxes must be paid in advance on a quarterly basis. The amounts due on March 10, June 10, September 10, and December 10 are determined by the tax office based on the preceding year's tax liability or on estimated profits. The notice of assessment will show the balance payable, which must be paid within one month, or the balance receivable (i.e. in case of overpayment), which will be refunded or credited against other tax liabilities.

Taxes paid more than 15 months after the end of the tax assessment year are subject to interest at an annual rate of 6%. The taxpayer may claim interest for overpaid taxes (tax refunds) in similar circumstances.

#### **6.2.8 Binding rulings (verbindliche Auskunft)**

German tax law provides for an advance ruling practice. A request may be submitted to the tax authorities for a binding ruling, which binds the tax authorities for the presented case provided the facts do not change.

Tax authorities are authorized to charge fees when a taxpayer requests such a ruling. The amount of the fee depends on the potential tax consequences of the matters set forth in the request. For this purpose, the tax owed under the taxpayer's interpretation of the law is compared with the tax owed in the event of contrary interpretation. The difference between these two amounts is the basis for calculating the fee (amount at stake in the binding ruling). The maximum fee is € 109,736. No fee will be charged if the time required to issue the ruling is less than two hours. The fee for binding rulings requested is payable even if (i) the tax authorities reject the taxpayer's interpretation of the law, (ii) the tax authorities ultimately refuse to issue any

binding ruling, or (iii) the taxpayer withdraws its request. Waiver of the charge by the tax authorities is possible in the latter case, however.

#### **6.2.9 Tax audit**

The tax authorities are entitled to examine a taxpayer's tax documents and records to verify whether proper payment of taxes has been made by paying an actual visit to the taxpayer's premises. Large-scale businesses are to be audited three years back in intervals of three years to ensure uninterrupted auditing. In addition, special audits may be carried out in particular to verify correct VAT payment. The taxpayer is obliged to produce the documents requested by the tax auditors, such as accounting and other business records. If data has been generated by means of electronic accounting systems, the tax authorities are entitled to inspect stored data files. If documents are not produced within a reasonable period of time, a default fee of € 2,500 to € 250,000 may be assessed. As a consequence of a tax field audit, tax base amounts and tax assessment notices may be revised.

### **6.3 Acquisition**

In general a seller's primary interest is to minimize the tax on the capital gain realized upon a sale or to generate a tax-exempt gain. As the preferential treatment of capital gains only applies to capital gains on the sale of shares in corporations, the seller will generally prefer a share deal over an asset deal.

By contrast, the purchaser will seek to structure the acquisition so as to maximize depreciation and amortization of the purchase price for tax purposes, which is not possible when only shares are acquired.

In general, the tax structuring considerations of the parties center around the following criteria:

- Treatment of capital gains resulting from the sale
- Depreciation/amortization of acquisition costs
- Deductibility of refinancing expenses
- Use of tax loss carryforward of the acquired entity

### 6.3.1 Asset deal

Where an acquisition is carried out by way of an asset deal, the book values of the assets transferred are stepped up to acquisition cost in the hands of the purchaser. The seller realizes a capital gain equivalent to the difference between the purchase price and the tax basis of the assets. The obvious advantage of an asset deal is that the purchaser may select the assets he wants to acquire. It should be noted, however, that liabilities resulting from employment contracts may be transferred to the purchaser by operation of law where the assets transferred qualify as a business (Betrieb) or an independent part of a business (Betriebsteil, see § 613a BGB – German Civil Code, Bürgerliches Gesetzbuch). Liabilities of the seller may also be transferred to the buyer by operation of law if the business is carried on under the former firm name (§ 25 HGB – German Commercial Code, Handelsgesetzbuch), although such liability may be avoided by a disclaimer that must be entered in the commercial register. Furthermore, there may be liability for certain tax obligations (§ 75 AO – Tax Procedure Law, Abgabenordnung), which may not be disclaimed.

The parties should agree on an allocation of the purchase price to the assets and liabilities acquired. Such allocation does not bind the tax authorities, but does provide a useful starting point. Non-competition agreements entered into in the context of an asset deal are generally treated as a part of the goodwill transferred and do not constitute separate assets.

Tangible and intangible assets are transferred to the tax accounts of the purchaser at acquisition cost. Any excess amount is capitalized as goodwill, which is amortized for tax purposes over a period of 15 years. Depreciable assets are depreciated over their useful lives (based on the official tax depreciation tables). Land and participations in other companies are not subject to scheduled depreciation.

Step-up structures involving an internal asset deal (i.e. where the business of an acquired corporation is sold within the group by way of an asset deal) may generate tax benefits if the seller's corporation has tax loss carryforwards, in particular when such loss carryforwards may be forfeited in the future (see chapter 6.2.2.7). The seller will have to recognize hidden reserves, which

are fully taxable for corporate income and trade tax purposes and may be offset against the tax loss carryforward. However, due to minimum taxation rules, such transfers may still result in a tax burden, which has to be weighted against the future tax savings resulting from the step-up received on the assets.

### **6.3.2 Share deal**

When shares in a corporation are acquired in a share deal, the book values of the assets and liabilities at the level of the target company remain unchanged. Capital gains arising from the sale of shares held by a corporation are exempt from tax. 5% of the capital gain is treated as non-deductible business expenses; for free float shares (< 10%), taxation is planned from January 1 2018 onward (see chapter 6.2.2.6). Write-downs to the lower going-concern value of the shares are not tax deductible for corporate income tax purposes (see chapter 6.2.2.1).

The acquisition of a partnership interest is, for tax purposes, treated as a pro-rata acquisition of the partnership's assets. Accordingly, the purchaser steps up the tax basis of the assets of the partnership to the level of its own acquisition cost. Technically, this step-up is carried out at the level of the partnership by way of supplementary balance sheets (Ergänzungsbilanzen). Any portion of the purchase price that cannot be attributed to acquired assets (including self-created intangibles such as patents or know-how not previously recognized in the partnership balance sheet) forms part of goodwill, which is amortized over 15 years for tax purposes.

## **6.4 Financing of inbound investments**

### **6.4.1 Permanent establishments and partnerships**

Thought must be given to how the inbound investment will be financed and what its distribution policy will be. The limited status of a partnership as a legal entity and the fact that a permanent establishment is not a separate legal entity are considerations relevant both to the choice of legal form and to the financing options.

A German permanent establishment is part of the foreign investor's business. Hence, loan agreements between the head office and the permanent establishment are not accepted legally or for

tax purposes. However, interest expenses attributable to the German permanent establishment may be deducted in Germany. The allocation of finance costs to the permanent establishment (direct/indirect method) is governed in the Betriebsstättengewinnaufteilungsverordnung (Decree on the Attribution of Profits to Permanent Establishments).

Loan agreements between a foreign partner and its German partnership are in principle recognized for tax purposes. However, interest deducted at the level of the partnership is added back at the level of the respective partner to determine the income of the partnership as such and the profit share of the individual partner. Hence, loan agreements between a foreign partner and a domestic partnership are only relevant for the profit allocation between the partners.

With the taxation of special partner remuneration as commercial income, Germany has adopted an exceptional position in the international environment. Because many other countries do not recognize special partner remuneration, qualification conflicts often arise with regard to the application of the relevant double tax treaty in cases of cross-border payment by the partnership to its partners. If the double tax treaty does not contain an explicit regulation on special partner remuneration, then Germany always assumes commercial income by way of a treaty override, irrespective of the classification under the treaty. In the event of a different assessment by the other country (e.g. interest income, royalties), this may consequently result in double taxation of income or double deduction of expenses.

#### ***6.4.2 Corporations***

German corporate subsidiaries can be financed by one or more of the following methods:

Equity financing: The minimum capital of a corporation depends on its legal form. The minimum registered share capital of a limited liability company (GmbH) is in principle € 25,000; for a stock corporation (AG) it is € 50,000. Additional capital may be paid into the corporation at any time by means of a formal increase of registered share capital or by a simple transfer of amounts to the capital reserve (Kapitalrücklage).

Debt financing: Contractual relationships with the parent company are recognized for tax purposes, assuming that the agreement is at arm's length (for further details on the arm's length principle under German tax law, please refer to chapter 6.2.2.9). Loans may be granted by the parent company, by affiliated companies, or by third parties (secured where necessary by the parent company or a related company).

Internal financing: Internal financing results from reinvestment of retained earnings in the business and deductions without impact on cash-flow (such as depreciation). Naturally, internal financing is only possible when a business is profitable.

A foreign investor carrying out business activities in Germany should compare the tax implications of debt and equity financing. While the distribution of dividends is not tax-deductible, interest is in principle deductible under German tax law. However, the deduction of interest expense is limited by the German earnings stripping rules. Under the earnings stripping rules, interest expense is fully deductible for tax purposes to the extent of interest revenue. In general, net interest expense (interest expense exceeding interest revenue) is deductible only up to 30% of EBITDA. For further details on the German rules limiting interest deductions, please refer to chapter 6.2.2.4.

## 6.5 Reorganizations

Various reorganizations and transactions are tax-privileged in accordance to the EU Merger Directive. The Directive's scope is limited to specific transactions (certain types of mergers, divisions, transfer of assets, and exchanges of shares), not all of which are familiar, or legally permissible, in all Member States. In broad terms, the objective of the EU Merger Directive is to allow specific types of reorganizations to take place without triggering tax. In 2006, German tax treatment of business reorganizations was revised in response to changes in European law and to redefine the tax consequences of inbound and outbound asset transfers.

The reorganization and restructuring of business entities in Germany is governed principally by the German Reorganization Act (Umwandlungsgesetz – UmwG), which provides a cohesive set of rules that enable German business entities to change their legal structure efficiently to suit their needs in a changing economic environment.

The tax consequences of a specific reorganization depend both on the general principles applying to all reorganizations and on those applying to the legal form of the entities involved. The tax consequences are codified principally in the German Reorganization Tax Act (Umwandlungssteuergesetz – UmwStG). In principle, a corporate reorganization may have tax consequences at the level of all entities involved in the reorganization, such as the transferring entity, the receiving corporation, and the shareholders.

In the Reorganization Tax Decree, the Federal Ministry of Finance described its view of the different reorganization processes.

Tax due diligence review: A tax due diligence is often carried out prior to a transaction. The scope and depth of a tax due diligence will vary according to the size and complexity of the transaction. A tax due diligence may include:

- Establishment of the tax status of the target
- Identification of tax risks
- Establishment of the effective tax rate of the target
- Support of cash-modelling
- Analysis of tax policy

The findings of the due diligence may have an effect on the warranties granted under the sale and purchase agreement or on the purchase price itself. They also serve to establish the factual basis for the optimization of the transaction structure.



# Indirect taxes

## Chapter 07

## 7.1 Value added tax (VAT)

German value added tax (Umsatzsteuer, Mehrwertsteuer) is inextricably linked to European VAT harmonization. In addition to the German Value Added Tax Law including complementary operating regulations and guidelines, Community law has become increasingly important. One of the reasons for this is that, as a rule, Community law prevails over national law. EU Directive 2006/112/EC (also referred to as the Common VAT System Directive, CVSD) – previously Directive 77/388/EEC – is particularly relevant to day-to-day tax practice. Regarding the interpretation of VAT law, both the case law of the Court of Justice of the European Union (CJEU) and of the German Federal Tax Court (BFH) are important sources.

On January 1 2010 the first phase of so-called VAT Package entered into force in the EU. In its essence it contains new rules on the place of supply of services, the reverse charge mechanism (cases in which VAT is owed not by the provider but by the recipient of the service), on filing requirements and the input VAT refund procedure within the EU. The final phase of the VAT package is effective since January 1 2015. It includes new regulations for telecommunication services, radio and television services, and electronically supplied services.

### 7.1.1 General

The nature of VAT is best described by referring to the case law of the Court of Justice of the European Union (CJEU). According to the CJEU, value added tax is characterized by the following features:

- It applies generally to all transactions relating to goods or services.
- It is proportional to the price charged by the taxable person in return for the goods and services which he or she has supplied.
- It is charged at each stage of the production and distribution process, including that of retail sale, irrespective of the number of transactions which have previously taken place.
- The amounts paid during the preceding stages of the process are deducted from the tax payable by a taxable person, with the result that the tax applies, at any given stage, only to the value added at that stage and the final burden of the tax rests ultimately on the consumer.

Thanks to input tax deduction, tax paid during the preceding stages is neutral for the business. This mainly affects the extent to which it is related to taxable output transactions or transactions not effected in Germany which would be taxable had they been effected in Germany. If output transactions are VAT-exempt, input VAT deduction is possible only in certain cases; these are, in particular, exports and intra-EC supplies.

### ***7.1.2 Taxpayer and VAT registration***

All individuals and entities engaged independently in a trade, business, or profession with the objective of earning income are liable to pay VAT. As a result, sole proprietors and self-employed professionals are subject to VAT, as are commercial entities, whether incorporated or not (e. g. partnerships, corporations, associations).

VAT liability begins – independently of the formation of the corporation or the partnership by civil law – with the inception of sustained business transactions. It ends when the entire legal relations of the business are completed, including the legal relationship with the tax office.

VAT liability arises regardless of citizenship, residence, principal place of management, or the place of billing or payment. The only criterion for liability for German VAT purposes is that the business executes taxable transactions within Germany in excess of certain limits. Microbusinesses that fulfill certain criteria are not liable for VAT in Germany pursuant to the so-called Kleinunternehmerregelung, but these provisions are generally only applicable to businesses established in Germany.

Basically, persons who acquire, retain, and sell interests in companies are not liable for VAT. When a holding company is actively engaged in the day-to-day business of the subsidiary, the acquisition, retention, and realization can be treated as business activity with VAT liability. The same applies if an investment was acquired to perform management services for subsidiary companies (e.g. administrative, financial, or technical services). If an interest is held not for the interest's sake (the mere intention to receive dividends), but in order to further an existing or intended business activity, holding such interest is deemed a business activity. This includes securing access to improved purchasing

terms, obtaining influence on potential competitors, or securing access to improved sales conditions.

Individuals who manage and represent companies in which they are partners or shareholders may act as self-employed persons if certain criteria are met. Corporations are considered to always act as self-employed, even if the corporation must comply with instructions adopted by shareholder resolution (but see below Organschaft – tax group for VAT purposes).

An exchange of consideration is possible between partnerships or corporations and their partners/shareholders. Transfers for no consideration from corporations/partnerships to their shareholders/partners may trigger VAT liability. Shareholder/partner contributions may also be subject to VAT unless they are discharged merely by sharing in the profit or loss.

Generally, when one or more businesses in Germany are “integrated” – according to the definition below – with each other in substance, they are treated as a single business for German VAT purposes under the Organschaft rules. The rules may need to be reinterpreted depending on CJEU jurisdiction. Currently, an Organschaft requires a controlling entity (Organträger) and a controlled company (Organgesellschaft). The latter must be a corporation (in particular AG, GmbH). Integration for VAT purposes is required financially, economically and organizationally:

- Financial integration – the members of the Organschaft must be under common control (control being defined as more than 50% of voting rights).
- Economic integration – the controlling entity in the Organschaft must exercise actual influence over the business of the controlled company and the controlled company must serve, promote, and supplement the business of the entire Organschaft.
- Organizational integration – the controlling entity in the Organschaft must be in a position to ensure that its instructions are followed by the controlled company, for example by having identical management boards. Other kinds of control has to be examined on a case-by-case basis whether they are sufficient.

As soon as all of the above criteria are met, an Organschaft for German VAT purposes comes into existence, and exists until such time that the criteria are no longer met. Companies cannot optionally elect to be an Organschaft or not.

The controlling entity is considered to be the sole business for German VAT purposes. Supplies between Organschaft members are disregarded for German VAT purposes, i.e. intra-group supplies of goods and services are not subject to VAT. In the case of an international group of companies, the Organschaft is limited to the German entities (corporations, partnerships, branches, etc.) of the group. In this case, the most significant of the entities in Germany from a business point of view is deemed to be the business liable for VAT.

A German business is normally allocated a single tax reference number for all taxes including VAT. Foreign businesses also receive a tax reference number upon registration. Furthermore, on application, a VAT identification number is issued for each registered business. Businesses and individual members of an Organschaft can also request a separate VAT identification number from the tax authorities to be quoted on invoices received and issued in relation to intra-EC supplies of goods.

### ***7.1.3 Taxable transactions***

The German Value Added Tax Law (Umsatzsteuergesetz – UStG) covers the following transactions which are within the scope of German VAT:

- Supplies of goods (Lieferungen) and services (Dienstleistungen) which a business delivers or renders for consideration (monetary or non-monetary) within Germany (this does not include the island of Helgoland, the Swiss enclave of Buesingen and German free ports; however, there are exceptions related to German free ports where such supplies are treated like transactions made in Germany).
- The following supplies of goods and services are treated for no consideration to the extent that the business providing the goods or services operates in Germany or such goods or services are provided from a fixed establishment located in Germany:

- Withdrawal or use of business assets for purposes other than the business of the company.
- Supply or use of business assets for private use of staff, with the exception of appropriate gifts of small value.
- Supply of goods also for business purposes, with the exception of gifts of small value and samples.
- Even if input VAT has not been deducted in preceding stages (!): other services for no consideration for non-business purposes as well as for private use of staff, with the exception of appropriate gifts of small value.
- The importation of goods from territories outside the EU into Germany is subject to German import turnover tax (Einfuhrumsatzsteuer).
- Movements of goods into Germany from another territory within the EU are subject to acquisition VAT (Besteuerung des innergemeinschaftlichen Erwerbs).

It should be noted that, as long as certain criteria are met, the transfer of a business as a going concern is not normally regarded as a taxable transaction.

#### 7.1.4 **Place of transactions**

The transactions referred to under 7.1.3 are subject to German VAT if their place of supply is Germany. As a general rule, unless transactions are zero-rated, the business supplying the goods or services is liable to pay VAT. In cases where the reverse charge procedure applies, it is, by way of exception, the recipient who is liable to pay VAT (see under 7.1.4.4).

##### 7.1.4.1 *Supplies of goods for consideration*

As a rule, the place of supply of movable goods is the place where transportation begins. This also applies to intra-EC supplies and exports. There are, however, several exceptions to this general rule, particularly the following:

- If goods are brought to Germany from a non-member country, the place of supply is Germany if the supplier or its agent are liable for import turnover tax (Einfuhrumsatzsteuer).
- In the case of distance selling (in particular, where the customers are final consumers) the place of supply is where transportation ends (to the extent that certain transaction volume limits are exceeded).

- Supplies forming part of a chain transaction between businesses are made either where transportation begins or where it ends, depending on each individual case. There are always two different places of supply within such a chain of transactions.

The place of supply of land is where the land is located. The place of supply of so-called work and materials supplies (Werklieferungen) is generally where the work on the foreign material is rendered, e.g. where the assembly and approval take place. There are also special rules on the supply of electricity, gas, cooling energy, and heat as well as for goods sold on board ships, aircraft, or trains in the case of transportation between EU Member States.

#### *7.1.4.2 Supply of services for consideration*

As a rule, supplies of services provided to a business for business purposes (so-called B2B services) are made when the recipient of the service is established. As an exception, if such services are provided to a fixed establishment of the recipient, the place of such fixed establishment is the place of supply. These rules apply mutatis mutandis to services provided to a non-business legal person who has been issued a VAT identification number and to a legal person for non-business purposes, if that person engages in both business and non-business activities and if the service is not intended for the private use of staff or a shareholder.

As a rule, the place of supply of services to customers who do not receive such services for their business (so-called B2C services) is where the business providing the services is established. As an exception, if such services are provided from a fixed establishment of the business providing the service, the place of such fixed establishment is the place of supply.

Apart from these principal rules, there are special rules for certain types of services. In particular, these are the following:

- The place of supply of services connected with land is where the land is located.
- The place of short-term hiring of a means of transportation (short-term means in general an uninterrupted period of no more than 30 days) is generally where the means of transportation is in fact made available to the customer.

- In the case of B2C services, the place of long-term hiring of a means of transportation is where the recipient has a permanent address or is established. If the means of transportation is a pleasure boat, the place is where the boat is actually put at the disposal of the customer, provided the supplier's place of business, place of management, or a permanent establishment from which this service is actually provided is situated in that place.
- The place of supply of the following services is where the business providing the service physically carries out the service:
  - Cultural, artistic, scientific, educational, sporting, entertainment, or similar services as well as services in the connection with fairs and exhibitions (in each case restricted to B2C services whereas the sale of tickets to such events in case of B2B services is taxable at the place of event).
  - In general restaurant and catering services.
  - Valuations of and work on movable tangible property in the case of B2C services.
- The place of supply of services by an intermediary in the case of B2C services is the place where the underlying transaction is supplied.
- If the customer is resident outside the EU, the place of supply of certain B2C services is where the customer is resident or domiciled. These include, but are not limited to: Use of patents, copyrights, and trademarks, advertising, legal, tax, technical and management consulting services, financial services, use of information and know-how, provision of personnel, hiring-out of movable property (except for means of transportation), and certain services related to natural gas, cooling energy, heat, and electricity distribution systems.
- In the case of B2C services, the place of supply of telecommunications services, radio and television services and electronically supplied services is where the customer is resident or domiciled (with effect from January 1 2015).
- There is a very limited number of exceptional cases involving suppliers or customers established outside the EU, in which the place of supply is the place where the service is used or enjoyed.
- The place of supply of passenger transportation is the place where the transportation takes place. Only the distance covered in Germany is subject to German VAT. The same applies to the transportation of goods for B2C purposes, which is

not an “intra-Community transportation of goods”. However, in case of an “intra-Community transportation of goods” for B2C purposes, the place of supply for tax purposes is the place of departure.

#### *7.1.4.3 Intra-EC acquisition of goods*

The place of an intra-EC acquisition of goods is normally deemed for VAT purposes to be the place where the goods are located at the time when the transportation to the person acquiring them ends. VAT (here: acquisition VAT, Besteuerung des innergemeinschaftlichen Erwerbs) is normally paid by the recipient in the country of destination, and the underlying intra-EC supply is zero-rated if corresponding evidence is provided.

Where goods are moved from Germany to another EU country without any change in legal and/or economic ownership, German VAT is due unless proof of shipment is held and the German business must be registered for VAT purposes in the country of destination. This rule applies even if the goods only remain in the ownership of the German business for a short time in the country of destination and are destined for a subsequent sale to a single customer in that country (i.e. consignment stock).

#### *7.1.4.4 Reverse charge procedure*

Under the reverse charge procedure, the liability for VAT is transferred to the recipient of a supply of goods or services. This applies, as a rule, if the recipient of the goods or services is a business; however, in some cases it also applies to recipients that are (non-business) legal persons.

The scope of the reverse charge procedure includes, in particular, the following cases:

- Work and materials supplies (Werklieferungen) and services of foreign businesses. A foreign business is a business that does not have a business domicile, registered office, place of management, or fixed establishment in Germany. When a business has a fixed establishment in Germany but the service in question is not rendered from such fixed establishment, the business is treated as a foreign business, and this service is generally subject to the reverse charge procedure.
- Supplies of objects transferred by way of security outside insolvency proceedings.

- Supplies within the scope of the Real Estate Transfer Tax Act (Grunderwerbsteuergesetz), if the supplier opts in favor of VAT.
- Construction work if the recipient is a business and sustainably supplies construction work, regardless of the specific use of the received construction work. This applies accordingly to building cleaning services.
- Supplies of gas, cooling energy, and heat through respective networks, and electricity by a foreign business to another business whose main activity is to sell the goods and own consumption of the goods is of minor significance.
- Supplies of gas through the natural gas network and of electricity by a business established in Germany to another business which also performs services of this kind.
- Transfer of greenhouse gas emission rights according to the Greenhouse Gas Emission Trade Law.
- Supply of certain gold, scrap, and waste materials.
- Supplies of mobile phones, tablet computers, game consoles, and integrated circuits (in a state prior to their integration into end-user products) if the total amount invoiced in the context of an economic transaction is at least € 5,000. No account is taken of any subsequently reduced consideration. This applies accordingly to supplies of certain precious metals, base metals, selenium, and Cermet.

The reverse charge procedure does not apply in the case of certain services of foreign businesses, in particular for:

- personal transportation services with land vehicles;
- personal transportation services with planes on cross-border flights;
- services of businesses including performance companies connected to the access authorization for domestic fairs, exhibitions or congresses, and catering services on board ships, aircraft, or trains.

A quick reaction mechanism has been established to enlarge the reverse charge procedure for the fight against fraud (see Art. 199b of the VAT Directive). It can be introduced by regulation from the German Ministry of Finance (BMF) with the approval of the German Federal Council (Bundesrat). Such a measure is possible when there is suspicion of tax evasion in an exceptionally serious case relating to these transactions. These cases must presumably result in significant and irretrievable tax reductions.

An extension implies in particular that the European Commission must have communicated that there are no objections against the extension.

### **7.1.5 VAT rates**

Generally, two different VAT rates apply in Germany. The standard rate for supplies of goods or services effected in Germany is 19%. This rate was increased from 16% to 19% at the beginning of 2007.

Certain goods and services are subject to the lower rate of 7%. The most common examples are paper books/newspapers and food. As of 2015, a reduced VAT rate for audio books has been introduced. This requires a physical object in the form of a storage device. Services provided electronically do not benefit from this provision.

Certain goods and services are exempt from VAT altogether ("zero-rated") if corresponding proof is provided. The most common examples are intra-EC deliveries of goods and exports of goods to a non-EU destination, and services related to these deliveries.

The exemption from VAT also applies to certain specified services, including medical, educational, charitable or financial services, and services relating to real estate. VAT on expenditure relating to all of these services cannot normally be recovered (there are various exceptions to this rule, the main one being certain financial services provided outside the EU). It is possible for the supplier to opt to charge VAT on some of these exempt supplies (mainly land and property, and financial services), to the extent that certain requirements are met, thus allowing the supplier to recover VAT on related expenditure.

### **7.1.6 Collection, filing, and payment of tax**

#### **7.1.6.1 Output tax**

Generally, the business must pay to the tax authorities the VAT due either on its supplies – regardless of whether the VAT has been collected from the business's customers – or due on advance payments.

If the business providing the goods or services is able to prove that the consideration owed by the customer is uncollectible,

the business has to correct the amount of VAT due to the tax authorities to its favor, but the customer, too, must correct his/her input tax deduction.

If a business issues a VAT invoice incorrectly showing VAT due on a supply, this VAT amount shown on the invoice becomes payable to the tax authorities, while the customer is not entitled to input VAT deduction. In order to avoid such tax liability, the business can correct the invoice. In certain cases, the consent of the tax authorities is required. This consent will be granted only if the risk for the treasury of losing tax revenue has been eliminated. This means that the issuer must show either that the invoice recipient did not claim an input tax credit based on the improper invoice or that any input VAT deducted has been repaid to the tax authorities.

According to current § 20 UStG, businesses whose "total turnover" in the previous calendar year did not exceed € 500,000 may pay VAT on the basis of cash receipts (instead of on the regular basis of performed supplies). The tax authorities are allowed to grant this kind of taxation upon receiving the corresponding application by a business. "Total turnover" includes certain supplies which come under the scope of German VAT law.

#### *7.1.6.2 Input tax*

The business can reduce the payment of VAT due to the tax authorities by the amount of VAT charged to it by its suppliers on business expenditures (note: certain employee expenditures may not qualify) to the extent that the business generates sales subject to VAT or equivalent sales (see chapter 7.1.1). However, in order to deduct input VAT in this manner, the business must be in possession of valid VAT invoices from its suppliers and must either have paid the suppliers or actually received the goods or services from the suppliers. Beside other invoice requirements, all invoices must show either the tax registration number or the VAT ID number of the taxable person who supplied the goods or services. Otherwise, without a valid invoice the invoice recipient is unable to deduct the related input VAT. Under certain circumstances, businesses are permitted to issue VAT invoices to themselves on behalf of their suppliers (self-billing).

Subject to the general requirements (see chapter 7.1.1), input VAT deduction is also possible in the case of import turnover

tax (Einfuhrumsatzsteuer), acquisition VAT (Erwerbsteuer) and reverse charge tax.

Electronic invoice transmission: German VAT regulations allow the electronic transmission of invoices if the recipient gives his consent. Electronic transmission includes invoices sent via e-mail, via an EDI procedure, as a PDF or text files, via computerized fax or fax server as well as invoices transmitted via online file transfer. The authenticity of the invoice's origin, the integrity of its content, and its legibility must be safeguarded to the same level as paper invoices.

There are two means by which authenticity and integrity can be safeguarded:

- through the use of a qualified electronic signature or the use of a qualified electronic signature with vendor accreditation.
- through electronic data transfer (EDI) (Art. 2 Recommendation 94/ 820/EG of the Commission dated 19 October 1994), if in the agreement concerning the data exchange an application of methods is foreseen which guarantee the authenticity of origin and intactness of the data. An additional summarizing invoice, on paper, or with a qualified electronic signature, transferred by electronic means, is not required by law.

In all other cases, there is the requirement for a reliable audit trail to be created between invoice and service by means of an internal control procedure.

Amendment of the input tax deduction within the scope of § 15a UStG: Under § 15a UStG, a deduction of input tax must be amended if the conditions upon which the original claim for an input tax deduction were based change substantially during the use of an asset.

Input tax deduction adjustments under § 15a UStG are made with respect to fixed and current assets and with respect to services (sonstige Leistungen).

For real estate, the adjustment period is ten years. For all other fixed assets, the adjustment period is generally five years. The adjustment must be made at the time of actual use.

### 7.1.6.3 VAT returns

Most businesses must file a VAT return with the tax authorities for each calendar month (under certain circumstances for each calendar quarter) and pay the net VAT amount due to the tax authorities at the same time.

The normal deadline for filing and payment is the 10th day after the end of the calendar month (if it is a working day), but the tax authorities will normally extend this deadline by one month upon request. A VAT return has to be filed as well for the calendar year, summarizing the information already reported in the monthly or quarterly returns and correcting any errors which are found in them. This annual return must be submitted by 31 May of the following year. Extensions may be granted by the tax authorities. Any additional VAT due to the tax authorities for that year must be paid to the tax authorities within four weeks of the submission date of the annual return.

There are special rules for certain businesses, for example in the case of digital services. As of 1 January 2015, in case of B2C services, a new regulation applies to the place of supply of telecommunications services, radio and television services and electronically supplied services. Generally, the decisive place is where the customer is resident or domiciled. As a consequence of these new regulations, affected suppliers generally have to comply with VAT registration obligations in various Member States. To avoid this, suppliers may voluntarily participate in the so-called Mini-One-Stop-Shop (MOSS). For suppliers resident within the EU, the MOSS established in their Member States is responsible. For suppliers resident within Germany, the German Federal Central Tax Office (Bundeszentralamt für Steuern) is the relevant MOSS. If a business decides to use the MOSS on a voluntary basis, it is obliged to apply the regulations in all Member States in which it supplies such services without having a fixed establishment there. Businesses not established in the EU that exclusively provide such services and are not registered for VAT purposes in any EU Member State may elect the German Federal Central Tax Office as well. In all these cases, businesses must file VAT returns including all their EU transactions with respect to such services on a quarterly basis. The normal deadline for filing and payment is the 20th day after the end of the calendar quarter (if it is a working day); input VAT may only be claimed using the input VAT refund procedure (see chapter 7.1.7).

#### 7.1.6.4 *EC Sales Lists*

Businesses must state in their recapitulative statement (European Sales List) "intra-EC supplies of goods" as well as supplies within the meaning of § 25b UStG in the context of intra-EC triangular trade. Furthermore, taxable supplies of services executed in other EU Member States must be reported for which the recipient of the service, who is established in another Member State, owes VAT in said Member State. This obligation is limited to those cases where the place of supply is determined by the principal rule for B2B services.

The EC Sales List must state the VAT identification number of each recipient of goods or services under which the respective transaction was made. The total net transaction value must be broken down by the three transaction types described above. EC sales lists must be filed either monthly or quarterly with some exceptions and specific deadlines.

Each of the Organschaft members involved in supplies within the EU must complete a separate EC Sales List (i.e. it is not acceptable to submit one EC Sales List for the entire Organschaft).

#### 7.1.6.5 *Intrastat declarations*

If a business registered for VAT purposes in Germany is involved in the movement of goods within the EU (from and to Germany), it generally has to file Intrastat declarations with the Federal Statistical Office for each calendar month in which movements of goods have occurred. Such movements of goods include commission or consignment transactions, contract processing and other transactions to be declared.

Businesses with a value of dispatches or arrivals to or from other EU Member States which did not exceed the amount of € 500,000 (per direction) in the preceding year are exempt from the obligation to declare their dispatches/arrivals. In the event that the limit mentioned above is exceeded for the first time in the current calendar year, the obligation to declare commences with the month in which the threshold has been exceeded, i.e. the first statistical declaration has to be submitted for such month and for dispatches and/or arrivals, as the case may be.

These declarations contain information about the goods being shipped, including *inter alia* the method of transportation, the

part of Germany in which the goods originated, the weight of the goods, and an Intrastat product classification number. In case of an Organschaft, each of the Organschaft members involved in intra-EC movements of goods must complete a separate Intrastat declaration (i.e. it is not acceptable to submit a single Intrastat declaration for the entire Organschaft).

The threshold for arrivals is € 800,000.

### **7.1.7 VAT refund for foreign businesses**

A foreign business carrying out non-taxable or taxable transactions in Germany is generally obliged to register for VAT purposes in Germany and, to the extent that it is entitled to input VAT deduction, it must claim such VAT deduction by filing a monthly/quarterly advance VAT return and the annual VAT return.

Businesses not established in Germany that do not effect business transactions in Germany or, in particular, only effect business transactions for which tax is owed by the recipient (reverse charge procedure), must claim input VAT deduction via the input VAT refund procedure.

A foreign business is a business that does not have a business domicile, registered office, place of management or permanent establishment in Germany. "Permanent establishment" is defined as a fixed establishment.

If a business established in the EU intends to apply for input VAT refund procedure in Germany, the business must transmit the refund application to the German Federal Central Tax Office (Bundeszentralamt für Steuern) via an electronic portal set up by the Member State in which the applicant is established. The refund has to be applied for within 9 months from the end of the calendar year in which the claim arose. Copies of invoices and import documents are to be submitted electronically with the refund application, where the consideration for the transaction amounts to at least € 1,000 (€ 250 or more where the transaction concerns fuel). In cases of well-founded doubts the German Federal Central Tax Office may request invoices and/or import documents in the original. The refund applied for must be at least € 50. However, to the extent that input VAT is claimed for part of the calendar year only, the minimum amount is € 400, unless the refund period is the last period of the calendar year.

If a business carries out transactions for which VAT deduction is partly precluded, the input VAT will be refunded subject to the proportion rules (Vorsteuerschlüssel) defined by the Member State in which the business is established.

For businesses established outside the EU, the refund may be applied for directly from the German Federal Central Tax Office using the officially prescribed form or data file. Businesses need to apply for the refund within 6 months from the end of the calendar year in which the claim arose. Originals of pertinent invoices and import documents are to be filed with the refund application as evidence for the input VAT amounts claimed. The refund applied for must be at least € 500. However, to the extent that input VAT is claimed for part of the calendar year only, the minimum amount is € 1,000, unless the refund period is the last period of the calendar year. The applicant must present a certificate issued by the authorities of the country in which the business is established which confirms that it is a business within the meaning of VAT law and possesses a tax reference number. Such a certificate according to form USt 1 TN must cover the refund period and may not be older than one year. Applications after June 30, 2016 must generally be filed electronically and no longer need to be signed by the taxpayer in person.

For businesses established outside the EU, there are restrictions on the filing of 13th EC Directive claims in Germany. Input VAT deduction is not possible insofar as the VAT applies to the purchase of fuel. Further, reciprocity is required. A list published by the German Ministry of Finance states countries with reciprocity and countries without reciprocity. Nevertheless, for countries without reciprocity, a 13th EC Directive claim in Germany is possible in certain situations (such as, where a foreign business only makes supplies in Germany which are liable to VAT due to reverse charge, so that such foreign business is not registered for VAT in Germany).

## 7.2 Other Indirect Taxes

The following chapter illustrates an additional selection of "indirect taxes". Real estate tax is also discussed with a view to real estate transfer tax (see chapter 7.2.5 and 7.2.6). Real estate tax is not an indirect tax but a non-personal tax levied by municipalities. It is imposed upon owners of real estate.

### 7.2.1 General

Aside from VAT there are other taxes in Germany designated as "indirect taxes". Such taxes comprise any other excise duties and transaction taxes.

### 7.2.2 Taxes on consumption (excise duties) – general

The main characteristic of excise duties is that they are levied on the utilization and consumption of certain commodities. The country-of-destination principle applies, i.e. the duties are levied in the country in which the commodities are actually used or consumed. An exception to the country-of-destination principle exists for goods purchased by private individuals for their own use. In this case, the country-of-purchase principle applies.

Excise duties in Germany are levied on the following products: mineral oil, coal, natural gas, gasoline and certain bio-fuels, alcohol, tobacco, coffee, beer and electricity.

Excise duties are levied indirectly via the selling price of the goods, meaning that the end-user acts as the ultimate taxpayer. The customs authorities are responsible for collecting the tax from the party legally liable. This is the owner of the manufacturing operation or the fiscal warehouse, or the importer in the event of import from a non-EU country. This procedure limits the number of parties liable for the tax, considerably reducing the administrative burden compared with a direct tax levy.

#### 7.2.2.1 Tax territory and commodity subject to tax

The tax territory comprises the Federal Republic of Germany excluding Buesingen and the Isle of Helgoland. A number of specific rules apply for trade with other EU countries (see chapter 7.2.2.4).

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Excise duties include not only taxes that are levied on goods for "final" consumption, i.e. taxes on private consumption. They can also affect the productive sector (see, for instance, chapter 7.2.3 on electricity tax).

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Whether or not a commodity is subject to excise duties depends in most cases on its classification in the EU Common Customs Tariff (CCT) (see chapter 3.1.1). If a commodity can be assigned to a particular customs tariff number in the CCT, it constitutes an object of taxation within the meaning of the relevant excise duty law.

#### *7.2.2.2 Time of tax liability and parties liable*

The levy of excise duties is linked to removal from the tax warehouse without further suspension arrangement or actual utilization or consumption of the goods. As a consequence of this principle, goods should remain untaxed until the time of use or consumption. This is achieved by the so-called tax suspension procedure. Provided certain conditions are fulfilled, it covers the manufacture, processing, storage, and transportation of goods, both within Germany and the EU.

Goods subject to excise duties that are imported into Germany from a non-EU country can either be cleared for free circulation immediately at the time of import (with the consequence that the duty is levied at this time) or they can be transferred into the suspension arrangements (postponing the levy of the duty until they are cleared for home consumption).

The party liable for excise duties is in each case the owner of the fiscal warehouse, the owner of the manufacturing operation, or the importer.

#### *7.2.2.3 Tax concessions*

The excise duty regulations provide for various tax exemptions and tax concessions. They apply for the most part where products subject to excise duties are passed on to a certain group of purchasers or where goods are processed into particular products or are used for particular purposes. In addition to or alongside the individual tax concessions, the individual excise tax laws also cover other situations where excise duties may be abated or reimbursed. This includes, for example, concessions available to manufacturing commercial enterprises (Unternehmen des produzierenden Gewerbes) in the area of energy tax on heating oil, natural gas and electricity (see below).

#### *7.2.2.4 EU directives*

The establishment of the EU internal market created the need for uniform EU excise duty laws to prevent differing excise duty regulations in the individual Member States from undermining the functioning of the EU internal market. The EU therefore issued a number of harmonization directives.

It should be noted that the harmonization directives only refer to harmonized excise duties, i.e. energy products, alcohol and alcoholic beverages, and tobacco products.

Excise duties are not levied while the goods are still subject to tax suspension arrangements. The transportation of products subject to excise duties within the EU may also take place under a tax suspension procedure. From January 2011 onwards, all transportation of products subject to excise duties under the suspension procedure between Member States must be rendered electronically via use of the so-called Excise Movement and Control System – EMCS (Council Directive 2008/118/EC dated December 16 2008).

### 7.2.3 Electricity tax

An electricity tax was introduced in Germany in April 1999.

The tax arises when electricity provided by suppliers residing in the tax territory is withdrawn from the supply network (electricity grid) by the final consumer. In addition, the electricity tax is also triggered when a supplier withdraws electricity from the supply network for its own use and when other generators (so-called self-generators) withdraw electricity for their own use. In the first two cases (i.e. electricity withdrawn by consumers or by a supplier for its own use), the tax is levied at the level of the supplier. In the third case, the tax is levied at the level of the self-generator.

**Table 14: Electricity tax rates**

Period	Normal rate (€ per MWh <sup>1</sup> )
From 1 January 2003 onwards	20.50

<sup>1</sup> MWh = megawatt hour

The party liable for the tax must file returns on a monthly or an annual basis and remit the amount due with the return. Suppliers generally pass on the tax burden to their customers via the electricity price. Manufacturing commercial enterprises can obtain a tax refund under certain circumstances. Electricity produced from renewable energy sources is tax-exempt if certain conditions are met (particularly in the case of an improvement in energy efficiency).

#### 7.2.4 Energy tax

In 2006, Germany implemented Council Directive 2003/96/EC restructuring the Community framework for the taxation of energy products and electricity. In addition, the European Commission reviews derogations from the Directive on an ongoing basis in order to achieve greater transparency and greater coherence in energy tax legislation.

In Germany, the taxation of energy products underwent a fundamental reform in 2006. Parts of the EU Energy Tax Directive were implemented in connection with the reform. As part of this reform, the previous Mineral Oil Tax Act (Mineralölsteuergesetz) was repealed and replaced with the Energy Tax Act (Energiesteuergesetz), effective as of August 2006. Compared with the prior tax situation, the legislation broadens the range of items subject to taxation. Under the new law, both lignite and hard coal are taxed and new regulations regarding the taxation of natural gas have been introduced.

**Table 15: Energy tax rates**

	Tax rate (in €)
Tax rate per 1000 liters of petrol/gasoline	654.50 <sup>1</sup>
Tax rate per 1000 liters of diesel	470.40 <sup>1</sup>
Tax rate per 1000 liters of heating oil <sup>2</sup>	61.35 <sup>3</sup>
Tax rate per 1 megawatt hour of natural gas <sup>2</sup>	5.50
Tax rate per 1000 kilograms of heavy heating oil <sup>2</sup>	25.00

<sup>1</sup> Sulfur content < / = 10 mg/kg (sulfur-free)

<sup>2</sup> When used for heating purposes. Mineral oil abatement or refund available to manufacturing commercial enterprises and agricultural and forestry enterprises.

<sup>3</sup> Sulfur content < / = 50 mg/kg

The commodity subject to tax is determined by its classification in the Common Customs Tariff.

One point worthy of mention is the interplay of the energy tax with the electricity tax: If an entity qualifies as a manufacturing commercial enterprise in terms of the Electricity Tax Act, it can also claim a reduction in the rate of the energy tax for certain kinds of energy products (in particular heating oil and natural gas).

### 7.2.5 Real estate transfer tax

Real estate transfer tax (Grunderwerbsteuer) is generally imposed on any transaction that causes a change in the ownership of real property situated in Germany, or in the person empowered to dispose of such property. Transferor and transferee, whether or not resident in Germany, are jointly and severally liable; in most cases, the contract specifies which party will pay the tax.

German real estate transfer tax is also triggered by direct or indirect transfers to new partners of at least 95% of the interests in a partnership owning German real property within a five-year period. The 95% requirement is determined in this case by the interest in the property of the partnership (Beteiligung am Gesellschaftsvermögen).

Furthermore, an acquisition of shares in a corporation or interests in a partnership owning German real property that results in a direct or indirect holding of at least 95% of the shares is also subject to German real estate transfer tax. The same applies if the shares of such a corporation or the interests in such a partnership are not held by a legal entity or sole proprietor after the acquisition, but rather by a group of controlled companies (e.g. members of a tax group).

From June 2013 onwards, a so-called "economic accumulation" of shares in a corporation or a partnership (of at least 95%) owning German real property is subject to German real estate transfer tax as well. The economic participation equals the sum of direct and indirect participations in the capital or assets of the company. Various transfers, such as acquisition by inheritance or donation, as well as acquisitions by spouses or descendants, are exempt from real estate transfer tax. In addition, specific intra-group business reorganizations are also exempt under certain preconditions.

The tax is normally assessed on the basis of the consideration given. Otherwise, the tax is based on the value of the real estate as established under the German Valuation Law (Bewertungsgesetz). The Federal Constitutional Court has declared the substitute measurement basis under the German Valuation Law to be unconstitutional. The legislator has been called upon to implement a change in the law with retroactive effect from

January 1 2009. Since 2006, the states (Länder) have the right to determine their own tax rates. The current rate of tax is 3.5% in Bavaria and Saxony, 4.5% in Hamburg, 5% in Bremen, Baden-Württemberg, Mecklenburg-Vorpommern, Lower Saxony, Rhineland-Palatinate, Saxony-Anhalt, and Thuringia (in Thuringia the tax rate will be 6.5% from 2017 onwards), 6% in Berlin and Hesse, and 6.5% in Brandenburg, North Rhine-Westphalia, Saarland, and Schleswig-Holstein.

### **7.2.6 Real estate tax**

Real estate tax (Grundsteuer) is an annual tax levied by German municipalities on real property. It is payable by the owner of the property irrespective of residence. The tax is levied on the assessed value (Einheitswert) of the property using the basic tax rate of 0.35%. There is dispute as to whether the current valuation using the assessed value is constitutional. The municipalities apply their respective multipliers to the resulting base amount (Steuermessbetrag) to arrive at the final tax due. The multipliers vary by municipality and may be different for industrial or agricultural property. Multipliers for industrial property typically range from 150% to 600%.



# Taxation of Individuals

## **Chapter 08**

## 8.1 Overview

The taxation of individuals in Germany is based on the principle of the taxpayer's ability to pay taxes. The German constitution (Grundgesetz – GG) only permits the state to tax the income of individuals if, after taxation, that individual has adequate economic means to maintain a minimum livelihood.

An individual's income is subject to income tax (Einkommensteuer) plus a solidarity surcharge (Solidaritätszuschlag) (see chapter 8.6). Church tax (Kirchensteuer) is collected if the individual belongs to one of the "recognized" churches (see chapter 8.7). Income generated by an individual from commercial business activity is also subject to trade tax (Gewerbesteuer) (see chapter 6.2.3).

Increases in wealth from inheritance or gifts are not classified as "income"; proceeds from these sources are, however, subject to inheritance tax (Erbschaftsteuer) and gift tax (Schenkungsteuer) (see chapter 8.8).

Value added tax (Umsatzsteuer) regulations apply if individuals operate a business (see chapter 7.1.1). Individuals are also affected by real estate transfer tax (Grunderwerbsteuer), which arises whenever real property is transferred for consideration (see chapter 7.2.5).

While several other European countries still have taxes on capital, Germany's net worth tax (Vermögensteuer) has not been levied since January 1 1997. The Federal Constitutional Court (Bundesverfassungsgericht – BVerfG) ruled in 1995 that certain aspects of the net worth tax were unconstitutional and that collection of the tax must cease at the end of 1996 if the defects were not remedied. The legislature has, however, intentionally failed to act. Accordingly, there is at present no legal basis to levy net worth tax in Germany.

Municipalities continue to levy a tax on real estate (real estate tax, Grundsteuer) (see chapter 7.2.6).

## 8.2 Basic principles of an individual's tax liability

### 8.2.1 *Distinction between unlimited and limited tax liability*

As in most other European countries, the German income tax system is based on the criterion of residency (Ansässigkeit). Citizenship is not a relevant factor. According to the concept of unlimited tax liability (unbeschränkte Steuerpflicht), individuals who reside in Germany are subject to income tax on their worldwide income. The status of unlimited tax liability is also relevant for various tax allowances and filing options (e.g. joint returns for married couples, child benefit payments, and child allowances).

For the purpose of income tax, an individual's residence is presumed to be the place where an individual is domiciled or has his customary place of abode (gewöhnlicher Aufenthalt). The term "domicile" (Wohnsitz) involves more than having a dwelling place (Wohnung) in Germany. In order to be liable for tax as a resident, the taxpayer must actually use the dwelling place or, at a minimum, it must be evident from the specific circumstances that there is an intention to use it on a long-term basis. If the individual does not have a dwelling place or if the intention to use it on a long-term basis is not evident, then resident tax status applies if the individual does in fact reside in Germany. However, the facts and circumstances must indicate that the physical presence is other than of a temporary nature. Physical presence for more than six months will result in deemed residence. Short interruptions, such as holidays in foreign countries, are not relevant and therefore count towards the six-month period.

Non-residents are subject to taxation only on certain income from German sources. This is known as the concept of a limited tax liability (beschränkte Steuerpflicht). If an individual has no German-source income, no taxes are levied. Consequently, unlimited tax liability (resident tax status) is based more on the individual, whereas limited tax liability (non-resident tax status) is based more on the source of the income.

### 8.2.2. *Special forms of tax liability*

Besides the standard categories of unlimited and limited tax liability, there are a number of specific cases where individuals not resident in Germany may also be subject to unlimited tax liability:

- German citizens working for German “governmental” organizations abroad, to the extent that these persons only have limited tax liability in the other country.
- Individuals who do not reside in Germany, but who earn the vast majority of their income in Germany and elect to be taxed on their German income only on a resident basis. For further information, see chapter 8.3.9.

## 8.3 Taxation of income

### 8.3.1 Taxation of resident individuals

Resident individuals are subject to income tax on their aggregated worldwide income that falls into one or more of the following seven categories of income:

- Income from agriculture and forestry
- Income from commercial business activity
- Income from self-employment
- Income from employment
- Income from capital investment
- Rental income from real estate and certain other tangible property and royalties
- Other income (of specific types)

“Other income” includes annuities, certain capital gains, and certain non-recurring income. Income that does not fall into one of the seven categories is not taxable.

### 8.3.2 Computation of taxable income

The tax year for income tax purposes is the calendar year.

In order to determine the total amount of taxable income, the amounts of income from the different categories must be calculated separately. For the first two categories of income (income from agriculture and forestry, and income from commercial business activity), the normal method of computing the gross income relevant for income taxation is the “equity comparison method” under which the relevant gross income is the difference between the net worth of the assets pertaining to each category of income at the end of the preceding assessment period compared to the current assessment period. The “equity comparison method” is mandatory for income from agriculture and forestry or commercial business activity if annual profits ex-

ceed € 50,000 and sales revenue exceeds € 500,000. If income is below these thresholds, the “cash basis accounting method” may be used. Under this method, taxable income is computed by reducing gross income by income-related expenses in accordance with cash receipts and disbursements. Business-related expenses are generally deductible under both methods. In the case of income from self-employment, the taxpayer can choose between the “equity comparison method” and the “cash basis accounting method”.

Net income from employment, rental income, and certain other income is determined by deducting any expenses incurred to produce, maintain, and safeguard that income (costs of earning non-business income, Werbungskosten) from gross receipts. For employees, these expenses include commuting expenses, tools, work clothes, certain membership dues, and certain away-from-home expenses. In the case of rental income, interest expenses, depreciation, and other related expenses can be deducted.

In 2009, a final withholding tax (Abgeltungsteuer) was introduced for income from capital and capital gains. Income from those categories is taxed at a fixed rate of 25% plus solidarity surcharge of 5.5%, and will not be included in the calculation of the gross income (for further information, see chapter 8.4.4 below).

The zero-bracket amount (Grundfreibetrag) is € 8,652 from 2016 onwards. For married taxpayers and civil partners (joint return, Zusammenveranlagung), the zero-bracket amount (Grundfreibetrag) is doubled.

### ***8.3.3 Income-related expenses***

The following standard annual deductions for costs of earning non-business income are allowed unless higher expenses can be itemized:

- For employment income: € 1,000
- For annuities: € 102
- Additional overall allowance when income from capital is determined (Sparer-Pauschbetrag): € 801 (for single taxpayers) and € 1,602 (for married taxpayers and civil partners who file a joint income tax return). Due to the flat tax character, higher expenses related to income from capital will no longer be deductible.

#### 8.3.4 Itemized deductions

The following itemized deductions are applicable:

- Special expenses (Sonderausgaben), which are private expenses rather than income-related expenses. German Income Tax Law provides an exhaustive list of special expenses that, typically, may be deducted only up to a certain maximum amount. The following are important special expenses:
  - Social insurance and similar expenses (Vorsorgeaufwendungen), e.g. pension insurance contributions or contributions to occupation-specific retirement plans; premiums for health and/or nursing insurances; unemployment insurance contributions
  - Alimony and maintenance payments in the case of spouses/legal partners living separately under a decree of divorce or legal separation
  - Expenses for the taxpayer's vocational education
  - Expenses incurred when a child entitled to tax-exempt child benefits (Kindergeld) attends specific schools
  - Expenses for childcare
  - Donations/membership dues for nonprofit organizations or political parties
- Extraordinary expenses (außergewöhnliche Belastungen): When a taxpayer incurs unusually high, unavoidable expenses due to extraordinary circumstances or hardship, relief may be granted by allowing as a deduction the excess of such expenses over a "reasonable burden". The definition of a reasonable burden is based on the net income before special expenses and on the number of children, and ranges from 1% to 7% of net income before special expenses. Certain expenses may be allowed, subject to an absolute rather than a percentage of income limitation.
- Moreover, additional allowances may apply in retirement situations, when specific payments are privileged due to a systematic change in the taxation of pensions.
- Foreign income taxes that do not qualify for foreign tax credit treatment or when a deduction is elected instead of tax credit.

#### 8.3.5 Child benefit payments, child allowances

The deductibility of expenses incurred by parents for their children is subject to special rules. In order to maintain a minimum livelihood for children, a system is in place that differentiates

between child benefit payments and child allowances. Tax-exempt child benefits are paid upon filing an application with the family welfare office (Familienkasse). This consists of a monthly amount of € 190 for the first and the second, € 196 for the third and € 221 for the fourth and each additional child. The child allowance, on the other hand, amounts to € 2,304 (€ 4,608 filing jointly) p.a. for each child (as a deduction against taxable income), plus an additional allowance of € 1,320 (€ 2,640 jointly filing) p.a. for each child for childcare, education, and training expenses. In most cases, however, the child allowances are not applied, because the payment of child benefits is more advantageous for most taxpayers. The tax office automatically applies the more favorable alternative. Taxpayers (German citizens or citizens of an EU/EEA Member State) must be residents of Germany in order to be entitled to child benefit payments or child allowance. Taxpayers who reside in non-member countries are not eligible, unless certain requirements are met. As an additional requirement, the children must have been accepted into the beneficiary's household.

### ***8.3.6 Utilization of losses***

Income and losses from different income categories can be fully offset against each other without limitations during any given tax assessment period. However, certain exceptions continue to exist for special types of income such as losses from livestock breeding businesses, or losses from private sales transactions.

If, after offset between the various income categories, a net loss results for an assessment period, it can be used to offset income in other assessment periods.

- The first option is to carry the losses back to the preceding year. There is a ceiling of € 1,000,000 (€ 2,000,000 for married couples and civil partners filing jointly).
- If a loss still remains after the carryback, or if the loss carryforward is chosen instead, it can be carried forward to future assessment periods indefinitely. Restrictions apply under the so-called minimum taxation rules, by which loss carryforwards may be fully offset against net income only up to a maximum of € 1m. Loss carryforwards in excess of this amount may be offset against only 60% of the total net income exceeding said € 1m threshold.

In addition to the general rules relating to the utilization of tax losses, income tax legislation also contains specific provisions on cross-border transactions. Losses not deductible under certain circumstances include the following: losses from a foreign permanent establishment, losses arising from the lease of property or relating to agricultural or forestry activities based outside Germany, and losses arising in connection with income which is tax-exempt in Germany.

### 8.3.7 Determination of tax liability

Individual income tax is imposed at progressive tax rates as summarized in the following tables for 2016:

For married taxpayers and civil partners filing jointly, tax liability is determined by doubling the tax taken from the basic tax table that would have been due on one half of the taxable joint income. Taxes withheld at the source, such as on employment income, can be credited against income tax liability.

In addition to income tax itself, a solidarity surcharge of 5.5% is also levied on the income tax amount assessed.

**Table 16: Single individuals**

Annual taxable income	Marginal tax rate	Tax due
up to € 8,652	0%	€ 0
€ 8,653 – € 13,669	14.00% – 23.97%	€ 1 – € 952
€ 13,670 – € 53,665	23.97% – 42.00%	€ 952 – € 14,145
€ 53,666 – € 254,446	42.00%	€ 14,145 – € 98,478
over € 254,447	45.00%	at least € 98,473

**Table 17: Married couples and civil partners filing jointly**

Annual taxable income	Marginal tax rate	Tax due
up to € 17,304	0%	€ 0
€ 17,306 – € 27,338	14.00% – 23.97%	€ 1 – € 1,904
€ 27,340 – € 107,330	23.97% – 42.00%	€ 1,904 – € 28,290
€ 107,332 – € 508,892	42.00%	€ 28,290 – € 196,946
over € 508,894	45.00%	at least € 196,946

### 8.3.8 Relief from double taxation

#### 8.3.8.1 Unilateral relief

Foreign income taxes that are substantially similar to German income tax may be credited against the German tax liability, limited to the amount of income tax actually paid (equivalent to German income tax) in the other country. Per country limitations also apply. Alternatively, foreign income tax can be deducted from the taxable income.

#### 8.3.8.2 Tax treaty relief

Tax treaties are agreements under international law between two countries. The purpose of such agreements is to avoid double taxation. Tax treaties are generally based on one of two systems: either (i) the country of the taxpayer's residence does not levy taxes on income having its source in the other treaty country (exemption system), or (ii) the country of residence taxes such income, but credits the taxes paid in the source country against its own income tax liability (credit system). Under credit systems, per country limitations normally apply. Germany may also credit notional foreign withholding taxes if so provided for in the relevant tax treaties. Provisions of this nature are included in a few tax treaties with industrially less developed countries, normally as an incentive for German companies to invest in those countries.

The treaty relief described above generally applies to resident individuals as well as to corporations. If income is exempt from tax under a treaty, Germany retains the right to take account of this income for purposes of determining the applicable average tax rate on other taxable income in Germany (progression clause, Progressionsvorbehalt). In addition to the treatment under tax treaties outlined above, the following principles generally apply to income from employment and self-employment:

- Remuneration paid to a resident of Germany for employment exercised in the other treaty country is normally taxed in that other country, unless (i) the recipient is present in the other country for not more than 183 days during the year, (ii) the salary is paid by an employer who is not a resident of the other country, and (iii) the salary is not borne by a permanent establishment of the employer in the other country. The tax treaties between Germany and a number of neighboring

countries contain specific regulations for cross-border commuters. Under these regulations, the country of residence retains the right to tax the employment income of the cross-border commuter under certain circumstances, even if the 183-day threshold is exceeded.

- Income from self-employment is usually taxable in the country of residence unless the individual has a fixed base regularly available to him in the other country for the purpose of performing his activities. Some treaties, however, apply the provisions for income from employment rather than the “fixed base” criterion.

### **8.3.9 Non-resident individuals**

Non-residents are subject to income tax on certain categories of income from German sources. To trigger German income tax, the income of the non-resident must have a specific connection with Germany. This includes:

- Income from agriculture and forestry activities in Germany
- Business income derived through a permanent establishment or a permanent representative in Germany
- Capital gains from the sale of shares in a resident corporation, provided the non-resident investor has a minimum holding of 1%
- Income from self-employment or employment (to the extent that the work is performed or used in Germany)
- Dividend income where the entity paying the dividend is resident in Germany; interest on mortgages and bonds issued by German borrowers
- Rental income, where the real estate or other tangible or intangible property is located or registered in Germany
- Certain other income, including gains on the sale of German real estate

Non-resident individuals are in some respects treated differently from residents. As outlined above, non-residents are subject to German income tax only with regard to certain categories of income from German sources. Depending on the type of income, the German source income of non-residents may be subject to tax either through withholding at the source or by direct assessment upon filing of an income tax return. Business expenses or costs of earning non-business income are only deductible to the extent that they are economically related to the relevant

income. Losses from one category of income may only be offset against income from another if both categories are subject to tax through direct assessment rather than the withholding tax procedure.

The tax withheld on income from capital is deemed to fully discharge the tax liability on that income unless it is derived through a permanent establishment in Germany, in which case the withholding tax is credited against the income tax payable upon direct assessment.

## 8.4 Capital gains

### 8.4.1 Sales of business assets

Gains on the sale of business assets are generally included in taxable income and taxed at ordinary rates. However, gains on the sale or disposal by an individual of his entire business, or an autonomous part thereof, or his partnership interest, are treated as "income from commercial business activity". An allowance of up to € 45,000 (under certain circumstances) is granted if the seller is 55 years of age or older. The amount remaining after this deduction is subject to a reduced tax rate (applicable to extraordinary income, außerordentliche Einkünfte). The rationale for this is to avoid the disadvantages of the progressive tax rate system, e.g. when a one-time gain is generated in return for assets which have been earned over a long period. The reduced tax rate is based on notional spreading of the capital gain over a period of five years (called the 1/5th rule). If the capital gain does not exceed the ceiling of € 5 million, older taxpayers (55 and older) may alternatively apply for a reduced tax rate. The reduced tax rate is 56% of the average tax rate. The minimum tax rate is 14%.

### 8.4.2 Sales of investments held as private assets

Capital gains on the sale of shares in a corporation held as private assets are subject to tax on a fictitious business-related basis if the individual is deemed to hold a substantial share in the corporation. A substantial shareholding is assumed if the individual has had a minimum holding of 1% within the preceding five years.

The capital gain is subject to tax if it exceeds an allowance of up to € 9,060 (pro-rated according to the holding in the corporation).

The “partial-income” rule applies to the remainder of the gain; in other words, 40% of the capital gain (less allowance) is tax-exempt. It should be noted, however, that expenses may not be deducted for the portion of the gain which is tax-exempt.

#### **8.4.3 Other private capital gains**

Gains derived by an individual from the disposal of capital assets not used in a trade or business (private Veräußerungsgeschäfte) are not subject to taxation, except in the following two cases:

A sale is taxable if the holding period is

- less than ten years in the case of real estate, or
- less than one year in case of other property.

The disposal of items for daily use will not be taxed.

The total net gain from a “disposal of capital assets not used in a trade or business” is subject to income tax at ordinary rates if it exceeds an allowance of € 600 per calendar year. Losses from the “disposal of capital assets not used in a trade or business” may only be offset against gains from such transactions within the same year. Losses on such gains, which cannot be offset with capital gains in the same calendar year may be carried back and forward in accordance with the general rules for loss carry-backs and carryforwards (see chapter 8.3.6).

Since the introduction of the final withholding tax, the above rules pertaining to the “disposal of capital assets not used in a trade or business” specifically no longer apply to gains from the disposal of capital assets. As such gains qualify as income from capital investment, they are taxed without regard to any holding periods. Special rules apply to capital assets acquired prior to 1 January 2009.

Items of daily use are excepted. These items shall not constitute other property in the above-mentioned meaning. Thus a capital gain shall not be taxable even if those items are sold within the holding period.

#### 8.4.4 Final withholding tax (*Abgeltungsteuer*)

Income derived from the investment of private capital assets qualifies as income from capital investment. This includes in particular:

- Current earnings such as interest and dividends, income from interests in investment funds, etc.
- Gains on the disposal of private capital assets

When determining income from capital, an amount of € 801 (€ 1,602 for married couples and civil partners filing jointly) is to be deducted as an overall allowance for costs of earning non-business income (Sparer-Pauschbetrag). Deducting the actual costs of earning non-business income is not permitted.

Tax liability is discharged with the final withholding tax of 25% (plus solidarity surcharge and – if applicable – church tax) being withheld by the domestic paying agent (bank, the client's custodian, etc.). No tax will be withheld if the taxpayer is able to furnish a certificate of non-assessment and/or a certificate of exemption. Assessments are possible in exceptional cases only.

As there are a multitude of capital investment products on offer, the form of applicable taxation depends on the individual case.

#### 8.5 Filing requirements and payment of tax

In general, income tax, church tax, and (since 1995) a solidarity surcharge are assessed upon filing of an income tax return (Einkommensteuererklärung).

Domestic taxpayers are required to file an income tax return if income for a particular assessment period exceeds the basic level of tax-exempt income (Grundfreibetrag: € 8,652) and the income has not been subject to tax withholding. Specific provisions apply to income tax returns filed jointly by married couples and civil partners. With regard to income from employment, there is often no requirement to file an income tax return since the withholding of wage tax will already have ensured that the income has been subject to taxation. In such cases, a special annual wage tax adjustment (Lohnsteuerjahresausgleich) is performed by the employer. Hence the amount of taxes for the year is settled as soon as possible. A non-resident individual must file an income tax return whenever he/she has German-source income

unless the tax liability is deemed to be satisfied by withholding at the source.

Returns must be filed with the local tax office by May 31 for the preceding calendar year. An extension until December 31 may be granted if the return is prepared by a professional tax advisor. Further extensions may be available upon request.

Since the 2011 assessment period, taxpayers who generate profit income have been required to send their income tax returns electronically. Profit income consists of income from agriculture and forestry, business operations, and self-employment. The obligation to send income tax returns electronically generally does not apply if income is generated from employment and total other income does not exceed the sum of € 410.

The tax is not payable with the return. Rather, the tax authorities will issue a final assessment notice after receipt of the return. Any balance due is payable within 30 days after receipt of the assessment notice.

The tax office will assess quarterly prepayments based on the prior year's tax or on estimates on income not subject to withholding taxes. These prepayments are due on March 10, June 10, September 10, and December 10.

The tax authorities are entitled to impose interest for late payment of tax, which applies to income, corporation, trade, and value-added tax claims. The interest rate is 6.0% p.a. or 0.5% per month.

Any taxpayer subject to unlimited tax liability who is not specifically required to file an income tax return may nevertheless do so in order to be assessed for income tax. This can be useful, for instance, when high costs of earning non-business income or business-related expenses are incurred or if income is earned for only a part of the assessment period. The filing of an income tax return is possible as long as the assessment period is not yet final and conclusive.

## 8.6 Solidarity surcharge

The solidarity surcharge (Solidaritätszuschlag) is levied as a supplement to income and corporate income tax; currently it is at a

rate of 5.5% of the assessed amount of income and corporate income tax (see chapter 6.2.1). It applies to taxpayers with unlimited tax liability and to the German-source income of taxpayers with limited tax liability.

### **8.7 Basic principles of church tax**

Church tax (Kirchensteuer) is levied by "recognized" churches in Germany that have been granted the right to impose a tax on their members. Recognized churches are *inter alia* the Roman Catholic Church (römisch-katholische Kirche), the German Protestant-Lutheran Church (evangelisch-lutherische Kirche), the Reformed Church (reformierte Kirche), and Jewish parishes (jüdische Kultusgemeinden). It does not apply to foreign churches. Depending on the German Federal State of residence, the tax amounts to 8% or 9% of the wage tax withheld and is remitted by the employer to the local tax office or the church tax office. For income not subject to wage tax withholding, quarterly pre-payments and final payments are made along with the relevant income tax payments. In this case, the church tax is calculated on the assessed income tax (or on the prepayments). Church tax is a deductible (special) expense for income tax purposes. Foreign employees working in Germany are subject to church tax if they are members of the Roman Catholic Church, since this church defines itself as a worldwide church.

In addition to banks and insurance companies, since January 1 2015, all companies that distribute capital gains and whose shareholders include at least one individual have been obliged to inquire about the church tax status with the Federal Central Tax Office and to deduct and transfer church tax.

## 8.8 Basic principles of inheritance and gift tax

Inheritance and gift tax (Erbschafts- und Schenkungsteuer) is levied on transfers of property by reason of death (inheritance tax), gifts during lifetime and transfers for certain specified purposes (gift tax), as well as on the net worth of certain family foundations or trusts (at intervals of 30 years).

The transfer of domestic property valued according to the provisions of the German Valuation Act (Bewertungsgesetz) is subject to inheritance and gift tax, regardless of whether the transferor and/or the transferee are residents of Germany. The transfer of foreign property is subject to inheritance and gift tax only if the decedent or donor is a resident of Germany at the time of death or at the time when the gift is made, respectively, or if the beneficiary or donee is a resident at the time when the tax liability arises, or if either the decedent/donor or the beneficiary/donee is a German citizen and emigrated within a five-year period preceding the taxable event.

The tax is generally assessed on the net worth (gross values less liabilities) of the property transferred after deducting certain exemptions. Comprehensive exemption rules (Verschonungsregelungen) exist for the transfer of so-called business property located in Germany or an EU/EEA Member State (business assets or substantial shareholdings in corporations). If the beneficiary/donee retains the property in his possession for the seven-year period required by law and the annual payroll total reaches 700% of the initial payroll in that period, the beneficiary/donee can obtain a tax exemption of up to 100%, depending on the model that has been chosen. However, in December 2014, the Federal Constitutional Court declared these "exemption regulations" for business property to be unconstitutional. The legislative process has already begun and is expected to be completed by June 30 2016. Until then, the currently valid regulations must still be applied. However, there is no protection of legitimate expectation with regard to a possible retroactive effect.

In the case of a resident transferor or of a resident transferee, personal exemptions depend on the family relationship of the respective individuals. The three classes of relationships and the respective personal exemptions for inheritance and gift tax purposes are:

**Table 18: Classes of relationship**

<b>Class relationship</b>		
I	Spouse and legal partners	€ 500,000
	(Step-)children and grand (step-)children of deceased (step-)children	€ 400,000
	Children of children	€ 200,000
	Grand (step-)children and (grand-)parents (in the event of transfers at death)	€ 100,000
II	(Grand-)parents (for gifts), siblings and their children (first degree), step-parents children-in-law, parents-in-law, and divorced spouse / legal partner	€ 20,000
III	All others	€ 20,000

**Table 19: Inheritance and gift tax classes**

<b>Net worth of inheritance/gift</b>	<b>I</b>	<b>II</b>	<b>III</b>
up to € 75,000	7%	15%	30%
up to € 300,000	11%	20%	30%
up to € 600,000	15%	25%	30%
up to € 6,000,000	19%	30%	30%
up to € 13,000,000	23%	35%	50%
up to € 26,000,000	27%	40%	50%
over € 26,000,000	30%	43%	50%

If neither the transferor nor the transferee is a resident, an allowance of € 2,000 applies throughout. In addition, there is a surviving-spouse exemption of € 256,000 less any survivors' benefits not subject to inheritance tax, and special exemptions for children ranging from € 10,300 to € 52,000 depending on their age. Other exemptions from tax may be allowed under certain circumstances.

Taxable transfers of property are subject to inheritance tax at graduated rates, depending on the value of the property and the classes of family relationship mentioned above. The tax rates can be illustrated as shown in table 19. For purposes of determining the applicable tax rate, transfers within a period of ten

years are accumulated, and any inheritance tax that should have been previously levied on the transfers is credited against the resulting entire tax liability. Accordingly, the personal exemptions are available every ten years.

# Labor law and labor costs

## Chapter 09

## 9.1 Employment

### 9.1.1 Employment contract

Employment contracts should be entered into in writing. However, a lack of written form does not render the contract void or unenforceable. An employment contract can be concluded for an indefinite period (permanent contract) or a limited period (fixed-term contract).

A clause limiting the term of an employment contract is enforceable if an acceptable justification for the time limitation exists, e. g. work on a temporary project. In addition, fixed-term contracts are also valid without objective justification in the following three cases, provided the duration of the contract is fixed according to the calendar.

- Fixed-term employment for periods of up to two years is permissible if the employee has not been employed by the same employer within the last three years.
- Fixed-term employment is permissible in the first four years after the formation of a company (start-up period).
- Fixed-term employment is permissible for periods of up to five years for employees who are 52 years of age or older at the time of hiring and have been unemployed for at least four months immediately prior to commencement of the fixed-term contract. This exception also applies to employees who meet the age requirement, but have not been unemployed because they were drawing certain transitional benefits or held a publicly subsidized job.

Time limitations are unenforceable unless they are made in writing. Employees wishing to challenge a time limitation in their employment agreement must file an action before the labor court.

### 9.1.2 Terms of employment

The employer and the employee are generally free to agree on the terms of the employment contract. However, this right is limited by mandatory laws (Gesetze), ordinances (Verordnungen), collective bargaining agreements (Tarifverträge), and works agreements (Betriebsvereinbarungen).

#### *9.1.2.1 Working hours*

Generally, the German work week comprises 35 to 40 hours. The maximum work week allowed by the German Working Hours Act (Arbeitszeitgesetz – ArbZG) is 48 hours. Working hours during working days may not exceed eight hours. However, they can be extended to ten hours if the average shift within six months or 24 weeks does not exceed eight hours per working day.

Generally, any time worked in excess of the contractually agreed working time (overtime) has to be compensated. Overtime is usually paid on an hourly basis calculated on the basis of the monthly or annual salary. Alternatively, the employer can reserve the right to grant time-off as compensation for overtime. The employer is not obliged to pay an overtime premium. However, many collective bargaining agreements (Tarifverträge) provide for such premiums.

#### *9.1.2.2 Paid vacation*

The statutory minimum vacation entitlement is 20 days per calendar year based on a five day working week. This corresponds to at least four weeks of paid annual vacation. In addition, employees continue to receive their salary on public holidays. The number of public holidays in Germany ranges from nine days to 13 days depending on the place of work.

#### *9.1.2.3 Continued payment of salary in the event of illness*

The law requires employers to continue payment during the first six weeks of absence from work due to illness (see chapter 9.3.2.1).

#### *9.1.2.4 Anti-discrimination*

In 2006, the German parliament enacted the General Law on Equal Treatment (Allgemeines Gleichbehandlungsgesetz – AGG). The AGG is based on EU equal treatment and anti-discrimination directives and prohibits discrimination based on race, ethnic origin, gender, religion, conviction, disability, age, or sexual identity. The AGG enables employees to sue their employers for “punitive damages” if the employer violates the prohibition of discrimination or fails to protect the employee against discrimination at the workplace.

#### *9.1.2.5 Requests to work part-time*

Any full-time employee who has been employed for more than six months by the same employer may request that he or she shall be employed on a part-time basis, provided the employer regularly employs more than 15 persons. The employer must grant this request unless it is unfeasible for operational reasons, e.g. because the reduction of working time would have a negative impact on the organization, work flow, or safety, or would lead to excessive costs. Other acceptable reasons for refusal may be specified by collective bargaining agreements (Tarifverträge).

#### *9.1.2.6 Maternity and parental leave*

During the last six weeks of pregnancy and the first eight weeks after giving birth, mothers are not permitted to work (maternity leave, Mutterschaftsurlaub). The law requires employers to continue payment during this period.

Furthermore, the mother or the father may choose to take up to three years' special leave to care for and raise the newborn child (parental leave, Elternzeit). Parental leave may be taken until the child reaches his or her eighth birthday subject to statutory prerequisites to be met (e.g. concerning the number of time periods, their duration, their start and end date). During parental leave, the contractual relationship between the employer and the employee is suspended.

Employees on parental leave may be entitled to parental pay (Elterngehalt) from the government. Parental pay generally amounts to 67% of the average monthly income earned over the last twelve months prior to parental leave. The maximum amount of parental pay is € 1,800 per month, the minimum is € 300 per month. It is paid for at least two but not more than 14 months for each child and couple. An individual parent can only get up to 12 months parental pay; therefore, to obtain the full 14 months, both parents have to take parental leave.

Parents of a child born on January 1 2015 or later may choose between parental pay and parental pay plus (Elterngehalt Plus). Parental pay plus enables parents to combine parental pay and part-time work. By opting for parental pay plus, they may substitute each month of parental pay for two months of parental pay plus. As a result, the total payment period may be extended

from 14 months to a maximum of 28 months. The amount of parental pay plus is limited to 50% of the amount of parental pay the mother or the father would have been entitled to without obtaining income on a part-time basis. Provided the parents simultaneously reduce their weekly work time for four consecutive months, actually working between 25 and 30 hours per week, both will be entitled to four additional months of parental pay plus (partnership bonus, Partnerschaftsbonus).

Once parental leave has ended, the employee has the right to resume his or her former job or a similar position with the same employer.

### ***9.1.3 Termination of employment***

Employment contracts can be terminated by either party by giving notice of termination (Kündigung) to the other contracting party. The notice of termination must be made in writing in order to be effective. German labor law distinguishes between "ordinary termination" (discretionary dismissal effective at the end of a notice period) and "extraordinary termination" (dismissal for cause with immediate effect).

Minimum notice periods are stipulated in the German Civil Code (Bürgerliches Gesetzbuch – BGB). Generally, a statutory notice period of four weeks applies. The statutory notice period for termination by the employer increases with the length of the employment (for instance, employment of five years extends the notice period to two months). Statutory notice periods are minimum notice periods and can generally be shortened only by collective bargaining agreements. When concluding an employment contract, the parties often agree on a probationary period (Probezeit) of up to six months. During this period, the employer and the employee can terminate the employment on only two weeks' notice.

Extraordinary dismissal is permissible if there is a good cause (wichtiger Grund) for immediate termination. In order to constitute a good cause, the circumstances must be such that continuing the employment until the end of the regular notice period (or, for fixed-term contracts, until the contractual expiration date) would be unreasonably burdensome for the employer. Criminal acts against the employer or colleagues are examples of good cause. Extraordinary dismissal is only possible within two

weeks of the time the employer learns the facts on which the termination is based.

Fixed-term contracts terminate automatically at the end of their agreed term. They are subject to ordinary termination only if this is agreed in the individual agreement or the applicable collective bargaining agreement.

Employees wishing to challenge the validity of their dismissal must file an action before a labor court within three weeks of having received the notice of dismissal.

Certain groups of employees, such as works council members, disabled employees, pregnant women, and employees on parental leave have special protection against dismissal.

If a works council (Betriebsrat) exists, it has to be involved before every dismissal, even though the works council's response does not bind the employer. Termination without proper hearing of the works council is ineffective.

#### **9.1.4 Protection Against Unfair Dismissal Act**

The right of the employer to terminate employment contracts without cause ("ordinary termination") is severely restricted by the Protection Against Unfair Dismissal Act (Kündigungsschutzgesetz – KSchG). In general, it applies to all employees who have worked for the employer for more than six months, provided the employer employs more than five employees or more than 10 employees if the employee were hired after December 31 2003.

A discretionary termination of an employment contract with an employee covered by the Protection Against Unfair Dismissal Act is ineffective unless the employer can prove that the termination is "socially justified". As a rule, "social justification" is deemed to exist only if the termination is occasioned by reasons relating to the person or the behavior of the employee or by compelling business reasons that prevent the continuation of the employment. In case of a termination based on compelling business reasons the employee to be dismissed must be selected from a pool of comparable employees based on social criteria (i.e. age, family situation, years of employment, severe disabilities).

## 9.2 Labor regulations

### 9.2.1 Collective bargaining agreements

In Germany, there are numerous legal provisions which establish a general framework for wages and salaries, as well as for other terms and conditions of employment. The detailed terms and conditions (e.g. the amount of wages and salaries and their constituent elements, working hours, notice periods, holidays, and non-mandatory social insurance payments made on the employees' behalf) are generally agreed in the course of collective negotiations between the trade unions (Gewerkschaften) and the employers' associations (Arbeitgeberverbände).

The individual trade union enters into collective bargaining agreements (Tarifverträge) through collective bargaining with the employer or employers' association either at the national, regional or local level, or at the company or industry sector level.

Each collective agreement consists of two parts: The first part deals with the rights and duties of the contractual partners. The parties' two main obligations are to maintain the industrial peace and to use all available means to ensure that their members abide by the agreement. The second part sets forth rules related to labor contracts, to operational questions, and to the works constitution within the meaning of the Works Constitution Act (Betriebsverfassungsgesetz – BetrVG).

Only members of the trade union and members of the employer association are actually bound by the agreements. If an employer does not join the employers' association, the unions may negotiate a collective bargaining agreement with the employer individually. The German Federal Ministry of Labor and Social Affairs (Bundesministerium für Arbeit und Soziales) may, at the request of one of the negotiating parties, declare a collective bargaining agreement to be generally binding. If such a declaration is made, the agreement applies to all employees in the industry sector and geographic region, even if their employer is not a member of the respective employer association.

In principle, the terms and conditions of employment for executive staff (leitende Angestellte) are not covered by collective bargaining agreements, but are subject to individual agreements instead. According to the German Works Constitution Act (Be-

triebsverfassungsgesetz – BetrVG), executive staff is defined as those employees who are entitled to hire and dismiss employees in the company independently, have full power of attorney or procuration (Prokura), or regularly make management decisions.

### ***9.2.2 Co-determination and work councils***

In Germany, employee participation, i.e. the ability and right of employees to influence company decision-making processes, takes place mainly through the works council (Betriebsrat) (at the operational level) and the supervisory board (Aufsichtsrat) (at the company level).

At the company level, the Coal, Steel, and Iron Industry Co-Determination Act (Montan-Mitbestimmungsgesetz – MontanMitbestG) requires stock corporations (Aktiengesellschaften – AG) and limited liability companies (Gesellschaften mit beschränkter Haftung – GmbH) in the coal, steel, and iron industry with more than 1,000 employees to grant employees equal representation on the supervisory board, meaning that the supervisory board consists of an equal number of shareholder and employee representatives. To avoid stalemates, the supervisory board also has a neutral member who has no allegiance to either the employees or the shareholders. Furthermore, a human resource director, who may not be elected without a majority of the votes cast by the employee representatives, is appointed to the management board and is ranked equally with other board members.

The Act on the Co-Determination of Employees (Mitbestimmungsgesetz – MitbestG) requires stock corporations (AG), partnerships limited by shares (Kommanditgesellschaften auf Aktien – KGaA), limited liability companies (GmbH) and cooperatives (Genossenschaft) with more than 2,000 employees to have equal representation for the employees and the owners of the company. In stalemate situations, the chairman of the supervisory board, who generally represents the interests of the owners, has a double vote. The human resource director is appointed to the management board and is ranked equally with other members of that board. In contrast to the rules set out in the Coal, Steel, and Iron Industry Co-Determination Act (MontanMitbestG) referred to above, this appointment can be made without a majority vote from the employee representatives.

The One-Third Participation Act (Drittelpartizipationsgesetz – DrittelpG) requires one third of the members of the supervisory board to be employee representatives in the case of a stock corporation (AG), a partnership limited by shares (KGaA), a limited liability company (GmbH), a mutual insurance association (Versicherungsverein auf Gegenseitigkeit – VVaG), and a cooperative (Genossenschaft) with more than 500 employees. The latter requirement (500 employees) does not apply to stock corporations (AG) and partnerships limited by shares (KGaA) which were registered in the commercial register prior to August 10 1994 and are not family-owned.

Co-determination at the operational level is governed by the German Works Constitution Act (Betriebsverfassungsgesetz – BetrVG). This law applies irrespectively of the legal form of the company. In all enterprises with at least five employees, an elected works council (Betriebsrat) must be established at the employees' request. The main function of the works council is to monitor all laws (Gesetze), ordinances (Verordnungen), collective bargaining agreements (Tarifverträge), and works agreements (Betriebsvereinbarungen) applicable to the employees. The works council must be involved in social, personnel, and economic matters as described in the Works Constitution Act (BetrVG) and even other statutory provisions.

The employer may agree with the works council on works agreements which are binding for the covered employees. The works agreements consist of detailed regulations governing the terms and conditions of employment (e.g. working hours, timing of breaks, safety issues). However, wages and other working conditions which are regulated or normally regulated by collective bargaining agreements are not permitted to be subject of such works agreements. The number of works council members within an enterprise increases with the number of its employees.

A general works council (Gesamtbetriebsrat) must be established in companies with multiple works councils at different business locations. The local works councils are not subordinate to the general works council. Rather, the general works council is responsible for dealing with matters which relate to the company as a whole or to several business locations and which

cannot be settled by the local works councils or which require uniform resolution throughout the entire company.

In a consolidated group (Konzern) in which there are works councils in more than one company, a group works council (Konzernbetriebsrat) can be established in order to represent the interests of all employees of the group. The group works council is responsible for dealing with matters which relate to the group or to several group companies and cannot be settled by the individual works councils (e.g. welfare services with group-wide effect) or which require uniform resolution throughout the entire group.

In the case of EU-wide operating enterprises (community-scale undertakings) or EU-wide operating groups of enterprises, the European Works Councils Act (Gesetz über Europäische Betriebsräte – EBRG) requires a European works council to be set up by means of an agreement if the employees request this. If no agreement can be reached, the European works council is established by law. An EU-wide operating enterprise is defined as an enterprise which has at least 1,000 employees within the Member States of the EU and at least 150 employees in each of at least two different Member States. An EU-wide operating group of enterprises is defined as a group which has at least 1,000 employees within the Member States of the EU and which consists of at least two enterprises seated in two different Member States each employing 150 or more employees. The European works council consists of employees of the EU-wide operating enterprise(s), i.e. representatives from each Member State in which the enterprise(s) operate(s). Once every calendar year, the European works council should be informed and consulted by the management of the EU-wide operating enterprise or the EU-wide operating group of enterprises about business developments and future prospects of the enterprise, and should be provided with the necessary documents relating to these topics on a timely basis. Furthermore, the European works council has to be informed and – on demand – consulted regarding extraordinary matters, e.g. cross-border production outsourcing.

The German Societas Europaea Implementing Act (SE-Ausführungsgezetz – SEAG) enables companies to merge into a European Company (Societas Europaea – SE, Europäische

Gesellschaft), see chapter 5.2.1. The SE is the first corporate entity to be uniformly available in all EU Member States. Co-determination is governed by the German Act on the Participation of Employees in a European Company (SE-Beteiligungsgesetz – SEBG). The details of the co-determination system are basically subject to negotiation between a special committee acting on behalf of the employees of the merging companies and the management of those companies. If a consensus cannot be achieved, an SE-works council is established by law. Furthermore, if a German corporation is involved, the general German co-determination rules apply. The number of employee representatives in the SE's supervisory board or board of administration (Verwaltungsrat) is equal to the highest number of employee representatives in any of the merging companies. Since the German co-determination rules provide for equal representation or one-third representation for employees (depending on the number of employees of the company), the German co-determination rules typically determine the number of employee representatives in an SE when a German corporation is involved.

Rules for cross-border mergers are set out in the German Act on the Co-Determination of Employees in Cross-Border Mergers (Gesetz über die Mitbestimmung der Arbeitnehmer bei einer grenzüberschreitenden Verschmelzung – MgVG). The system of employee participation is very similar to that which applies when establishing an SE by way of a merger. However, there are some important differences. Unlike the rules governing employee participation in an SE, the Act on the Co-Determination of Employees in Cross-Border Mergers provides for employee participation only at the company level, not at the operational level.

### 9.3 Labor costs

#### 9.3.1 Wage regulation

Employment contracts normally provide for salary or wages payable on a monthly basis. When employment contracts are subject to universally binding collective bargaining agreements (allgemeinverbindliche Tarifverträge) specifying a particular minimum payment, the salary or wages must equal or exceed the minimum amount for the relevant job.

Starting January 1 2015 all employees are entitled to a minimum wage of € 8.50 per hour according to the German Minimum

Wage Act (Mindestlohngesetz – MiLoG). However, the law does not apply to certain apprentices and trainees. Penalties for non-compliance with the Minimum Wage Act include a fine or the exclusion from procurement procedures. Until December 31 2017 deviating regulations of a collective bargaining agreement of representative parties take precedence over the statutory minimum wage, provided they have been made generally binding on all employers. The same applies to minimum industry wages. From January 1 2017 such deviating regulations must provide for at least a payment of € 8.50 per hour.

### **9.3.2 Social insurance system**

The German public social insurance system provides for pension insurance, health insurance, nursing care insurance, unemployment insurance, and accident insurance. In general, social insurance coverage is mandatory for all employees working in Germany, regardless of their citizenship or the residence of their employer. Employees temporarily transferred by a foreign employer to a German branch of the same enterprise are exempt from German social insurance contributions as a general rule. In order to qualify for the exemption, employees must be able to prove their intention to return to their home country, and the foreign employer must retain the essential functions of an employer, such as decisions about salaries, promotion, transfers, etc. The critical factor for the German authorities is whether the employee will remain on the non-German payroll.

In general, the employer and the employee pay equal contributions to the insurance system, except for statutory accident insurance, which is borne entirely by the employer. The employer's portion of social insurance contributions does not constitute taxable income for the employee. The employer is liable for remitting its contributions as well as those of the employee and generally deducts the employee's portion from wages or salaries.

#### **9.3.2.1 Health insurance and nursing care insurance systems**

Health and nursing care insurance is mandatory for employees. Contributions are computed as a percentage of earnings and are generally shared equally by the employer and employee. The current rate for health insurance is 14.6% (shared in equal amounts by employer and employee). Moreover, there is an additional surcharge by an average of 1.1% (set by the health insurance

companies and solely paid by the employee). The current rate for nursing care insurance is 2.35% (2.55% from 2017 onwards (Pflegestärkungsgesetz II)). A childless employee must pay an additional contribution of 0.25 percentage points to the nursing care insurance system.

The wage and salary amount that is subject to insurance contributions is capped. In 2016, the applicable ceilings for health and nursing care insurance contributions are € 50,850 per year or € 4,237.5 per month. Wages and salaries in excess of these amounts are not counted when calculating health and nursing care insurance contributions.

Employees may opt for private health and nursing care insurance instead of public insurance if their gross annual salary exceeds € 56,250. Employees who opt for private health insurance are usually legally entitled to a tax-free reimbursement from the employer up to the maximum contribution payable by the employer under the public system.

In general, the public health insurance system covers the employee and his or her family and provides benefits that include medical and dental treatment, prescription medicines, and under certain conditions glasses (i.e. for children under 18 years), preventive examinations, maternity care, hospitalization, and surgery. However, some restrictions do apply. The nursing care insurance system provides long-term care benefits.

If an employee is ill, the employer is required to continue payment of wages for a period of six weeks. Once the six-week period has elapsed, the employee is entitled to receive a sickness allowance (Krankengeld) paid by the public health insurance. The sickness allowance is 70% of the gross salary (but not exceeding 90% of the net salary), limited to a maximum of € 2,966.40 per month. It is generally not subject to a time limit, although it cannot exceed 78 weeks in the case of one and the same illness within a period of three years.

According to the Home Care Leave Act (Pflegezeitgesetz – PflegeZG), employees are entitled to remain absent from work for a period of up to 10 working days due to an acute case of nursing care concerning a dependent close relative. In addition, they are entitled to reduce their work time in partial or in full for

a period of up to six months in order to care for a dependent close relative in their home environment provided the employer employs more than 15 employees. Furthermore, according to the Family Care Leave Act (Familienpflegezeitgesetz – FPfZG), employees are entitled to reduce their weekly work time to the minimum of 15 hours per week for a period of maximum 24 months in order to care for a dependent close relative in their home environment, provided the employer employs more than 25 employees. The Federal Office for Families and Civil Social Tasks (Bundesamt für Familie und zivilgesellschaftliche Aufgaben) may grant an interest-free loan upon application if certain statutory prerequisites are met. Such a loan must be reimbursed by monthly installments.

#### *9.3.2.2 Public pension insurance system*

The current contribution rate for the public pension insurance is 18.7% of the employee's gross monthly earnings shared equally by the employer and the employee. For 2016, pension insurance contributions are calculated on the basis of earnings up to € 74,400 annually or € 6,200 monthly (€ 64,800 annually or € 5,400 monthly in the East German states). The ceiling amounts are generally increased annually.

The public pension system provides for old age, disability, survivors', and orphans' pensions, and some rehabilitation treatments. Old-age benefits are normally available from age 65 onwards. However, in 2007 the German Parliament (Bundestag) increased the statutory retirement age (Regelaltersgrenze) from 65 to 67. The statutory retirement age will be raised step by step starting in 2012 and will reach age 67 in 2029 for those born in 1964 or later. The minimum vesting period for old age, disability, and survivors' pensions is five years. However, if certain statutory prerequisites are met (e.g. concerning birth year, number of contribution years (Beitragsjahre), gender, and handicap) employees may apply for a full retirement pension even before they reach the statutory retirement age.

Pensions are computed on the basis of a formula which takes into account factors such as the insured's gross income, the average income of all the persons insured by the system, and the recognized period of coverage. Pensions are generally adjusted annually depending on the development of the general earnings level. In 2005, the ratio of the number of retired persons to the

number of contributors was added as a supplementary pension adjustment factor (Nachhaltigkeitsfaktor). Since then, pensions have not risen as fast as wages and salaries as a consequence.

The taxation of public pensions was radically changed in 2005. Until 2004, beneficiaries paid tax only on the “income portion” of their pension payments. The taxable portion varied depending on the age of the recipient at the time of the first pension payment (e.g. 27% for persons retiring at age 65). Starting in 2005, the taxable portion of the pension depends solely on the calendar year in which the first payment occurs; the beneficiary’s age is irrelevant. Under the new regime, full taxability of pension payments is phased in over a transition period that begins in 2005 and ends in 2040. For pensions first drawn in the years 2005 et seqq., a tax-exempt amount is determined by applying a percentage – the so-called exemption quota – to the monthly pension in the initial year. The amount so determined remains fixed for the duration of the pension; hence subsequent increases in the pension amount do not alter the amount of the exemption. For pensions commencing in 2005, the exemption quota is 50%. For pensions commencing in subsequent years, the exemption quota decreases in steps of 2% annually through 2020, then 1% from 2021 to 2040, so that pensions commencing in 2040 or thereafter are fully taxable.

#### *9.3.2.3 Unemployment insurance system*

In 2016 unemployment insurance contributions are calculated as 3% of an earnings base that is capped at € 74,400 annually or € 6,200 monthly. For the East German states, the ceiling is € 64,800 annually or € 5,400 monthly. The contribution is shared equally by the employer and the employee. Unemployment insurance provides benefits in the event of termination of employment, layoffs due to weather conditions (e.g. in the construction industry), and temporary layoffs due to reduced production levels.

#### *9.3.2.4 Statutory accident insurance*

Contributions to the statutory accident insurance are determined on the basis of a risk rating applicable to each individual enterprise. This rating depends, in turn, on the industry sector in which the enterprise operates. The contribution will typically range from 0.5% to 4% of the total payroll amount. The cost is borne solely by the employer, who is a mandatory member of the statutory accident insurance.

The statutory accident insurance provides benefits in case of occupational diseases, as well as for injuries suffered at work or on the way to or from work. The benefits include medical and hospital treatment, rehabilitation therapy, sickness allowance, as well as disability, survivors', and orphans' pensions.

#### *9.3.2.5 International agreements*

The EU has established regulations on social insurance which provide for reciprocal coverage among the Member States of the EU and the European Economic Area (EEA): Austria, Belgium, Bulgaria, Croatia, Cyprus (Greek part), Czech Republic, Denmark, Estonia, Finland, France, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Romania, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, and the United Kingdom. Additionally, Germany has entered into social insurance agreements with Bosnia and Herzegovina, Croatia, Kosovo, Macedonia, Montenegro, Morocco, Serbia, Tunisia, and Turkey. With Australia, Brazil, Canada, Chile, Israel, Japan, Korea, the United States and Uruguay, Germany has entered into social insurance agreements on pension insurance only.

In general, the social insurance agreements provide that an expatriate continues to contribute only to the social insurance plan in his or her home country if the stay in the other country does not exceed 24 months. In most cases, an extension can be applied for. Generally, people can choose between the social security systems of the two countries. According to the agreements, past work credits from both countries are combined for the purpose of determining eligibility for social security benefits under one of the two systems.

Under German domestic law, in principle no pension payments are made to non-resident aliens. However, an expatriate leaving Germany may apply for a refund of the employee portion of the contributions made to the German pension system at any time once two years have passed since the last contributions were payable.

The social insurance agreements that Germany has concluded generally allow pension payments to foreigners living abroad. Most agreements provide for a voluntary continuation of

contributions once a foreigner lives abroad, but do not permit a one-time refund.

With India and China, Germany has concluded social insurance agreements with respect to workers temporarily posted (expatriates) to the other contracting state by their employers (Entsendeabkommen). These agreements are designed to avoid situations where expatriates are covered by two insurance systems and would have to pay pension and unemployment insurance contributions twice. However, they do not contain any other provisions, for example on later pension payments.



## 10.1 Withholding tax rates

Country	Dividends		Interest (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies (%) [holding of at least] <sup>1</sup>		
Albania	15	5 [25]	0/5	5
Algeria	15	5 [10]	0/10	10
Argentina	15	15	0/10/15	15
Armenia	15	15	0/5	0
Australia <sup>8</sup>	15	15	0/10	10
Austria	15	5 [10] <sup>2</sup>	0 <sup>3</sup>	0 <sup>3</sup>
Azerbaijan	15	5 [25]	0/10	5/10
Bangladesh	15	15	0/10	10
Belarus	15	5 [20]	0/5	3/5
Belgium	15	15 <sup>2</sup>	0/15 <sup>3</sup>	0 <sup>3</sup>
Bolivia	10	10	0/15	15
Bosnia-Herzegovina	15	15	0	10
Bulgaria	15	5 [10] <sup>2</sup>	0/5 <sup>3</sup>	5 <sup>3</sup>
Canada	15	5 [10]	0/10	0/10
China (People's Rep.) <sup>4</sup>	10	10	0/10	7/10
Croatia	15	5 [10] <sup>2</sup>	0 <sup>3</sup>	0
Cyprus	15	5 [10] <sup>2</sup>	0 <sup>3</sup>	0/5 <sup>3</sup>
Czech Republic	15	5 [25] <sup>2</sup>	0 <sup>3</sup>	5 <sup>3</sup>
Denmark	15	5 [10] <sup>2</sup>	0 <sup>3</sup>	0 <sup>3</sup>
Ecuador	15	15	0/10/15	15
Egypt	15	15	0/15	15/25
Estonia	15	5 [25] <sup>2</sup>	0/10 <sup>3</sup>	5/10 <sup>3</sup>
Finland	15/25	10 [25] <sup>2</sup>	0 <sup>3</sup>	0/5 <sup>3</sup>
France	15	5 [10] <sup>2</sup>	0 <sup>3</sup>	0 <sup>3</sup>
Georgia	10	0 [50]/5 [10]	0	0
Ghana	15	5 [10]	0/10	8
Greece	25	25 <sup>2</sup>	0/10 <sup>3</sup>	0 <sup>3</sup>
Hungary	15	5 [10] <sup>2</sup>	0 <sup>3</sup>	0 <sup>3</sup>
Iceland	15	5 [25]	0	0
India	10	10	0/10	10
Indonesia	15	10 [25]	0/10	7.5/10/15

Country	Dividends			
	Individuals, companies (%)	Qualifying companies (%) [holding of at least] <sup>1</sup>	Interest (%)	Royalties (%)
Iran	20	15 [25]	0/15	10
Ireland	15	5 [10] <sup>2</sup>	0 <sup>3</sup>	0 <sup>3</sup>
Israel <sup>6</sup>	25	25	0/15	0/5
Italy	15	15 <sup>2</sup>	0/10 <sup>3</sup>	0/5 <sup>3</sup>
Ivory Coast	15	15	0/15	10
Jamaica	15	10 [25]	0/10/12.5	10
Japan <sup>7</sup>	15	15	0/10	10
Kazakhstan	15	5 [25]	0/10	10
Kenya	15	15	0/15	15
Korea (Rep.)	15	5 [25]	0/10	2/10
Kosovo	15	15	0	10
Kuwait	15	5 [10]	0	10
Kyrgyzstan	15	5 [25]	0/5	10
Latvia	15	5 [25] <sup>2</sup>	0/10 <sup>3</sup>	5/10 <sup>3</sup>
Liberia	15	10 [25]	0/10/20	10/20
Liechtenstein	15	0 [10] / 5 [10]	0	0
Lithuania	15	5 [25] <sup>2</sup>	0/10 <sup>3</sup>	5/10 <sup>3</sup>
Luxembourg	15	5 [10] <sup>2</sup>	0 <sup>3</sup>	5 <sup>3</sup>
Macedonia	15	5 [10]	0	5
Malaysia	15	5 [10]	0/10	0/7
Malta	15	5 [10] <sup>2</sup>	0 <sup>3</sup>	0 <sup>3</sup>
Mauritius	15	5 [10]	0	10
Mexico	15	5 [10]	0/10/15	10
Moldova	15	15	0/5	0
Mongolia	10	5 [10]	0/10	10
Montenegro	15	15	0	10
Morocco	15	5 [25]	0/10	10
Namibia	15	10 [10]	0	10
Netherlands	15	5 [10] <sup>2</sup>	0 <sup>3</sup>	0 <sup>3</sup>
New Zealand	15	15	0/10	10
Norway	15	0 [25]	0	0

Country	Dividends			
	Individuals, companies (%)	Qualifying companies (%) [holding of at least] <sup>1</sup>	Interest (%)	Royalties (%)
Pakistan	15	10 [20]	0/10/20	10
Philippines	15	10 [25]/5 [70]	0/10	10
Poland	15	5 [10] <sup>2</sup>	0/5 <sup>3</sup>	5 <sup>3,5</sup>
Portugal	15	15 <sup>2</sup>	0/10/15 <sup>3</sup>	10 <sup>3</sup>
Romania	15	5 [10] <sup>2</sup>	0/3 <sup>3</sup>	3 <sup>3</sup>
Russia	15	5 [10]	0	0
Serbia	15	15	0	10
Singapore	15	5 [10]	0/8	8
Slovak Republic	15	5 [25] <sup>2</sup>	0 <sup>3</sup>	5 <sup>3</sup>
Slovenia	15	5 [25] <sup>2</sup>	0/5 <sup>3</sup>	5 <sup>3</sup>
South Africa <sup>9</sup>	15	7.5 [25]	10	0
Spain	15	5 [10] <sup>2</sup>	0/15 <sup>3</sup>	0 <sup>3</sup>
Sri Lanka	15	15	0/10	10
Sweden	15	0 [10] <sup>2</sup>	0 <sup>3</sup>	0 <sup>3</sup>
Switzerland	5/15/30	0 [10]	0	0
Syria	10	5 [10]	0/10	12
Tajikistan	15	5 [10]	0	5
Taiwan	10/15	10/15	0/10/15	10
Thailand	20	15 [25]	0/10/25	5/15
Trinidad and Tobago	20	10 [25]	0/10/15	0/10
Tunisia	15	10 [25]	0/10	10/15
Turkey	15	5 [25]	0/10	10
Turkmenistan	15	15	0/5	0
Ukraine	10	5 [20]	0/2/5	0/5
United Arab Emirates	10/15	5 [10]	0	10
United Kingdom	10/15	5 [10] <sup>2</sup>	0 <sup>3</sup>	0 <sup>3</sup>
United States of America	15	0 [80] <sup>5</sup> /5 [10]	0	0
Uruguay	15	5 [10]	0/10	10
Uzbekistan	15	5 [25]	0/5	3/5
Venezuela	15	5 [15]	0/5	5
Vietnam	15	5 [70]/10 [25]	0/5/10	7.5/10
Zambia	15	5 [25]	0/10	10
Zimbabwe	20	10 [25]	0/10	7.5

<sup>1</sup> The rates in this column apply if the holding is at least the indicated percentage of the German company's capital or voting power and in general only if a corporation resident in the other country holds the capital or voting rights. Beyond the minimum percentage of the holding the DTT may require further conditions to be met, in order to apply the reduced withholding tax rate (for example minimum amounts of the holding in euro or currency equivalent or minimum holding periods).

<sup>2</sup> Upon request dividend payments to qualifying EU companies are exempt from withholding tax (see chapter 6.2.2.5).

<sup>3</sup> Upon request interest and royalty payments to qualifying EU companies are exempt from withholding tax (see chapter 6.2.6).

<sup>4</sup> Germany and China concluded a new Double Tax Treaty on 28 March 2014. The new treaty will become effective after ratification and will replace the existing treaty.

<sup>5</sup> Complete elimination of taxation at the source on cross border dividend distributions, provided the recipient company holds at least 80% of the voting rights in the distributing company and meets one of the requirements listed in Article 28 Tax Treaty between Germany and the United States.

<sup>6</sup> On 21 August 2014 Germany and Israel concluded a new Double Tax Treaty. The new treaty has not yet entered into force. In order to become effective it requires ratification.

<sup>7</sup> On 17 December 2015 Germany and Japan concluded a new Double Tax Treaty. The new treaty has not yet entered into force. In order to become effective it requires ratification.

<sup>8</sup> On 12 November 2015 Germany and Australia signed a new Double Tax Treaty. The new treaty has not yet entered into force. In order to become effective it requires ratification.

<sup>9</sup> On 9 September 2008 Germany and South Africa signed a new Double Tax Treaty. The new treaty has not yet entered into force. In order to become effective it requires ratification.

### **Amendments to German Double Tax Treaties**

The following new Double Tax Treaties are signed, but not yet in force. In order to become effective ratification is required:

- Double Tax Treaty Costa Rica (signed 13 February 2014)
- Double Tax Treaty Oman (signed 15 August 2012)
- Double Tax Treaty Jersey (signed 07 May 2015)

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## 11.2 KPMG tax and legal services\* in Germany

KPMG offers a wide range of tax and legal\* services. From locations throughout Germany professionals provide individual consultancy in the following service lines:

### Corporate Tax Services

Providing tax advice to businesses is our primary area of focus. We offer our clients a broad range of services, from tax compliance services, the preparation of tax returns and global tax outsourcing services, to support and advice during corporate tax audits, to tax advice during legal\* proceedings. Corporate Tax Services also include developing and implementing tax strategies for your business. We offer support in integrating the tax strategies you have selected into your overall business strategy.

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### Global Mobility Services

The Global Mobility Services Team helps our clients to get it right with regard to taxes, social security, immigration, employment law, and all related global mobility issues arising from international assignments of employees.

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\* Legal Services are rendered by KPMG Rechtsanwaltsgesellschaft mbH

### Global Transfer Pricing Services

The Global Transfer Pricing Services Team develops concepts for the implementation of tax-optimized intra-group transfer pricing systems. When foreign subsidiaries and foreign permanent establishments are formed, the resulting intra-group flow of products and services needs to be properly structured and documented. For this purpose, we conduct margin analyses, make royalty computations, and provide assistance particularly in the creation of transfer pricing documentation systems.

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### Indirect Tax Services

Our team of specialists supports you in the diverse areas of VAT and Customs & Trade. Complicated VAT and customs questions are increasingly common even for companies without a high level of international operations. Our specialists advise you how to minimize VAT and customs risks, optimize national and international flows of goods and services, and identify excise tax savings opportunities.

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## International Tax Services

The International Tax Services team provides the global tax planning required by global companies. From inbound and outbound investment to financing strategies and post-merger integration, our professionals have the technical knowledge and practical experience needed to assist multinational clients at every stage of global growth to achieve tax efficiency in their international operations.

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## Deal Advisory, M&A Tax

The purchase or sale of any business gives rise to complicated tax issues. Our advisors lead you through this process and accompany you during the integration of the target business. In addition to advice on the most tax efficient structure for the transaction, we also provide support when conducting due diligence. To enable us to provide integrated advice for every form of transaction, we work closely with our colleagues from Corporate Finance and Transaction Services.

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### Tax Management Consulting

In an interdisciplinary team including auditors, tax advisors, and IT specialists, we help you to manage and monitor tax as a business issue in the areas of tax accounting, tax compliance, and tax risk management. Our advice focuses on audit and accounting related tax services as well as IT-related tax services, in order to manage and optimize your tax processes and tax risks. Proprietary technology underpins those services.

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### International Private Clients & Family Offices

Maintaining and increasing private wealth is a challenge, especially in light of rising internationalization. KPMG provides private individuals and family offices with comprehensive advice on how to develop and implement a forward-looking and secure tax strategy.

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### Wage Tax Services

Employers must increasingly take on more and more withholding tax functions. They not only have to calculate, file, and pay the correct payroll tax on time, they must also observe extensive record-keeping and certification duties. Employers cannot afford to ignore these statutory obligations. On the contrary, they must ensure that the tasks transferred to them as part of the wage tax withholding procedure are carried out carefully and conscientiously. Should they fail to do so, employers and possibly also the legal representatives will be made liable for any wage tax not paid.

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### Tax Dispute Proceedings

Tax audits, tax disputes, and preliminary proceedings are becoming more prevalent; proceedings will be carried out more efficiently and more rigorously. Tax dispute proceedings will trigger questions whose answers will require comprehensive experience and a high level of expertise. KPMG has proven experts who can successfully resolve tax dispute proceedings for individuals and companies. In the process, our team ensures that the available scope is fully utilized. We always focus on procedural efficiency and adequate solutions.

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### KPMG Law (KPMG Rechtsanwaltsgeellschaft mbH)

As a full-service law firm with more than 220 lawyers, we advise on all areas of business and commercial law. Our clients are businesses, public authorities, and private individuals. We serve them in multidisciplinary teams with our colleagues of KPMG AG Wirtschaftsprüfungsgesellschaft – thereby enabling our clients to receive a one-stop-shop service package covering all legal, business management, and tax aspects they require.

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