

Tax Aspects of Doing Business in Germany

This brochure has been designed for foreign investors to give them an initial introduction to the tax and accounting environment in Germany.

A. Forms of Doing Business in Germany

When foreign companies operate in Germany, they either prefer to start through a representative office, a branch or a subsidiary company.

1. Representative office

Under German law there is no such thing as a representative office. Such an office can be operated either by an external self-employed person (e.g. a commercial representative) or as a part of the foreign company's own business organisation in Germany.

The German tax authorities will decide whether the activity is a permanent establishment within the boundaries set by the German general tax code or the applicable Double Taxation Treaty (DTT), or not. In order to avoid a permanent establishment, one should not have a fixed place of business or plant in Germany that has a certain degree of organisational and effective independence or is for more than merely a temporary purpose.

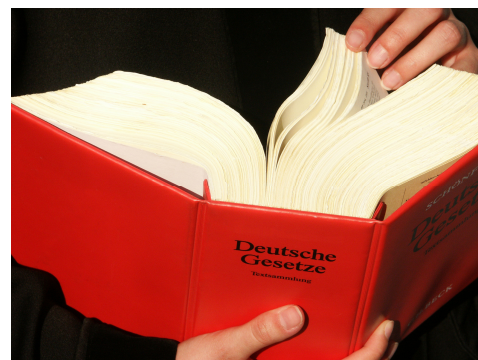
In case the German representation is not considered as a permanent establishment, it will not be liable to taxes on income in Germany. Profits and losses will be included in the books and financial statements of the foreign entity in its home country. Nevertheless, the German activities might be liable to **Value Added Tax, payroll tax, social security contributions** (for employers) or **income tax** (for employees) working in Germany. Input VAT might be refundable under certain conditions and within tight time limits.

2. Branch

A branch can take the form of a business branch (dependent branch office) or an autonomous registered branch office. A business branch can be set up without establishing a new legal entity in Germany and without having to be entered in the commercial register. An autonomous branch office is not an independent legal entity but needs to be entered in the commercial register. It should be noted that a (foreign) corporation has unlimited liability for all actions of its branch.

If the branch is registered in the German commercial register or the operational decisions (e.g. closing contracts with customers) are usually made in Germany, a permanent establishment will almost always be assumed by the fiscal authorities. This means that it is liable to taxes on income earned in Germany. Profits have to be calculated according to German tax law which requires bookkeeping according to German standards.

If there is a Double Taxation Treaty, profits taxed in Germany can either be exempt from taxation in the parent company's home country or are subject to tax there and the tax paid in Germany can be offset against the amount of tax imposed by the home country. If no DTT has been concluded, taxes paid in another country can often be deducted as costs from the taxable income in Germany. It is of particular importance that all intercompany activities are made at arm's length, being accurately documented because this is often subject to critical review in tax field audits.



Should taxable services be rendered by the branch, **VAT** would have to be remitted to the German tax office and refund of input VAT could be reclaimed.

Foreign employees working in Germany are not subject to German payroll tax and social security contributions if the employment with the foreign parent company continues and if the employees are seconded to the German branch under this

employment contract for a very limited period of time, which is often 183 days.

If these requirements are not complied with, the branch will be obligated to withhold **payroll tax and social security contributions** from the gross monthly salary and any other non-cash taxable benefits (e.g. company car, company flat, insurance contributions, stock options, free meals), and to report and remit this tax to the German tax office, starting from the first day of activity in Germany. In this case, the employees of the branch will normally also be treated as being a resident in Germany for **income taxation** purposes as long as they work in Germany.



3. Subsidiary company

For companies, which may like to use the German stock market or for which size is important, an **AG** (public company) might be the best solution. An AG requires a nominal share capital of 50,000 € minimum and is subject to many formal obligations.

The type of corporation favoured most by foreign investors is the **GmbH** (private limited company) because it is much easier to handle than an AG. The minimum nominal share capital is 25,000 €.

In order to **establish a GmbH** various documents from the parent company are needed. A German notary has to notarize the articles of association (normally prepared by a lawyer) and registration is needed in the commercial register. After establishment but before final registration, a German bank account has to be opened in the name of the GmbH and at least 50% of the share capital has to be paid in. The share capital can be used to buy fixed assets after registration of the company. Registration with the local trade office and fiscal authorities of the municipality where the company is located is necessary in a special format.

The establishment of a GmbH up to registration can be done in one or two weeks. If non EU-shareholders

are involved, it will usually take much longer because of the time needed to get all necessary documents from abroad translated, certified or legalized with apostille and to satisfy the client identification procedures when opening the bank account. Fees for the notary, court and legal and tax consulting will normally amount to several thousand Euros.

As an alternative to individualised articles of association one-page **standard minutes** ('Musterprotokoll') which cannot be changed at all can be used if a company does not have more than one managing director and not more than three shareholders.

We recommend not using standard minutes if there is more than one shareholder because they do not cover a number of important topics that can normally be found in individualised articles of association and therefore will probably be very unpredictable when shareholders disagree or sell their shares.

There is also a Mini-GmbH with a minimum share capital of 1 € called "**Unternehmergesellschaft (haftungsbeschränkt)**" or short "UG (haftungsbeschränkt)". We strongly advise not to use this legal form for operating companies as its reputation is so bad that it does not give any credibility.

In order to **get a German tax number** a detailed questionnaire in German needs to be filled in and has to be submitted along with many other documents. For foreign shareholders a rental agreement for office space or a labour contract with the managing director is often required. Also a tax auditor may come and visit the office and ask questions about the business strategy before a tax number is granted. All this aims at avoiding that mere letter box companies will be set up in Germany or foreigners



investing only little funds abuse the GmbH just in order to get VISA's or work permits in Germany.



if such records are only stored abroad.

All tax-relevant data that is computerized has to be in a format electronically accessible for the German tax authorities upon demand. Original receipts have to be stored in Germany. It may cause problems

4. Other forms and publication

There are other types of business entities like **partnerships** which are rarely used by foreign investors.

Annual **publication** (or deposit for small corporations) **of financial data** is mandatory for all corporations and for such partnerships exceeding certain size limits or without a natural person as shareholder with unlimited liability. Penalties for late filing are painful and no extension of the deadline will be granted. You should be aware of the fact that third parties such as competitors or clients can view your financials in the internet.

Choosing the right form of business in Germany and processing registration requires detailed legal and tax knowledge.

B. Taxation of Corporations

Corporations with a registered office and/or its central place of management in Germany are liable to **unlimited taxation in Germany**. The following tax rules will be applicable:

1. Taxes on income

Depending on the location, usually **23%-35% of the income** is paid for Municipal Trade Tax, Corporate Income Tax and Solidarity Surcharge.

2. Dividends

The **25%-withholding-tax** can be exempted or refunded according to EU Parent/Subsidiary Directive or when a DTT allows this.

3. Losses of the German corporation

- a **Loss carried backwards:** limited to one year and 511,500 €; not granted for trade tax.
- b **Loss carried forward:** unlimited in time and amount. The first 1 million € can be fully deducted, with any excess losses being relieved at 60%.
- c **Fiscal unity:** It is possible to add profits and losses of several corporations registered in Germany if all requirements for group relief are met beforehand. The willingness of German tax authorities to accept losses of foreign subsidiaries is still very limited although EU court decisions put them under pressure.

4. VAT

The normal tax rate is 19%, the reduced tax rate is 7%. VAT liability depends on the kind of service rendered. Especially when there are cross-border deliveries and services, VAT problems often arise and getting tax advice before business is conducted is recommendable in order to avoid problems.

5. Transaction and wealth taxes

- Buying land and buildings – 3.5% -6.5% of purchase price, depending on the federal state, with a tendency to increase rates.
- Lease of land and buildings – none
- Stamp duty – none
- Shares – none
- Immaterial goods – none
- Stock-exchange transfer tax – none
- Wealth tax –none

6. Transfer pricing

All companies with intragroup deliveries or services must prove that their transfer prices are at arm's length upon request. If intragroup deliveries exceed 5 million Euros or services exceed 500,000 Euros a detailed documentation according to German transfer pricing rules must be provided upon request within 60 days (30 days in case of an extraordinary business transaction). If the company fails to do so or the documentation is not acceptable, higher profits, imputed dividends or contributions can be assessed by the tax authorities and late filing penalties can be assessed of up to 1 million Euros.

C. Taxation of Individuals

1. Domicile

Individuals with a permanent residence in Germany **or who stay more than 183 days per year in Germany** are liable to unlimited taxation of their worldwide income in Germany. Tax Relief is possible if stated in a DTT. Other foreigners who receive income from German sources are liable to German income tax on their German income only.

2. Income tax rates in 2017

The **top income tax rate** of 45% is reached at a taxable income of 256,304 € for singles and at 512,608 € for joint assessment of married couples. For investment income a flat tax rate of 25% is applicable. **Solidarity surcharge** of 5.5% and, if applicable, 8% or 9% for **church tax**, each of them on the income tax amount, will be added if applicable.

Income tax rates for employees 2017

Annual taxable income €	Average tax rate	
	single %	married %
20,000	12.6	1.8
40,000	21.9	12.6
70,000	29.9	20.1
100,000	33.5	25.1
300,000	39.6	36.3
500,000	41.8	38.6

3. Payroll taxes

Payroll tax will be **deducted at source by the employer**. The tax rate depends on the income. A personal income tax return may have to be filed by the employee for each calendar year. Payroll tax amounts withheld by the employer are credited to the payable income tax of the individual.

4. Social security contributions

Employer and employee pay **about 20% of the gross salary as social security contributions** each, up to the upper limit, which is 52,200 € annually for health insurance and 76,200 € in West Germany

annually for statutory pension and unemployment insurance in 2017. Exemptions are possible for foreigners working in Germany for a limited period of time, managing directors who hold a majority of the share capital and employees whose wages exceed the above mentioned limits.

5. Inheritance/Gift tax

This tax applies if there is an acquisition by reason of death, gifts inter vivos, earmarked gifts or endowments and the testator, donor or foundation is resident in Germany or domestic German property is accessioned by foreigners. There are exemptions/different evaluations for certain kinds of assets and personal exemptions of up to 500,000 €. Tax rates range from 7% to 50%.

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