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Doing Business in Germany

Tax Aspects

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If business activities are planned in Germany, the investor has a variety of alternatives:

a) Branch (Zweigniederlassung)
b) Permanent Establishment (Betriebsstätte)
c) Representation (Repräsentanz)
d) Corporation (examples)
e) Partnership (examples)

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a) Branch (Zweigniederlassung)

Has to be registered in Commercial Register.

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b) Permanent Establishment (Betriebsstätte)

According to the double tax treaty Permanent Establishment means a fixed place of business of an enterprise, or an dependant agent of a company which is not registered in Germany.

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c) Representation (Repräsentanz)

- independent agent of a company which is not residential in Germany
- Representation Office only collecting information, market analysis

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d) Corporation (examples)

- Gesellschaft mit beschränkter Haftung (GmbH)
- Aktiengesellschaft (AG)

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e) Partnership (examples)

- General Partnership
  Offene Handelsgesellschaft (OHG)
- Limited Partnership
  Kommanditgesellschaft (KG)
- Civil Law Association
  Gesellschaft bürgerlichen Rechts (GbR)

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1. Business Taxation

Several requirements of taxation have to be satisfied accordingly

1) Business Taxation
2) Dividend Taxation
3) Indirect Tax

The tax status of taxable entities depends, first of all, on whether or not they are incorporated.

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Branch and **Permanent Establishment** like corporations are subject to limited taxation (beschränkte Steuerpflicht) income generated in Germany

- Corporate Income Tax currently 15%
  (Körperschaftssteuer)
- Solidarity Surcharge currently 5,5%
  (Solidaritätszuschlag)
- Trade Tax
  (Gewerbesteuer)

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Representation (Repräsentanz)

No income tax implication but VAT claim possible for the Representation Office.

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Corporations in Germany are subject to unlimited taxation (income worldwide generated)

- Corporate Income Tax currently 15% (Körperschaftsteuer)
- Solidarity Surcharge currently 5,5% (Solidaritätszuschlag)
- Trade Tax (Gewerbesteuer)

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Trade Tax is levied by the local municipalities with an effective rate varying between approximately 9% to 14,35%.

Trade Tax on income is based on taxable income with various modifications; mainly interests are not tax deductible at 25%.

From the fiscal year 2008 onwards also Trade Tax rates are reduced so that the total burden of Corporate and Trade Tax will not exceed 30%.

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Partnerships are only autonomous tax paying entities regarding Trade Tax. They are not taxable entities for corporation or income tax purposes.

The income determined at the level of the partner-ship is allocated to the individual partners (corporation of individual) in accordance with the applicable profit allocation key.

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If we assume that the partner is

a) a corporation → consequently corporation tax law is applicable

b) an individual → the income tax law (Einkommensteuergesetz) is applicable to the progression zone with increasing marginal tax rates of 15% to 45% [1]

[1] from tax year 2007 as result of the so-called rich tax

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Under certain requirements partnerships are entitled to cap the income to minimize tax in that year (from fiscal year 2008 onwards)

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2. Dividend Taxation

No tax impact at the level of the company which has distributed

Inbound

If the shareholder is a **corporation**

→ the dividend is fully tax exempt according to corporation tax law (KStG) 5% of the capital gains must be treated as non-deductible business expenses

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If the shareholder is an **individual person**

→ only profit distributions or dividends are subject to income tax (half-income-rule) and consequently associated income-related expenses therefore also only 50% deductible (Corresponding Taxation for Hidden Profit Distribution).

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Outbound

If the shareholder is a **corporation**

→ dividend is paid out to a parent/subsidiary company residential in another EU-State; withholding tax rate is 0 %

→ double tax treaty defines circumstances which offer possible tax rates in steps from 0 %, 5 % and 15 % withholding tax

Precondition: Exemption declaration by Federal Revenue Office

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If the shareholder is an **individual person**

→ dividend income and interest income is subject to withholding tax at a rate between 20 % and 35 %

In conjunction with the business taxation reform (Unternehmenssteuerreform) tax withhold (Abgeltungssteuer) of 25 % is levied (from 2009) for shareholders who are individuals.

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The consideration of the withholding tax at the level of the dividend recipient is in accordance to the local court and the double tax treaty of each country.

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3. Indirect Tax (Value Added Tax)

All entrepreneurs (individuals and entities), who are engaged independently in a trade business or profession with the object of generating income, are liable for VAT.

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Tax rates:

- 19% (standard rate)
  supplies of goods or services taking place in Germany

- 7% (reduced rate)
  certain goods and services are subject to the lower rate

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Transfer Pricing

Transaction between related companies are subject to the following documentation duties:

- transfer price documentation and procedural regulation according to General Tax Code (Abgabenordnung)
- all transactions between related companies must be carried out according to the Arm's Length Principle

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Accounting

Every business is required to maintain accounts and to record them in business transaction. Its financial position has to be in accordance with German principles of proper accounting.

In order to fulfil certain requirements for publication and reporting companies may replace their regular annual financial statements with annual financial statements prepared in accordance with IFRS.

The Federal Ministry of Justice has released draft legislation that is intended to modernize German accounting law (Accounting Modernisation Act – Bilanz Modernisierungsgesetz BilMoG).

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The basic purpose of changes is to make German GAAP an actually adequate and simple alternative to International Finance Reporting Standards (IFRS).

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