

International Tax Germany Highlights 2017



Investment basics:

Currency – Euro (EUR)

Foreign exchange control – No restrictions are imposed on the import or export of capital; however, a declaration must be filed with customs for cash transfers of more than EUR 10,000 into or out of the EU.

Accounting principles/financial statements – German commercial GAAP/IFRS. Financial statements must be prepared annually. Taxpayers are required to maintain their books in Germany, although electronic bookkeeping may be transferred abroad if prior approval is obtained from the tax authorities.

Principal business entities – These are the joint stock company (AG), limited liability company (GmbH), general and limited partnership, sole proprietorship and branch of a foreign corporation.

Corporate taxation:

Residence – A corporation is resident if it maintains its registered office (as determined by its articles of incorporation) or central place of management in Germany.

Basis – Residents are taxed on worldwide income; nonresidents are taxed only on Germany-source income. Branches are taxed in the same way as subsidiaries.

Taxable income – Corporation tax is imposed on a company's profits, which consist of business/trading income, passive income and capital gains. Business expenses may be deducted in computing taxable income.

Taxation of dividends – Dividends received by a German resident corporation (from both resident and foreign corporations) generally are 95% tax exempt; however, the exemption is not applicable if the dividends

are treated as tax-deductible expenses for the payer. Minimum shareholding requirements apply.

Capital gains – Capital gains generally are included in taxable income. Capital gains derived from the sale of a domestic or foreign corporate subsidiary generally are 95% tax-exempt.

Losses – Losses may be carried back one year and carried forward indefinitely. Losses may be offset against profits up to EUR 1 million without restriction, but only 60% of income exceeding EUR 1 million may be offset against loss carryforwards. A direct or indirect change in ownership of more than 25%/50% to one purchaser/related party results in a partial/complete forfeiture of all tax loss carryforwards. Loss carryforward forfeiture may be avoided in certain intragroup restructurings. Loss carryforwards continue to be available to the extent built-in gains in the loss company are subject to tax in Germany.

Rate – The corporate tax rate is 15% (15.825%, including the solidarity surcharge). The municipal trade tax typically ranges between 14% and 17%. The effective corporate tax rate (including the solidarity surcharge and trade tax) typically ranges between 30% and 33%.

Surtax – A 5.5% solidarity surcharge is levied on the corporate income tax.

Alternative minimum tax – No

Foreign tax credit – Foreign tax paid may be credited against German tax that relates to the foreign income, or may be deducted as a business expense. Germany typically applies the exemption system.

Participation exemption – See under "Taxation of dividends" and "Capital gains."

Holding company regime – No

Incentives – Incentive programs are available, e.g. investment allowances for certain start-ups and for small and medium-sized businesses. No tax incentives are available for R&D, but attractive nonrepayable cash grants are offered, e.g. for R&D in the energy sector.

Withholding tax:

Dividends – A statutory rate of 25% (26.375%, including the solidarity surcharge) applies, with a possible 40% refund for nonresident corporations, giving rise to an effective rate of 15.825%, unless the rate is reduced under a tax treaty. No tax is levied on dividends qualifying under the EU parent-subsidiary directive.

Interest – Withholding tax generally is not levied on interest, except for interest on publicly traded debt, interest received through a German payment agent (usually a bank), convertible bonds and certain profit participating loans. The statutory rate is 25% (26.375%, including the solidarity surcharge) unless the EU interest and royalties directive applies or the rate is reduced under a tax treaty.

Royalties – The withholding tax on royalties paid to a nonresident corporation or an individual is 15% (15.825%, including the solidarity surcharge), unless the EU interest and royalties directive applies or the rate is reduced under a tax treaty.

Technical service fees – No

Branch remittance tax – No

Other taxes on corporations:

Capital duty – No

Payroll tax – No, but the employer is required to withhold wage tax on a monthly basis from an employee's income and remit it to the tax authorities. Wage tax certificates must be transmitted electronically and be authenticated by the employer.

Real property tax – Tax is levied by the municipality in which real estate is located, at a rate of 0.35% of the tax value of the property, multiplied by a municipal coefficient.

Social security – The employer generally is required to bear 50% of the wage-related social security contributions (health, nursing care, unemployment and pension insurance). Additional charges (e.g. statutory accident insurance, insolvency fund levy, etc.) may apply.

Stamp duty – No

Transfer tax – A real estate transfer tax of 3.5% to 6.5% of the sales price/value of transferred German real estate or 95% or more of the shares in a real estate-

owning company is levied. The rate depends on the state in which the real estate is located. Exceptions may apply for certain intragroup restructurings.

Other – Municipal trade tax is an income tax levied by municipalities at a minimum rate of 7%. All entrepreneurs with commercial activities carried out through a subsidiary or a nonresident's commercial permanent establishment in Germany are liable for trade tax. Corporations are deemed to carry on commercial enterprises (trade or business), regardless of their actual activities. (Individuals, alone or in partnerships, are not liable for trade tax on professional or other independent services unless the activities are deemed to be commercial under the income tax law.) The municipal trade tax rate varies, but averages between 14% and 17% of income. The trade tax is based on taxable income as calculated for corporate income tax purposes, with several income adjustments.

Shipping companies may apply for lump sum tonnage taxation in certain cases.

Anti-avoidance rules:

Transfer pricing – Business dealings between related persons must be in accordance with transactions that would have been agreed upon by independent third parties dealing at arm's length, under which the underlying principle is the normal degree of commercial prudence shown by a sound and conscientious business manager. Taxpayers are required to document all facts and evidence that support their positions. Specific transfer pricing rules apply to cross-border intragroup transfers of functions. An exit tax will be imposed on the "profit potential" that is deemed to be transferred, based on the discounted cash flow value of the subsidiary/branch before and after the restructuring. Germany generally applies the authorized OECD approach.

Country-by-country reporting, in line with the OECD's BEPS action item 13, is required for financial years commencing after 31 December 2015 (after 31 December 2016 in the case of secondary reporting).

Thin capitalization – A taxpayer may immediately deduct (net) interest expense up to 30% of taxable earnings before net interest expense, tax, regular depreciation and amortization (tax EBITDA). An EBITDA carryforward is generated if the taxpayer has net interest expense lower than 30% of the EBITDA for tax purposes, unless an exception to the interest limitation (see below) applies. The difference between 30% of the EBITDA and the net interest expense (excess EBITDA) may be carried forward and used in the following five years when the net

interest expense exceeds 30% of current EBITDA. The limitation does not apply where (i) the annual (net) interest burden is less than EUR 3 million; (ii) the taxpayer is not part of a group of companies; or (iii) the taxpayer can demonstrate that the equity ratio of the German borrower does not fall short by more than two percentage points of the worldwide group's equity ratio. Excess interest may be carried forward indefinitely (although change-in-ownership rules apply). Disallowed interest expense will not trigger withholding tax.

Controlled foreign companies – Passive income of subsidiaries in low- or no-tax jurisdictions will be attributed to German shareholders that hold, directly or indirectly, more than 50% of the subsidiary (lower ownership percentages apply where the low-taxed CFC generates passive investment income). Typical passive income is income from the rental of real estate, income from licensing or income from the lending of capital. A jurisdiction is regarded as a low-tax jurisdiction if the income of the subsidiary is subject to an effective tax rate of less than 25%. Credit and refunds at the shareholder level are taken into account when determining whether the effective tax rate abroad falls below the 25% threshold. Credit for tax paid on attributed income can be granted upon the application of the taxpayer.

Disclosure requirements – A taxpayer generally must disclose all facts relevant for taxation, especially regarding transactions with foreign related parties.

Compliance for corporations:

Tax year – The tax year is 12 months or the period for which accounts are prepared, if shorter. The tax accounting period may not exceed 12 months in total.

Consolidated returns – Although companies may be taxed on a consolidated basis, each company must file a separate tax return (except for VAT). Tax consolidation for corporate income tax and municipal trade tax purposes (*Organschaft*) requires that the parent in the consolidation hold the majority of the voting rights in the subsidiary from the beginning of the subsidiary's fiscal year. The parties must conclude a profit and loss transfer agreement (PLTA), which must be in effect and carried out for at least five years, unless an important reason exists for termination of the agreement (e.g. sale of the subsidiary) before the end of the five-year period. Strict formal requirements for a PLTA apply. Tax consolidation for VAT purposes does not require a PLTA, but the subsidiary in the consolidation must be financially, organizationally and economically integrated in the parent company.

Filing requirements – The tax return generally must be

filed electronically by 31 May of the year following the tax year; extension of the filing deadline to 31 December of the year following the tax year typically is granted if a tax advisor is involved. (For tax assessment periods commencing after 31 December 2017, filing generally will be required by the last day of February of the second year following the tax assessment period, if a tax advisor is involved.) Quarterly advance payments of corporate tax are due in March, June, September and December. Quarterly advance payments of trade tax are due in February, May, August and November.

Penalties – Penalties may be imposed for late filing (up to 10% of the tax due and a maximum of EUR 25,000), as well as for late payment of assessed taxes (1% on the outstanding rounded-down tax amount per month or part thereof). Findings in tax audits generally do not result in penalties. However, taxes assessed as a result of an audit are subject to interest of 0.5% per full month (6% per year). The interest calculation begins 15 months after the calendar year in which the assessment became effective. Penalties also can be imposed if the taxpayer does not comply with the transfer pricing documentation requirements. If the taxpayer fails to submit, or submits inadequate documentation, an additional charge between 5% and 10% of any transfer pricing adjustment (a minimum of EUR 5,000) can be assessed. An additional charge for the late submission of documentation can be assessed of at least EUR 100 per day, up to EUR 1 million.

Rulings – A taxpayer may apply for an advance ruling on the tax consequences of a proposed transaction. Administrative fees may apply.

Personal taxation:

Basis – Resident individuals are taxed on their worldwide income; nonresidents are taxed only on German-source income.

Residence – An individual is resident if he/she is domiciled or has a habitual abode in Germany. A habitual abode is deemed to exist if the individual spends more than six months in Germany. Domicile can be presumed where an individual has permanent accommodation at his/her disposal in Germany; it is not necessary that the individual actually uses the accommodation.

Filing status – Married couples and members of civil partnerships living together may opt for joint or separate assessment.

Taxable income – Taxable income is the sum of income from employment, the exercise of a trade or profession, agriculture and forestry, capital, rent and leasing and other income.

Capital gains – Sales of real estate and rights to private property (not business property) generally are subject to tax if the taxpayer owned the property for less than 10 years. The sale of other private assets generally is taxable if the taxpayer held the assets for less than one year. Normal tax rates apply.

Sixty percent of the capital gain from the sale of shares is taxable at the normal rates if the taxpayer has held a direct or indirect interest of 1% or more in the corporation within the last five years. If the taxpayer has held less than 1%, the entire capital gain from the sale of privately held shares is subject to a flat 25% tax rate (26.375%, including the solidarity surcharge), regardless of how long the shareholding has been held. Taxpayers may opt for taxation at their individual tax rate, if lower

Deductions and allowances – Personal allowances are available for the taxpayer and his/her children. Other deductions, which are subject to restrictions, are available (e.g. social security contributions, insurance, medical expenses, etc.). Expenses may be deducted from the tax base, provided they were necessary to generate the income.

Rates – Rates are progressive up to 45%. A solidarity surcharge of 5.5% (resulting in a top rate of 47.5%) and a church tax of 9% (8% in Bavaria and Baden-Württemberg) are levied on the income tax.

Private investment income, including capital gains, generally is subject to a 25% (26.375%, including the solidarity surcharge) final withholding tax. Taxpayers may opt for taxation at their individual tax rate, if lower.

Other taxes on individuals:

Capital duty – No

Stamp duty – No

Capital acquisitions tax – No

Real property tax – Tax is levied by the municipality in which real estate is located, at a rate of 0.35% of the tax value of the property, multiplied by a municipal coefficient.

Inheritance/estate tax – Inheritance and gift tax rates range from 7% to 50%, with various exemptions available. Business property/assets are valued at fair market value. Under certain conditions, the inheritance of business property can be 85% or 100% tax free.

Net wealth/net worth tax – No

Social security – Employed individuals are required to make a contribution for pension, health, nursing care and

unemployment insurance. The employer generally bears 50% of the total contribution.

Compliance for individuals:

Tax year – Calendar year

Filing and payment – An individual can file a tax return to declare additional expenses and receive a refund. Mandatory tax returns generally are due by 31 May of the following year. The final tax is assessed after filing of the tax return. If an individual receives income other than employment income, quarterly advance payments of income tax are due in March, June, September and December.

Penalties – See under “Corporate taxation.”

Value added tax:

Taxable transactions – VAT is levied on the sale of goods and the provision of services.

Rates – The standard rate is 19%, with a reduced rate of 7% applying to specified transactions. Certain transactions are exempt.

Registration – German entrepreneurs generally must register for VAT purposes. The registration threshold is turnover of EUR 17,500 in the previous calendar year and estimated turnover of EUR 50,000 in the current calendar year. Nonresidents that make taxable supplies of goods or services in Germany also must register.

Filing and payment – The tax year is the calendar year. The entrepreneur must file an electronic quarterly preliminary VAT return by the 10th day of the following month and pay the VAT due. A refund will be paid if the input tax exceeds the VAT. If the tax for the previous calendar year was more than EUR 7,500, monthly preliminary returns must be filed.

Source of tax law: Income Tax Act, Corporate Income Tax Act, Municipal Trade Tax Act, VAT Act, Reorganization Tax Act, Foreign Tax Act, General Tax Code, Real Estate Transfer Tax Act, Real Estate Tax Act and Annual Tax Acts

Tax treaties: Germany has an extensive tax treaty network (over 90 tax treaties).

Tax authorities: Federal Ministry of Finance, Federal Central Tax Office, Ministry of Finance of the German states

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