



Tax Aspects of Doing Business in Germany

By Oliver Biernat, February 2009

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

Whilst under German law there is no such thing as a representation office, one 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 meaning of the German general tax code or the applicable Double Taxation Agreement (DTA), or not. A permanent establishment is a fixed place of business or plant. It must have a certain degree of organisational and effective independence and must have more than merely a temporary purpose.

Should they determine that there is no permanent establishment, the office 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 (VAT), payroll tax, social security contributions (for employers) or income tax (for employees) working in Germany.

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 settled 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 has to be entered in the commercial register. It should be noted that a corporation has unlimited liability for all actions of its branch.

If the branch is registered in the German trade 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 DTA, profits taxed in Germany can 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 DTA has been concluded, taxes paid in another country often can be deducted as costs from the taxable income. It is of particular importance that all intercompany activities are made at arm's length because this is very often a major subject in tax field audits.

Should taxable services be rendered by the branch, **VAT** must be remitted to the German tax office. Only in this case German input tax for contracted services and goods bought can be refunded.

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 is obligated to withhold **payroll tax and**

social security contributions from the gross monthly cash 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 are normally also treated as being resident in Germany for **income taxation** purposes whilst 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 share capital of 50,000 € 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 share capital of a GmbH is 25,000 €.

In order to **establish a GmbH**, today various documents from the parent company are needed. A German notary has to notarize the articles of association (normally prepared by a lawyer) and the registration to the commercial register. After establishment but before final registration a German bank account has to be opened and at least half 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. When foreign

shareholders are involved, it usually takes much longer because of the time needed to get all necessary documents from abroad translated, certified or apostilled 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 to use 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.

For those investors who have a problem with raising the minimum share capital and for whom it is not important to have a good reputation in Germany an "**Unternehmergeinschaft (haftungsbeschränkt)**" or short "UG (haftungsbeschränkt)" which means "entrepreneur-company with limited liability" may be an alternative. The UG is a kind of small GmbH with a minimum share capital of just 1 Euro, which has to be paid in cash. The shareholders are obliged to allocate 25% of their annual profits to retained earnings. As soon as 25,000 € are reached, the company can be turned into a normal GmbH.

The company will be granted a German **tax ID number** after the fiscal authorities have checked documents including the fiscal questionnaire, opening balance sheet according to German GAAP, notarized articles of association in German, rental agreement for the office premises in Germany and detailed information on the foreign shareholder(s). An ID number will sometimes be refused if none of the executive directors is located in Germany because, for tax purposes, operational decisions have to be made at the registered office of the company inside Germany.

All tax relevant data that is computerized has to be in a format electronically accessible for the German tax authorities upon demand. It may cause problems if such records are only stored abroad.

4. Other forms and publication

There are other types of business entities like **partnerships** which are rarely used by foreign investors. **British Private Limited Companies** (Ltd.) with very little share capital that act via a German branch are no longer necessary due to the German UG.

Annual **publication of financial data** is obligatory for all corporations and partnerships exceeding certain size limits or without a natural person as shareholder with unlimited liability.

Choosing the right form of business in Germany and 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

About **30% 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 subject to EU Parent/Subsidiary Directive or when a DTA allows this.

3. Losses of the German corporation

- a **Loss carried backwards:** one year, maximum 511,500 €.
- b **Loss carried forward:** unlimited in time and amount. The first 1 million € can be deducted in full, 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. Cross-border fiscal unity is still almost impossible according to EU legislation.



4. VAT

Normal tax rate is 19%, reduced tax rate 7% (e.g. for food). VAT liability depends on the kind of service rendered. Especially when there are cross-border deliveries and services, VAT problems often arise and tax advice is recommendable in order to avoid problems.

5. Transaction and wealth taxes

- Buying land and buildings – 3,5%
- 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

Detailed Documentation on cross-border intragroup transactions and proof that transfer prices meet the arm's length principle have to be presented to the financial authorities upon request within a 30 (extraordinary items) and 60 day time-limit. Otherwise higher profits, imputed dividends or contributions can be assessed by the tax authorities.

C. Taxation of Individual Persons

1. Domicile

People who are **resident or stay more than 183 days per year in Germany** are liable to be taxed on their worldwide income in Germany, even if this income is also taxed in other countries. Relief is possible if stated in a DTA. Other foreigners who receive income from German sources are liable to German income tax on their German income only.

2. Income tax rates in 2009

The **top income tax rate** is 42% for profit income and 45% for other income like income from employment. For investment income a flat tax rate of 25% is applicable. **Solidarity surcharge** of 5.5% and -if applicable- 8 or 9 % on the income tax amount for **church tax** will be added.

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.

Income tax rates for employees 2009

Annual taxable income €	Average tax rate	
	single %	married %
20.000	14.3	4.0
40.000	23.1	14.3
70.000	30.7	21.3
100.000	34.1	26.2
150.000	36.7	31.4
500.000	41.9	38.8

4. Social security contributions

Employer and employee pay **about 20% of wage income** each, up to the upper limit which is 44,100 € annually for health insurance and 64,800 € (54,600 € in Eastern Germany) annually for statutory pension and unemployment insurance in 2009. Exemptions are possible for foreigners working in Germany for a limited period of time, managing directors which hold a majority of the share capital and employees whose wages exceed the above limits.

Contact

Benefitax GmbH

Steuerberatungsgesellschaft
Wirtschaftsprüfungsgesellschaft

Tax Consulting Company
Public Audit Company

Oliver Biernat, Managing Partner
German Chartered Accountant, Tax Advisor and
Specialist Advisor in International Taxation

Fon: +49 (0)69 - 25 62 27 60
E-mail: info@benefitax.de
Internet: www.benefitax.de



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