

# International Tax

## Germany Highlights

In Plain English



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## 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 applies. 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:

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### Rates

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Corporate Income Tax Rate	15% (15.825% including solidarity surcharge), plus municipal trade tax of 7%-17%
Branch Rate	15% (15.825% including solidarity surcharge), plus municipal trade tax of 7%-17%
Capital Gains Tax Rate	15% (15.825% including solidarity surcharge), plus municipal trade tax of 7%-17%; 95% exempt under certain conditions

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**Residence** – A corporation is resident if it maintains its registered office (as determined by its articles of incorporation) or effective 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.

**Rate** – The corporate tax rate is 15% (15.825%, including the solidarity surcharge). The municipal trade tax typically ranges between 14% and 17%, and the minimum rate is 7%. 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** – There is no alternative minimum tax.

**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. According to the change-in-ownership rules, a direct or indirect change in ownership of more than 50% to one purchaser/related party within a five-year period results in a complete forfeiture of all tax losses (both current-year losses and loss carryforwards). Loss forfeiture may be avoided in certain intragroup restructurings. In addition, losses continue to be available to the extent built-in gains in the loss company are subject to tax in Germany, or in certain cases where the historic business of the loss company is continued on an unchanged basis.

**Foreign tax relief** – 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** – There is no holding company regime.

**Incentives** – Incentive programs are available, such as investment allowances for certain start-ups and for small and medium-sized businesses. As from 1 January 2020, an R&D tax incentive of up to EUR 500,000 per year, per entity/group has been introduced. In addition, attractive nonrepayable cash grants are offered, e.g. for R&D in the energy sector.

### **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 purposes). Tax consolidation for corporate income tax and municipal trade tax purposes (“Organschaft”) requires the parent in the consolidation to 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 consecutive years, unless an important reason exists for termination of the agreement (e.g. sale of the subsidiary to a third party) 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 with the parent company.

**Filing and payment** – The tax return generally must be filed electronically by 31 July of the year following the tax year; extension of the filing deadline to the last day of February of the second year following the tax year typically is granted 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.

There are also country-by-country (CbC) reporting filing requirements and filing requirements in connection with mandatory disclosure rules (DAC 6); see “Transfer pricing” and “Disclosure requirements” under “Anti-avoidance rules.”

**Penalties** – Penalties may be imposed for late filing (up to 0.25% of the tax due, at a minimum of EUR 25 for each commenced month of delay 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 documentation, 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. For failure to comply with CbC reporting requirements, penalties up to EUR 10,000 may be imposed.

For failure to comply with mandatory disclosure rules under DAC 6, penalties up to EUR 25,000 may be imposed.

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

## Individual taxation:

Rates (not considering church tax that may apply)		
Individual Income Tax Rate	Taxable Income	Rate
	EUR 9,408 – EUR 14,532	Progressive tax rates from 14%- 24% (plus solidarity surcharge)
	EUR 14,533 – EUR 57,051	Progressive tax rates over 24% and below 42% (plus solidarity surcharge)
	EUR 57,052 – EUR 270,500	42% (44.31% including solidarity surcharge)
	Over EUR 270,500	45% (47.48% including solidarity surcharge)
Capital Gains Tax Rate	Varies	

**Residence** – Individuals are resident if they are domiciled or have 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 individuals have permanent accommodation at their disposal in Germany; it is not necessary that the individual actually uses the accommodation.

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

**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.

**Rates** – Rates are progressive up to 45%. A solidarity surcharge of 5.5% (resulting in a top rate of about 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. The solidarity surcharge will be partially abolished/decreased for certain individual taxpayers as from 2021.

**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 domestic or foreign 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 taxpayers and their 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.

**Foreign tax relief** – Foreign tax paid may be credited against German tax that relates to the foreign income. Germany typically applies the exemption system (the exemption with progression method, i.e., tax-exempt income is taken into account to determine the applicable tax rate).

### **Compliance for individuals:**

**Tax year** – The tax year is the calendar year.

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

**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 July of the following year; an extension until the end of February of the second year following the tax year typically is granted if a tax advisor is involved. 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.” **Rulings** – A taxpayer may apply for an advance ruling on the tax consequences of a proposed transaction.

Administrative fees may apply.

## Withholding tax:

Rates				
Type Of Payment	Residents		Nonresidents	
	Company	Individual	Company	Individual
Dividends	25% (26.375% including surcharge)	25% (26.375% including surcharge)	25% (26.375% including surcharge), with possible 40% refund	25% (26.375% including surcharge)
Interest	0%/25% (26.375% including surcharge)	0%/25% (26.375% including surcharge)	0%/25% (26.375% including surcharge)	0%/25% (26.375% including surcharge)
Royalties	0%	0%	15% (15.825% including surcharge)	15% (15.825% including surcharge)
Fees for Technical Services	0%	0%	0%	0%

**Dividends** – A statutory rate of 25% (26.375%, including the solidarity surcharge) applies to dividends paid to residents; the tax typically is creditable against the corporate income tax or refundable for resident companies, and partially (40%) creditable against the individual income tax or refundable for resident individuals.

A statutory rate of 25% (26.375%, including the solidarity surcharge) applies to dividends paid to nonresidents, 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 (PSD). The distributing company may apply the exemption under the directive or a reduced withholding tax rate under a treaty only if the recipient obtains a clearance certificate from the tax authorities in advance and presents the certificate before the payment is made; otherwise, a refund may be possible.

**Interest** – Withholding tax generally is not levied on interest paid to residents or nonresidents, 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). Where interest is paid to nonresidents, the rate may be reduced under a tax treaty or an exemption may be available if the EU interest and royalties directive applies.

**Royalties** – Withholding tax is not levied on royalties paid to residents. 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. The payer may apply the exemption under the directive or a reduced withholding tax rate under a treaty only if the recipient obtains a clearance certificate from the tax authorities in advance and presents the certificate before the payment is made; otherwise, a refund may be possible.

**Fees for technical services** – There is no withholding tax on fees for technical services.

**Branch remittance tax** – There is no branch remittance tax.

### **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.

CbC reporting, in line with the OECD's BEPS action 13, is required.

**Interest deduction limitations** – 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 expense 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.

**Hybrids** – General anti-hybrid rules must be enacted into German domestic tax law with effect as from 2020, based on the EU anti-tax avoidance directive (ATAD 2). Anti-hybrid rules already exist in connection with dividends received (linking rules) and certain “double-dip” structures involving German Organschaft entities (dual consolidated loss rules) and German partnerships.

**Economic substance requirements** – Relief from withholding tax under a treaty or the EU PSD is not available to a foreign company if, and to the extent that:

- The shareholders of the foreign company would not be entitled to the relief had they received the dividend directly (“personal entitlement test”);
- The earnings of the foreign company do not arise from its own business activities in the relevant financial year (“active earnings test”); and
- Either:
  - \* With reference to these earnings, there are no economic or other bona fide reasons for interposing the foreign company (“business purpose test”); or
  - \* The foreign company does not participate in general commerce through a business establishment that is adequately equipped (“substance test”).

The burden of proof for meeting the business purpose test and the substance test lies with the foreign company. The rule does not apply to foreign companies that are listed on a stock exchange and whose shares are regularly traded, or to those that qualify as investment funds.

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

Mandatory disclosure rules for certain types of restructurings were enacted at the end of 2019, based on the EU administrative cooperation directive (DAC 6).

**Exit tax** – The tax law allows the taxation of unrealized capital gains when Germany’s right to tax the gains on the sale or use of assets is restricted or excluded as a result of a transaction (e.g. if a taxpayer transfers its tax residence to a foreign country or if an asset is transferred out of Germany). The exit tax is imposed on the “profit potential” that is deemed to be transferred out of Germany, usually measured by performing a hypothetical arm’s length analysis. Valuation can be based on the capitalized earnings approach or the discounted cash flow method; comprehensive valuation of the respective “business function” instead of an asset-by-asset valuation may be required.

**General anti-avoidance rule** – Germany has a long-standing general anti-avoidance rule (GAAR), under which taxpayers are not allowed to circumvent the tax law by abusing

legal tax planning opportunities. Abuse is presumed when the taxpayer chooses an inappropriate legal structure that, in comparison with an appropriate structure, leads to a tax advantage not intended by the law. The presumption may be rebutted by demonstrating that the particular structure has been chosen for nontax reasons, provided such reasons are relevant considering all the facts and circumstances.

**Other** – The deductibility of royalties and similar payments made to foreign related parties is restricted if such payments are subject to a non-OECD compliant preferential tax regime (i.e. an intellectual property regime not based on the “nexus approach” as described in action 5 of the OECD BEPS project) and taxed at an effective tax rate of less than 25%.

### Value added tax:

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Rates	
Standard Rate	19%
Reduced Rate	0%/7%

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**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. However, if turnover did not exceed EUR 17,500 in the previous calendar year and is estimated not to exceed EUR 50,000 in the current calendar year, German entrepreneurs can opt for the special scheme for small businesses, so that no VAT is imposed by the German tax authorities. 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.

### Other taxes on corporations and individuals:

Unless otherwise stated, the taxes in this section apply both to companies and individuals and are imposed at the federal level.

**Social security contributions** – Employed individuals are required to make a contribution for pension, health, nursing care, and unemployment insurance. The employer generally is required to bear 50% of the total contribution. Additional charges (e.g. statutory accident insurance, insolvency fund levy, etc.) may apply.

**Payroll tax** – There is no payroll tax, 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.

**Capital duty** – There is no capital duty.

**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.

**Transfer tax** – A real estate transfer tax (RETT) of 3.5% to 6.5% of the sales price/value of transferred German real estate applies. RETT also applies if 95% or more of the shares in a real estate-owning corporation are directly or indirectly transferred or combined for the first time at the level of a new shareholder, or if 95% or more of the interests in a real estate-owning partnership are directly or indirectly transferred to new partners within a five-year period. The rate depends on the state in which the real estate is located. Exceptions may apply for certain intragroup restructurings.

**Stamp duty** – There is no stamp duty.

**Net wealth/worth tax** – There is no net wealth/net worth tax.

**Inheritance/estate tax** – Inheritance and gift tax rates for individuals 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.

**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.

**Tax treaties:** Germany has an extensive tax treaty network (over 95 tax treaties). Germany signed the OECD multilateral instrument (MLI) on 7 July 2017.

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

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