



International tax

Germany Highlights 2012

Investment basics:

Currency – Euro (EUR)

Foreign exchange control – No restrictions are imposed on the import or export of capital; however, it is necessary to file a declaration with customs for transfers of more than EUR 12,500.

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 German-source income. Branches are taxed the same 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) are effectively 95% tax exempt.

Capital gains – Capital gains derived from the sale of a domestic or foreign corporate subsidiary are effectively 95% tax exempt.

Losses – Losses may be carried back 1 year and carried forward indefinitely. However, minimum taxation applies: 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 1 shareholder results in a partial/complete forfeiture of all tax loss carryforwards. Loss carryforwards will not be forfeited if a single person or entity owns directly or indirectly 100% of the shares in the transferring and the receiving company. 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 rate is 15%. The municipal trade tax typically ranges between 14% and 17%. The effective corporate rate (including the solidarity surcharge and trade tax) typically ranges between 30% and 33%.

Surtax – A 5.5% solidarity surcharge is levied on the income tax or 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. Typically, Germany applies the exemption system.

Participation exemption – See under "Taxation of dividends."

Holding company regime – No

Incentives – Various incentive programs are available, e.g. for the purchase or production of movable assets in Eastern Germany and for founders of new business.

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. Strict anti-treaty shopping rules apply.

Interest – Generally no withholding tax is levied on interest, except for interest on deposits with German banks/financial

institutions (25%) and certain hybrid instruments.

Royalties – The withholding tax on royalties paid to nonresident corporations or individuals 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 – No

Other taxes on corporations:

Capital duty – No

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

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

Social security – Employers are required to bear 50% of the wage-related social security contributions (health, nursing care, unemployment and pension insurance).

Stamp duty – No

Transfer tax – A real estate transfer tax of 3.5% - 5% of the sales price/value of transferred real estate is levied. The rate depends on the federal state where the real estate is located.

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 always deemed to carry on commercial enterprises (trade or business), regardless of actual activities. Individuals, alone or in partnerships, are not liable for trade tax on professional or other independent services unless activities are deemed to be commercial under the income

tax law. The municipal trade tax rate varies from community to community, but averages between 14% and 17% of income. The trade tax is based on taxable income as calculated for corporate income tax purposes, but several income adjustments apply.

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, whereby 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 before and after the restructuring.

Thin capitalization – A taxpayer may only immediately deduct (net) interest expense up to 30% of annual pre-interest, pre-loss-carryforward profits for tax purposes, increased by the tax depreciation incurred (EBITDA). An EBITDA carryforward is generated if the taxpayer has net interest expense lower than 30% of the EBITDA for tax purposes. The difference between 30% of the EBITDA and the net interest expense (the excess EBITDA) may be carried forward and used in the following 5 years when the net interest expenses exceeds 30% of current EBITDA. The limitation does not apply where the annual (net) interest burden is less than EUR 3 million, where the taxpayer is not part of a group of companies or where it can demonstrate that the equity ratio of the German borrower is at least equal to the worldwide group's equity ratio (there is a tolerance of 2 percentage points). Excess interest may be carried forward (a change-in-ownership rule applies). 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 a German shareholder that holds directly or indirectly more than 50% of the subsidiary (lower ownership percentages apply where the low-taxed CFC generates passive investment income). Passive income includes 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 on application of the taxpayer.

Other – No

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

Administration and compliance:

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. Tax consolidation for corporate income tax and municipal trade tax purposes (Organschaft) requires that the parent in the consolidation holds 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, which must be in force and carried out for at least 5 years, unless an important reason exists for termination of the agreement (e.g. sale of the subsidiary) before the end of the 5-year period. Tax consolidation for VAT purposes does not require a profit and loss transfer agreement, but the subsidiary in the consolidation must be financially, organizationally and economically integrated in the parent company.

Filing requirements – The tax return must be filed by 31 May of the year following the tax year, and quarterly advance payments of corporate tax are due in March, June, September and December.

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 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. Further, 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 – Taxpayers may request a ruling on the tax consequences of a proposed transaction.

Personal taxation:

Basis – German residents are taxed on their worldwide income. Nonresidents are taxed 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 6 months in Germany. Domicile can be presumed where an individual has a permanent accommodation at his/her disposal in Germany; it is not necessary that the individual actually uses the accommodation.

Filing status – A married couple 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 or other income. Private investment income, including capital gains, is subject to a 25% (26.375%, including the solidarity surcharge) final withholding tax.

Capital gains – Sales of real estate and rights to private property (not business property) are subject to tax if the taxpayer owned the property for less than 10 years. The sale of other assets is taxable if the taxpayer held the assets for less than 1 year. Normal tax rates apply.

Sixty percent of the capital gains from the sale of shares are taxable at normal rates if the taxpayer has held a direct or indirect interest of 1% or more in a corporation within the last 5 years. The entire capital gain from the sale of shares is subject to a flat 25% tax rate (26.375%, including the solidarity surcharge), regardless of how long the shareholding has been held if the taxpayer has held less than 1%.

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% (Bavaria and Baden-Württemberg 8%) are levied on the income tax.

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. The rate is 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 and unemployment insurance. The employer bears 50% of the total contribution.

Administration and compliance:

Tax year – Calendar year

Filing and payment – An individual can file a tax return to declare additional expenses and receive a refund. Tax returns are generally due by the end of May of the following year. The final tax is assessed after filing of the tax return. If an employee receives other income or if an individual receives income other than employment income, quarterly installments are assessed and must be paid.

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 must generally 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 tax 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 and Annual Tax Acts.

Tax treaties: Germany has 91 income tax treaties.

Tax authorities: Federal Ministry of Finance, Ministry of Finance of the German Lands; local superior tax authorities and local tax authorities.

International organizations: EU, EFTA, OECD, WTO

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