



# Tax And Accounting Profile Germany

## Executive summary of German tax and accounting rules

**This brochure** focuses on German tax, accounting and corporate/commercial law. Foreign resident companies and individuals will find here the most relevant information for investments or doing business in Germany.

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**Götter, Schleweit & Partner** is a partnership of tax advisors located in Heidenheim (South Germany). We serve German and international companies and individuals in all matters of inbound and outbound businesses. We assist foreign companies in setting up a company or branch in Germany or in purchasing a German company. Audits of financial statements are performed by our audit partner.

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This brochure was updated in January 2007 by Götter, Schleweit & Partner. All information contained herein is subject to amendments by legislation. Its interpretation by jurisprudence and the fiscal authorities may change. In summarizing the complex laws, some of these complexities had to be omitted. Please remember that, in planning your affairs, this brochure cannot substitute professional advice.



## Common Legal Forms for Business in Germany

### Stock Corporation – Aktiengesellschaft (AG)

Liability	The shareholder's liability is limited to his capital contribution.
Statutory capital	At least € 50,000.00.
Corporate bodies	Stockholders' meeting, board of directors, supervisory board.
Audit of financial statements	Mandatory, if 2 of the following conditions are met in 2 subsequent years: Number of employees > 50 Turnover > € 8,030,000.00 Balance sheet total > € 4,015,000.00
Income taxation	<p>Earnings before income taxes after corrections</p> <ul style="list-style-type: none"> <li>- Trade tax on income of aprox. 12% - 21%</li> <li>+/- Corrections</li> <li>= Tax basis for corporation income tax</li> <li>- <u>Corporate income taxes 26.375%</u></li> <li>= Earnings after income taxes</li> </ul> <p>Dividend withholding tax 20%, reduced to 0% - 15% by double tax treaties, 0% within EC.</p>

### Limited Liability Company – Gesellschaft mit beschränkter Haftung (GmbH)

Liability	The shareholder's liability is limited to his capital contribution.
Statutory capital	At least € 25,000.00.
Corporate bodies	Shareholders' meeting, board of directors, supervisory board (discretionary).
Audit of financial statements	Same as for Stock Corporation
Income taxation	Same as for Stock Corporation



### General Partnership – Offene Handelsgesellschaft (OHG)

Liability	All partners are personally and jointly liable for the partnership's liabilities without limitation.
Statutory capital	Not required.
Corporate bodies	The partners represent the company. A General Partnership is no corporate entity.
Audit of financial statements	Not required <sup>1</sup> .
Income taxation	Earnings before income taxes - Trade tax on income of 12% - 21% = Tax basis for the partners' income tax. Each partner's portion is subject to his personal income tax or corporate income tax.  Credit of trade tax on income only against the partners' personal income tax (only for individuals). No dividend withholding tax.

### Limited Partnership – Kommanditgesellschaft (KG)

Liability	The general partners are unlimitedly, personally and jointly liable for the partnership's liabilities. The Limited Partners are only liable with their capital contributions to the company.
Statutory capital	Not required.
Statutory bodies	Only the General Partners are entitled to represent the company. A Limited Partnership is no corporate entity.
Audit of financial statements	Not required <sup>2</sup> .
Income taxation	Earnings before income taxes - Trade tax on income of 12% - 21% = Tax basis for the partners' income tax. Each partner's portion is subject to his personal income tax or corporation income tax.  Credit of trade tax on income only against the partners' personal income tax (only for individuals). No dividend withholding tax.

<sup>1</sup> Except under certain conditions.

<sup>2</sup> Except under certain conditions.



**Limited Partnership with a Corporation as the General Partner – GmbH & Co. KG**

The General Partner is typically a GmbH without own business activities and with low statutory capital. The Limited Partners are holding substantial interests in the partnership and combine limited liability with tax transparency (flow-through).

Liability	The General Partner is unlimitedly and personally liable for the partnership's liabilities. The Limited Partners are only liable with their capital contributions to the company.
Statutory capital	Not required for the KG, € 25,000.00 for the GmbH.
Statutory bodies	Only a General Partner is entitled to represent the company. A GmbH & Co. KG is a partnership and no corporate entity.
Audit of financial statements	Required for medium sized and large companies <sup>3</sup> .
Income taxation	<ul style="list-style-type: none"> <li>- Earnings before income taxes</li> <li>- <u>Trade tax on income 12% - 21%</u></li> <li>= Tax basis for the partners' income tax. Each partner's portion is subject to his personal income tax or corporation income tax.</li> </ul> <p>Credit of trade tax on income only against the partners' personal income tax (only for individuals). No dividend withholding tax.</p>

**Branch Office – Zweigniederlassung/Betriebstaette**

Liability	Unlimited.
Statutory capital	Not required (assigned equity is required in some cases).
Statutory bodies	Not required (no separate corporate entity); only a representative is required.
Audit of financial statements	Not required <sup>5</sup> .
Income taxes	<ul style="list-style-type: none"> <li>Earnings before income taxes</li> <li>- <u>Trade tax on income 12% - 21%</u></li> <li>= Tax basis for personal income tax or corporation income tax. Hereof corporation tax or personal income tax.</li> </ul> <p>No dividend withholding tax, no branch profits tax.</p>

<sup>3</sup> Same as for Stock Corporation.



## Important Tax Rates - Companies

### For Corporations and Branches of Foreign Resident Corporations

Trade tax on income	12% - 21% <sup>4</sup> .
Corporation income tax	25%.
Withholding tax on dividends (domestic rate)	20% <sup>5</sup> .
Withholding tax on interest (domestic rate)	0% - 35% <sup>6</sup> .
Withholding tax on royalties (domestic rate)	20%.
Solidarity surcharge	5.5% of corporation income tax and withholding taxes <sup>7</sup> .
Construction withholding tax	15% <sup>8</sup> .
Payroll tax (to be withheld by the employer)	➔ Chapter "Important Tax Rates - Individuals".
Social security taxes - employer portion	➔ Chapter "Important Tax Rates - Individuals".
Value-added tax (German VAT law is harmonized tax law of the European Community. However, the tax rates vary from the other member states. )	19% since Jan 01, 2007 (standard rate). 7% (reduced rate). 0% (various exemptions, e.g. export of goods and services).
Real estate transfer tax	3.5%.
Real estate tax (land tax, property tax)	0.8% - 2.1% <sup>9</sup> .
Estate and gift tax	7% - 50% <sup>10</sup> .
Net assets tax	not imposed.
Capital transfer tax <sup>11</sup>	not imposed.

<sup>4</sup> Rates are varying locally.

<sup>5</sup> Not applicable for branches (no branch profits tax).

<sup>6</sup> Only for certain kinds of interest income.

<sup>7</sup> The solidarity surcharge on withholding taxes is normally reduced to nil under double tax treaties.

<sup>8</sup> Exemptions possible.

<sup>9</sup> Varies locally; tax base is the assessed value for tax purposes which is substantially lower than the market value.

<sup>10</sup> Practically of minor importance for corporations.

<sup>11</sup> On the purchase or sale of interest in a company.



## Important Tax Rates – Individuals (1)

Trade tax on income <sup>12</sup>	12% - 21% (rates varying locally) with a lump-sum tax credit against individual income tax.
Individual income tax <sup>13</sup> basic rates:	0% - 42% (+ 3% on income > 250,000 / 500.000 Euros) minimum rate of 25% for non-resident individuals (exception: salaries), but certain relief for EC residents <sup>14</sup> .
splitting tariff:	Reduced rates for married couples under certain conditions.
reduced rates:	On certain types of income, e.g. “half rate” on capital gains from the sale of a business at an age of at least 55 years.
Payroll tax	Withheld by employer. Rates are based on individual income tax rates. Splitting tariff for married couples. Credited against individual income tax.
Solidarity surcharge	5.5% of individual income tax, payroll tax, withholding taxes.
Church tax - for members of certain churches	8% or 9% of individual income tax and payroll tax.
Withholding tax for non-resident supervisory board members	30% <sup>15</sup>
Withholding tax for self-employed artists, professional athletes, authors and journalists	20% <sup>16</sup>
Withholding tax on interest income from banks in Germany and from bonds which are publicly registered in Germany	30% <sup>17</sup> 35% for over-the-counter transactions <sup>18</sup>
Withholding tax on royalties	20% <sup>19</sup>
Construction withholding tax	15% <sup>20</sup>

<sup>12</sup> Only on business profits

<sup>13</sup> Tax credit of trade tax on income is not reflected in the tax rates

<sup>14</sup> The minimum tax possibly violates EC law and is void; a court case is pending.

<sup>15</sup> Domestic rate.

<sup>16</sup> Domestic rate.

<sup>17</sup> Domestic rate.

<sup>18</sup> Domestic rate.

<sup>19</sup> Domestic rate.

<sup>20</sup> Domestic rate. Zero rate possible.



## Important Tax Rates – Individuals (2)

Social security taxes <sup>21</sup> (as of 2007)	
▪ employer portion	50%
▪ employee portion	50% + additional percentages
<ol style="list-style-type: none"> <li>1. Pension Insurance - 19.9% of compensation up to €63,000 (former Western German states) and €54,600 (former Eastern German states) per year. Employer and employee each pay 9.95%.</li> <li>2. Unemployment Insurance - 4.2% of compensation up to €63,000 (former Western German states) and €54,600 (former Eastern German states) per year. Employer and employee each pay 2.1%.</li> <li>3. Health Insurance – 14% (approx. average rate 2007) of compensation up to €42,750 per year. Employer pays 7%, employee pays 7% + 0.9% = 7.9% (on average).</li> <li>4. Disability Insurance (nursing care) - 1.7% of salary up to €42,750 per year. Employer pays 0.85%, employee pays 0.85% + 0.25% = 1.1%.</li> </ol>	
Value-added tax	19% standard rate 7% reduced rate 0%
Real estate transfer tax	3.5%
Real estate tax (property tax)	0.8% - 2.1% <sup>22</sup>
Estate and gift tax	7% - 50% <sup>23</sup>

<sup>21</sup> Imposed on income from employment. Figures as of 2007.

<sup>22</sup> Varies locally; tax base is the assessed value for tax purposes which is substantially lower than the market value.

<sup>23</sup> Dependent on degree of relationship and value of property transferred; generous allowances not considered.



## Corporation Income Tax (1)

Taxable persons	Corporate entities with place of incorporation or place of management in Germany and German branches of foreign corporate entities.
Tax residence in Germany	Place of incorporation or place of management.
Corporation income tax rate Solidarity surcharge	25% - not including trade tax on income. 5.5% of corporation income tax
Taxable income if resident in Germany	Worldwide income.
Taxable income if resident abroad	Income from German source.
Taxable income of branches	Income derived by the branch (direct method is generally preferred).
Important types of exempt income	Income exempt under double taxation treaties, dividends, capital gains from the disposal of shares in corporate entities, subsidies pursuant to the Investitionszulagegesetz, shareholders' capital contributions.
Important deductions	Business expenses, loss carry over <sup>24</sup> , trade tax on income, depreciation, provisions <sup>25</sup> and reserves on certain capital gains, write-down to lower going concern value <sup>26</sup> .
Disallowed business expenses	Business expenses which are directly related to tax-exempt income, certain taxes like corporation tax and solidarity surcharge, interest exceeding the safe haven under thin capitalization rules, certain donations <sup>27</sup> , entertainment expenses exceeding 70% of reasonable costs, gifts to persons who are not employees of the taxpayer, exceeding € 35 per person and per year, penalties with punitive character, 50% of the remuneration to supervisory board members, dividends, including constructive dividends.
Capitalization of expenses	Expenses connected with the purchase, the production or the change of substance of an asset must be capitalized and depreciated; maintenance and replacement costs are normally deductible.

<sup>24</sup> Carry back of tax losses: 1 year up to an amount of € 511,500.00. Carry forward of losses: up to € 1 million without limitation, exceeding amount deductible at 60%. Rest of losses to be carried forward to next years under the same rules. Restriction possible if > 50% of interest in the corporation are purchased and certain other conditions are met.

<sup>25</sup> Some types of provisions are not deductible.

<sup>26</sup> A write-up is required if the going concern value increases again.

<sup>27</sup> Up to certain limits, donations to acknowledged entities for specific purposes are tax deductible.



## Corporation Income Tax (2)

Thin capitalization rules	
Apply to:	<p>Three conditions must be cumulatively met:                  Loans from shareholders (participation &gt; 25% or strong influence on the corporation as specifically defined) or other persons related to such a shareholder to a corporate entity which is tax resident in Germany. It also applies to loans from banks if the bank received guarantees from the shareholder or a related person for such a loan.</p> <p>+                  The total of the consideration for loans from such shareholders and such other persons exceeds € 250,000.00 in the business year.</p> <p>+                  The loan is no short-term loan.<sup>28</sup></p>
Safe haven:	<p>If the consideration for the loan is exclusively determined as a fraction of the principal (fixed interest loans) → safe haven = equity 1 : loan 1.5.                  If the consideration is not exclusively determined as a fraction of the principal (variable components, hybrid financing) → no safe haven available.</p>
Consequences:	As far as the loan exceeds the safe haven, the interest is not tax-deductible for corporate income tax and is qualified as a constructive dividend.
Arm's length test:	If the consideration for the loan is exclusively determined as a fraction of the principal and the loan exceeds the safe haven, the company may demonstrate that it would have received the loan from an unrelated party under the same circumstances at identical conditions. Then the full tax deduction of the interest expenses is granted.
Constructive dividends	
Definition:	Reduction of the corporate entity's equity, caused by the shareholding relationship and affecting its taxable income.
Examples:	<p>German company purchases goods or services from parent company at a price which is higher than a price at arm's length.</p> <p>German company sells goods to a sister company at a price which is below a price at arm's length (being considered as a constructive dividend to its shareholder, not to the sister company).</p>
Consequences:	<p>The taxable income has to be increased.</p> <p>The correction of the taxable income is treated as a dividend, which may trigger dividend withholding tax.</p>
Consolidated tax group	Possible within the German jurisdiction under certain conditions.

<sup>28</sup> Usually up to 6 months.



## Trade Tax on Income

Taxable persons	Corporate entities, partnerships and sole proprietorships.
Taxable income	Income from trade or business as defined in the German tax laws, if derived by a German permanent establishment.
Tax basis	Trade tax income = Income from trade or business, modified according to the provisions of the Trade Tax Act.
Typical additions to the taxable income - not completely listed  (generally the addition premises that the amount has reduced the income from trade or business before)	50% of interest expenses or other remuneration for “long-term” loans (normally > 1 year), the profit share of a silent partner unless the silent partner is subject to trade tax with his profit share, tax-exempt dividends from German resident corporate entities where shareholding is < 10%, tax-exempt dividends from corporate entities resident abroad with passive income where shareholding is < 10%, 50% of rental and leasing expenses for fixed assets - except real estate - , unless the payments are trade tax income for the recipient, shares in losses of a partnership with trade or business income.
Important deductions from the taxable income - not completely listed  (generally the deduction premises that the amount has increased the income from trade and business)	Loss carry forward at 100% for losses up to € 1 million, 60% of exceeding amount is deductible, the rest to be carried forward to following tax periods 1.2% of the tax value of real estate belonging to the business property, profit shares of a partnership with trade and business income, dividends from a German resident corporate entity where shareholding is at least 10%, income derived from a foreign permanent establishment, received rental and leasing payments for fixed assets - except real estate - , to the extent the payments have been added to the trade tax income of the payer, dividends from corporate entities resident abroad (a) with active income where shareholding is at least 10% or (b) in certain cases where double tax treaties apply and the shareholding is at least 10%, thin capitalization adjustments.
Tax rates	The tax rates vary locally, they are determined by the municipalities by fixing a multiplier. The trade tax is deductible from its own calculation basis. Examples: Multiplier 300% ==> tax rate 13.04% Multiplier 400% ==> tax rate 16.67% Multiplier 500% ==> tax rate 20.00%
Credit against individual income tax <sup>29</sup>	Trade tax income x 5% x 1.8 = individual income tax credit.

<sup>29</sup> The tax credit is normally not commensurate to the trade tax; no such tax credit against corporate income tax.



## International Holding Companies Based in Germany

Dividends	95% of the dividends are tax-exempt income.
Gains from disposal of companies	Tax-exempt income.
Income from foreign branches <sup>30</sup>	Tax-exempt income <sup>31</sup> .
Dividend withholding tax	Statutory rate 20%, treaty rates mostly 5%/15%, for dividends to EC member states 0% <sup>32</sup> .
Losses from disposal of corporate entities.	Not deductible.
Losses from foreign branches	Not deductible - as far as income from such branches is exempt.
Cost of financing the acquisition of interest in subsidiaries	Deductible.
Thin capitalization rules	Debt : equity = 1 : 1.5 <sup>33</sup> .
Consolidated group taxation	Yes, generally.
Controlled Foreign Corporation rules	Yes <sup>34</sup> .
Nominal aggregate tax rates of corporation income tax plus trade tax on income, including solidarity surcharge	36% - 42% <sup>35</sup> .
Network of double taxation treaties	High number of income tax treaties + several other treaties <sup>36</sup> .
Elimination of double taxation in treaties	Credit method for interest and royalty income, exemption method for dividends and gains from the disposal of shares.
EC incentives	No customs, uniform VAT rules within EC.
Business reorganization <sup>37</sup>	in certain cases tax neutral.
Expatriates' individual income tax	Top rate 42%, whereas average rate is lower. Taxable base = income minus substantial exemptions and allowances.

<sup>30</sup> Where a double taxation treaty applies.

<sup>31</sup> Generally, where a double taxation treaty applies.

<sup>32</sup> If shares of at least 25% / 10% are held for at least 12 months.

<sup>33</sup> Safe haven is granted only for loans with fixed interest rates.

<sup>34</sup> On passive income derived by foreign corporate entities in low-tax countries.

<sup>35</sup> The aggregate tax rates vary from municipality to municipality.

<sup>36</sup> Estate tax, gift tax, air and sea transportation and shipping.

<sup>37</sup> E.g. mergers and de-mergers, changes of the legal form of a company.



## Branch or Subsidiary?

### Branches

Liability	Unlimited.
Registration duties	yes.
Audit of financial statements	not required <sup>38</sup> .
Trade tax	12% - 21%.
Corporate income tax <sup>39</sup>	25%.
Solidarity surcharge	5.5% of corporate income tax.
Withholding tax on distribution of profits (branch withholding tax)	none.
Head office expenses	deductible, if reasonably allocated to the operations of the branch.
Cost of finance	Loans which the head office arranged exclusively for the purpose of branch operations are deductible; no thin capitalization rules.

### Subsidiaries

Liability	limited.
Registration duties	yes.
Audit of financial statements	mandatory for AGs and for certain GmbHs and GmbH & Co. KGs <sup>40</sup> .
Trade tax	12% - 21%.
Corporate income tax	25%.
Solidarity surcharge	5.5% of corporate income tax.
Dividend withholding tax	0% - 20%.
Expenses for services from parent company to its subsidiary	deductible, subject to an arm's length test (stewardship expenses are not deductible).
Cost of finance	Loans from the parent company to its subsidiary are generally deductible, subject to an arm's length test + thin capitalization rules.

<sup>38</sup> Except under certain conditions.

<sup>39</sup> Branches of individuals are subject to personal income tax.

<sup>40</sup> For a GmbH: If the thresholds for a small company are exceeded.



## Business Acquisitions

### Can the buyer depreciate the purchase price?

asset deal	yes, the purchase price is allocated to the assets and to goodwill (land and shares in corporate entities cannot be depreciated, goodwill is depreciated over 15 years for tax purposes).
purchase of interest in a partnership	yes, see above.
share deal	no.

### Is the cost of financing the purchase price tax deductible?

asset deal	yes (subject to arm's length test and thin capitalization rules).
purchase of interest in a partnership	yes.
share deal	No.

### Are the seller's capital gains subject to tax?

asset deal	yes.
purchase of interest in a partnership	yes.
share deal	yes (exempt if a German corporate entity disposes of shares in another corporate entity).

### Can an existing loss carry over be utilized by the buyer?

asset deal	no.
purchase of interest in a partnership	no.
share deal	Yes, if economical identity can be preserved - § 8 IV KStG. If > 50% of the shares in a corporation are acquired and certain other conditions are met, the losses cannot be utilized.

Please note: Such sales transactions might trigger real estate transfer tax.



## Withholding Taxes - German Double Taxation Treaty Rates

Country	Dividends		Interest	Royalties
	Qualifying Companies	Other companies, Individuals		
This chart is an overview. The applicable double tax treaty should be consulted for details.	%	%	%	%
Argentina	15	15	10/15	0/15
Australia	15	15	10	10
Austria	5	15	0	0
Azerbaijan	5	15	10	5/10
Bangladesh	15	15	10	10
Belgium	15	15	0/15	0
Bolivia	10	10	15	15
Brazil (terminated)	15	15	10/15	15/25
Bulgaria	15	15	0	5
Canada	5	15	10	0/10
China (without Hong Kong and Macao)	10	10	10	7/10
Cyprus	10	15	10	0/5
Czech Republic	5	15	0	5
Denmark	5	15	0	0
Ecuador	15	15	10/15	15
Egypt	15	15	15	15/25
Estonia	5	15	0/10	5/10
Finland	10	15	0	0/5
France	5	15	0	0
Greece	domestic rate	domestic rate	10	0
Hungary	5	15	0	0
Iceland	5	15	0	0
India	10	10	10	0/10
Indonesia	10	15	10	7.5/10/15
Iran	15	20	15	10
Ireland	10	10	0	0
Israel	25	25	15	0/5
Italy	15	15	0/10	0/5
Ivory Coast	15	15	15	10
Jamaica	15	10	10/12.5	10
Japan	15	15	10	10
Kasachstan	5	15	0/10	10
Kenya	15	15	15	15
Korea (Rep.)	5	15	10	2/10
Kuwait	5	10/15	0	10
Latvia	5	15	0/10	5/10
Liberia	10	15	10/20	10/20
Lithuania	5	15	0/10	5/10
Luxembourg	10	15	0	51
Malaysia	5	15	15	101



Malta	5	15	10	0/10
Mauritius	5	15	0	15
Mexico	5	15	10/15	10
Mongolia	5	10	10	10
Morocco	5	15	10	10
Namibia	10	15	0	10
Netherlands	10	15	0/15	0
New Zealand	15	15	10	10
Norway	0	15	0	0
Pakistan	10	15	10/20	0/10
Papua-New Guinea	15	15	10	10
Philippines	10	15	10/15	10/15
Poland	5	15	5/0	5
Portugal	15	15	10/15	10
Romania	5	15	3	3
Russia	5	15	0	0
Singapore	10	15	10	01
Slovak Republic	5	15	0	5
South Africa	7.5	15	10	0
Spain	10	15	10	5
Sri Lanka	15	15	10	10
Sweden	0	15	0	0
Switzerland	0	15	0	0
Tajikistan	5	15	0	5
Thailand	15	20	10/25	5/15
Trinidad and Tobago	10	20	10/15	0/10
Tunesia	10	15	10	10/15
Turkey	15	20	15	10
Ukraine	5	10	2/5	0/5
United Arab Emirates	5	15	0	0
United Kingdom	15	15	0	01
United States	5	15	0	0
Uruguay	15	15	15	10/15
USSR – subsequing states	15	15	5	0
Uzbekistan	5	15	5	5/3
Venezuela	5	15	5	5
Vietnam	5/10	15	5	7.5/10
Yugoslavia – and subsequing states	15	15	0	10
Zambia	5	15	10	10
Zimbabwe	10	20	10	7.5

Withholding tax rates under domestic law may be lower than the treaty rates or even be nil. Only certain types of interest are subject to withholding tax under German tax law. Under the EC Parent-Subsidiary Directive the withholding tax on dividends to companies in other EC member states is nil. A few territorial exemptions have to be observed under which German treaties are not applicable. The treaty between Germany and former Yugoslavia further applies to the Federal Republic of Yugoslavia, Bosnia-Herzegovina, Croatia, Macedonia and Slovenia. The treaty between Germany and the former USSR further applies to Armenia, Byelorussia, Georgia, Kyrgyzstan, Moldova and Turkmenistan.



## Individual Income Tax (1)

Taxable persons	Individuals.
Tax Residents	Worldwide income is subject to tax.
Non-residents	Only income from German source is subject to tax.
Tax residence in Germany	Residence <sup>41</sup> or habitual abode <sup>42</sup> in Germany.
Taxable income – most important categories	Trade (business) income. Income from self-employed activities <sup>43</sup> . Income from employment, Income from capital investment <sup>44</sup> . Rental income. Certain capital gains from the disposal of assets other than real estate realized within a holding period of 1 year <sup>45</sup> . Capital gains from the disposal of real estate within a holding period of 10 years.
Important types of exempt income	Income exempt under double taxation treaties. 50% of dividends. 50% of capital gains from the disposal of shares in corporate entities. Long-term capital gains <sup>46</sup> . Subsidies for the acquisition of fixed assets pursuant to the Investitionszulagegesetz.
Important types of exempt income paid or reimbursed by the employer	Mandatory social security contributions (employer's portion). Travelling expenses for business trips. Moving expenses for professional reasons. Double housing allowance. Kindergarten fees, voluntarily paid by employer. Certain pension schemes.
Important deductions from business income	Business expenses. Trade tax on income. Depreciation. Provisions <sup>47</sup> . Reserves on certain capital gains. Write-down to lower going concern value <sup>48</sup> .

<sup>41</sup> Normally an apartment or other rooms being available for living there qualify as a residence.

<sup>42</sup> Six months test.

<sup>43</sup> E.g. an architect.

<sup>44</sup> Like dividends or interest.

<sup>45</sup> E.g. securities.

<sup>46</sup> If not income from trade or business.

<sup>47</sup> Some types of provisions are not deductible.

<sup>48</sup> A write-up is required if the going group value increases again.



## Individual Income Tax (2)

Disallowed business expenses	Business expenses which are directly related to tax-exempt income. Certain taxes like individual income tax and solidarity surcharge. Entertainment expenses > 70% of reasonable costs. Gifts to persons who are not employees of the taxpayer, exceeding € 35 per person and per year. Penalties with punitive character.
Capitalization of business expenses	Expenses connected with the purchase, the production or the change of substance of an asset must be capitalized and depreciated; cost of maintenance and replacements are deductible.
Important general deductions	Basic allowance. Allowances for children. Allowances for certain insurances. Tax adviser fees, as far as related to income. 30% of fees for certain private schools. Certain donations <sup>49</sup> . Allowances for handicapped persons. Allowances for support of relatives without substantial own income and property. Loss carry over <sup>50</sup> .
Tax rates	See table "Important Tax Rates - Individuals".
Tax collection – overview	Annual tax assessments where payroll tax, prepayments of individual income tax and withholding taxes are credited against the annual tax liability <sup>51</sup> .
Tax collection - income from employment	Payroll tax, to be withheld by the employer <sup>52</sup> .
Tax collection - other income	Quarterly prepayments by the taxpayer.
Tax collection - certain types of income	Subject to withholding tax.

<sup>49</sup> Up to certain limits, donations to acknowledged entities for specific purposes are tax deductible

<sup>50</sup> Carry back of tax losses: 1 year up to an amount of € 511,500.00. Carry forward of losses: up to € 1 million without limitation, exceeding amount deductible at 60%. Rest of losses to be carried forward to next years under the same rules.

<sup>51</sup> In specific cases the payroll tax and the withholding taxes may be a final taxation.

<sup>52</sup> The employer must either be resident in Germany or have a branch there.



## Tax Depreciation

Accounting depreciation is based on the useful lifetime of an asset. For accounting purposes, the tax depreciation is generally acknowledged.

<b>Depreciation methods</b>	
Straight-line method	Equal amounts during the useful lifetime for all depreciable fixed assets including intangibles.
Declining-balance method	A fixed rate of depreciation up to 20% (limited to 200% of the straight-line depreciation rate) is applied to the declining residual book value of the asset. Only for movable fixed assets. For investments in 2006 and 2007 the rate is 30 % (limited to 300% of the straight-line depreciation rate)
Change between straight-line and declining-balance method	Only admitted from declining-balance to straight-line method.
Accelerated depreciation	In case of extraordinary use.
Production method	The depreciation rate varies according to the physical wear.
<b>Depreciation rates for commercial buildings</b>	
1. straight-line depreciation	2% to 3% <sup>53</sup> for solid buildings.
2. declining-balance method	3.3% - 12.5% for light weight constructions. 8 years 5% , then 6 years 2.5%, then 36 years 1.25% <sup>54</sup> .
<b>Examples<sup>55</sup> (straight-line method)</b>	
Machinery	6.25% to 12.5%.
Office equipment	10% to 16.67%.
Office furniture	7.7%.
Computers	33.3%.
Telecommunication	12.5% (average).
Cars, trucks, etc.	11.15% to 16.7%.
Goodwill	6.67%.
Land	Not depreciable.
Shares in corporate entities	Not depreciable.
Intangible assets with a limited useful lifetime <sup>56</sup>	Depending on the useful lifetime.
Low-value assets	100% (with acquisition cost (without VAT) of up to €410).

<sup>53</sup> The rates depend on the date of the application for the construction permit or the date of purchase.

<sup>54</sup> If the building was purchased or the application filed after 31 December 1995 and is used for residential purposes.

<sup>55</sup> These are average rates. The useful lifetime of an asset can be derived from a schedule of recovery classes published by the German tax authorities.

<sup>56</sup> Straight-line method only.



## Provisions (Accruals)

The creation of provisions (accruals) leads to expenses, their dissolution to income. Some provisions *must* be created in the balance sheet, others *can* be created. Where the business entity has an *option* to create provisions they are *not* tax deductible. The chart shows the treatment of the most important types of provisions. Their assessment is not described below.

Provisions for...	Tax Treatment
contingent liabilities (obligatory <sup>57</sup> )	Tax deductible.
imminent losses from pending transactions (obligatory)	Not tax deductible.
omitted maintenance expenses which are spent in the first 3 months of the subsequent business year (obligatory)	Tax deductible.
omitted maintenance expenses which are spent between the 4th and the 12th month of the subsequent business year (option <sup>58</sup> )	Not tax deductible.
guarantees granted without the requisite legal obligations (obligatory)	Tax deductible.
pension schemes (obligatory)	Generally tax deductible
liabilities which have to be paid only to the extent that future revenues or profits incur (obligatory)	Not tax deductible until such revenues or profits incurred.
anniversary bonuses promised to employees (obligatory)	Tax deductible under certain conditions.
acquisition or production of an asset	Not tax deductible.
finances assessed by German or EC courts or authorities (obligatory)	Tax deductible only in exceptional cases.
uncertain tax liabilities - obligatory if the enterprise is the taxpayer	Tax deductible if the tax is a deductible expense (like trade tax; e.g. corporate income tax is not deductible).
deferred taxes	Not tax deductible.

<sup>57</sup> Obligatory = they must be created in the balance sheet under the Commercial Code.

<sup>58</sup> Option = they can be created in the balance sheet.



## Value Added Tax

Taxpayers = “entrepreneurs”	Corporations, partnerships, sole proprietorships and other business entities.
Taxable transactions	Domestic supplies of goods or services, imports of goods from outside the European Community (EC), intra-EC purchase of goods in Germany.
Standard rate	19% since Jan 1, 2007.
Reduced rate	7% (e.g. on certain agricultural supplies, cultural services like those of theaters, opera houses and museums, arrangers of concerts and theater performances, supplies of food items, newspapers, beverages and books).
Examples of zero-rated transactions	Exports of goods, sale of shares in a company, banking and insurance services, sale of land and buildings, rental of land and buildings.
Tax base	For supplies of goods and services: the consideration without the VAT; for imported goods: the customs value.
Input VAT from received supplies of services or supplies of goods and from imports of goods	Can be set off against the VAT liability if the goods or services are used for taxable supplies, including some specific zero-rated taxable supplies.
VAT compliance for registered taxpayers	Annual VAT tax returns/assessments; prepayments of VAT on the basis of monthly or quarterly VAT returns.
Foreign-resident taxpayers	are generally liable for VAT equal to German-resident taxpayers.  They pay VAT either by means of VAT registration in Germany or by means of the reverse-charge mechanism.  VAT refund for non-registered taxpayers is only possible if reciprocity <sup>59</sup> is given by the other state.
European Community	EC Law governs the VAT Acts of all member states → uniform VAT law within EC

<sup>59</sup> The German Ministry of Finance updates the list of countries, which grant a VAT refund under the same conditions as Germany, on a regular basis. EC member states grant the reciprocity.



## Labor Law

Residence permit	<p>Required for foreign nationals<sup>60</sup>; to be obtained in their home country before entering Germany for a stay of more than 3 months.</p> <p>Prior approval from the local German immigration office<sup>61</sup> is required.</p>
Work permit	<p>Foreign nationals who intend to work as an employee in Germany generally also need a work permit.</p> <p>The work permit is granted by the local German employment office; the immigration office asks them for their consent to issue a visa.</p> <p>The employment office's approval should be available when applying for a visa at a German consulate or embassy.</p> <p>Members of the management board of a German corporate entity don't need a work permit, only a residence permit.</p>
Labor regulations	<p>are based on contracts of employment, legislation and collective agreements<sup>62</sup>.</p> <p>Contracts of employment can either be in writing or as a verbal contract. Usually such contracts are in writing.</p> <p>Legal minimum vacation days p.a.: 20 days with a working time of 5 days per week = 24 days with a working time of 6 days per week.</p> <p>Employees are entitled to salary during their vacation and during the first six weeks of sickness.</p> <p>The official daily maximum working hours are 8 hours; however, exemptions and overtime are possible.</p>
Social security system	<p>==&gt; "Important Tax Rates - Individuals".</p>

<sup>60</sup> Except nationals of EU member states

<sup>61</sup> I.e. foreigners office - Ausländerbehörde

<sup>62</sup> Collective bargaining agreements - Tarifverträge