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Doing Business and Investing in Germany

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By Andrew Miles

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This guide has been prepared for the assistance of those interested in doing business in Germany. It does not cover exhaustively the subjects it treats, but is intended to answer some of the important, broad questions that may arise. When specific problems occur in practice, it will often be necessary to refer to the laws, regulations and legal decisions of the country and to obtain appropriate professional advice.

Whilst we have made every attempt to ensure the information contained in this guide is accurate, neither PwC nor the author can accept any responsibility for errors or omissions in the factual content.

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Preface

For decades, Germany has been a country with a highly developed, high-cost, economy. The opportunities – but also the risks – of a German investment are numerous, real and calculable. On the positive side, Germany offers the foreign investor exciting national and international marketing and business perspectives. These are inextricably linked to the long-standing commitment to European integration and the traditionally strong business and cultural ties to other European countries – West and East. The cultured, highly trained and educated working population provides the medium for turning these perspectives to practical advantage.

The downside to this is that costs – and especially employment costs – when measured in terms of wage rates, social security and other charges levied on employers – are comparatively high. Investment success in Germany is thus dependent on a carefully planned, sophisticated operation. In this sense, Germany is very much an "up-market" country.

The German investment climate, both inward and outward, is open and complex. Germany is fortunate in being one of the few developed market economies to have emerged from the economic crisis largely unscathed – thanks in good measure to decisive government action in launching a massive stabilisation programme – and she is now called upon to lead the return to growth in Europe. This of itself generates new investment opportunities. It is our hope that this guide to doing business and investing in Germany will give those seeking to take advantage of the coming recovery the necessary insight to determine their own specific areas of interest. Any reader who would like a more detailed discussion is cordially invited to contact a partner in any of our German offices, or in any of our German Business Groups around the world.

Frankfurt am Main, January 2014

Andrew Miles
PricewaterhouseCoopers AG Wirtschaftsprüfungsgesellschaft

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A Germany: a profile

1 Geography

Germany covers an area of about 357,000 square km (138,000 square miles) in the central part of Northern Europe. The country borders on Denmark, Poland, the Czech Republic, Austria, Switzerland, France, Luxembourg, Belgium and the Netherlands, and on the North and Baltic Seas. As might be expected from her geographical location, Germany enjoys a temperate climate; there are no great extremes of heat or cold, although the weather can often only be described as wet. The topography rises progressively from the flat plains of the northern coasts through the undulating hills and forests in the centre of the country (Eifel, Harz, Taunus, Black Forest and Erzgebirge) to the Alpine foothills in the south. Indeed, the southern border passes through the Alps themselves, giving Germany her own area for skiing and other winter sports.

Except for the Danube in the south of the country and its tributary, the Inn, Germany's rivers all flow in the general direction of south to north. The Danube flows east, ultimately into the Black Sea south of Odessa. The other main rivers are the Rhine with its tributary, the Main, the Elbe and Oder. The Rhine and the Main are linked to the Danube by a canal and all three rivers are navigable by large, freshwater barges. This system is a recognised international waterway between Rotterdam and the Black Sea ports.

2 Population and social patterns

The German population is currently estimated at 80.5m on the basis of extrapolations taken from a mini-census taken in May 2011. Annual deaths regularly exceed births, so the general tendency is that of a falling and ageing population. For the present, this is partially compensated (in some years, overcompensated) by immigration from abroad, although this latter is not expected to continue to the same extent. Official estimates suggest that the population will fall to some 65 million by 2060, if current trends remain unchecked.

Germany is more densely populated than either of her two largest neighbours, France and Poland. The population density is greatest in the traditionally industrial areas of the Ruhr and parts of the Saar, the commercial centres of Cologne/Düsseldorf, the Rhine-Main area of Frankfurt/Wiesbaden, Berlin, and on a smaller scale in and around the other larger cities. Few areas can be described as under-populated.

There is no significant tendency on the part of the population to emigrate, although all residents are free to do so, and to take all their assets with them. There is still a certain amount of migration within Germany itself, generally from east to west, although this trend is now slowing as living standards and costs in the east rise towards the national average.

The German population does not have a tradition of mobility within the country. Movement is hampered by cultural differences and by other factors, such as the decentralised education system with a different syllabus for the schools of each province. There are only two indigenous national minorities, a small Danish minority in northern Schleswig-Holstein (just south of the Danish border) and a small Sorb population living in the general area to the south east of Berlin. The foreign population numbers some 6.6m (8.2% of the total), of which Turkish citizens form by far the largest single national group, numbering 1.6m. Other significant groups are Italians, Poles, Greeks, Croats, Russians and Bosnians.

From the early 1950s to the early 1970s, the then West German state actively encouraged the recruitment of foreign labour, particularly in other European countries with high unemployment, to live and work in Germany for a temporary period. This policy was reversed in 1973 to one of restriction, with the general aim of reducing or at least containing the number of non-EU citizens working in Germany. The restriction gave foreign workers already resident a considerable inducement to remain if they possibly could, so the foreign population tended to become permanently, rather than temporarily, resident. Indeed, by now, at least half the foreigners living in Germany have been here for more than ten years and many of the younger individuals are second or third generation residents who have never lived anywhere else.

3 Language

The official language is German. English is by far the best known foreign language and is generally accepted as the common medium for all forms of communication abroad. It is also quite usual for educated Germans to have a good command of at least one other foreign language, the most widespread being French, Italian, Spanish, and the various Slav languages.

4 Political system

The constitutional form is the Federal Republic of Germany (*Bundesrepublik Deutschland*). Sixteen provinces (*Länder*) form the federation implied by the name. Each level of government (federation, province, district and local community) is directed by an elected body competent to take decisions on all matters remitted to it by the constitution. Berlin is the capital and the home of both chambers of the federal parliament. Many government departments are located in various other German towns, particularly in Bonn, the former West German capital.

The federal parliament has two chambers. The lower chamber (*Bundestag*) is elected by the population for a four-year term. Its seats are allocated on a system of proportional representation. The government is formed by the party or coalition (in practice, invariably a coalition) with a majority of the seats. The remaining parties represented in the *Bundestag* form, collectively, the opposition. The upper chamber (*Bundesrat*) is made up of members delegated by the parliaments of the individual provinces with votes in rough proportion to the size of their populations. The party allegiances of its members reflect the identity of the governing party or coalition in each province.

Most acts of parliament are initially proposed and debated in the *Bundestag*. The *Bundesrat* does have certain rights to propose, or to propose changes to, bills, although its primary function is to safeguard the interests of the provinces against acts of expropriation by the federation. Since all laws affecting the interests of the provinces are subject to its approval, very few laws of national importance can be passed by the *Bundestag* without the support of the majority of the *Bundesrat*. This division of political functions and responsibilities encourages a spirit of compromise on all major political issues.

Bills are enacted on signature by the federal president (*Bundespräsident*) to whom they are submitted after acceptance by both chambers of parliament. The signed acts then take effect on promulgation in the Federal Journal of Statutes (*Bundesgesetzblatt*).

The present government is a coalition of the Christian Democrats (CDU/CSU) and the Social Democrats (SPD) following the general election held on September 22, 2013.

Germany is a founder member of the European Union (EU) and takes an active part in the activities of all its subordinate institutions.

5 Legal system

The ultimate source of all law is the constitution or “Basic Statute” (*Grundgesetz*). Acts of either the federal or a provincial parliament are void if they conflict with the constitution or are passed in an unconstitutional manner. Similarly, all acts of the provincial parliaments must be in accordance with the provisions of the constitution of the relevant province.

The government, individual ministries and other authorities have the power to issue guidelines, decrees and other pronouncements. These ordinances are of varying degrees of authority and require the approval of differing levels of government. Tax guidelines, for example, but not decrees, require the consent of the *Bundesrat*. These extra-statutory instruments bind, at least to the extent of their own terms, the issuing authority and its subordinate authorities, but not courts of law. They cannot amend the law as it stands, but give guidance on the issuing authority’s preferred interpretation thereof.

The German court system is decentralised. Initially, cases are held locally and appeals are made to a higher court responsible for a wider geographic area. The courts are divided into a number of different streams, each specialising in its own field of law. There are therefore separate courts to try suits on tax, commercial and labour law. At the head of each stream is a single, federal supreme court to which appeals can be made by either side on points of law, but not of fact. The ultimate arbiter is the Constitutional Court in Karlsruhe to which final appeal can be made, although only on the grounds of conflict with the constitution.

The judgments of the Federal Constitutional Court are binding on all other courts. The judgments of all other courts including the supreme court of each stream are only binding in respect of the case tried and do not set binding precedents for other cases of a like nature. They may, however, give guidance to other courts, especially to lower courts of the same stream, although even a lower court is free to depart from an established precedent if it feels that circumstances warrant a change.

6 The economy

Almost all forms of industry are represented within the broad-based German economy. As befits a country with high employment costs but with a well-educated population and a well-trained workforce, the most exciting prospects today are offered by industries in the forefront of technology and by the providers of sophisticated technical, commercial and financial services.

Agriculture and tourism are less significant, although they are of social and cultural importance, especially for the preservation of living and recreational standards.

Traditionally, the German economy is oriented towards manufacturing. This extends to the service sector, where there are many companies developing and applying leading-edge technologies for industrial use. For decades, manufacturing output has exceeded the consumption requirements of the domestic economy; in effect, Germany is and remains a major exporting nation in order to maintain domestic employment. In keeping with this tradition, Germany's recovery from the economic crisis was export-led. Nevertheless unemployment remains a concern. In December 2013 it was running at 6.7%, roughly similar to the previous year and to the pre-crisis level.

B Economy and investment environment

1 Economic climate

Germany has a social market economy, meaning that she embraces the spirit of free enterprise, but tempered with controls and other administrative legal measures designed to prevent large economic participants from seriously damaging other interests. Laws against unfair competition, including the antitrust provisions, and for the protection of the environment, as well as those protecting employees, all illustrate this latter point. In general, the work force is highly motivated, and highly trained and disciplined. The strong and well-established trade union movement usually keeps to established bargaining procedures and, over the years, has achieved an impressive degree of protection for employees. As a result, cases of serious industrial unrest are rare although there are a few instances of demarcation disputes (conflicts between rival employee representations, rather than between labour and management), especially in the passenger transport sector.

Most German industry is dynamic and, except in the depressed areas, expanding. The state does not encourage the development of specific industries as a deliberate act of policy, but it does offer substantial subsidies and other support for, in particular, research and development likely to lead to new marketable products. There is thus a move toward high-tech industries and the more sophisticated parts of the services sector are also expanding. The labour force numbers some 41.2 million gainfully employed by 3.6 million enterprises. 23% of the latter are corporate entities, the remainder being partnerships, sole traders and public utilities.

The typical business in Germany is a small family-owned unit. Any outside shareholders are usually long-term employees or others with long-standing personal relations with the original family. Most large businesses are publicly held corporations with many shareholders. However, the original family owners often retain a significant minority holding and there are still a few large businesses closely held by only a few individuals. Many medium-sized publicly-listed corporations issue a different class of shares to the public (quite frequently non-voting preferred stock) in order to give the original owners a greater degree of control and influence than warranted by their investment.

2 Ownership trends

A few large German corporations are still in partial state ownership. However, these holdings are progressively being placed on the market with the objective of privatisation amongst a large number of individuals rather than to a strategic investor.

There is also a general, but slowing, trend toward industry concentration, and as a result, mergers and acquisitions are frequent. In addition, new businesses are constantly being formed (and old ones going out of business), thus keeping German industry in a state of movement.

The recent economic turbulences forced the government to buy shares in some of the banks in order to safeguard the public interest during rescue operations. These holdings are intended to be temporary.

3 Investment environment

It is government policy to encourage a wide spread of share ownership among the general public, and a number of incentive programmes support this objective. However, these programmes are all rather small in scale and have little effect. Virtually all shares of publicly held corporations are bearer shares and are usually deposited with banks. The banks offer caretaking services to the shareholders, which include collecting dividends on their behalf and also acting as proxies at shareholders' meetings. Since the banks generally recommend how shareholders' votes should be cast, they are often seen as having greater voting power than justified by their own portfolios.

There are no significant controls preventing or restricting foreign investment as such and the typical form of foreign participation in German industry is that of a wholly or substantially majority-owned subsidiary. Joint venture or minority investments are comparatively rare and are usually the result of special circumstances.

4 Government policy

The main thrust of government industrial and economic policy is to allow industry and commerce to develop as they please within a controlled environment. One of the most important aims is to protect the existing employment level and, if possible, to increase it. To this end, there are still various incentives available in the eastern part of the country for the encouragement of manufacturing and of small and medium-size business in other fields. These last are, however, normally irrelevant to foreign investors, since the definitions of “small” and “medium-size” apply to the parameters of the German company combined with those of its foreign shareholder.

Unemployment is generally seen as one of the most significant medium-to-long-term problems faced by the German economy. Currently, it is roughly stable at 6.7% or 2.9m jobless (December 2013), although there is a tendency for it to fluctuate between months.

Since Germany has both high standards, and high costs, of living, overall employment costs are high and protection of employees against wrongful dismissal is extensive. There is therefore a disincentive for employers to recruit new staff, while at the same time there is some reluctance on the part of employees to accept new employment at the first opportunity, since they do not wish to lose existing long service rights. The German labour market is therefore often seen as being too rigid in both directions, and the situation is exacerbated by the high level of compulsory deductions from an employee’s wages and by the extensive rights of employees to holiday and other benefits. Almost invariably, there is a wide disparity between the take-home pay of an employee and the corresponding wage costs in the profit and loss account of the employer.

For a considerable time, different German governments have been attempting to improve the flexibility of the system and to reduce the gap between the expectations of the employee and the employer. A health service reform with the general intention of reducing health insurance costs took effect in January 2004 and was followed by another in 2008/9. Unfortunately, initial savings from the 2004 reform resulting from the curtailment of benefits were largely mopped up by price increases, so health insurance contribution rates have remained much as they ever were. There have also been cuts in benefits in other parts of the social security system, but these, too, have largely been absorbed. Despite these efforts, rates remain high at 39.45%.

Germany has no overall national economic plans, but does offer various specific incentives and regional programmes. In the West, this applies particularly to high-tech industries with a strong orientation toward research and development. Programmes in the East are less specific, in line with the more general aim of overall economic support. Companies benefiting from the programmes receive incentives and other support on fulfilment of specified conditions, most of which are negotiated individually and usually include a guaranteed minimum employment level. Generally, the scope and number of programmes is falling, especially as they are all subject to EU approval.

5 Local considerations

Most German towns have established their own trading estates, in many cases more than one. Any prospective investor in a green-field project is well-advised to approach the local authorities at an early stage to ascertain the degree of help and support the project might enjoy locally. Cheap land, for example, might be available. The discussions will in any case give the investor access to essential local information, such as the immediate availability of labour.

There are no free-trade or privileged economic zones within Germany. Similarly, there is no specific industry encouragement, although there are certain activities, such as in renewable energy generation, that do find official favour. There is also an arrangement in place for exempting IT and certain other skilled employees from non-EU countries from some of the more rigorous aspects of the procedure for work permits.

Prospective foreign investors can take advantage of the full range of consulting services readily available in Germany at all levels of sophistication. There is thus no hindrance to obtaining in-depth marketing information, initiating searches for potential investment targets, or to obtaining the necessary outside professional support for the solution of complex problems. General information is freely available from various government and other authorities, such as the federal ministry for the economy, from local Chambers of Commerce and Industry, or from German embassies and consulates abroad.

C Regulatory environment

1 Government policy

There is almost no government guidance of business, although there are many restrictions and prohibitions designed to protect business and non-business interests and to prevent abuses. Within the business and economic environments, the overall intention is to ensure as far as possible equality of treatment between the different players and to avoid hindering the entry of new businesses into a given market. Some monopolies and semi-monopolies remain, however.

Government policy is to encourage competition on a level playing-field. One of the principle instruments for this is the Unfair Competition Act, which contains, among other things, detailed regulations prohibiting unfair advertising, antitrust and anti-cartel provisions that are particularly relevant to large acquisitions, as well as rules for the protection of the general public. Stock exchange takeovers are regulated by a Securities Acquisition and Takeover Act designed to ensure that management's recommendations are not coloured by self-interest. However, it also allows a 95% majority shareholder to requisition minority interests against reasonable cash compensation ("squeeze-out" rules).

2 Corporate governance

Corporate management boards are held to a semi-voluntary code of conduct and disclosure, the Code of Corporate Governance. The text of this code is periodically updated and is maintained by the Federal Ministry of Justice. As such, it does not have direct statutory force, although all publicly quoted companies must disclose any instances where they have not followed its recommendations. The ministry hopes that this "comply or explain" approach will prove more flexible and more effective than a set of rigid provisions. It also hopes that the Code will become the yardstick for good corporate behaviour generally and thus be followed in spirit by all companies.

In one of the first reactions to the worldwide financial crisis, the government initiated legislation to limit the remuneration of directors of, particularly, public companies to levels justified by the performance of the company and by the market generally. Company performance must be seen in the light of the long-term interests of the business, rather than in that of short-term fluctuations. The legislation recognises that the question is, to a large degree, subjective and is therefore in part unspecific. However, remuneration packages for senior management are now more clearly the responsibility of the supervisory board, which now has the power to reduce salaries, should company performance fall short of expectations. Long-term thinking is encouraged by the ban on stock option exercise within four years of grant, and supervisory board independence is enhanced with a compulsory waiting period of two years before a former director may take a seat on the board. There is also an element of personal liability for board members, should the salaries of senior management prove to have been excessive.

3 Trade registers

Each entity carrying on a trade or business in Germany must register with the local registry court (trade register) for the town of its seat or of its principal place of business. Branches in other towns must also be registered if the branch effectively trades independently, but not if it solely supports, and is dependent on, the activities of the main company. The same distinction applies to German branches or other establishments of foreign companies. A German subsidiary, as a legal entity, must be registered in at least one trade register.

The trade registers are open to public inspection. The publicly accessible file for each company includes the basic rights of representation (the personal details of the directors and their respective powers), and a copy of the statutes.

The trade registers have recently been converted to an electronic format and it is now no longer possible to file hardcopy documents. Parallel to the local registers, the Federal Gazette maintains a database of registered businesses. It is open to interrogation by members of the public in the internet "www.unternehmensregister.de". Financial statements (annual reports) of companies are also filed with the Federal Gazette, where they are open to public inspection at "ebundesanzeiger.de". The Federal Gazette accepts only softcopy filings in a set XBRL (eXtensible Business Reporting Language) format.

4 Safety and the environment

Apart from the registry court, each town or other local authority maintains a Trading Office. Each place of business must be registered with the local Trading Office, which exercises a degree of supervision over matters such as public access and safety, adherence to any applicable regulations regarding the use to which certain premises may be put, and any compulsory opening and closing times. Since the objectives of the Trading Offices are supervision of local businesses on behalf of the local authority, their records are not open to the general public.

Germany has a wealth of statute and other law on all aspects of environmental and consumer protection, including, especially, minimum warranties and product liability. All the relevant fields of law are intensively regulated by the EU. Often, the applicable EU directive has been transposed into German national law more or less as it stands, although there are still a number of instances where the German version is more restrictive than its EU counterpart.

5 Regulated industries and professions

Banks and other financial services institutions, insurance companies, stock-brokers and asset managers are subject to close supervision by the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungs-aufsicht* or *BaFin*). This supervision involves not only frequent reviews of the financial position of the business, but close control over the methods by which business is done and the amounts transacted. In some cases, there are daily reporting requirements.

A number of products are subject to specific German government and EU registration requirements. Pharmaceuticals are the most widespread instance of this, although there are rules for the technical examination of any electrical or mechanical product offered on the German domestic market. A technical examination is not always compulsory for every product, although even where this is not the case, the supplier or importer often arranges for voluntary examination, if only to be able to advertise the result. Similarly, a number of services on offer to the general public must meet certain conditions; an example of this is compulsory insurance cover for tour operators in the travel trade.

The liberal professions, doctors, auditors, tax consultants, engineers, architects, and lawyers are subject to institutional supervision. This supervision invariably extends to ethical conduct as well as technical competence. The relevant EU directives on the subject are, in practice, generally of secondary importance to the more stringent rules of the supervising institutes themselves.

D Banking and finance

1 Currency

Germany no longer maintains her own currency, having adopted the euro on January 1, 1999. The euro is managed by the European Central Bank in Frankfurt led by a multinational board of delegates from the central banks of the participating countries. Participation is obligatory for EU member states once they meet certain economic criteria for stability and solvency for a two to three-year period, although Denmark, Great Britain and Sweden have options not to join. The current members are Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain.

The German central bank, *Deutsche Bundesbank*, is responsible for minting the German euro coins currently in circulation. It also sends representatives to sit on the board of the European Central Bank. Within Germany, it exercises various supervisory functions over the banking system acting in consort with the Federal Financial Supervisory Authority.

2 Banking system

Banking services are offered to the public, both to business and to private households, by a variety of different types of financial institution. The business banks offer the most comprehensive services, but there is also a range of savings banks, similar institutions and building societies. The business banks, often referred to in Germany as "universal banks", offer a full range of services, retail and wholesale, including all forms of investment banking, corporate finance and related consultancy. They are also the traditional doorway for German business and for the investing public to the stock exchange.

Traditionally, no fundamental distinction is drawn between the various types of business banks. Banking business itself is broken down into different categories by the Banking Act, but this is merely to enable banking licenses to be restricted to specified activities, so that each bank need only adhere to the specific conditions and control requirements relevant to its own particular sphere. However, the larger German banks are active in all fields, although there is still plenty of scope for the smaller institution specialising in a particular activity or market.

The German financial and money markets are almost entirely free of exchange controls. Indeed, transactions within the eurozone are for almost all practical purposes identical to domestic transactions (statistical reporting requirements being the main exception). Both local business and foreign entities may deposit or borrow funds freely through the German banking system; thus, for example, it is usually possible for a foreign investor choose the financing source for a German investment from competing offers from different countries. His choice can be based on taxation and other business considerations of real importance.

3 Capital markets

Germany operates a flourishing money market and stock exchange. Her bond market is the third largest in the world, after New York and London, and her stock market is the fourth, after New York, London and Tokyo. There are nine German stock exchanges, although they are all linked to the Frankfurt exchange, the centre of the German money market and the seat of the various organs that ensure the smooth control and completion of transactions.

Companies seeking a quote on the German stock market do so through a so-called listing partner. All the major banks and most of the larger accountancy and legal practices have been granted recognition as listing partners. Basically, a quote is available to any company with shares open to public trading. Trading is on the regulated and unregulated (or open) markets. Issuers on the regulated market are required to meet either the general or the prime standard of transparency and governance. The two standards are not dissimilar, though the prime standard sets additional reporting requirements. The minimum equity capital for both is €1.25m.

The unregulated market is open to issuers with an equity capital of at least €250,000. The publication and reporting requirements are less arduous than those for regulated market quote holders. Issuers fall into two categories, first and second quotations. Applicants for a first quotation must publish a prospectus meeting EU standards and otherwise satisfy the requirements of the stock exchange (and of the Federal Financial Supervisory Authority) as to the financial standing and past history of the company. This is referred to as the "entry standard" as distinct from the prime and general standards of the regulated market. Companies with an existing quote on another stock exchange automatically fall into the second category. In this case, there is no need for a further prospectus, and otherwise the compliance requirements are greatly eased with the acceptance by the German authorities of effective supervision in the company's home country. This acceptance is automatic where the first quote is on a recognised market within the EU and is largely a formality where the first quote is in the USA or Japan. However, first quote holders from other countries will need to satisfy the German stock exchange that they meet standards of transparency and governance in their home countries that are at least as rigorous as those of the EU.

Foreign companies may meet all stock market filing and publication requirements in English. Financial statements and disclosures may follow IFRS or US GAAP.

4 Money laundering

In concert with other EU members, Germany has equipped herself with an impressive arsenal of rules and institutional procedures designed to prevent money laundering, or at least to make it more difficult. The same goes for the fight against the misuse of German financial institutions for organised crime, drug-trafficking, terrorism and other serious offences. Most of the rules are impositions on service providers at risk of being abused, such as banks and other financial institutions, investment consultants and agents, lawyers, accountants and all businesses handling large amounts of cash. The customer's main awareness of these procedures generally comes from requests to positively identify himself and to explain the circumstances of particular transactions in rather more detail than might seem strictly necessary for smooth processing.

E Exporting to Germany

1 Import restrictions

The only import restrictions of general application are those imposed in accordance with UN sanctions. Otherwise, there is a special licensing procedure for certain specific types of goods, mostly military equipment and drugs. Some import quotas are imposed by the EU (e.g. for textiles), and these are also applied by Germany, which issues licences freely until the quota is filled. Products whose sale is prohibited in Germany can sometimes be imported, but they will not be cleared through customs and will therefore have to be re-exported. Since the EU member states constitute a single European market, deliveries to and from Germany and other EU countries do not qualify as imports or exports. Within the EU there are no longer any border controls of any description or any customs duties or other restrictions on intra-union traffic apart from certain minor formalities for travellers. The terms "export" and "import" therefore technically now only refer to trade between Germany and non-EU countries.

2 Import duties

Customs duties are the main duties effectively increasing the price of foreign goods over that of domestic or EU products. German customs duties are all based on value and are levied at rates dependent on the type of goods and on the country of origin. Imports from Iceland, Liechtenstein, Norway and Switzerland are generally free of duty, and the same applies to most imports from Turkey and the other EU candidate or associate countries. The rate of duty on imports of manufactured products from other countries is often zero and rarely rises above 10%. Additional duties are levied from time to time on specific products from specific countries at the direction of the EU, usually as a result of an anti-dumping case.

Goods are classified for customs duty purposes under the Harmonised System and the TARIC (integrated customs tariff of the European Union) nomenclature, and the valuation principles follow the internationally recognized customs code. The basis for assessing duties is usually the supplier's invoice unless it is obviously incorrect. This basis is subject to amendment, either in response to subsequent price adjustments, or because of other charges and credits raised separately or otherwise borne by the importer that directly affect the import value of the goods. Customs duty auditors regularly inspect the books of German importers to establish whether they have appropriately accounted for such adjustments.

Special procedures are in force with respect to agricultural products. These are subject to special EU levies, usually based on net weight. Maximum rates by value have been fixed for certain items.

Except for large importers with their own bonded warehouses, the administration of customs duties is substantially completed at the point of entry into the country by the carrier or other forwarding agent. The duties imposed, together with the VAT on imports (*Einfuhrumsatzsteuer* – EUSt) and any excise or other taxes levied (see Chapter L), are charged back to the importer as cash outlays. The importer must also comply with the reporting and return requirements of the Intrastat system of the EU and must, of course, establish a suitable filing system for the retention and recovery of the import documentation as needed for customs or tax audits.

3 Authorised economic operator

Regular importers and logistics businesses are increasingly aware of the benefits of registration as an "authorised economic operator" under EU-harmonised rules. Authorisation will be granted to businesses who have shown themselves to be reliable from the financial, record keeping and, as relevant, technical points of view. Authorisation is granted locally, but is valid throughout the EU. Thus an authorised economic operator from another member state does not need to re-apply in Germany in order to enjoy the benefits here.

Two types of authorisation are available. A business, the "economic operator", may apply for either or both. Customs simplifications are the one and security and safety the other. Neither authorisation frees the holder from the obligation to declare imports and pay the relevant duty, or from the security and safety regulations currently in force, although both enable Customs to grant the holder priority in dealing with his requests for permits or rulings. Other benefits include fewer test checks of transactions and a more flexible approach to routine examinations.

4 Local representation

From the point of view of processing imports, local representation is neither necessary nor helpful. The actual processing is done in any case by the carrier.

Foreign businesses may freely sell and then ship most goods to Germany. The import will be the responsibility of the purchaser, who will have to obtain customs clearance.

A foreign business may require access to local German storage and onward delivery facilities. Logistic services of this nature are offered by most well-known carriers and courier services.

Foreign exporters who wish to station their own employees in Germany or to appoint their own German representatives may well meet the preconditions of a taxable "permanent establishment" in Germany under the terms of the relevant double tax treaty. Effectively, part of the net profit earned on the sale of the goods to German customers then becomes chargeable to German income taxes and the foreign business is subject to German accounting and record-keeping requirements.

It is also quite usual for a foreign business to establish a German sales subsidiary or branch to regularly and systematically exploit the German market. There are usually no fundamental reasons why this should be impracticable, although it does lead to taxation in Germany.

5 Consumer sales from foreign websites

Foreign businesses providing electronic services or downloads to private, non-business consumers in Germany from outside the EU must register for VAT in an EU state of their choice. VAT is to be charged as though the service had been performed from that state and must be accounted for accordingly. Luxembourg currently has the lowest standard rate of VAT at 15%. The German rate of 19% will probably make it unattractive to foreign businesses to register in Germany, but if they do, they will have to abide by the German requirement to keep records in support of the VAT returns filed. These include obligations to submit the records in softcopy to the Central Tax Office on demand and to retain them in hard and softcopy for ten years.

F Business entities

1 Types of entity

Foreign businesses may establish their German operations as companies, partnerships or branches of the parent entity. It is also possible to establish an informal presence through a liaison or contact office or, for that matter, by merely recruiting an individual to live and work in Germany as a direct employee of the parent company.

2 Companies

Almost all German companies are AGs (*Aktiengesellschaften* – public limited companies) or GmbHs (*Gesellschaften mit beschränkter Haftung* – private limited companies). Originally, the AG was intended as the appropriate form for entities owned by a large number of shareholders and under the day-to-day control of employed managers, whilst the GmbH was designed to suit the circumstances of an owner-managed business with its own legal personality. Historically, the two corporate forms were widely different, but many of the differences have since disappeared, mostly with the ascendancy of legal provisions on accounting, auditing, publication requirements and employee supervision of management that apply to both types of company. The major remaining distinction is that the shares of an AG may be publicly traded on a stock exchange, whereas those of a GmbH may not. In consequence, the AG's formation and shareholders' meeting procedures are considerably more cumbersome. Foreign investors wishing to form a German subsidiary therefore tend to opt for the AG if any form of public offering is contemplated now or later, whilst the GmbH will usually be chosen for simplicity where it is intended that the German entity remain entirely in group ownership.

3 Capital requirements

An AG has a minimum share capital of €50,000 divided into ordinary shares of equal nominal value of at least €1. Once the share capital has been fully paid up, each shareholder receives a certificate for each share held, and it is these share certificates that are traded on the stock exchanges. Almost invariably, the shares issued are bearer shares. The AG may also issue other shares of different classes, such as preference shares with no voting rights but with a preferential dividend entitlement, but there are restrictions on the issue of ordinary shares with differing voting rights. It is not therefore possible for a minority investor to control the vote at a general meeting through a "golden share".

The minimum share capital of a GmbH is €25,000. On formation, each shareholder of a GmbH receives a single share in the amount of the share capital he holds; shares issued may be split later as necessary to effect a whole or partial transfer of a holding. A GmbH does not issue share certificates and its shares are not freely transferable. Quite apart from any restrictions that may be laid down in the articles, existing shareholders have the right of first refusal before a shareholder may transfer his interest to an outside party. The admission of a new shareholder must also be approved by the existing shareholders.

A special rule in the GmbH Act provides for registration of an "incorporated business" (*Unternehmergesellschaft*) with an issued, but fully paid up, capital of less than €25,000. Such a business must disclose its status in its firm name and must take one quarter of its annual net profit to a legal reserve. On increase of its capital to the legal minimum, it is free of the reserve obligation and may (but need not) change its name to that of a GmbH.

4 Shareholders, directors and officers

Both the AG and the GmbH are managed by one or more directors. The directors of an AG meet as a board (*Vorstand*), take decisions collectively and record their meetings in board minutes. The directors of a GmbH (*Geschäftsführer*) meet informally and take decisions collectively or on their sole responsibility as determined in standing procedures established by the shareholders. Often, the directors of both types of company are individually responsible for specified fields under the overall control of a chairman of the board (AG) or of the senior director or general manager (of the GmbH).

Either form of company must appoint a second director as "labour director" with special responsibility for all employment matters where the employees regularly exceed 2,000. These companies will therefore always have at least two directors.

Shareholders' meetings are generally called by the directors, although there are provisions for them to be called by other bodies or persons in an emergency. The shareholders of an AG may vote on the resolutions tabled at shareholders' meetings and may, under certain circumstances and under due periods of notice, propose resolutions of their own. However, as shareholders, they have no direct rights of influence, management, or information over the company.

A GmbH's shareholders may resolve on all resolutions laid before them, and may propose other resolutions of their own. There is no need to observe any formal notice periods, provided the other shareholders agree. Indeed, there is no need to hold a meeting at all, unless one of the shareholders insists on doing so. A proposed resolution can be circulated among the shareholders, and becomes valid when the last shareholder signs. Individually, the shareholders of a GmbH may request any information from its directors. The directors may not refuse the request unless it is made outside working hours or is otherwise manifestly unreasonable. The shareholders of a GmbH may also word the articles of the company to specify transactions or types of transaction that the directors may only conclude with their approval.

Signing rights of directors may be sole or joint. A single director will always be able to sign on his or her own, but most German companies require the signature of at least two directors where more than one director has been appointed.

Any company with more than 500 employees must appoint a supervisory board. The supervisory board is a separate body made up of non-executive directors. This body has responsibility for the supervision of the executive board, monitoring financial reporting and the appointment of directors and auditors on behalf of the shareholders. If the employees number between 500 and 2,000, one-third of the seats on the supervisory board fall to the representatives of the employees. The remaining two-thirds are elected by the shareholders. If the employees number more than 2,000, the supervisory board comprises 12 seats. This rises to 16 where there are at least 10,000 employees and to 20 where the number of employees exceeds 20,000. In each of these three cases, half of the seats fall to the shareholders and the other half to the representatives of the employees including delegates from the trade union. This principle of "parity of employee co-determination" is slightly undermined, except in the steel industry, by the rule giving the chairman of the supervisory board a second, casting vote in the event of a tie. The chairman is elected by the representatives of the shareholders from one of their number, unless the full board elects both chairman and deputy chairman with a two-thirds majority. The office of deputy-chairman then falls to the employees. However, the deputy has only a single vote.

A small AG with fewer than 500 employees must, by virtue of its legal form, appoint a supervisory board of at least three members elected by the shareholders.

5 Corporate governance

All quoted companies, i.e. those with a stock or capital market listing, and other “public interest entities” must follow the German Code of Corporate Governance issued by the Ministry of Justice. The companies’ compliance, or any non-compliance, must be publicly disclosed. The fact of the disclosure is also verified by the auditor.

6 Partnership limited by shares

German company law also provides for a partnership limited by shares (*Kommanditgesellschaft auf Aktien – KGaA*). Although constituted as a partnership, the *KGaA* of modern times is effectively treated as an AG for most purposes and its shares can be traded on the stock exchange as though they were shares in an AG. The *KGaA* has at least one partner with unlimited liability. The shares are issued to and held as investments by the partners with limited liability who thus have a similar status to that of shareholders in an AG. All rights to manage the *KGaA* fall to the unlimited partners, who therefore have, in this regard, the same position as the members of the *Vorstand* of an AG. The division of profits and losses among the partners is a matter for the statutes of the *KGaA*.

The *KGaA* has a long tradition on the German corporate scene, although there are only a few notable examples still in existence. It is, however, favoured by insurance companies.

There are also various other German corporate or semi-corporate legal forms, but these are all either highly specialist in nature or are otherwise unsuitable for foreign investors.

7 Partnerships

There are two German partnership forms in common use, the general partnership (*offene Handelsgesellschaft – oHG*) and the limited partnership (*Kommanditgesellschaft – KG*). Legally, the *KG* is a variation on the *oHG*; thus the rules applicable to an *oHG* apply equally to a *KG* unless an exception is expressly provided for. The difference between the two forms is that some (but not all) of the partners of a *KG* have limited liability.

A partnership is not a legal entity, although it can acquire rights and assume obligations in its own name, take up ownership and other rights to real estate, and sue or be sued. It is therefore a separate business entity from an operating point of view, although it is not legally separate from its owners (the partners) in many respects, including taxation.

The day-to-day management of a German partnership is reserved to the general partners, that is, to those with unlimited liability. These may, as a body, appoint an employed manager to act on their behalf, although they still carry the responsibility to the limited partners for the successful management of the business. The limited partners have rights to meet and to be consulted on matters of overall importance including business policy decisions; in most cases these rights are specified in detail in the partnership agreement.

Where all the partners in a general partnership are themselves limited companies, the abbreviation *oHG* is replaced by *GmbH & Co.* or *AG & Co.* A limited partnership where all the general partners themselves have limited liability is referred to as a *GmbH & Co. KG* or an *AG & Co. KG*. These abbreviations, however, merely indicate that there is no ultimate unlimited liability for the partnership's debts and obligations; they are not different legal forms. By far the most common form of limited partnership is the *GmbH & Co. KG*.

8 European economic interest grouping

The European economic interest grouping (*Europäische Wirtschaftsinteressen-Vereinigung – EWIV*) is not a separate legal form in Germany. Rather, it is equated in every respect to a general partnership (*oHG*).

9 Branches of foreign companies

A foreign business may carry on operations in Germany through a branch registered for that purpose. Registration is with the local court for the area in which the branch is located or on which the German activities are centred. There are no formal minimum capital or other requirements (except for branches subject to specific industry supervision), but one or more local branch managers must be named. Registration is required if the German activity constitutes an apparently independent business unit capable of a self-contained and self-supporting existence, but is not possible if this is not the case, as for example with a liaison, or sales support, office.

In point of fact, many companies effectively have a choice as to whether they register their German operation as a branch. The specific sets of facts and circumstances are rarely completely unambiguous when taken as a whole, so that those wishing, or not wishing, to register a branch may see, or not see, a need to register, depending entirely upon which aspects of the local arrangements they place the most emphasis.

A branch, registered or not, is not a separate legal entity from its foreign parent company. The parent business therefore always bears ultimate legal liability for all liabilities and obligations of the branch. However, all suits brought before German courts against the company on the basis of obligations, commitments or liabilities entered into by the branch must first be directed against the branch, that is, they will be dealt with locally. In practice, recourse to the foreign business is to be had only where either the branch has been wound up or otherwise disappeared, or where it is unable to meet its obligations from locally available resources.

In principle, a branch's registration is not decisive for its liability to taxation, as formal registration is not part of the tax treaty definition of permanent establishment. However, in practice, a registered branch will almost always rank as a permanent establishment, simply because of the registration condition that it be running an independently functioning business, whereas an unregistered liaison office or other entity may or may not be a tax treaty permanent establishment, depending on the nature and scope of the activities carried out and the responsibilities borne.

10 Change of legal form

All forms of corporate reconstructions, mergers, splits, spin-offs, drop-downs, and changes of legal form are regulated by an omnibus Reconstructions Act. In many cases, these manoeuvres can even be done free of tax. Broadly speaking, provided the proper formalities and procedures are observed, any corporation may change its legal form to that of another corporation without immediate tax or other consequences, and a corporation may change to a partnership and *vice versa*, at least without having to recognise a taxable capital gain. Similarly, depreciation policies and valuation options will be carried over into the new entity, although there may be noticeable effects in connection with losses carried forward or previously accumulated reserves now experiencing a change of status. Branches, however, cannot generally be converted to corporations without triggering a taxable gain for the previous owner (taxable as ordinary trading income) and the down-grading of a corporation to a branch would be seen as the liquidation of the corporation.

From a civil law point of view, the most important points to be observed are that the reconstruction or change in legal form must be based on a set of statutory accounts drawn up not earlier than eight months before the reconstruction documents are filed with the trade register, and that the reconstruction itself entails adhering to a number of requirements for the information and protection of the employees. Similarly, care should be taken to ensure that there is no likelihood of a business partner being able to use the reconstruction as an excuse for withdrawing from a, from his point of view, unfavourable contract.

11 The European company (SE)

The EU Council order on the *Societas Europaea* (SE or European Company) was transposed into German national law for 2005 through two statues, the SE Implementation Act and the SE Participation Act. A number of other statutes were changed at the same time – mostly regulating the processes of litigation – as necessary to give the SE from the outset full scope to deport its legal personality. The first of these two statutes, the SE Implementation Act, transposes the European Council Order (EC) No. 2157/2001 of October 8, 2001 on the SE statute into German law, whilst, at the same time exercising the national options and derogations. This Implementation Act governs the formalities of formation, whether by merger or by acquisition – a Holding SE – including especially the rights of protection for dissenting shareholders and creditors. However, minority dissenters are not able to hold up proceedings against the will of the majority, although there are circumstances in which the creditors can demand a surety. The Act also allows the SE to choose between two management structures, a dual system of a management and a supervisory board, and a single system of a board of directors who in turn should elect one or more managing directors. Under the single system, the board may not be less than three persons or, if the share capital is over €10m, more than 21. Under the dual system, these limits apply to the supervisory board and there must be at least 2 managing directors if the share capital is more than €3m (€120,000 is the minimum).

The SE Participation Act regulates the participation of the employees in the running of the company. This includes both the traditional workers' council level of representation of employee interests before management and the co-determination level of employee involvement in the supervision of management. The Act sets forth procedures for the employees to elect a negotiating committee in order to reach agreement on these matters with the employer. Only if negotiations fail, does the model foreseen by the Act become compulsory. Those involved in the negotiations are protected against unfair pressure from the employer and are also given rights to consult trade unions and other outside bodies – including professional consultants – as necessary.

G Labour relations and social security

1 Availability of labour

The German labour force is well-trained and well-educated, and is used to high standards of efficiency and of organisation. It is also used to high standards of protection and to generous fringe benefits and remuneration. In a nutshell, German labour is of a high standard, but is also expensive.

Despite the 6.7% unemployment level, finding skilled employees at short notice is often difficult. Partly, this is because of a certain geographic imbalance in the unemployment rate – it is higher in the east than in the west of the country – and partly it is because many of the unemployed are, for one reason or another, unable to retrain.

2 Employment relations

The overall climate of labour relations can only be described as good, at least in comparison to neighbouring countries. Traditionally, there has always been a strong desire on both sides of the negotiating table to reach a compromise, and while harsh words are often heard, serious strikes or cases of widespread industrial unrest are rare. Partly as a result of this history of repeated compromise; German employment relationships are regulated by a wealth of statutory and extra-statutory instruments, trade union and similar agreements, and by individual agreements reached on the shop floor. Most of these regulations and provisions are highly specific and very detailed. Broadly, German labour law applies to all employment relationships, although there are exceptions to ease the lot of small businesses.

3 Workers' councils and unions

Organised employee representation is at two levels. The first is the "workers' council", elected for each "shop" by its employees. Each business regularly employing five or more persons must allow its employees to form a workers' council from among their number. The size of the council depends on the number of employees. For example, the workers' council of a small business employing between 5 and 20 individuals will consist of a single member. This rises to three members for between 21 and 50 employees. The limit of the table is reached with 35 members where there are between 7,001 and 9,000 employees. Thereafter, the worker's council grows by two with each newly begun step of 3,000 employees. There are also provisions for individual and combined “central” workers’ councils for diversified concerns.

The second, or external, level of employee representation is through the trade unions. Generally, there is one union for each major sector of industry, mirrored by a corresponding employers’ association. The two sides represent employees and employers in the regularly recurring industry-wide negotiations on wage levels, other benefits and on working conditions. These agreements run for between one and two years. In theory, they are negotiated separately for each province, although, in practice, one province is often chosen by mutual consensus as a pilot, and the agreement reached there is then adopted throughout the rest of the country with only very little modification.

Traditionally, only one union was active in respect of each employer. Demarcation disputes between two unions competing for membership were therefore avoided. Agreements reached by the union and the employers’ association were binding in respect of all relevant employees, regardless of union membership, whilst on the other hand employers generally followed the agreement, even if they were not members of the association negotiating it. However, there have been a number of incidents recently suggesting changed attitudes in the wake of long-term structural changes in employment relations. On the employer side, there have been instances of employers withdrawing from their association, solely in order to negotiate their own agreement with the relevant union. It is worth noting that the thought behind this is more often than not a desire to be more generous towards the employees than the association wishes, in order to avoid the unrest and ill-feeling that long negotiations can induce. On the employee side, there is a noticeable tendency towards specialist unions representing particular skills and appealing to those who feel themselves to be under-represented by unions representing all employees as a body. Perhaps the best known examples of this are the airlines and railways, where the pilots and engine drivers formed their own unions because they felt neglected in favour of other employees.

4 Wages and salary levels

The average monthly gross earnings of full time employees is €3,391 (2012). This average is lower in the east, and even in the west many unskilled workers also earn less than this. On the other hand, skilled workers can earn considerably more. On the average, a reasonably experienced secretary capable of working independently and with a knowledge of written and spoken English can expect to earn a monthly gross salary of around €3,200. Middle management salaries and those of professionally qualified technicians and engineers are typically around €4,500 to €6,000. General managers of many smaller foreign subsidiaries receive approximately €7,500 to €9,000. These figures vary largely, depending on various factors, and should not be treated as anything more than a very rough indication.

5 Fringe benefits

Pension schemes apart, fringe benefits in Germany tend to revolve round canteen meals and similar amenities that make the work place more attractive. There is a growing tendency for larger companies to provide child care and similar support for young mothers returning to work. Company cars are common among more senior employees and those who do a great deal of business travel, although the tax rules on benefits in kind do mean that there is little or no advantage for many high income earners in accepting a company car in lieu of salary.

There are two traditional ways for German companies to provide for employees' retirement or ill health, the relief fund and the unfunded pension plan. The relief fund was established for the help of present and retired employees in need and is financed by regular contributions by the employer. These are tax deductible when made, provided certain limits based on the fund assets and annual outgoings are adhered to. Pension plans are invariably of the defined benefit variety and are reflected in the financial statements as a provision for future and current pensions payable. Annual allocations to the provision are tax deductible as current expense provided the amounts are supported by an actuarial computation based on prescribed formulae and provided the plan, itself, meets certain formalities. Because there is no funding requirement, granting present employees future pension rights achieves a current tax deduction without a cash outflow for the employer and without a corresponding burden on the beneficiaries, who do not tax the income until receipt.

Taking out insurance policies covering a company's pension obligations is also popular, particularly with smaller companies or to provide for individual managerial employees. If the company is the beneficiary under the policy, the tax deductible current expense is the premium plus the actuarially calculated annual accrual minus the increase in the adjusted surrender value of the policy. There is no immediate tax effect on the employee. If the employee is the beneficiary, the premium payment is treated as an employee cash benefit.

Rather more recently, deferral schemes to commute salary increases and future bonus or other discretionary payments to retirement benefits have gained in popularity. These schemes are often backed by a pension fund. Provided the prescribed formalities and limitations are observed, the annual expense is deductible for the company, but the income is not taxable by the employee until receipt.

Those wishing to provide for their employees can also do so through a pension fund. Pension funds are supervised by the official supervisory authority but are not subject to the same restrictions on investment as insurance companies. Most company funds are managed by insurance companies, banks and other operators as a service. Contributions are tax deductible, but the company does not have to show a future pension liability in its accounts.

Present and former employees with both funded and unfunded pension rights are protected against employer bankruptcy by a government supported and regulated Association for the Assurance of Pensions. Employers making pension promises of all descriptions other than insurance policies taken out in the name of the employee to benefit must join the Association and pay an annual premium based on their total commitment. The Association sets the rates to cover its actual expenditure over the previous year; thus effectively, it spreads the pension risk from employer bankruptcy over all contributing employers.

There are also various government sponsored schemes run by insurance companies for private individuals. These used to be heavily advertised by the government, but have not lived up to initial expectations for various reasons including a surfeit of formality and low upper limits.

Legally, employers must continue to pay employees at least their average net pay for the first six weeks of sickness. Thereafter, the health insurance institutions will provide sick pay to their members, although only up to a relatively low maximum amount. Employers will often make up the difference for a not inconsiderable period thereafter, particularly to long-serving executives, although usually without a formal obligation to do so.

6 Working hours and holidays

Working weeks vary by industry sector and by location, but are mostly within the range of 37 to 40 hours.

Overtime is often payable at premium rates. There are legal restrictions on the maximum amounts of overtime that can be worked and the trade unions often add to this by putting pressure on managements and on workers' councils to be reticent about requiring or approving overtime. Their hope is to force additional employment. In any case, the current trend is towards more flexible models of working time to allow employees to work in advance or in arrear as dictated by the mutual interests of employer and employee but without having to worry about a cash settlement.

The legal minimum paid holiday entitlement is 20 working days each year for employees on a five-day working week. Trade union and other agreements usually improve on this considerably, and most actual holiday entitlements fall within the range of 25 to 30 days. Middle-management and more senior employees almost invariably enjoy 30 to 32 days. Bank, or public, holidays vary by province from 10 to 13 days annually. However, the actual cost to the employer in terms of lost working time is less than this, as a public holiday falling on a weekend will not be compensated with an additional day off. German public holidays are invariably celebrated on the day of the event that they commemorate; thus May Day is always celebrated on May 1, rather than on the first working day in May.

7 Health and safety

All employers are subject to health and safety regulations. These are extensive and detailed and vary by industry and type of business. The workers' council usually has an important say in the establishment of specific procedures. This also extends to, in many cases compulsory, arrangements with a local doctor for accidents and for regular medical supervision. All employers are required to take out an industrial accident insurance for their employees with a body enjoying a monopoly in that industry and area. This body can and does send inspectors to visit industrial and commercial premises, especially if there has been an accident. The inspectors have the right to demand corrective measures, should they find the safety measures to have been deficient.

8 Termination of employment

In principle, employers and employees can terminate contracts of employment at any time by giving four weeks' notice to the 15th or end of any month. However, the Act on Protection against Termination (*Kündigungsschutzgesetz* – KSchG) provides for longer minimum notice periods for long-serving employees. In some cases, this is extended even further (unless there is compensation in lieu) where it would cause grave social hardship to an individual for him to lose his job. Certain persons, such as expectant mothers, the disabled and members of the workers' council enjoy more or less absolute protection against redundancy. All mass redundancies must be discussed with the workers' council and, isolated instances apart, agreement must be reached with them in the form of a so-called "social plan" to alleviate hardship.

9 Social security

The German social security system is broken down into four main and a number of minor elements. The main components are retirement insurance, unemployment insurance, invalidity insurance, and health insurance. In 2014, the monthly premiums are 18.9%, 3.0%, 2.05% and 15.5% of gross salary. Basically, the cost is split equally between employer and employee, although childless employees are required to bear an additional 0.25% premium for the invalidity insurance. The health insurance premium is another departure from the principle of equal split of the burden: the employee contribution is 8.2% and that of the employer 7.3%. The total of these contributions amounts to 39.45% of an employee's gross salary (39.7% if the employee is childless), although the contributions are only due on salaries up to a certain level. In 2014, the monthly levels are €5,950 (€5,000 in the east) for contributions to the retirement and unemployment insurance, and €4,050 (throughout Germany) for premiums to the invalidity and health insurance. With certain specific exceptions, the first two of these insurances are compulsory; the health and invalidity insurance are voluntary for those with annual earnings of more than €53,550. However, those opting out must take out private health insurance. They are also generally unable to rejoin the state scheme later, unless their regular monthly earnings fall below the opt-out level while they are still under 55.

The social security systems of the EEA countries (EU, Iceland, Liechtenstein and Norway) are coordinated by an EC regulation with the broad objective of ensuring that those who move between one member state and another do not suffer any fundamental loss of current or future rights. Thus pension rights acquired in different member states accumulate on retirement and visitors from another member state are entitled to the same health benefits as the locally insured, if they fall ill. There is also provision for those living in one EEA country and working in another.

Beyond the EEA countries, mutual social security arrangements are governed by bilateral treaties. Germany has concluded social security treaties with Australia, Bosnia-Herzegovina, Brazil, Canada, Chile, China, India, Israel, Japan, Korea, Kosovo, Macedonia, Montenegro, Morocco, Serbia, Tunisia, Turkey, United States and with Uruguay (not yet in force). Generally, these treaties allow employees taking up temporary residence in the second country to retain their membership in the social security scheme of their home country, provided they continue in a home country employment, for two or four years. They also provide for the accumulation of pension entitlements from premiums paid in both countries and often for the provision of medical treatment in the one country to travellers from the other.

10 Working and residence permits for foreigners

EU citizens have the right of migration to Germany. Once they have found living accommodation, the local authority will inform the immigration authority of their arrival. This may request further information, for instance on their ability to support themselves. However, their right to take up residence in Germany may not generally be refused and they also have an unrestricted right to take up employment or to engage in business activities as though they were German citizens.

Citizens from Croatia fall under temporary restrictions running for up to seven years from the date of Croatia's accession to the EU (July 1, 2013).

Individuals of other nationalities moving to Germany require residence and work permits. Basically, the two documents are issued under a combined procedure which includes a review of the local job market to ensure that there is no German or EU job seeker available to fill the position. The prospective employer is therefore involved from an early stage.

In most cases, the procedure starts with the application by the employee to the German consulate in his home country for a three-month entry visa. His intending employer should file an application for an employment permit at the same time, as the consulate will refer the visa request to the local authorities of the intended place of residence. Thereafter, work/residence permits are granted at yearly intervals which can be extended later to two or five years.

Citizens from Andorra, Australia, Canada, Israel, Japan, Monaco, New Zealand, San Marino and the USA are privileged in that they may apply for a work/residence permit from within Germany. Thus they are able to come to Germany as visitors, find a job and then make the necessary application with the help of their future employer. They may not, however, start work before the permit is granted.

Other relaxations apply to doctors and engineers, to graduates and to highly qualified IT staff and craftsmen and women (demonstrated by the ability to command an annual salary of at least €46,400). Essentially, applications from those appropriately qualified will be granted without specific review of the local employment situation on the assumption that the applicant will not be displacing an otherwise employable EU citizen.

H Audit requirements and accounting practices

1 Statutory requirements

The Commercial Code requires all but the smallest businesses to keep an orderly set of books. The books must conform to a generally accepted standard of record keeping, must provide a complete record of all transactions and must be supported by a complete set of vouchers and other documentation. They must be kept in euros and must be written-up in a living language. If they are not in German, the tax authorities have the right to demand a translation.

The tax acts also contain provisions affecting the accounting records. Foremost among these are the "principles of orderly computerised accounting systems" and a formal requirement that the books be prepared and retained in Germany at all times, unless the responsible tax office permits otherwise. If this requirement is ignored, the tax auditors might see the company's books as "disorderly". This could lead to difficulties in respect of any aspect of taxation (including VAT) dependent upon the accounting records. However, there is a procedure for applying for tax office permission to keep (electronic) books and records in another country. In principle, approval will be granted where the tax office is satisfied that its right to audit will not be compromised.

The Commercial Code also contains additional requirements for the audit and publication of financial statements of all limited companies and of partnerships in which no natural person ultimately carries unlimited liability. Thus, the *GmbH & Co. KG* (see section F), in which the unlimited, general partner's share is held by a GmbH, is subject to an audit and publication requirement. These rules also describe in more detail the accounting principles to be applied. These rules also apply to very large partnerships and sole traders.

From the point of view of the audit and publication of financial statements, companies are categorised into small, medium-sized or large. A small company is one not exceeding any two of the three criteria: a) annual sales of €9,680,000, b) balance sheet total of €4,840,000 and c) 50 employees. A medium-size company does not exceed any two of the following three criteria: a) annual sales of €38,500,000, b) balance sheet total of €19,250,000 and c) 250 employees. A company changes its status when it has met or fallen below the respective criteria for the second consecutive year.

Small companies are not subject to an audit requirement, and may satisfy the publication requirement by depositing electronically a condensed balance sheet and notes thereto, but without a profit and loss account. Medium-size and large companies must have their financial statements audited, but the publication requirements for medium-size companies are easier to fulfil, and these companies are exempt from various otherwise required disclosures. Large companies are subject to the full publication requirement, i.e., depositing their full annual report with the trade register and electronic publication in the Federal Gazette (*e-Bundesanzeiger*) and one other newspaper as well as on the internet. There are additional publication requirements for companies that are listed, or publically issue bonds, in Germany.

2 Accounting principles

All German statutory financial statements must agree with the underlying accounting records and must follow the historical cost convention. They must be complete and accurate and be drawn up within three months of the company's year-end. This period is extended to six months for small companies, but only on the condition that the delay can still be seen as being within the confines of an "orderly manner of doing business". The financial statements must follow the accruals accounting principle. Consistency and prudence are emphasised as principles. Financial statements must be drawn up under the assumption of going-concern, that is, that the company will continue its business operations into the foreseeable future, unless there are specific circumstances (legal or otherwise) to the contrary. Appropriate depreciation of fixed assets must be recorded, liabilities must be taken up at their anticipated repayment amounts and provision must be made prudently for foreseeable financial risks.

3 Form and content of annual reports

The basic German financial statements are a balance sheet and a profit and loss account. The notes thereto are the subject of an "appendix" (*Anhang*). The financial statements are accompanied in the annual report by the auditor's report and the proposal or resolution for profit appropriation. Finally, the annual report includes the directors' report (the so-called "business report" or *Lagebericht*). The directors' report should discuss the business situation of the company and also specifically mention major risks and opportunities, a description of the internal control system, the future outlook for the company, any important subsequent events, anticipated development of the company's business and the branches it maintains. The directors' report is subject to audit inasmuch as the auditors must read it and satisfy themselves that it is not at variance with other published information or otherwise misleading, before they may pass an opinion on the financial statements.

Quoted companies must also publish a cash flow statement and a declaration of compliance with the Code of Corporate Governance (see F. 5 above). Instances of non-compliance are to be explained.

4 Valuation of shareholders' equity, assets and liabilities

4.1 Shareholders' equity

Shareholders' equity consists of the issued share capital, capital and other reserves and the retained earnings. Unpaid and uncalled amounts on share capital are shown as a deduction from the nominal amount of issued share capital. Amounts called up but not yet paid are an asset. The retained earnings are net of dividends declared during the year and may also be shown net of the dividend proposed.

If the shareholders' equity is negative because the accumulated losses exceed the capital paid up and the accumulated reserves, the net amount is shown on the assets side of the balance sheet as "accumulated losses in excess of equity paid". In that case, it will be necessary to explain in a note to the accounts why the company has not instigated insolvency proceedings.

4.2 Fixed assets

Fixed assets consist of tangible fixed assets, intangibles and investments. No planned amortisation may be taken on the investments or on land, but all other assets must be depreciated over their useful lives. The tax rules contain guidelines for determining the useful lives of various types of assets and these are often followed in the statutory accounts, if only for simplicity. Under the Commercial Code, goodwill should be amortised over a maximum of five years, unless there is a good reason for taking a longer period. However, the tax rules allow a deduction for goodwill amortisation straight-line over a 15-year period. Under certain conditions internally-generated intangible assets such as software may be capitalised as a matter of company accounting policy. However reserves equal to the book value of such assets (net of any deferred tax) may not be distributed.

4.3 Inventories

Inventories are valued at the lower of cost or market. Most generally known costing methods are acceptable for the determination of cost. Inventory usage is normally accounted for on an averaging method or by FIFO. Other methods may be used if they more accurately reflect usage in practice.

4.4 Accruals and provisions

Prudent provision must be made for all foreseeable financial risks. Expenses already incurred must be accrued. Provisions for a loss in the value of assets are deducted from the assets themselves; provisions for claims and other expenses are shown on the liabilities side of the balance sheet.

Long-term provisions (those not expected to be utilised during the coming twelve months) are discounted over the expected period of reversal at the average market rate of interest during the past seven years. Average interest rates for this purpose are published monthly by the *Bundesbank*. For pensions an average reversal period of fifteen years may be assumed.

4.5 Payables and other liabilities

Payables and other liabilities include only those amounts where the amount, the obligation to pay and the identity of the creditor are certain. If any of these are uncertain, the amount should be shown as a provision or accrual, rather than as an account payable. Deferred income is shown separately from the liabilities and the accruals.

4.6 Foreign currency balances

Foreign currency balances due within one year are translated into euros at the official middle rate on balance sheet date. Long-term receivables and payables are not to be valued at more than respectively historical cost or repayment amount. Thus unrealised exchange gains on long-term foreign currency balances are not to be taken up.

4.7 Taxes

Unpaid taxes actually assessed are included in other liabilities. Income taxes currently payable but not yet assessed are shown as a separate item under the amounts accrued.

Deferred taxes are calculated using the liability method. The calculation is to be based on all timing (temporary) differences between the carrying value in the financial statements and the tax base without regard to the expected period of reversal. The effect of tax losses expected to be offset against income during the next five years is also to be included. The rate to be taken is that anticipated by the company for the year of reversal. If not known, the latest known rate should be assumed. If the net deferred tax balance is a liability, it should be shown as the last item on the liabilities side of the balance sheet. If it is an asset, it may be capitalised and disclosed as the final asset item.

4.8 Pensions

Pension provisions are shown as a separate item under provisions and accruals. They are to be calculated on recognised actuarial principles under the rule for discounting long-term provisions – see 4.4. Under certain circumstances, pension plan assets and liabilities are set off against each other.

4.9 Leasing

The leasing attribution rules in the tax law are almost invariably followed in the statutory financial statements. Partial pay-out leases are almost always treated as operating leases, full pay-out leases are generally capitalised by the lessee if the minimum lease period is less than 40% or more than 90% of the asset's anticipated useful life. A variety of other relevant factors taken from tax law also need to be considered, for example where the ownership falls to the lessee at the end of the lease.

5 Consolidated accounts

A German company with at least one subsidiary must prepare and publish a set of audited consolidated financial statements, unless the consolidated whole fits the definition of a small group. Broadly, a small group will employ no more than 250 employees, and have total annual sales (including intercompany items) of less than €46,200,000 and combined gross assets of less than €23,100,000 before eliminations. The consolidation obligation arises where two of these three criteria are consistently exceeded.

Companies can be exempted from the consolidation requirement if they themselves are subsidiaries of an EU or foreign parent and that parent publishes a German translation of its own consolidated financial statements in Germany. This exemption provision applies to all EU parent companies, and to those in other countries, such as the United States, with internationally recognized accounting principles and auditing standards.

The German accounting profession has established an accounting standards committee (Accounting Standards Committee of Germany) for the debate and promulgation of nationally acceptable accounting standards. Its pronouncements primarily interpret the accounting principles of the Commercial Code in respect of consolidated reporting requirements.

6 International financial reporting standards – IFRS

Following European law, all quoted companies must draw up their published consolidated financial statements under IFRS. German law allows non-quoted companies and other commercial entities to do this as an option. However, companies publishing under IFRS will still need Commercial Code accounts for each individual member of the consolidation as a measure of the maximum distributable dividend and as a basis for the tax returns.

7 Enforcement

A privately organised review board (*Deutsche Prüfstelle für Rechnungslegung* – German Accounting Review Board) has been set up under the Financial Statements Review Act. This board is subject to the overall control of the Federal Financial Supervisory Authority. It conducts field reviews of the published financial statements and other reports of quoted companies. It selects its review candidates at random, in reaction to specific suspicions of irregularities, or at the explicit request of the Supervisory Authority. Publication of its findings is the primary sanction on a company found to have misrepresented its position without being criminal. Companies must cooperate with the board. Failure to do so is reported by the board to the Authority, which may then decide to conduct its own investigation – possibly acting through the board's staff.

8 Auditing profession and auditing standards

The auditing profession is led by the *Institut der Wirtschaftsprüfer* (Institute of Auditors), with a membership of some 13,000 qualified *Wirtschaftsprüfer* and accounting firms. Membership in the Institute is voluntary. Membership in the Chamber of *Wirtschaftsprüfer* is compulsory for the some 17,000 *Wirtschafts-prüfer* and firms. Admission is open to those holding a university degree, who have served for three years with a qualified auditor or who can demonstrate other, equivalent practical experience, and who have passed a rather difficult exam. Qualified *Wirtschaftsprüfer* are the only people permitted to act as the auditors of companies required to publish their statutory financial statements, although other qualified professionals, for example tax advisors, may perform special-purpose audits and investigations or numerous other accounting services.

The *Institut der Wirtschaftsprüfer* lays down detailed and extensive standards of auditing and reporting. It also sets rules for ethical behaviour and professional conduct. In all these respects the German profession can take its place among the world leaders. In contrast to other countries, the German auditor is required to prepare a detailed report for management and the supervisory board on the scope and extent of the audit and its results, and must also comment on management's appreciation of the financial position and prospects of the company as shown in the directors' report. The requirement is specified in the Commercial Code, and the *Institut der Wirtschaftsprüfer* has issued extensive guidance statements indicating how its members should draw up such reports.

There is no legally prescribed wording for an audit opinion. However, the opinion must be easily understandable, must draw clear attention to major problems – especially those endangering the business as a going concern – and must confirm that the directors' report is not misleading. If the opinion is unqualified, it must state that there are no adverse audit findings and that the financial statements give a realistic view of the assets, financial and profit positions of the company.

I Tax system and administration

1 Principal taxes

Most German taxes are levied on income or on transactions. Capital taxes are part of Germany's tax tradition, although they are now only levied locally on land ownership. Even there, their effect is small and, for a profitable business, is in any case partially compensated by a corresponding trade tax deduction.

Business income is subject to two taxes, trade tax and then either corporation or income tax. Trade tax is levied under national rules but at rates fixed by the local authority where the business has establishments. The profit of an incorporated business is also subject to corporation tax; that of an unincorporated business owned by a natural person forms part of his or her income tax assessment. Partnerships are transparent vehicles once the trade tax has been paid; that is, the taxable income is allocated to the partners in profit-sharing ratio and is then subject to corporation or income tax in their hands. Although the partnership is transparent from the point of view of the tax burden, it is not so from the point of view of the tax administration; the taxable income allocated to the partners is based on returns filed by the partnership, as are any additional expenses of the partners that they may wish to deduct but did not charge to the partnership (such as interest on a loan taken out to finance the purchase of a partnership share).

Individuals pay income tax on their accumulated income from all sources except investment income. The sources are classified as agriculture and forestry, employment, rentals and leases, incidental activities, trade or business, and capital gains on the sale of property. The rules defining trade or business income also apply to the income of corporations unless the Corporation Tax Act specifically rules otherwise. Thus, there is a degree of conformity in the determination of the taxable income of businesses, regardless of legal form. However, the entire income of a corporation ranks as business income by legal definition.

Investment income of individuals is taxed at a flat rate of 25%. It consists of dividends, interest, capital gains on the sale of securities and the various surrogates for these items. If paid through the domestic banking system, it is taxed at source. If not, the recipient must report it on his tax return and pay the 25% by assessment. Special rules apply to income on investments held as business assets.

The major German transactions tax is VAT, levied under the harmonised EU system. Other significant transactions taxes are excise taxes, insurance tax, real estate transfer tax, and inheritance and gift tax. Insurance tax is levied on most forms of insurance premium. It is paid by the insurance company or agent, but is invariably passed on to the insured person, and thus has the economic effect of increasing the insurance costs of resident businesses and individuals. Real estate transfer tax is effectively a stamp duty on direct or indirect sales of real estate, while inheritance and gift tax is levied on all forms of capital transfer between private individuals.

2 Sources of tax law

German taxation is based on acts of parliament. Each tax is governed by its own act; there is thus a Corporation Tax Act (*Körperschaftsteuergesetz* – KStG), a Trade Tax Act (*Gewerbesteuergesetz* – GewStG), an Income Tax Act (*Einkommensteuergesetz* – EStG) and a VAT Act (*Umsatzsteuergesetz* – UStG), to name only the most important examples. These acts are supplemented by a number of specific acts to regulate the tax consequences of a given type of transaction or set of circumstances. Examples are the Reconstructions Tax Act (*Umwandlungsteuergesetz* – UmwStG), which basically allows incorporated and unincorporated businesses to reorganise themselves free of immediate taxation, or the Foreign Tax Act (*Außensteuergesetz* – AStG), which, broadly, is a collection of anti-abuse provisions for the prevention of avoidance or evasion of German taxation through the accumulation of income under a low-tax regime abroad. It is this act which provides the fundamental legal basis for the extensive set of transfer pricing rules applicable to transactions between related parties. These acts are linked by a Tax Management Act (*Abgabenordnung* - AO) that regulates reporting, filing, assessment, and appeal procedures common to all, or nearly all, taxes. It also sets forth a number of general definitions and establishes the basic rights and duties of taxpayers as well as regulating some of the procedural questions of the tax administration.

The act for each major tax is supplemented by a set of official guidelines. These guidelines discuss the practical application of the various provisions of the act, often by way of example. They also contain references to relevant case law. The guidelines are written in the finance ministry, but are published with the approval of the *Bundesrat*. They therefore have a degree of parliamentary authority, although they are not formally a statute and do not bind the courts. They do, however, effectively bind the tax authorities in most cases. The acts are further supplemented by a collection of decrees and ordinances issued at various levels of the tax administrations, often in response to problems arising.

Some of these decrees are far-reaching, for example the decree embodying the related-party transfer pricing rules. As with the guidelines, these decrees do not have legal force and do not therefore bind the taxpayers or the courts. In principle, they do not bind the tax authorities either, especially as the authority issuing a decree can change or withdraw it at any time. In practice, tax offices will almost always follow a decree, if only because it would be a breach of discipline for them not to do so. Nevertheless, the decrees only interpret the law; they are not the law itself. Thus it would be unwise to rely too heavily on a literal rendering of a decree when taking a position clearly at variance with its intent.

The other important source of tax law is the case law handed down from the tax courts. Under the German legal system, there is no doctrine of binding precedent in the Anglo-Saxon sense of the term, and lower tax court decisions are, at best, indicative, or of use in developing one's own line of argument. Cases decided by the appeal court, the Supreme Tax Court, carry far greater weight and are usually respected as precedents by the tax authorities. If the finance ministry disagrees with the position taken, it will often issue a "decree of non-appliance" ordering tax offices to ignore the judgment except in the case actually decided. Case law handed down from the Constitutional Court or from the European Court of Justice is, of course, binding, although often the effect is to prompt the government to take action to amend the statute.

3 Returns

The tax year is the calendar year. Taxes on business income based on financial statements supported by a proper accounting system will be levied on the net profit for the business year ending in the given calendar year. A business year can be shorter, but never longer, than twelve months. Changes in accounting year-end will therefore always have the effect that, in at least one tax year, the taxable income will be based on the combined results for two accounting periods. A company or other business has a free choice in determining its accounting year-end date on formation or start-up and may also change this at any time to the calendar year-end, provided the company law formalities are adhered to. However, tax office approval is required for changes to a date other than December 31; this approval can be applied for informally and is usually given where the change is to conform to the year-end date of a foreign parent company, or for another good reason.

In principle, businesses must file tax returns by the May 31 following the year-end. This deadline is automatically extended – to December 31 in 2013 – if the returns are prepared with the help of a qualified consultant, unless the tax office responsible asks in individual cases for earlier submission. Further extensions may be granted up to the end of the following February, but only for a specific reason.

Once the tax office has reviewed the returns filed, it will issue notices of assessment. These assessment notices will usually agree with the return; if they do not, the reason must be stated on the assessment notice. The assessments often take several months to issue and are “preliminary”, that is, subject to a future tax audit. Since it is always open to a taxpayer to re-file returns at any time before the assessment for that year becomes final and binding, the appeal deadline of 30 days highlighted in the assessment notice is often of little relevance at this stage of the proceedings.

Electronic tax administration is a major priority. The forms can be downloaded by the taxpayer, filled out off-line and then submitted by e-mail. In most cases, they can also be submitted online. All major taxes are now covered and electronic submission is generally compulsory for businesses (with a hardship clause for small businesses) but voluntary for private individuals. Electronic submissions must be authenticated with a certificate issued by the tax office on registration for electronic filings. Certificates are valid for three years and can be renewed online.

Electronic filing of accounts in support of the taxable income shown in the tax returns was introduced in 2013 (for the 2012 accounts).

2013 was the first year in which employee withholding taxes were fully automated. Each taxpayer has been given a unique tax identification number by the Central Tax Office as a permanent identifier in all tax respects. Eventually, this is to replace all existing tax numbers, most of which are allocated by local tax offices and which are of necessity subject to change on any local tax office reorganisation or move to a different town by the taxpayer. Currently, correspondence with the tax office shows the numbers from both systems.

4 Payments

Taxes are paid quarterly during the year with a final adjusting payment or refund when the assessment is issued. The quarterly prepayments are based on a taxpayer’s estimated results, often derived from the assessment notice last issued. Newly registered taxpayers must give profit estimates for the first two years when registering, and other taxpayers are sometimes asked for their own profit estimates for a current period. Often these requests are prompted by the tax office’s noticing an increase in sales revenue from the periodic VAT returns.

VAT returns are monthly or quarterly, but these "periodic" returns are only preliminary. A VAT return must be filed for each tax year (but, in this case, for the twelve-month period ending on December 31, regardless of the accounting year-end) within the same deadlines applicable to the returns of income taxes. Payments and refunds follow the amount shown on the periodic and annual returns. Assessment notices are only issued if the tax office wishes to depart from the return. Often this is the consequence of a tax audit.

5 Audits

Tax audits are conducted at three to five-year intervals. Larger companies with foreign shareholders are almost always audited regularly, although not every year is necessarily reviewed with equal intensity. Tax audits are usually detailed field reviews of the books, records and of the other relevant documents of the company and often take several months to complete. In most cases, they conclude with a closing meeting during which the tax auditors discuss their findings and conclusions. Usually, both sides are able to agree on questions of fact, although a taxpayer who disagrees with a position to be taken by the tax auditors is entitled to ask for the appropriate reservation to be made in the audit report. Once the report is issued, the taxpayer is again given an opportunity to comment. The comment must be made within a period of some three weeks; otherwise the report will be forwarded to the section of the tax office responsible for issuing assessment notices. These notices will amend or confirm the preliminary assessments previously issued and become final and binding 30 days after receipt by the taxpayer. Any appeal must be filed by then, and this deadline must be taken seriously, as a final and binding assessment can only be reopened in unusual circumstances.

The tax auditors have the right of direct access to the computer of any taxpaying company that keeps its books electronically. They may interrogate the data on site using the hardware and software of the taxpayer, or search or analyse copies of it off site using their own audit software. They may also ask the taxpayer to analyse or summarise data by criteria which they set.

6 Appeals

There is a three-tier appeal system. The first appeal is to the tax office that issued the assessment notice, essentially asking the inspectors to reconsider their view on the point at issue. The next step is then to the competent regional tax court, and from there to the one Supreme Tax Court which acts as the tax court of appeal for the whole of Germany. Appeals to a regional tax court can be on points of law or of fact, but appeals to the Supreme Tax Court can only be on points of law. If the Supreme Tax Court takes a different view of the law than the regional court but cannot decide the case for lack of factual information, it must refer the case back to the lower court rather than research the facts for itself. With the agreement of the tax office, an appeal against an assessment can be filed directly with the regional tax court, that is, one may “spring over” the first step in the appeal process. This permission is often given where the taxpayer is challenging the validity of some point in the official tax guidelines or of a decree, but where the facts of the case are not in dispute.

A taxpayer who feels that an assessment breaches European law may base an appeal upon that contention. However, the German appeal process must be followed – the taxpayer cannot turn directly to the European Court of Justice. He or she can, however, request the tax court, but not the tax authorities, to do so. Cases heard before the ECJ typically take some two years to resolve, and it should be noted that that Court will not rule for or against a taxpayer in a specific instance, but rather on whether Community law allows or precludes a given point of national law or practice. The ECJ judgment thus takes the form of an answer to a “preliminary” question posed by the referring court, and not of an order for or against a taxpayer.

7 Penalties

Simple interest is levied at 6% p.a. on all amounts paid late. However, the interest period does not start until 15 months after the end of the year of assessment. Late payment interest is not a tax-deductible expense, although the corresponding income (on a tax refund due) is a taxable benefit. Various other penalties can also be levied, although – transfer pricing documentation issues apart – the more serious ones are usually only imposed or threatened where there has been a wilful attempt to defraud. The rules on documentation of transfer prices with foreign related parties are the exception to this remark. Failure to follow them adequately exposes the taxpayer to penalty payments based on the amount of tax under-collected because of the breach. This is usually significant, because the breach entitles the tax auditors to base their findings on the extreme upper end of any possible range of estimates. This contrasts with the position routinely taken by the Supreme Tax Court on differences in interpreting adequate documentation, to the effect that a taxpayer cannot be reproached if his position lies at any point within an acceptable range. A tax auditor is thus entitled to do no more than propose reassessment based on the lower extreme of any range – if the documentation was adequate.

8 Tax office rulings

There is a set procedure for tax office rulings on the tax consequences of a planned action. Broadly, application is to the tax office responsible for the given taxpayer and must contain a detailed description of the intended action, of the taxpayer's view of the law, and of the reason why the ruling is considered necessary – both in terms of the potential risk and of the uncertainty involved. A ruling will not be given on a matter where the taxpayer is already committed to a particular course of action. A fee will be charged based on the amount of tax at risk. The scale is that for court costs and the range is from €241 to €91,456. No fee is charged if the subject value is less than €10,000.

Advance pricing agreements are the responsibility of the Central Tax Office. This office negotiates them on the request of a taxpayer with the corresponding authority abroad as a "mutual agreement" under the relevant double tax treaty. They are therefore bilateral, although, according to the official notice on the subject, a multilateral effect can be achieved by negotiating the same agreement with a selection of foreign authorities. The notice emphasises the need for full and frank cooperation between the taxpayer and the Central Tax Office, both during the negotiations and during the currency of the agreement (typically between three and five years). It clearly assumes that the taxpayer sees his interests as coinciding with those of the tax office and displays a marked preference for agreeing on methods and parameters ("critical assumptions") rather than on rates or amounts. Obviously, a taxpayer may well be more interested in ensuring that income is only taxed once, than in the actual split between the two countries.

The Central Tax Office charges a fixed fee for its negotiations. The standard amounts are €20,000 for a new agreement, €15,000 for an extension of an existing agreement and €10,000 for a change to reflect changed circumstances. These amounts are halved for minor instances – annual sales of related party products of up to €5,000,000 or of up to €500,000 in services.

9 Withholding taxes

Germany has an extensive system of withholding taxes (WHT) deducted in order to secure the tax revenue. The most important of these is the income tax deducted from employees salaries (the so-called "wage tax"), followed by withholding taxes of 25% from dividends, interest and capital gains from investments held for safe-keeping by banks. There is also a requirement on institutions to deduct 15% from payments to most builders. The wages and other withholding taxes are uplifted by a "solidarity surcharge" of 5.5%.

Investment income apart, these domestic withholding taxes are not final burdens, unless the taxpayer does not file a tax return. Any resident taxpayer may file a tax return; those whose only income is from a single employment are not obliged to do so.

Withholding taxes on payments abroad are in most cases restricted or eliminated by double tax treaty or by the provisions of the EU Parent/Subsidiary Directive. German law in isolation foresees withholding tax of 30% on directors' fees, 25% on dividends and 15% on royalties and sporting or artistic income. There is also a provision allowing tax offices to order a withholding tax of up to 25% on other payments to foreigners where there are specific grounds for fearing a loss in tax revenue. There is no withholding or similar tax on the repatriation of branch profits or on most interest payments.

10 International exchange of information

For several years, Germany has been forceful in promoting the international exchange of tax information and has concluded a range of bilateral treaties on this subject with countries with which she has not concluded a general double tax treaty. Ideally, the government would like the information exchange to be automatic, but has been prepared to accept limiting exchanges to specific requests if the other state insists and is willing to discourage evasion with a meaningful WHT. However, attitudes are hardening, not least in the wake of the US Foreign Account Tax Compliance Act (FATCA) and the *Bundesrat* refusal to ratify an agreement with Switzerland, seen by many as being too protective of evaders. Indeed, Germany is now pressing for a fully automated system within the European Union and for EU insistence on this from European tax havens outside.

In 2012, Germany participated in a working group with France, Italy, Spain, the United Kingdom and the United States with the task of drafting a model FATCA agreement designed to keep Germany's own banks FATCA-compliant, acquire equivalent rights from the United States in respect to Germany's own taxpayers, and to resolve potential legal difficulties arising from co-operation of German banks with the tax authorities of a foreign power. A bilateral agreement with the United States on this model was signed on 31 May 2013, and Germany has agreed with the other members of the working group to exchange information on the same lines as a pilot project within the European Union. The current hope is that this will lead to a European FATCA in the form of an EU legal act ensuring a multilateral exchange of information between all member states.

J Taxation of corporations

1 Tax rates and total tax burden

German business profits are subject to two taxes, trade tax and then to income or corporation tax. The income or corporation tax is subject to a surcharge, the so-called “solidarity surcharge”, of 5.5% of the amount due.

All businesses are subject to trade tax regardless of their legal form. The basis of assessment is the taxable income derived from the before tax accounting profit under rules applicable throughout Germany. This basis is determined centrally by the tax office responsible for the company’s German taxation (the place of German management). The tax office then allocates this basis over the various local authorities where the company has business establishments, generally in proportion to the total wages paid to the employees in each. Special rules apply to German permanent establishments without employees, such as pipelines passing through Germany, but operated and controlled from abroad. Each local authority then issues its own notice of assessment to the taxpayer, that is, it charges its share of the overall basis of assessment to trade tax at its own local rate. The local authorities are also responsible for collection.

Trade tax rates of larger towns generally fall within the range of 14–17%. Those of smaller towns and country districts are usually between 12% and 16%, although there are a few isolated instances of local authorities with rates of lower than 12%. The legal minimum is 7%. Tax-rate competition between town and country tends to be overshadowed by the other distinctions between the two (rents and other costs are often more expensive in the towns, although communications are frequently better). However, there may well be a noticeable trade tax advantage in locating a factory, warehouse or similar facility immediately beyond the city limits rather than just inside them.

A company’s profit is then subject to corporation tax. Profits earned by individuals are charged to income tax. Partnerships pay trade tax in their own right but then allocate the taxable income to their partners in profit-sharing ratio. The partners are then subject to corporation or income tax on their profit shares as their own trading income.

Corporation tax is levied at 15% on both domestic and foreign corporations. Thus, there is no difference in the rate of corporation tax levied on the profits of a German GmbH and that levied on those of the German branch (or partnership share) of a foreign corporation.

Foreign corporations may freely repatriate their German branch profits, other forms of permanent establishment income, or profit shares from their partnership holdings without further taxation. There is no form of “branch profits tax” or other substitute for a dividend withholding tax. Dividends repatriated by companies are subject to a dividend withholding tax, which will be a final burden from the German point of view, unless the recipient of the dividend is a German tax-resident corporation or natural person.

The domestic rate of dividend withholding tax is 25% plus the solidarity surcharge. Almost all the German tax treaties reduce this to 5%, 10% or 15% on dividends paid to foreign corporate shareholders with at least a 25% holding in the German company. The Swiss and – for holdings of at least 80% – US treaties waive it altogether. Treaty provisions notwithstanding, the EU Parent/ Subsidiary Directive exempts dividends paid by a German corporation to a shareholder incorporated in another EU country holding at least 10% for an uninterrupted period of at least 12 months. This period does not have to be completed before the dividend is paid; any withholding tax initially levied will be refunded, once the minimum period has expired.

The total German income tax burden from investing in Germany therefore depends on the location of the German operation, and on the home country of the investor if the German investment is incorporated locally. The ultimate burden worldwide will, of course, depend upon the foreign tax relief mechanisms available to the investor in his home country. Trade tax at 17%, corporation tax at 15% and the 5.5% solidarity surcharge imply a total burden of 32.8%. This is the burden borne in respect of a German subsidiary of an EU corporation, or of the German branch of any foreign corporation, conducting its operations in a trade tax-expensive town. If the profits are subject to a 5% withholding tax (for example, holdings below 80% under the U.S. treaty), the burden rises to 36%. If the trade tax is only 15%, the respective burdens are 30.8% and 34.3%; if the trade tax rate is only 12%, the burdens fall to 27.8% and 31.4%. These burdens are to be seen as illustrative only; their accuracy depends on an identical basis of assessment to trade and corporation taxes – a rare occurrence.

Profits earned by German-resident corporations up to 2000 were charged to corporation tax under a different, imputation system. This old system made the corporation tax payable by the company dependent on its distribution policy and also gave a credit against a resident shareholder’s own income or corporation tax in the amount of the equivalent corporation tax previously borne by the company. Under the changeover provisions, companies with retained earnings taxed under the old system established their remaining imputation tax credit at one-sixth of the old taxed retained earnings still undistributed on December 31, 2006. This credit is being paid out in ten equal annual instalments from 2008 to 2017. A corresponding provision applies to retrospectively tax the distribution element of any remaining old system untaxed retained earnings of domestic source on December 31, 2006; the total burden is taken at 3% of the nominal amount, to be paid in 10 equal annual instalments from 2008 to 2017. September 30 is the due date for both credit and additional levy. Neither bears interest, though there is a provision for voluntary early payment of the remaining levy instalments at a discount of 5.5% for each remaining year outstanding.

2 Taxable income – corporation tax

Taxable income is derived from the statutory accounts drawn up in accordance with the provisions of the Commercial Code. In principle, all income is taxable except for dividends and capital gains on the sale of shares. The dividend exemption applies to shareholdings of 10% or more regardless of the length of time for which they were held and it also applies equally to German and foreign investments. The capital gain exemption is similar except that there is no minimum shareholding level. The non-deductible directly related cost of earning this tax-free income is irrefutably presumed to be 5% of the dividend received or capital gain realised. Banks are subject to special rules on their trading portfolios.

The tax computation (calculation of taxable income) starts from the net result for the year as shown in the Commercial Code financial statements. This figure is adjusted by adding back disallowable expenses and deducting tax-free income (permanent differences). It is then further adjusted with the temporary or timing differences resulting from the differing exercise of accounting options for tax purposes. There are also instances of accounting policy requirements in the Income Tax Act that are more rigid than the corresponding provisions of the Commercial Code. These, too, can lead to timing differences. All timing differences must be recorded in a register showing for each one its legal basis and its reversal. A company may not depart from its financial statements as finalised by their adoption by the shareholders in respect of matters for which there is no explicit accounting option in a tax act. Thus, it is free to depreciate a fixed asset on the declining balance method for tax whilst showing straight-line depreciation in its legal accounts, but may not change its mind about capitalising the item at all. If, by the time the tax returns are prepared, it is seriously felt that the item should have been written off to expense, the only permissible conclusion is that the financial statements were incorrect and should be amended. This, though, is at that stage a cumbersome and costly process.

2.1 Amortisation and depreciation

Intangible fixed assets are amortised straight-line over their useful lives. Often these can be objectively determined, such as in the case of patents and trademarks with a specific expiry date. Goodwill is amortised over 15 years. Investments may be neither written down nor regularly amortised with tax effect. Land is also not subject to regular amortisation, although it may, in rather unusual circumstances, be written down to a lower fair market value. Buildings constructed under planning permission applied for on or after April 1, 1985 are amortised at 3%, although different rules apply to older buildings. Movable fixed assets are depreciated straight-line, in theory over their estimated useful lives. The Ministry of Finance publishes guidelines, the so-called depreciation tables, listing its estimates of the useful lives of movable fixed assets of different types as used in different industries. These tables are for guidance only and it is open to a taxpayer to argue that his actual or intended use of the assets concerned justifies a shorter depreciation period.

Items purchased or commissioned during an accounting period are depreciated at one-twelfth of the annual amount for each month of use.

Fixed assets, movable or otherwise, may be written down whenever a permanent loss in value becomes apparent. There is, however, a write-back requirement should the value subsequently appreciate above the level that would have been reached had only ordinary, regular depreciation been deducted.

2.2 Inventories

Inventories must be shown at the lower of cost or market. LIFO (last in, first out) is expressly permitted by the Income Tax Act, unless it would be in conflict with German accounting principles. However, once LIFO has been applied, it must be continued with in subsequent years, unless the tax office agrees otherwise. Losses in value must be deducted from the original cost if they can be specifically determined. General provisions for technical obsolescence or reduced marketability on account of age or further developments are permitted in principle, although the attitude of the tax authorities tends to be sceptical. Those making generalised calculations or global provisions must expect to be asked to justify the deduction by reference to specific facts and circumstances and/or to the past history of the business.

2.3 Accounts receivable

Accounts receivable should be shown at their original value. If the repayment value is higher (e.g. a zero-bond) the appreciation should be taken to income progressively until the repayment date. Short-term accounts receivable in a foreign currency due within one year are to be translated into euros at the year-end rate. Long-term items are to be translated at the lower of the historical and year-end rates. Specific provision must be made for anticipated bad debts. As with provisions for loss in value of inventories, the tax authorities look carefully at the provisions actually taken. Specific provisions must be justified specifically; general provisions must reflect the past experience of the business and even so will not be accepted without further explanation and investigation if they exceed 1% of all amounts outstanding.

There is no deduction for the bad debt expense of a shareholder with an interest of more than 25% in the debtor, unless a third party creditor would have granted the debt or allowed it to remain outstanding in otherwise similar circumstances.

2.4 Liabilities

Liabilities are to be taken up in a manner corresponding to the treatment of accounts receivable. However, liabilities with a remaining term of 12 months or more at balance sheet date must be discounted at an annual rate of 5.5%, unless they are either interest-bearing (at any rate) or result from payments in advance, or on account, of services rendered.

2.5 Pension provisions

Pension provisions must be computed actuarially under specific and detailed rules. In most cases, an under-provision in any one year cannot be recovered by simply recalculating the provision in future years, but, rather, must be carried forward until the employee's pension falls due. The funding of pension promises and the vesting of pension rights do not, as such, affect the calculations of the tax-deductible provisions. Prior or past service cost is spread over the period in which the provision accumulates to its balance on retirement date. No provision may be taken up for employees under 28.

2.6 Provisions for future costs

Provisions for future costs must be calculated net of anticipated future benefits; thus a provision for future rental costs of a building no longer required should be made for the remainder of the lease net of the likely sub-rental income. Provisions for obligations other than payment and/or for obligations of uncertain incidence or extent – such as is the case with warranty provisions – should assume the actual incidence as being in accordance with past experience and should be based upon the anticipated direct costs together with an uplift for the indirect costs. Newly formed businesses or those without an adequate cost accounting system will therefore have difficulty showing that their warranty provisions conform to the tax rules.

2.7 Rollover relief on capital gains

Gains from the sale of land and buildings and freshwater shipping need not be taken to income immediately, but may be deducted from the cost of purchasing replacement assets in the same or in the previous year. Alternatively, the gain may be carried forward and be deducted from the purchase price of replacements acquired during the following four years or from the construction costs of a building erected during the following six. This reserve may be released back to taxable income at any time, but the release triggers additional taxable income of 6% of the amount released, for each year in which the reserve was carried. The release and uplift to taxable income are compulsory at the end of the fourth year, unless construction on a new building has already started. The effect of this rollover relief provision is to defer the taxation of a gain on sale by deducting it from the acquisition costs of replacement assets and thereby reducing their amortisation basis. The reserve is often referred to as a "6b reserve" after its governing section in the Income Tax Act.

3 Taxable income – trade tax

The taxable income for trade tax is calculated on the same lines as for corporation tax. However, there are important differences, particularly in the area of interest and other financing costs.

The first €100,000 of interest expense is allowed in full. One-quarter of the annual interest cost over this amount is disallowed. Interest includes not only that paid under loan agreements or charged as such on overdrawn bank accounts and similar, but also the implicit interest in rentals, leasing fees and royalty payments. The implicit interest is seen as 20% of the amounts paid for moveable assets, 25% of the royalties for the use of rights (unless the only use made of them is to grant sub-licences) and 50% of property rentals. The term of the agreement is irrelevant.

For trade tax only, there is a lump-sum deduction of 1.2% of the taxable value of all real estate owned by the taxpayer. This deduction partially compensates the charge to land tax, an annual tax levied by the local authorities on the taxable value of real estate. The trade tax deduction therefore serves the purpose of relieving business from some of the burden of land tax.

The corporation tax exemption for dividend income on shareholdings of at least 10% applies to trade tax provided the holding is at least 15%.

4 Loss relief

For corporation, but not trade, tax, taxpayers may claim a loss carryback of up to €1,000,000 to the previous year. This is an option and not a requirement. Amounts not carried back may be carried forward and utilised against future profits without time limit. The relief claimable in each year from losses brought forward is limited to €1 m plus 60% of the current taxable income exceeding that amount. Companies with annual profits of more than €1 m thus face current taxation on 40% of the excess. This is referred to in Germany as “minimum taxation”. However, the loss relief claimed in any one year from a loss brought forward does not reduce that subsequently claimable in retrospect against the remaining profit of the same year from a loss brought back.

The carry-forward and its offset rules apply to both trade and corporation taxes.

Under a provision designed to hinder the purchase and sale of tax losses, the right to carry a loss forward is lost where more than 50% of the shares in a company are acquired by a new or existing (foreign or domestic) shareholder within a five-year period. If the holding acquired is more than 25% but not more than 50%, the loss carry forward will be annulled in proportion to the amount acquired. Acquisitions of up to 25% do not lead to forfeiture of loss carry forwards. Acquisitions can be direct or indirect, and there is also an extension referring to related parties. This loss forfeiture rule does not apply to group internal restructurings, that is, where the same person holds the immediate or ultimate interest in the entire share capital of the company before and after the transaction. The rule is also disapplied to the extent the losses are covered by hidden reserves in the company (measured as the difference between the shareholders’ equity and the market value of the shares) and the sale was a German taxable event.

In reaction to the financial crisis, the loss forfeiture provision was set aside in respect of share acquisitions within the context of a corporate recovery programme designed to save a troubled business. To qualify, the company had to show that it had concluded, and was following, a shop agreement on job preservation, that the total employee remuneration paid during the five years following the share transfer was at least equal to 400% of the annual average paid in the five years before, or that shareholders had contributed new capital of at least 25% of the gross assets shown in the immediately preceding tax balance sheet within one year following the acquisition. The European Commission formally notified Germany that it regarded this general aid to corporate recovery as unlawful state aid and demanded amendment of the statute. The German appeal against this decision was rejected by the ECJ as having been filed out of time; however the government is supporting a number of private appeals currently pending. For the moment, the provision is in abeyance.

Losses are not transferred on merger or other corporate reorganisation.

5 Group taxation and group relief

Legally, each German company is an independent legal entity and is therefore required to file its own tax returns. There is no concept of filing a consolidated return as such, although if two or more entities are so closely inter-linked that they can be seen as being effectively a single business, they combine their results for tax purposes, that is, they pool profits and losses. However, they do not eliminate intercompany profits. This type of group is referred to in Germany as an *Organschaft*.

An *Organschaft* parent may be any German business entity, including an actively trading partnership or locally managed German branch of a foreign company. The subsidiary must be managed from Germany and have its registered office in an EU/EEA member state. Two or more entities form an *Organschaft* if the parent directly or indirectly controls more than 50% of the voting rights over the subsidiary and they conclude a profit pooling agreement to run for not less than five years. This profit pooling agreement must be entered in the trade register of the subsidiary and must be followed in practice. Its effect is that the subsidiary surrenders its entire annual profit after recovery of any loss brought forward to the parent as of the end of each business year, while the parent enters into a corresponding obligation to assume any loss. The subsidiary’s financial statements will therefore show an annual result of nil (certain specific but unusual exceptions apart) and its balance sheet will carry an amount payable to or receivable from the parent equivalent to the profit surrendered or the loss subsidised. This balance must be settled once the amounts have been finally determined in the following year if accusations of non-fulfilment of the profit pooling agreement are to be avoided.

A profit pooling agreement may be cancelled during its five-year term for good cause. A typical example of a good cause is the divestment of the subsidiary outside the group. If the agreement is cancelled other than for good cause during the first five years, or is simply not implemented for any one of those years, it will be retroactively voided. The tax assessments will then be reissued as though the *Organschaft* had never existed and the subvention payments to the subsidiary will be seen as additional capital contributions by the parent, while the profit surrenders will be recast as dividend distributions. Cancellation following the first five years merely means that the agreement will lose its validity as of the year of cancellation; failure to implement it during any one year following the initial period suspends it for that year.

One of the effects of an *Organschaft* is that the profits of the subsidiary can be offset against the losses brought forward by the parent. However, the converse is not true; any losses brought forward by the subsidiary are frozen until the *Organschaft* is terminated, the current result, profit or loss, being attributable in full to the parent. This contrasts with the accounting treatment which follows from a company law prohibition on profit surrender before recovery of previous losses. The profit actually surrendered and shown as such in the financial statements is the net result for the year, less any remaining losses brought forward.

There are no differences of definition or effect of *Organschaft* between trade and corporation taxes.

Under a provision in the Corporation Tax Act, the losses of an *Organschaft* parent or subsidiary may not be offset against present or future German income if they taken into account for taxation abroad by any entity. Caution is therefore advised, both for dual resident companies and for those seen as part of another entity under foreign law (such as under the US “check-the-box” rules).

It should be emphasised that an *Organschaft* is usually necessary for German groups or sub-groups with centralised financing arrangements. Interest charged within the *Organschaft* is ignored. Outside interest, as well as the trading profits, are concentrated on the parent for the purposes of calculating the interest limitation.

6 Related-party transfer pricing

Germany has extensive related party transfer pricing rules. Indeed, transfer pricing issues are almost always one of the most important components of tax audits of German subsidiaries of multinational concerns. The German transfer pricing rules are substantially in accordance with the OECD reports and recommendations on the subject, although they are more detailed and more specific. They are based on the premise that the German subsidiary should trade at arm’s length with its parent, fellow subsidiaries and other related parties as though each unit involved were an independent entity. To demonstrate this, it is necessary that all important overall relationships and each charge for services (anything other than the delivery of goods) be covered by a prior written agreement. A prior verbal agreement will fail this test.

Charges for specific transactions or series of transactions may be based on the comparable uncontrolled price, the resale price, or the cost-plus method. The German entity must document for itself the method used as the most appropriate in the circumstances and must be prepared to defend its choice accordingly. However, the tax auditors will usually accept the method chosen unless it is manifestly unreasonable, although they are not bound by the subsidiary’s determination of an appropriate profit margin, uplift rate or other matter of accounting estimate.

Many formalities must be observed, particularly in respect of agreements governing continuing relationships, such as the appointment of the German subsidiary as a commissionaire, or pooled research and development or similar activities. Under the statute, the substance, rather than the form, of trading at arm’s length is to be respected. However, the authorities (and also to a large extent the courts) tend to see failure to observe forms as an indication that the substance as depicted by the taxpayer is not necessarily the true substance to which he agreed in advance. Thus, the rule in practice in Germany is not “substance over form”, but “substance and form” as two distinct tests.

A recent change in the law has introduced enhanced duties of documentation. Arm’s length documentation is no longer sufficient; a German taxpayer must now fully document all aspects of its trading and other relations with foreign related parties. This extends to the internal reasons for the decisions taken and pricing policies followed and includes records of third-party comparisons as well as any adjustments thereto in reflection of differing circumstances. Two Finance Ministry decrees set out the official expectations in detail. Failure to document adequately or, for unusual transactions, promptly will lead to serious penalties. If weak documentation means that the tax auditors can determine taxable income only within a range, they may base their finding on the end of the range least favourable to the taxpayer. Any doubts go to his detriment. This will almost guarantee a negative audit finding, opening the way to a fine of between 5% and 10% of the income adjustment.

A further change in the law has established a legal basis for the growing expectation on taxpayers to justify their transfer pricing by reference to a range drawn from publicly or semi-publicly available comparisons. If the price under review falls anywhere within the range, it is to be accepted. If it does not, adjustment is to the median of the range. If no comparables are available, the taxpayer can be asked to show that the price in question is at the most appropriate point on the range between the highest price a buyer would be willing to pay and the lowest at which a seller would still be willing to sell.

Another amendment has institutionalised the transfer pricing relevance of a transfer of functions together with their related risks and opportunities from Germany to a related party or to a permanent establishment abroad. The transfer is to be at market value based on the profit expectations of the parties at the time of transfer. There is a rebuttable presumption that – in cases of uncertainty – independent third parties would have agreed on a retrospective adjustment to actual, should their expectations later turn out to have been misplaced. At all events, the taxpayer is required to identify the intangibles attaching to the function.

7 Related-party and third-party finance

All borrowings to and from related parties must be at arm's length. They must be governed by a prior written agreement which must be certain as to amount, repayment term (although this can be at will, or until further notice), currency and interest rate. Failure to conclude a written agreement in advance means that the interest expense is disallowable for the German borrower; it gives the tax office every opportunity of imputing its own concept of a fair market rate of interest to the income of the German lender.

Unusual circumstances apart, there is no requirement for a related-party loan to be secured. Rather, any need for security is deemed to be fulfilled by the German transfer pricing concept of "support within a group", which means that a German company can neither bear any costs of securing or guaranteeing a related-party debt, nor can it incur with tax effect any form of bad debt write-off on any finance given to related parties. The few exceptions to these general rules all relate to unusual circumstances, such as when a company becomes a related party during the term of a loan.

The arm's-length interest rate is that relevant to the currency of the loan. The currency chosen must be reasonably plausible in the circumstances, but the choice is not otherwise limited by any hard and fast rules. The corollary is, of course, that exchange gains and losses when measured against the euro also fall to the German company. Interestingly, there is no need for strict consistency, as long as the German company is seen to enjoy an equal chance of gain or loss.

The transfer pricing rules state that the interest rate should always be based on bank lending rates, i.e., on the rate at which the German company could have borrowed the funds on otherwise the same terms and in the same currency from a German or foreign bank. This applies regardless of whether the German company is the borrower or the lender on the theory that the German company is not a bank and is therefore not entitled to mirror banking practices. On the other hand, the Supreme Tax Court has held that simply because a German company is not a bank it does not need to cover the costs of running a banking business, and its interest received should therefore be based on a rate lying somewhere between bank borrowing and lending rates. The Court declined to define what it meant by "somewhere between", so the case does not necessarily give legal authority to take the arithmetic mean, even though this is often done in practice.

No withholding tax is levied on loan interest paid abroad other than on debentures. However, if the loan is secured by a mortgage on German real estate or on a German ship, the foreign lender is seen as having earned income from leasing or rentals rather than from interest on a loan. This renders him liable to German trade and corporation taxes on the income net of all relevant expenses (and he is therefore required to file tax returns as a non-resident), but the tax actually levied (including the solidarity surcharge) may not exceed the maximum rate of withholding tax on interest laid down in the relevant treaty. Similarly, interest on convertible bonds or on profit sharing loans is subject to a dividend withholding tax under domestic law and is therefore only not taxed by withholding where the treaty recognises it as interest chargeable at a nil rate.

Thin capital rules are no longer in force. Their substitute is an "interest limitation" restricting the deductibility of the negative interest margin (surplus of interest expense over the interest income) to 30% of the total net earnings before interest, taxes on income, depreciation and amortisation (EBITDA). This limitation does not apply where the negative interest margin for the year is no more than €3,000,000, or where the company is not part of a group. There is also an exemption where the interest paid to any one shareholder (of more than 25%) is not more than 10% of the negative interest margin and the equity to gross assets ratio of the company is no more than two percentage points below that of the group. This demonstration is to be based on financial statements under IFRS consistently applied. The accounting principles of any member state of the EU, or – as a last resort – US GAAP may be taken in place of IFRS if more relevant in the circumstances.

The interest limitation rules extend to related parties of shareholders and to third party lenders with rights of recourse to a shareholder or his related party. Back-to-back financing is a particular target of these caveats.

Interest expense disallowed under the limitation in any one year can be carried forward for future offset without time limit. Future offset starts in the first year the limitation is not met by adding the amount brought forward to the interest margin for that year. The same carry forward is available for excess EBITDA to be calculated in retrospect from 2007. The interest, but not the EBITDA, carry forward is subject to the same curtailment of loss carry forwards that ensue on a change of shareholders. Acquisition of over 50% of the capital of the company by a single shareholder (and his related parties) destroys the carry forward entirely; acquisition of between 25% and 50% curtails it in proportion to the level acquired; acquisition of 25% or less is harmless.

8 Special features of branches

Traditionally, Germany has taken a legalistic position denying that transactions between a branch and its head office can lead to a gain or loss for either unit. Rather, such transactions have been seen as transactions within the same legal entity and many of Germany's double tax treaties still reflect this position. This manifests itself in treaty provisions allowing expense or income arising in or for a branch to be attributed to that permanent establishment regardless of where incurred or received. Refusal to accept service fees, interest charges or royalties within the same legal entity is the corollary.

2013 saw a radical change in the Foreign Tax Act, adopting the "authorised OECD approach" of treating a permanent establishment as though it were a separate legal entity for the purposes of determining its taxable income. Thus, a German head office or permanent establishment is now expected to follow the transfer pricing rules – including the documentation rules – in respect of all routine or unusual transactions with its counterpart abroad. The permanent establishment is to be defined by reference to the functions performed by its staff, the assets they use, the risks and opportunities attaching to or derived from their activities, and the provision of an adequate branch capital. The finance ministry is authorised to issue ordinances with the approval of the *Bundesrat* to govern these provisions on the allocation of branch income and capital in detail. A draft was published in 2013 but has not yet been finalised.

The Foreign Tax Act explicitly provides that a double tax treaty will only take precedence over the new rules for determining branch income if the taxpayer shows that the other state continues to apply the treaty as it stands and this leads to actual double taxation.

9 Anti-abuse provisions

Germany has a number of anti-abuse provisions designed to prevent the misuse of legal forms, the use of tax havens, treaty-shopping or the use of proxies. Partly, these provisions give the tax authorities the right to ignore artificial circumstances and relationships seen as abusive, and partly they make the tax deductibility of expenditure dependent on full and complete disclosure of the identity of the other business partner. Relationships with foreign entities subject to "low-tax regimes" are subject to special provisions in the Foreign Tax Act charging a supplementary tax on the indirect German owners of income accumulated abroad and putting German taxpayers purchasing goods and services from tax haven countries under an almost impossible burden of proof. Taxpayers are under an extended duty to cooperate with the tax authorities in respect of all business relationships with partners outside German jurisdiction and therefore beyond the reach of the German tax auditors. Essentially, the German taxpayer must proffer all documentation, information and explanations from or on the foreign party that would have been available had he insisted in advance on access rights to the relevant records.

K Taxation of individuals

1 Territoriality and residence

All resident individuals (natural persons) are taxed on their worldwide income. Domestic law deems a person to be resident if he has a home or his habitual abode in Germany. Generally, individuals are deemed to have their habitual abode in Germany if they are physically present for more than six months in any one calendar year or for a consecutive period of six months over a year-end. However, persons with their permanent and habitual abode in Germany will not lose their tax residence simply because they happen to be travelling for longer than six months. Non-resident individuals are taxed (usually by withholding) on their German-source income only.

Contrary provisions in double taxation treaties override German national law unless the latter is more favourable (from the German tax point of view only) to the taxpayer. However, German law contains a number of provisions to prevent what the authorities see as treaty-abuse, such as those making treaty relief conditional on taxation in the other state. On the other hand, a tax treaty determination that a person is resident in the other state – for example where he has a home in both states, but has closer links to the other – does not mean that he loses his status as a German resident in respect of his German source income. Thus he remains entitled to allowances and reliefs available to residents only (so-called taxpayer with unrestricted liability).

Nationality is not of itself a criterion for determining residence or tax liability, although it may give an indication in (unusual) cases of doubt where a taxpayer has ties of equal strength to at least two countries.

2 Gross income

Income from employment includes all salary, bonuses, allowances, benefits in kind, and all other forms of remuneration given to, or provided for, an employee. Benefits in kind are valued, in principle, at cost to the employer or, if goods, at their local retail market value. There are also some cases of fixed-rate allocations (mainly cars), mostly for administrative simplicity. Certain minor benefits in kind, such as annual employee outings or, within limits, sales of goods to staff at reduced prices are not taxed at all. Reimbursement of an employee's relocation costs to Germany is not a taxable benefit, provided certain, basically adequate limits are adhered to. There are no special concessions for foreigners.

Investment income, defined as dividends, interest and capital gains on the sale of securities purchased on or after January 1, 2009 is taxable at a flat rate of 25% (26.675% including the solidarity surcharge). If the income is paid through the banking system, the tax will be withheld at source, generally as a final burden. If the income comes from elsewhere, e.g. from a foreign bank, the taxpayer must report it in his income tax return. The flat rate charge will then be levied by assessment, independently of all other features of the taxpayer's situation.

The one exception to the flat rate charge on investment income is where the investment is held as a business asset. In this case, the taxpayer may opt to treat the income as business income, leading to the inclusion of 60% of the amount in the total of his income taxable at his scale rate.

The amount of investment income actually charged to flat rate taxation in the hands of an individual is reduced by a personal "saver's relief" of €801 (€1,602 for a married couple) but with no possibility of claiming further expenses.

Capital gains on the sale of real estate are fully taxable, unless the real estate was held for longer than ten years.

Other income earned by an individual from incidental activities, such as from publishing articles in the professional press, is fully taxable. However, minor fees for certain activities enjoying special favour, such as coaching an amateur basketball team, are exempt.

The granting of stock options by German or by foreign employers is not generally seen as a taxable event. The taxable event is the transfer of the shares following exercise of the option, and the taxable benefit is the difference between the option price and the fair market value of the shares on the date of transfer. Where there is a significant delay between the grant and the exercise of the option, particularly if the earliest date of exercise is spread over a number of years, it may be possible to argue that the options were granted in order to secure an employee's future loyalty, rather than as a reward for past services rendered. This might allow taxable income to accrue over the option period, so it would not be entirely taxable in Germany if the employee was resident abroad for part of that period. Failing that, there is Supreme Tax Court authority for maintaining that an option benefit has been earned over more than one year – where more than a year has elapsed between option grant and share transfer. This reduces the tax charge to five times the tax on one fifth or the incremental income, which will be of benefit to employees not already taxed near the top rate of the scale.

Otherwise, there is no significant tax advantage in remunerating an employee by way of stock options as opposed to cash, although the corollary also applies in respect of the expense deduction for the employer; amounts charged to a German subsidiary for its purchase of shares in the ultimate parent company for allocation to its employees exercising their options are equally as deductible an expense as a cash bonus.

3 Deductions

Business expenses if properly documented and necessarily incurred may be deducted by an individual, unless they are reimbursed by the employer. This includes tools and equipment, technical literature, business subscriptions and membership fees of professional associations. Travel to and from work is recognised with a lump-sum allowance based on distance. There is a blanket employee allowance for business deductions of €1,000 annually and itemising the expenses actually incurred will only increase the deduction if they exceed this sum.

Non-business expenses such as social security contributions and insurance premiums can be deducted up to specified limits. Mortgage interest is deductible, but only against income from the property. Church tax (see below) is deductible, but the deduction for tax advisors' fees has been withdrawn. Contributions to charities are deductible up to 20% of gross income. One-half of an individual's political contributions up to a total of €1,650 p.a., i.e. €825 is deductible from his tax payable.

The basic personal allowance is a lump sum "general allowance" of €8,004 built into the tax tables and taxed at a rate of nil. Child allowances are granted at various levels depending on the age and schooling status of the child. For children at school under 16 and living with their parents, the total annual allowance is €7,008 for each child. Interestingly, children's grants are also paid under the provisions of the Income Tax Act; for the first two children the monthly grant is €184 each. Children's grants are integrated into the tax system in that the tax office when issuing the assessment will automatically grant the taxpayer the more favourable of the €7,008 child allowance or the €184 monthly grant. If the allowance is more favourable to the taxpayer, the monthly grant will be treated as a reduction of prepaid income taxes.

Certain other specific allowances and reliefs favour the elderly and disabled, and there is also provision for tax recognition of "unusual burdens" of a financial nature that a taxpayer is morally or otherwise obliged to accept.

4 Tax credits

Full credit is granted for all withholding tax deducted from German-source employment income. Foreign withholding taxes on income from abroad are usually credited against the applicable German income tax, unless the relevant tax treaty specifies otherwise. Employment income taxable abroad is often exempt from further German taxation in the hands of a German resident, while most treaties declare a German resident's foreign investment income to be taxable in Germany but allow a credit for the foreign withholding tax actually paid. No credit is given for underlying income or corporation tax and any unused foreign tax credit can be neither carried forward, nor applied against the tax on domestic-source or third-country income.

5 Tax returns and assessments

All resident taxpayers must file an annual income tax return, unless their only income is employment income from a single employer. Even in this case, it may be to a taxpayer's advantage to file a return if, for example, the income has fluctuated from month to month and the employer has not made compensating adjustments to the monthly "wage" withholding tax calculations.

The tax year is the calendar year and the return is, in principle, due by the following May 31 or, if a tax consultant has been appointed, by December 31. The May deadline can, however, be extended and an informal application is often sufficient. The December deadline can be extended for a further two months, but only for a specific reason.

Husbands and wives file joint returns, unless they are legally separated, or unless one spouse requests otherwise. The income of both spouses is totalled and the married couple is then assessed to income tax as though each spouse had earned exactly half the total of each income category. This system of "splitting" thus ensures the best possible use of allowances and of the lower progressive rate in the scale and, indeed, is an important feature of the German system of support for married couples and families.

The basis of assessment is the income earned or received in the tax year on a cash basis. The assessment notice will generally be issued between six weeks and three months after the return is filed, and payment of any outstanding balance is then due within the next 30 days. A refund can also be expected promptly. If there is a final payment to be made, the taxpayer can generally expect to be asked to make quarterly payments on account of the tax due for the following year.

6 Tax rates

German income tax is levied at rates rising on a sliding scale. The exact rate to be levied depends upon the amount of the income itself; this rate is then applied to the entire income in excess of the tax-free "basic allowance" and not merely on specific slices thereof.

The rate scale for 2014 is:

Table 1 2013 rate scale

Taxable income in euros	Tax rate
€0–8,354(basic allowance)	0
€8,355–13,469	14%
€13,470–52,881	Sliding scale up to 42%
€52,882–250,730	42% less €8,239
€250,731 and over	45% less €15,761

Because of the "splitting" system, the scales double for married couples filing jointly.

7 Other taxes on income

There are two other taxes on income, both levied as surcharges on the income tax. The first is the solidarity levy of 5.5% of the income tax due and has the announced political purpose of financing economic development in eastern Germany. This surcharge has been declared as temporary, although no date has been set for its expiry. Its continued existence has been held by the Supreme Tax Court to be constitutional.

The second surcharge on the income tax is the church tax levied on the income tax charged to members of specified churches. The rates are either 8% or 9% depending on the province in which the individual lives.

8 Gift and inheritance tax

Gift and inheritance tax in Germany is a single tax levied on the current market value of assets transferred without consideration, that is, by way of gift or inheritance. The rates vary between 7% and 50% depending on the amount of the transfer and on the closeness of kinship between donor and beneficiary.

Smaller gifts or inheritances are exempted from tax altogether by deducting "general allowances" from the value of the assets transferred. These general allowances vary by degree of kinship from €500,000 on transfers between spouses, €400,000 on settlements on children to €20,000 on gifts to unrelated persons. Non-resident recipients are only entitled to a reduced allowance of €2,000, although this is increasingly being challenged before the European Court of Justice.

Transfers are chargeable to German gift and inheritance tax where either the donor or the beneficiary is tax-resident in Germany at the time of the transfer. Transfers of German real estate (including loans secured by a mortgage on German real estate), of a German business, of shares in a German company by a holder of at least 10% of the issued capital or of German registered patents, trademarks and similar are also chargeable, even if neither donor nor beneficiary are resident. International double taxation is avoided by crediting the corresponding tax due in the country of the donor against the German liability of the beneficiary. Germany has concluded double taxation treaties on inheritance taxes with six other countries, and her general double taxation treaties also extend to inheritance taxes in a few other cases. However, since these treaties also grant relief from double taxation by crediting the tax borne in the country of the donor against that chargeable in the country of the beneficiary, their main effect is to ensure relief in situations where domestic law sees the transfer as chargeable in Germany alone (e.g. a private bank account abroad).

L Indirect taxes

1 Introduction

Indirect taxes, most of which are transaction taxes, are an important factor in the budgets of the state, the provinces, and the local authorities. The most important of all German indirect taxes is VAT, levied as a general sales tax, followed by the various excise taxes and by customs duties on goods imported. Real estate transfer tax and land tax are also often classified as “indirect” taxes, although this classification is not necessarily true in each instance.

2 Value added tax (VAT)

VAT is levied in Germany under the harmonised EU system. The standard rate is 19%, and there is a reduced rate of 7% for certain basic foodstuffs, books, newspapers, antiques, live animals, hotel accommodation and for some other items. The VAT levied on the sales by a business is shown on the customer invoice and is therefore passed on to each customer. The VAT borne by a business on amounts billed to it by its suppliers (the “input tax”) is deducted from the “output tax” charged to customers in order to arrive at the net amount payable to, or refundable by, the tax office. This reckoning is monthly, quarterly, or, in some few cases, annually.

Exports and international transports outside the EU are “zero-rated”, that is, the charges to customers are not subjected to VAT, but any related input tax may still be fully deducted from amounts payable to the tax office. Intra-EU sales are also zero-rated, but the carriage of goods and passengers to or from other EU countries is subject to German VAT, unless the carrier has made the transaction subject to the VAT of another EU country. Special provisions apply to air travel. A number of specific services, including especially banking services and insurance premiums, are exempt from VAT.

Since VAT effectively burdens domestic consumers, it is necessary to prevent them from avoiding the burden by buying abroad. Imports into Germany from non-EU countries are therefore subject to an “import VAT” on entry (in much the same way as customs duties are levied) and initially VAT-free purchases by a German business from other EU countries are subject by that business to an “acquisition tax”. Both import VAT and acquisition tax are levied at the VAT rate relevant to the type of goods in question, and both taxes rank as input tax of a business once paid. To purchase goods free of VAT in any member state of the EU, the EU buyer must offer proof of registration as a VAT-paying business in another member state (the so-called "VAT registration number"). Since a private consumer would not have such a number, there is no possibility of avoiding VAT altogether by purchasing goods for private consumption in other EU countries, and private imports into Germany from outside the EU are tightly controlled by the customs authorities on the borders. However, there is some degree of cross-border shopping within the EU to take advantage of a lower rate, though this changed radically for Germany on January 1, 2007 when the standard rate was raised from 16% (one of the lowest within the EU) to 19%.

While VAT is not, by its nature, a direct cost for businesses, it is a tightly controlled and strictly supervised tax. The administrative, accounting and other compliance requirements and obligations on businesses are intense and the consequences of any failure to adhere to all the detailed rules and regulations, including matters which might appear to be mere formalities are often severe. Indeed, a frequent result is that otherwise VAT-free ("zero-rated") sales become fully taxable with no possibility of passing the burden on to the customer, or that otherwise perfectly acceptable input tax becomes non-deductible with no recourse to the original supplier. Consequently, attempts to reduce the not inconsiderable VAT accounting and other compliance costs by taking "short-cuts" frequently prove to be false economies.

3 Excise taxes

Germany levies a range of excise taxes on specific products, essentially with the object of increasing their price on the domestic market. At the same time, substantial revenue is raised for the government at only a few points of collection and therefore cheaply. In each case, there is a single taxpayer within the supply chain. This is the manufacturer, importer, or first domestic wholesaler. There are specific exemptions for exports, deliveries to other EU countries, and, in some cases, for specified consumers. Excise taxes are levied mainly on alcohol and alcoholic drinks, tobacco and cigarettes, on all forms of mineral and fuel oils and their derivatives, and to a lesser extent on other fuels and electric power. Insurance premiums are also subject to a rather similar tax (insurance tax at 19%) as one of the few German examples of an excise tax levied on a service.

Excise taxes create extensive accounting, administrative and other compliance requirements for their few immediate taxpayers, although they do not directly have a major effect on most other businesses. Road haulage and other transport businesses are, perhaps, the major exception to this remark.

4 Real estate transfer tax

This tax can be an important factor for consideration when restructuring corporate groups with German subsidiaries or with German intermediary holding companies. It may also have a dampening effect on the mobility of the population. It is levied on the sales price or other transfer value on each change of ownership in land and buildings. There are very few exceptions other than sales between husband and wife or transfers subject to gift and inheritance tax.

The basic rate of real estate transfer tax rate is 3.5%, although the provinces have the power to levy the tax at a different rate on transfers of property within their territory. Only two provinces still charge the tax at the basic rate of 3.5% – Bavaria and Saxony. Hamburg charges 4.5%. The Saar rate is 5.5% and the rate in Berlin is 6%. The Schleswig-Holstein rate is the highest at 6.5%. The remaining provinces all charge 5% - Baden-Württemberg, Brandenburg, Hesse, Mecklenburg-Pomerania, North Rhine-Westphalia, Rhineland-Pfalz, Saxony-Anhalt and Thuringia.

Legally, both parties are jointly and severally liable to the tax, although by tradition contracts for the sale of real estate almost invariably pass the burden on to the buyer. Since all contracts for the sale of real estate must be concluded before a notary public who, among other formalities, notifies the tax authorities, and since the recording of the new ownership in the land registry is linked to the actual payment of the tax, there is little incentive or opportunity for the buyer to abscond before meeting the contractual obligations to pay the tax. Real estate transfer tax qualifies for the buyer of real estate as part of the costs of acquisition. If the buyer is a business, the cost of the tax is therefore capitalised, so that its deduction from taxable income is deferred until the site is sold.

From the corporate restructuring point of view, what was originally intended as an anti-avoidance measure often has an unfortunate effect. The tax is also levied on indirect changes in the ownership of real estate following the transfer of 95% or more of the shares in companies (or partnerships) owning real estate. Unfortunately, these rules apply regardless of the business background of the share transfer, that is, they apply equally to the straight sale of the shares in a real estate owning company at market value to an outside third party as to otherwise tax-free dropdowns, mergers or other forms of corporate reconstruction within a closely related group of companies, whether for consideration or not. They also apply to the transfer of shares indirectly held, that is, to share transfers of an ultimate or intermediary holding company outside Germany that owns the shares in another German or foreign holding company owning in turn the shares of another company owning the German site. Thus, a corporate reorganisation or merger agreed and implemented at a level far above that of the German subsidiary will trigger the liability to this German tax, even though there may well be no perception within the corporation of the reorganisation as a German taxable event.

Some relief for the corporate restructuring situation is available from an exemption from real estate transfer tax on transactions (mergers, spin-offs and drop-downs) under the Reconstructions Act where at least 95% of the immediate, intermediary and ultimate interest in the property remains unchanged for at least five years before and after the transfer.

Where the tax is levied on a share transfer, that is, where the consideration is not directly linked to the real estate, the basis of assessment will be 12.5 times the "rentable value" of land and buildings. This "rentable value" is derived from the average rentals actually achieved over the past three years if the site was rented out. If not, the value is derived from estimates prepared by the local valuation office (a branch of the local authority) suitably adjusted to take account of factors such as the age of the buildings or pollution of the soil. Where the site is undeveloped, recourse must be had to the figures from the local valuation office, regardless of whether or not it was rented out in the past.

The Real Estate Transfer Tax Act (*Grunderwerbsteuergesetz* – GrEStG) contains some provision for the avoidance of a double levying of this tax on successive transfers of ownership. However, this mostly addresses questions of transfers within a partnership or transfers back to a previous owner, rather than successive transfers between different parties that can occur in the course of reorganising a corporation. German real estate transfer tax can therefore be a factor in the planning of such reorganisations, as it may well be possible to reduce the overall cost by carefully planning the order of the steps.

On April 20, 2011 the Supreme Tax Court referred to the Constitutional Court on the question of the conformity of the real estate transfer tax system with the constitutional principle of equal treatment of like matters. Its primary point – supported by a Constitutional Court ruling on a net assets tax now no longer levied – was that transfers of property by way of sale are taxed on the sales proceeds, that is, on the current market value of the property, whereas indirect transfers of ownership, such as through transfer of the shares in a company owning the property are valued on a formula that can only reflect current market values by coincidence. The Constitutional Court case has not yet been heard, but taxpayers faced with a real estate transfer tax assessment may see merit in keeping their own case open by filing an appeal and then asking for suspension of the proceedings until the Constitutional Court has delivered its judgment. Taxpayers should, however, be aware that the authorities are unlikely to agree to a suspension of payment, and that it is open to the

Constitutional Court to hold the provisions to be unconstitutional whilst allowing their continued application for a set period in the interests of protecting public finances.

5 Land tax

Land tax is assessed annually on the owners of land and buildings as a charge on the taxable value. The tax is levied by the local authority at rates varying considerably throughout the country. The amount is almost always minor and the tax is, in any case, a deductible expense for corporation and trade taxes.

Traditionally, German leases give the owner of the property the right to charge this tax to the tenant or lessee as a cash outlay. Consequently, the tax is not a factor in “rent or buy” decisions.

Appendix: Withholding taxes

Domestic corporations paying certain types of income are required to withhold tax as shown in the following tables. There is also a solidarity surcharge of 5.5% on the tax due.

Table 2 Withholding taxes

Recipient of German-source income	Dividends[1]	Interest[1, 2, 3]	Royalties	Movable asset rentals[4]
Resident corporations and individuals	25%	25%	–	–
Non-resident corporations and individuals[1]				
• EU corporations[5, 6]	–	–	–	–
• Non-treaty corporations	25%	25%	15%	15%
• Non-treaty individuals	25%	25%	15%	varies

[1] Corporate recipients of dividend and interest income (interest on convertible and profit-sharing bonds) can apply for refund of the tax withheld over the corporation tax rate of 15% regardless of any further relief available under a treaty.

[2] Generally, only interest paid by banks to a resident is subject to a withholding tax. 25% tax is also withheld from income on convertible or profit-sharing bonds.

[3] Interest paid to non-residents other than on convertible or profit-sharing bonds is generally free of withholding tax. Tax on loans secured on German property is not imposed by withholding, but by assessment to corporation tax at 15% (plus solidarity surcharge) of the interest income net of attributable expenses. The tax authorities can order a withholding tax of 15.825% (including solidarity surcharge) if ultimate collection of the tax due is in doubt. Both forms of tax are reduced by treaty relief.

[4] Moveable asset rentals are taxed by assessment rather than by withholding. For corporations, the rate is the standard 15% corporation tax rate (plus solidarity surcharge) unless reduced by treaty.

[5] Where the EC Parent/Subsidiary Directive applies, dividends paid by a German company to a qualifying parent company resident in another EU member state are exempted from German withholding tax. The minimum shareholding is 10%, to be held continuously for at least one year.

[6] The EC Interest and Royalties Directive exempts payments from withholding tax, if made to an associated company in another EU member state. The association must be through a common shareholding of at least 10%, to be held continuously for at least one year.

Table 3 Withholding taxes – treaties

Recipient of German-source income	Dividends[1]	Interest[1, 2, 3]	Royalties	Movable asset rentals[4]
Albania	5%/15%	5%	5%	0%
Algeria	5%/15%	10%	10%	0%
Argentina[5]	15%	10%/15%	15%	15%
Armenia[5, 6]	15%	5%	0%	0%
Australia[5]	15%	25%	10%	10%
Austria[5]	5%/15%	0%	0%	0%
Azerbaijan[7]	5%/15%	0%/10%	5%/10%	0%
Bangladesh[5]	15%	25%	10%	10%
Belarus[7]	5%/15%	0%/5%	3%/5%	5%
Belgium[5, 8]	15%	0%/25%	0%	0%
Bolivia[5]	10%	25%	15%	15%
Bosnia-Herzegovina[5, 9]	15%	25%	10%	10%
Bulgaria[5]	5%/15%	5%	5%	5%
Canada[10]	5%/15%	0%/10%	0%/10%	10%
China, P.R.[5]	10%	25%	10%	7%
Croatia[5]	5%/15%	25%	0%	0%
Cyprus	5%/15%	0%	0%	0%
Czech Republic[11]	5%/15%	0%	5%	5%
Denmark[5]	5%/15%	25%	0%	0%
Ecuador	15%	10%/15%	15%	15%
Egypt[5, 12]	15%	15%	15%/25%	15%
Estonia[5]	5%/15%	25%	10%	5%
Finland[13]	10%/15%	0%	0%/5%	5%
France	5%/15%	0%	0%	0%
Georgia[5]	0%/5%/10%	25%	0%	0%
Ghana[5]	5%/15%	25%	8	0%
Greece	25%	10%	0%	0%

Recipient of German-source income	Dividends[1]	Interest[1, 2, 3]	Royalties	Movable asset rentals[4]
Hungary[5]	5%/15%	0%	0%	0%
Iceland	5%/15%	0%	0%	0%
India[5]	10%	10%	10%	10%
Indonesia[5, 24]	10%/15%	25%	10%/15%	10%
Iran	15%/20%	15%	10%	10%
Ireland, Republic of	5%/15%	0%	0%	0%
Israel[23]	25%	15%	0%/5%	5%
Italy[5, 14]	15%	25%	0%/5%	5%
Ivory Coast[5]	15%	25%	10%	10%
Jamaica[20]	10%/15%	10%/12.5%	10%	10%
Japan	15%	10%	10%	10%
Kazakhstan[5]	5%/15%	25%	10%	10%
Kenya	15%	15%	15%	15%
Korea, Republic of[5]	5%/15%	25%	10%	2%
Kosovo[5, 9]	15%	25%	10%	10%
Kuwait[5]	5%/15%	25%	10%	10%
Kyrgyzstan[5]	5%/15%	25%	10%	0%
Latvia[5]	5%/15%	25%	10%	5%
Liberia	10%/15%	10%/20%	10%/15%	10%
Liechtenstein	0%/5%/15%	0%	0%	0%
Lithuania[5]	5%/15%	25%	10%	5%
Luxembourg	5%/15%	0%	5%	0%
Macedonia[5]	5%/15%	5%	5%	0%
Malaysia[20]	5%/15%	10%	7%	7%
Malta[5]	5%/15%	25%	0%	0%
Mauritius[5]	5%/15%	0%	10%	0%
Mexico[5]	5%/15%	5%	10%	10%
Moldova[5, 6]	15%	25%	0%	0%

Recipient of German-source income	Dividends[1]	Interest[1, 2, 3]	Royalties	Movable asset rentals[4]
Mongolia[5]	5%/10%	2%	10%	10%
Montenegro[5, 9]	15%	25%	10%	10%
Morocco	5%	10%	10%	10%
Namibia[5]	10%/15%	25%	10%	10%
Netherlands[15]	10%/15%	0%	0%	0%
New Zealand[5]	15%	25%	10%	10%
Norway[5]	0%/15%	25%	0%	0%
Pakistan[5]	10%/15%	5%	10%	10%
Philippines[5, 16]	10%/15%	25%	10%/15%	10%
Poland[5]	5%/15%	25%	5%	5%
Portugal[5]	15%	25%	10%	10%
Romania[5]	5%/15%	25%	3%	0%
Russia[5]	5%/15%	0%	0%	0%
Serbia[5, 9]	15%	25%	10%	10%
Singapore[5]	5%/15%	8%	8%	8%
Slovakia[11]	5%/15%	0%	5%	5%
Slovenia[5]	5%/15%	25%	5%	0%
South Africa[17]	7.5%/15%	10%	0%	0%
Spain	5%/15%	0%	0%	0%
Sri Lanka[5]	15%	25%	10%	10%
Sweden[5]	0%/15%	25%	0%	0%
Switzerland[5]	0%/15%	25%	0%	0%
Syria	5%/10%	10%	12%	0%
Taiwan	10%	10%	10%	0%
Tajikistan[5]	5%/15%	25%	5%	0%
Thailand[18, 20]	15%/20%	0%/10%/25%	5%/15%	0%
Trinidad and Tobago[19, 20]	10%/20%	10%/15%	0%/10%	10%
Tunisia[21]	10%/15%	10%	10%/15%	0%

Recipient of German-source income	Dividends[1]	Interest[1, 2, 3]	Royalties	Movable asset rentals[4]
Turkey[5]	5%/15%	10%	10%	10%
Turkmenistan[5, 6]	15%	25%	0%	0%
Ukraine[5, 18]	5%/10%	25%	0%/5%	0%
USSR[5, 6]	15%	0%	0%	0%
United Arab Emirates[5]	5%/10%	0%	10%	10%
United Kingdom[5,17]	5%/10%/15%	0%	0%	0%
United States[5, 22]	0%/5%/15%	25%	0%	0%
Uruguay[5]	5%/15%	10%	10%	0%
Uzbekistan[5, 18]	5%/15%	25%	3%/5%	0%
Venezuela[5]	5%/15%	25%	5%	5%
Vietnam[5]	5%/10%/15%	25%	10%	10%
Yugoslavia[5, 9]	15%	25%	10%	10%
Zambia	5%/15%	10%	10%	10%
Zimbabwe[5]	10%/20%	25%	7.5%	7.5%

1 Corporate recipients of dividend and interest income (interest on convertible and profit-sharing bonds) can apply for refund of the tax withheld over the corporation tax rate of 15% regardless of any further relief available under a treaty.

2 Generally, only interest paid by banks to a resident is subject to a WHT. A 25% tax is also withheld from income on convertible or profit-sharing bonds.

3 Interest paid to non-residents other than on convertible or profit-sharing bonds is generally free of WHT. Tax on loans secured on German property is not imposed by withholding, but by assessment to corporation tax at 15% (plus solidarity surcharge) of the interest income net of attributable expenses. The tax authorities can order a WHT of 15.825% (including solidarity surcharge) if ultimate collection of the tax due is in doubt. Both forms of tax are reduced by treaty relief.

4 Movable asset rentals are taxed by assessment rather than by withholding. For corporations, the rate is the standard 15% corporation tax rate (plus solidarity surcharge) unless reduced by treaty.

5 The treaty does not (effectively) limit the taxation of profit-based interest income; thus, the domestic rate (plus solidarity surcharge) applies.

6 The USSR treaty continues in force with Armenia, Moldova, and Turkmenistan.

7 The lower royalty rate applies to commercial and industrial royalties, as opposed to cultural royalties.

8 Mortgage interest to a Belgian business is exempt unless the recipient holds at least 25% of the voting rights in the payer.

[9] The Yugoslav treaty continues in force with Bosnia-Herzegovina, Kosovo, Montenegro, and Serbia. Croatia, Macedonia, and Slovenia have their own treaties.
[10] The higher royalty rate applies to film and television (TV) royalties, licences to use trademarks and names, and to franchises.
[11] The Czechoslovak treaty continues to apply to the Czech Republic and to Slovakia. Interest on profit-sharing bonds is taxed as a dividend.
[12] 25% on trademark royalties.
[13] The higher royalty rate of 5% applies to commercial, industrial, and scientific royalties.
[14] Cultural royalties are exempt.
[15] Interest on convertible and profit-sharing bonds is taxed as a dividend; mortgage interest is exempt.
[16] The 15% royalty rate applies to copyrights.
[17] Treaty relief on interest, royalties, and rentals is conditional on taxation in country of receipt.
[18] The 5% royalty rate applies to copyrights.
[19] Royalties for copyrights, except for films and TV, are exempt.
[20] The 10% interest rate applies in certain circumstances where the recipient is a bank.
[21] The 15% royalty rate applies to patents, trademarks, films, and TV.
[22] The dividend exemption applies to corporate shareholders with at least 80% throughout the previous 12 months.
[23] The 5% royalty rate applies to industrial, commercial, film, and TV royalties.
[24] The 10% royalty rate applies to access to industrial, commercial, or scientific experience.

Treaties signed, but awaiting ratification: Netherlands, Norway (protocol), Oman, Philippines and South Africa.

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