

# *Doing business and investing in Germany*

*A guide covering everything  
you need to know about  
doing business in  
Germany – from corporate  
and labour law to finance,  
regulatory matters and tax.*

**January 2018**



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January 2018, 112 pages

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, PwC cannot accept any responsibilities for errors or omissions in the factual content.

The material contained in this guide reflects the position on January 1, 2018.

Preface



Prof. Dr. Norbert Winkeljohann

Despite the uncertainties the latest annual PwC Global CEO survey of 1,293 top managers from 85 countries showed more confidence in future economic expansion. 57% of respondents predicted worldwide growth in 2018. But the record jump in positivity with regard to global economic growth does not translate into an equivalent leap in confidence in their own organisation’s 12-month prospects.

The German CEOs were a bit more confident compared to their international colleagues. 61% of respondents from Germany saw future worldwide economic development in a positive light.

This underlines the value of the political stability, the innovative capacity, the flexibility and the overall quality of the German economy. The major economic and political challenges mentioned by German CEOs are over-regulation, populism, geopolitical uncertainty and cyber-criminality. However opportunities for further growth in Germany are more than satisfactory. 20% of all respondents predicted the country as the third most important source of future growth.

This Guide to Doing Business and Investing in Germany is intended to be of interest to business owners and executives looking to enter the German market or to grow their German operations. It has chapters on the important topics common to all industries and thus discusses the economy generally, business regulation, the employment situation, corporate and legal forms, accounting, auditing and, last but not least, taxation. However, it cannot answer every specific question you may have, so please feel free to turn to your usual PwC contacts or one of our German Business Groups located in PwC offices around the world.

On behalf of PwC Germany, I wish you every success in our country.

Norbert Winkeljohann



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PwC has 21 offices in Germany. Addresses and contact details can be found online:

[www.pwc.de/en/standorte](http://www.pwc.de/en/standorte)





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PwC has 25 German Business Groups in over 80 countries worldwide. Contact details can be found online.



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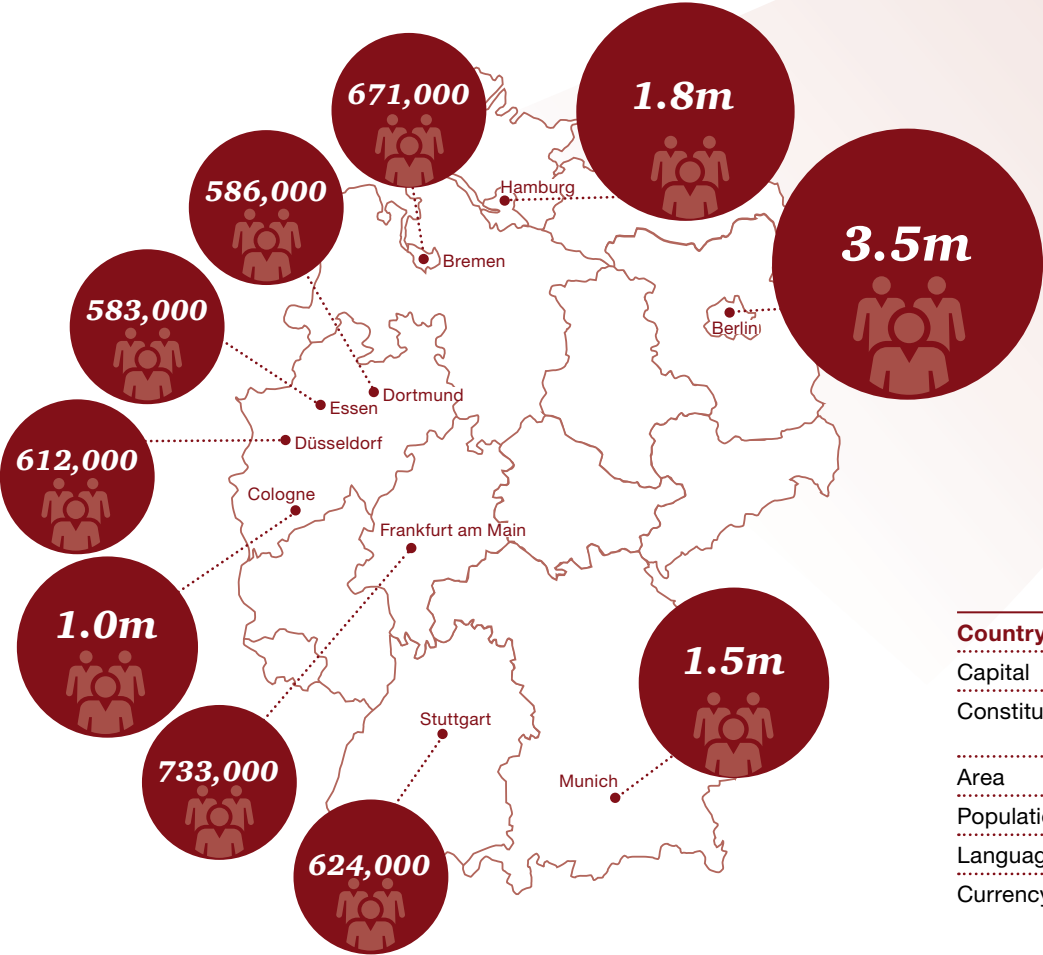


# 1 Germany: a profile

## 1.1 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 tributaries, 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.



Country facts	
Capital	Berlin
Constitutional form	Federal Republic of Germany
Area	357,000 km²
Population	82.5m
Language	German
Currency	Euro

## 1.2 Population and social patterns

The German population on December 31, 2016 was estimated at 82.5m on the basis of extrapolations taken from a mini-census taken in December 2015. Annual deaths regularly exceed births, so the general tendency is that of a falling and ageing population. For the present, this is compensated by immigration from abroad. Official estimates suggest that the population will fall to some 68m by 2060, if current trends remain unchecked. However, the short-term and long-term effects of the current influx of refugees from Africa and the Middle East are not yet clear.

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 herself, 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 10m (12% of the total), of which Turkish citizens form by far the largest single national group, numbering 1.5m. Other significant groups are Poles, Italians, Romanians and Greeks.

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.

## 1.3 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.

## 1.4 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).

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

## 1.5 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 for example separate courts to try suits on tax or 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.



# Economy and investment environment

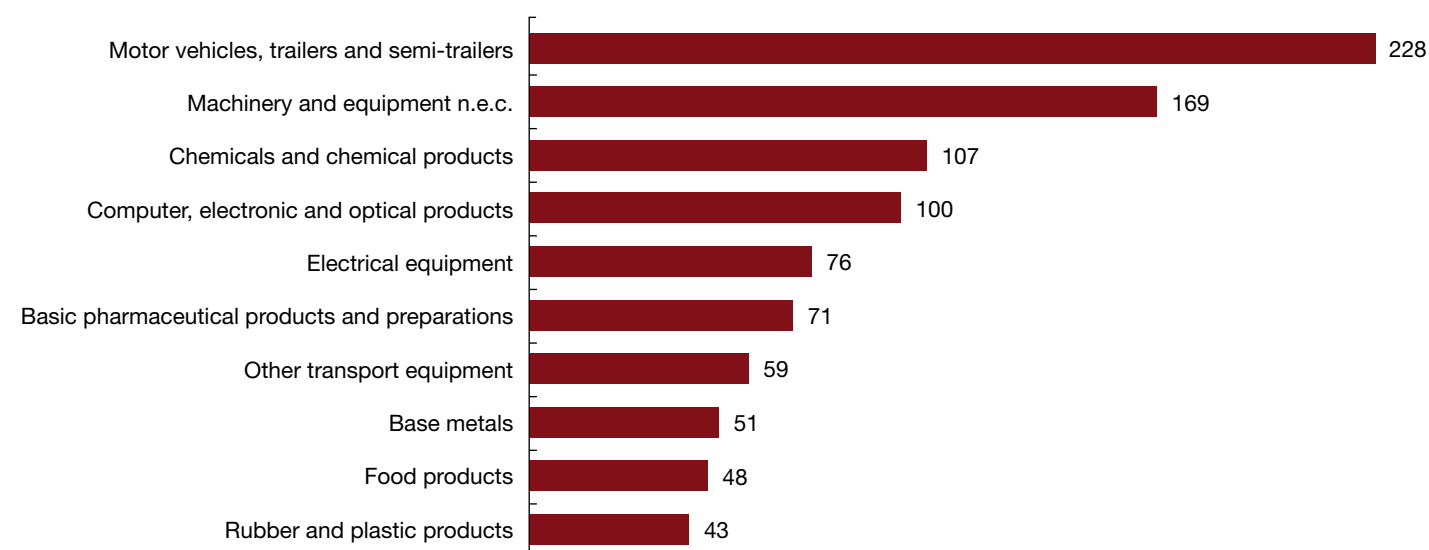
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### 1.6 The economy

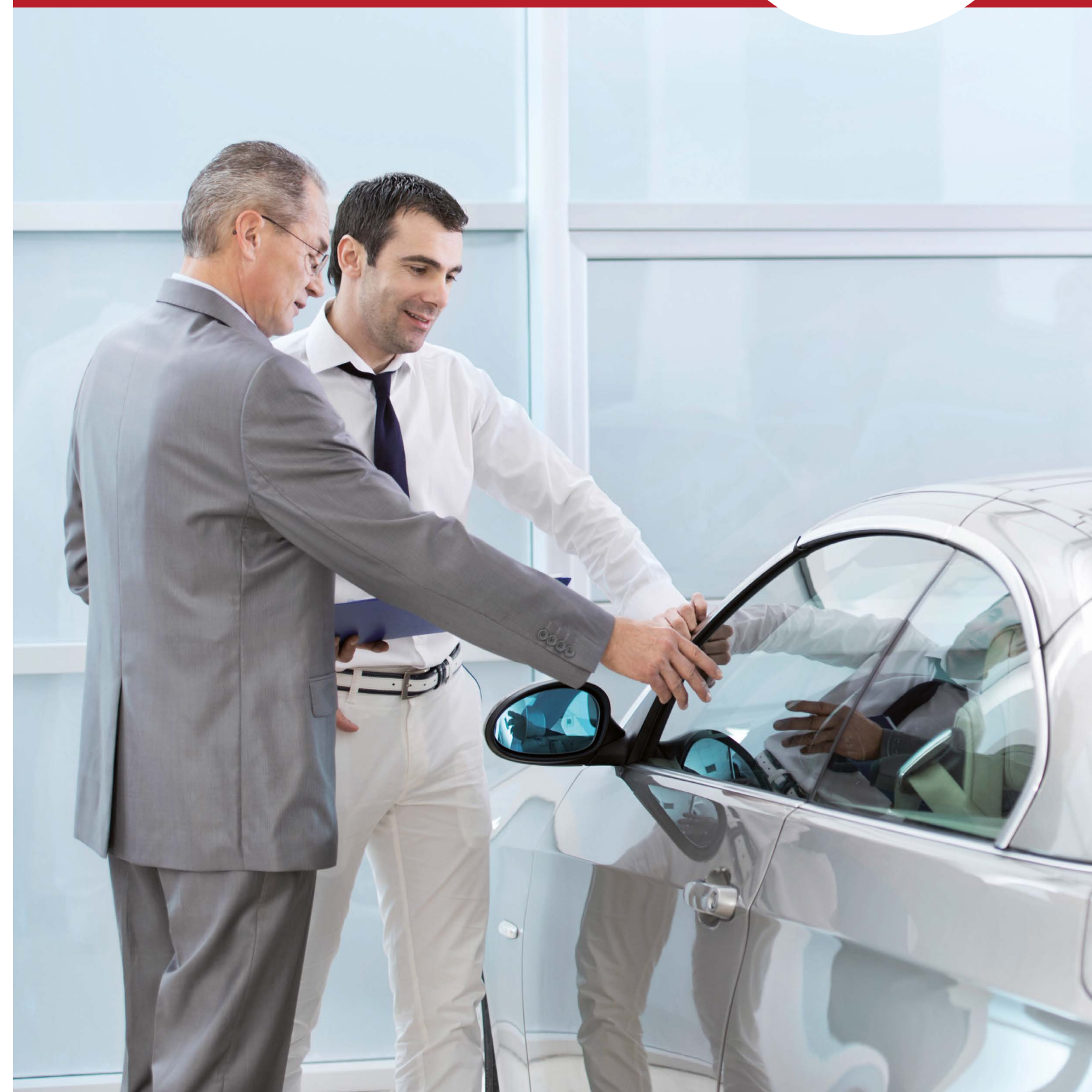
Almost all forms of industry are represented within the broad-based German economy. As befits a country with high employment costs but with a well-educated population and a well-trained workforce, the most exciting prospects today are offered by industries in the forefront of technology and by the providers 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 2016 it was running at 5.8%, December 2017 it was running at 5.3% slightly below the previous year end level.

The main German trading goods, 2016 (in euro bn, export)



Source: Statistisches Bundesamt, Wiesbaden 2017



## 2 Economy and investment environment

### 2.1 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 except for demarcation disputes (conflicts between rival employee representations, rather than between labour and management) 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 towards high-tech industries and the more sophisticated parts of the services sector are also expanding. The labour force numbers some 44.1m gainfully employed by 3.5m enterprises. 18% 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.

### 2.2 Major industries

#### 2.2.1 Automotive

The German automotive industry plays a crucial role in the country's economic landscape. Last year, it generated sales of over €400bn meaning that every fourth euro in German industry has been generated through an automotive product. It employs more than 820,000 people throughout Germany, of which roughly 60% were directly employed by Original Equipment Manufacturers (OEMs). The remainder is employed by suppliers, mostly small and medium sized enterprises, which form the backbone of the German *Mittelstand*.

Contributing 7.7% to Germany's total economic output, the automotive industry is likely to keep its national importance, as the German car market keeps growing. For the fourth consecutive year, new passenger car registrations climbed in 2017, reaching the highest volume of this decade with 3.4m units, which is +3% more than last year's numbers. Germany's total light vehicle assembly numbers are the 4th largest worldwide, with 5.9m units produced in 2017.

The German automotive industry not only serves domestic and European consumer demand, but, due to its global nature, follows worldwide trends in the ongoing globalisation of production, R&D, and sourcing. With over 77% of all vehicles produced in Germany being exported and manufacturers such as Volkswagen producing only ~2.5m of its 10.7m units in Germany, the interconnectedness of the global automotive world is apparent.

With the 2020 EU emission target of 95g CO<sub>2</sub>/km (which translates into 4.1l gasoline or 3.6l Diesel) on the horizon, the EU has recently proposed further and stricter regulations for the upcoming years. Reducing the emissions by a further 15% and 30% by 2025 and 2030 respectively, Germany manufacturers are under increased pressure as their heavy premium-brand vehicles will make meeting these targets without alternative powertrains increasingly difficult. OEMs are investing heavily in a technology offensive to meet emission targets, leading to a significant increase in the production of alternative powertrain vehicles.

While new car registrations have reached the highest level since 2009, Diesel shares continue to tumble in light of potential driving bans, down to 38.8% in 2017(–7.1% vs. 2016).The share of direct new-car-registrations to private buyers was only 35.0% in 2016, while commercial registrations feeding indirectly into the private sector such dealer and rental fleets accounted for another 30.4%.

For 2017, sales of battery electric cars increased by 155.8% to 25,056 units. Plug-in hybrids are up +94.2% to 29,436 cars and sales of other hybrids have grown strongly too at +62% to 55,239. All alternative powertrains account for a market share of 4.3%.

The switch from traditional combustion engines to alternative powertrains brings uncertainty and turmoil into the financial sector, with potential business opportunities across the industry. Automotive suppliers have been a driving force in the mobility innovation process and have traditionally been supported by private banks and credit unions. Recently, however, foreign takeovers particularly by Chinese entities, have changed the playing field.

## 2.2.2 Energy

Ensuring a sustainable energy supply is the primary aim of German energy policy. In the summer of 2015, the federal government produced a white paper “An electricity market for energy transition” following the discussions on the power market design of the future. Based on this, the Power Market Act came into effect on 30 July 2016. In the transition phase following the expansion of renewable energies, the termination of nuclear energy use in Germany in 2022 and the merging of the European power market, this law is supposed to ensure that electrical power supply in a developed power market is cost efficient and environmentally safe. After years of political control on the power generation mix in Germany, market mechanisms are to be strengthened now. In this context, the legislator recognizes a liberalised, European electricity market. The integration of the European domestic market ought to be promoted. Competition is supposed to set incentives for innovation and sustainability, improve the integration of sources of renewable energy and decrease the extraction costs of renewables.

The plan is to determine the funding amount for wind energy onshore and offshore, photovoltaics and possibly also for biomass, via competitive calls for proposals and for an end to the determination of funding on a national basis.

Energy efficiency, energy saving and renewables are the cornerstones of the future energy system that Germany is heading towards in its energy transition. The results of current studies show that increased energy efficiency as well as the extension of renewables has a positive impact on macroeconomics in terms of increased economic performance and additional employment. This is possible due to additional investments on the one hand and decreasing energy costs on the other. Achieving the energy policy goals is likely to require the investment of between €31bn and €38bn per annum by 2020.

This is a long-term process opening up promising export opportunities, if Germany can prove that the energy transition can succeed in a leading industrial country and bring added benefits

The Energy Transition – Digitisation Act came into effect in September 2016; it defines the schedule for the rollout of the smart meter. This is an important step towards facilitating the infrastructure necessary for the integration of Renewables. In 2015, the German federal government set up the programme “Sinteg” to support the development of intelligent grids. A foundation for the digitisation, not only of energy systems but of the economy as a whole, is the ongoing broadband expansion. The expansion will be fueled by the “Act facilitating the expansion of digital high speed networks”. The draft law was passed by the *Bundesrat* in 2016. In addition to these, political developments entrepreneurial investments are also being made to promote digitisation through process optimisation and new business models.

Germany has immense deposits of coal which accounted for about 34.6% of primary energy consumption in 2016. Around 40% of power generation is coal-fired. However, a decision has been taken to phase out subsidies for domestic production of hard coal and to decommission all mines by 2018. Oil remains a main source of energy in Germany, making up for one third of the country’s total primary energy

consumption in 2015. The country has only a few oil deposits of its own and relies largely on imports to meet demand. All in all, with 464 mio t SKE, Germany was the largest energy consumer in Europe and the seventh-largest primary energy consumer in the world in 2016.

Germany currently imports about 70% of its energy needs. One of the main goals of government policy is to reduce the country’s dependence on imports. The increase of energy efficiency and renewable energies could solve this problem and contribute to the long-term security of supply.

Germany remains a popular location for direct investment by international companies in the energy sector. Renewable energy continues to be one of the most popular and profitable areas for international investors. The Renewable Energy Sources Act has made renewable energy sources an attractive prospect for the future. It encourages further development in the interests of keeping electric power-hungry manufacturing in Germany competitive.

## 2.2.3 Healthcare

The health industry continues to expand more rapidly than the economy as a whole. It is now one of the most important industries, employing some 7.0m or over 16% of the total workforce in Germany.

Medical care in Germany enjoys an enviable reputation for efficiency and quality. The service is universal and comprehensive, both for inpatients and outpatients.

As the biggest European market, Germany offers excellent local conditions for healthcare companies. The healthcare industry is very attractive to private investors due to above-average growth and strong cash-flows, without being dependent on economic cycles. In particular, there are major investment opportunities in the hospital sector. Currently, more than one third of hospitals are operated privately.

The healthcare industry generated gross value of €3.36bn in 2016. This turnover was spread among 230,000 companies and institutions, mainly consisting of hospitals, public health funds and private health insurers. Health organisations can be found all over the country since German policy is to ensure a full range of locally available care. Important future topics for the health sector are preventive medicine, innovation in medical technologies and maintenance of present standards. eHealth has been identified as a major topic for the future and although encouraged through respective legislation at the end of 2015, it is still struggling over a number of legal and reimbursement hurdles.

Although the German healthcare system is highly regulated, it promises high growth, not least due to the increasing demand of an ageing population.



## 2.2.4 Industrial products

The major sectors of industrial production in Germany are metals, engineering and construction, chemicals, and industrial manufacturing. Around 6.5m people were employed by more than 40,000 companies in these sectors in 2016, generating more than €1.200bn in revenues and about 20% of German GDP. German manufacturers are clearly export-oriented and in fact the third biggest machine producers in the world behind the US and China.

The companies – mostly situated in the west or southwest of Germany – supply their products to all major industry sectors all over the world. They create value at all points in the supply chain, be it by providing basic materials (basic chemicals, gases, metals) or mid-tech and high-end products (such as specialised chemicals, special tools robotics and laser technology). Additionally, the German industrial product sector is connected to research clusters, to supplier and OEM networks all around the globe.

Key players in these market segments include BASF, Bayer, Siemens and ThyssenKrupp. Their products typify the brand “Made in Germany”. Preserving the symbolic power of this prestigious brand without being cut off from new developments like IoT, 3D printing, Blockchain, Predictive Maintenance Robotic process automation etc. will be one of their main challenges in the future. It will be necessary for them to defend their leading market position against global competitors by developing innovative business models, products and services, exploring new markets and digitalising their supply chain (*IIoT resp. Industry 4.0*). One of the biggest tasks for German industrial players will be expanding and investing in emerging and developing markets by building up production lines and sales services whilst maintaining their high quality standards.

## 2.2.5 Pharma and MedTech

The pharmaceutical and medical technology industries are important sectors for Germany. Direct access to internationally renowned scientists, outstanding research units, and major pharmaceutical markets make Germany a unique business location. According to government statistics, larger companies (of 20 or more employees) employed some 153,000 in the pharmaceutical industry and 133,000 in the medical technology industry in Germany in 2015. These companies generated revenues of €38.9bn and €27.6bn from the pharmaceutical and medical technology industries respectively. Revenues are expected to increase in both sectors over the coming years: In 2017, Germany exported pharmaceuticals worth €70bn. Hence Germany is the second biggest exporter after the US with a world trade share of 15.5%.

The German health market is characterised by extensive development of medical technology products, innovative medicines and new methods of treatment and care. Global players such as Roche, Hexal, Novartis, Sanofi-Aventis, Ratiopharm and Pfizer have chosen Germany as one of their central locations in order to take advantage of a strong and central infrastructure within Europe and a powerful

combination of different industrial sectors. A growing health market, the ageing population, rising health awareness and a comparatively high average income ensure an increasing demand for new and high-quality medicine. Furthermore, the workforce in Germany is considered to be excellent.

The Pharma and MedTech industry in Germany – as in other European countries – must comply with a complex range of regulations and statutes. Nevertheless, Germany remains an attractive location for innovative pharmaceutical and medical technology companies.

## 2.2.6 Retail and consumer

The retail and consumer goods industry is one of the most important sectors of the German economy. In 2017, 3.0m people were employed in the retail sector; another 1.5m worked in the branded consumer goods industry. With a market volume of €513bn in 2017 (15% of Germany's GDP), Germany has the largest retail market within the EU. Food retailing accounts for almost 50% of retail sales followed by apparel and shoes (12%) and consumer electronics (8%). Germany has a leading role as a food exporter. The food sector generated a record level of €56.7bn exports in 2016, a nominal rise of 3.6% over the previous year.

The leading five German food retailers, Edeka Group, Rewe Group, Schwarz Group (Lidl, Kaufland), Aldi and Metro Group account for 75% of food retail sales. The largest fashion retailers are Otto Group, H&M and C&A. The leading consumer electronics retailer is CECONOMY, resulting from Metro Group's demerger, with the brands Media Markt, Saturn and Redcoon. Consumer goods production is dominated by global players such as Nestlé, Procter & Gamble, Unilever, CocaCola and Henkel, but there is also a significant number of middle market family-owned consumer goods companies.

Over the last number of years, online retailing has become a relevant factor in retail sales. For 2017 online sales reached revenues of €48.7bn. With a market share of 10%, e-commerce is the main growth driver for Germany's retail sector. Leading online retailers are Amazon, Otto Group, Zalando and notebooksbilliger.de.

The private consumption share of GDP has continuously increased over the last five years. Germany's price level for fast moving consumer goods is well below the Eurozone level. Due to rising energy prices (+3.1%), food prices increased by 3.1% compared to last year. The price increase had an effect on mostly all food product categories. In 2016, Germans spent on average 14% of their monthly consumption expenditure on food and drinks; 10% on leisure, entertainment and culture and 4% on textile.

There are several trends having an impact on the retail and consumer goods industry in Germany. The pace of digital change is accelerating and consumers are becoming more demanding. They expect greater transparency over the origin, production methods and supply channels for goods as well as products that are better tailored to their personal needs. Retailers need to perfectly dovetail online and offline shopping channels. They also need to create a unique and emotionally

stimulating shopping experience to persuade customers to buy their products. In emerging countries the rapidly expanding prosperous middle class is adopting Western consumption patterns, opening new sales opportunities for German companies. At the same time the aging and declining population in industrial countries is leading to a change in the demand for products, services and shops. Owing to several food scandals in recent years, topics such as sustainability and transparency over the supply chain have become more important than ever. Consumers are asking for sustainably produced products and information about the origin, production and transport of products. These developments represent both opportunities and challenges for retailers. They will need to adapt by aligning their business models and supply chains and develop innovative products and sales concepts.

### 2.2.7 Technology, media and telecommunications

The technology industry comprises companies from the IT, electronics, internet and semiconductor segments and is the backbone of technological development and innovation, especially in the field of digitisation. In addition to current trends, including Software as a service (SaaS), mobile and cloud computing, Augmented and Virtual Reality, Big Data and Industry 4.0, there are new trends comprising Artificial Intelligence and service architecture. Infineon, Siemens and SAP are among the world's leading companies in the market. Moreover, there is a burgeoning of tech start-up companies. Berlin is becoming one of the two most important start-up hubs in Europe and Düsseldorf is also gaining in significance.

The media industry includes broadcasting, publishing, gaming and music companies as well as advertising and media agencies. It is also heavily influenced by the internet economy and digitisation with the main challenge being the conversion of traditional offline media content into paid-for digital content. Revenues in the media segment amounted to €76.25bn in 2016 and PwC forecasts an annual growth of 2.4% by 2021, mainly driven by digital media. Due to higher competition between and the decreasing margins of media companies, it is most important for companies to put the consumer at the heart of their strategies and provide attractive offerings to win and retain consumers. Consumers are choosing offerings that combine an outstanding and personalised user experience with an intuitive interface and ease of accessibility. Video streaming especially is a growing segment which is projected to grow by 10% annually by 2021.

Digital media is growing rapidly and is already compensating for losses in traditional media segments such as music, book sales and video games. In 2021, approximately 43% of media content revenue will be digital. High penetration of tablets and smartphones are key drivers of these changes and as a result, digital and mobile shifts are a strategic focus for today's entertainment and media companies. Digital challenges includes building an infrastructure e.g. expansion of broadband and 5G networks to meet the high demand in data consumption.

In the telecommunications market, digitisation can lead to new opportunities and service offerings. For example, in the field of Big Data, telecommunications

companies have an abundance of data, but still struggle to use it effectively. Also, cloud services can play a significant role in the future of the telecommunications market. Technological progress is however a challenge, as it requires investment at a time when the industry is facing extreme cost pressure and struggling with the high degree of regulation in the market. The need to expand and increase the quality of broadband networks is an ongoing political priority and no solution has yet been reached as to who will bear the costs. In terms of mobile networks, the German government set the goal to provide all main roads and the 20 largest cities with 5G by 2025. To support this, the 5G strategy for Germany was published in 2017. In 2017, the total revenue in telecommunication services in Germany rose to €65.7bn which is an increase of 0.4% compared to the previous year. The increase in revenues stems from the increase of smartphone sales and the expansion of telecom network infrastructure. The German telecommunications industry is dominated by Deutsche Telekom, Vodafone and Telefónica. The already highly consolidated German mobile market has seen another major merger: United Internet acquired Drillisch, into which United Internet's telecommunication branch 1&1 was integrated. They are planning to become the fourth major force in the German mobile telecommunications market.

### 2.2.8 Transport and logistics

As the backbone of industry, the German transport and logistics sector has grown steadily over the last 20 years. The average annual growth rate between 2009 – after the only year in recent times when this market declined – and 2017 was 2.5%, resulting in a total volume of €263bn. With this volume, the German logistics sector does not only contribute a full 25% to the European logistics market, but is also the third largest sector in Germany, employing nearly 3m people in 2017.

These people work for a large number of logistics companies of differing sizes. The market is led by the three biggest German key players, Deutsche Post (DHL), Deutsche Bahn and Lufthansa. These companies are among the world's leaders in their fields. Duisport, at the confluence of Rhein and Ruhr, is one of the largest inland waterway ports in the world. These organisations are supplemented by a large number of small and medium sized enterprises operating in the logistics sector.

The good state of German transport infrastructure works as a multiplier for the country's exports. According to the World Bank's Logistics Performance Index (LPI), which assesses each country's transport infrastructure, Germany regained the top position in 2016.

The efficient and effective infrastructure combines with cutting-edge logistics services and the location at the heart of the European continent – bordering nine other European countries – to make Germany the most important logistics hub in Europe. As a gateway, Germany grants access to a consumer market of 250m people within a radius of 500km.



## 2.3 Ownership trends

A few large German corporations are still in partial state ownership. The general intention is to dispose of these state holdings at a suitable opportunity to 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.

## 2.4 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.

## 2.5 Government policy

The social market economy is the guiding principle of German economic policy. It combines a free market capitalist economic system alongside social policies which aim to establish both fair competition within the market and a welfare state. As a result, the main thrust of government industrial and economic policy is to allow industry and commerce to develop as they please within an environment of social redistribution.

Whereas unemployment has been a major concern of economic policy in the past, the German labour market remained resilient during the economic and financial crisis of 2007/2008 and was stronger in 2017 than ever before. Unemployment has fallen by more than 40% since its peak in 2005, and reached the lowest level since German reunification in 1990. In 2017 2.5m people were unemployed (5.7%).

This development reflects the strength and competitiveness of Germany's economy, which is the biggest economy in the EU. However as Germany has both high standards and high costs of living, overall employment costs remain high and protection of employees against wrongful dismissal is quite extensive. There is a high level of compulsory deductions from an employee's wages and employees have broad rights to holiday and other benefits. Hence, there is considerable disparity between the take-home pay of an employee and the corresponding wage costs in the profit and loss account of the employer. In recent years, the government has put in place new labour market regulations, such as a statutory minimum wage as well as a regulation requiring listed companies and those entities subject to co-determination regulations to have a 30% quota for women on seats on the supervisory board.

Despite the generally good shape of the economy, German economic policy is facing a number of challenges, including accelerated technological change, an ageing society and resulting labour shortages as well as the integration of refugees. Furthermore, the move to renewable energy sources must be designed in a way that strengthens Germany's competitiveness in the future.

While Germany has no overall national economic plans, it does offer various specific incentives and regional programmes. However, investment activity has been sluggish in Germany for quite some time. Compared with other countries in the EU, the increase in public investment has been below average. The government has therefore set itself the target of strengthening private-sector and public-sector investment. Furthermore, the government's investment strategy focuses also on (digital) infrastructure projects – especially high-performance broadband networks –, education, as well as on research and development. In order to promote digitisation, several incentive programs are in place with a strong orientation toward the industrial sector and German SMEs (*Mittelstand*). Regional policy programs – that are mainly funded by the EU – are about supporting regions that are structurally weak. They are less specific and companies benefiting from the programmes receive incentives and other support subject to the fulfilment of specified conditions, most of which are negotiated individually and usually include a guaranteed minimum employment level.

## 2.6 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.



# *Regulatory environment*

# 3

There are no free-trade or privileged economic zones within Germany. The promotion of specific industries depends upon regional and state programmes, for example with regard to building certain industry clusters or promoting renewable energy generation. 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.





## 3 Regulatory environment

### 3.1 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).

The pace of development in the digital economy is challenging Germany’s existing regulatory and policy frameworks. In 2016 the German government thus approved the amendment of the Act against Restraints of Competition in order to adapt competition policy to the prerequisites of the digital age. However, further regulations are currently under discussion.

### 3.2 Corporate governance

The corporate governance framework for companies doing business in Germany mainly depends on their legal form. Large companies regularly have a two tier governance structure with a separation between management boards and supervisory boards (for details see chapter 6). Most of the corporate governance regulation results from the German Stock Corporation Act (*Aktiengesetz*), with some of the rules only applicable for public listed companies. For companies of several industries, particularly the financial services sector, additional German and/or European governance rules apply.

Management Boards and Supervisory Boards of public listed companies are obliged to comply with the German Corporate Governance Code. The code is written and gets periodically reviewed by a commission (*Regierungskommission Deutscher Corporate Governance Kodex*) appointed by the Federal Ministry of Justice. As such, it does not have direct statutory force, although the boards of public listed companies have to disclose annually any instances where they have not followed the code’s recommendations (“the comply or explain principle”).

In the past few years, some important fields of regulation regarding corporate governance, particularly for listed companies, have been:

- Executive remuneration and its transparency
- Qualification, time commitment and independence of supervisory board members
- Substantiation of supervisory boards’ tasks
- Rotation and independence of statutory auditors

### 3.3 Trade registers

Each entity carrying on a trade or business in Germany must register with the local registry court (trade register) in 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 are maintained in an electronic format and it is not possible to file hardcopy documents. Parallel to the local registers, the Federal Gazette maintains a database of registered businesses. It is open to examination by members of the public on the internet “[www.unternehmensregister.de](http://www.unternehmensregister.de)”. Financial statements (annual reports) of companies are also filed with the Federal Gazette, where they are open to public inspection at “[www.bundesanzeiger.de](http://www.bundesanzeiger.de)”. The Federal Gazette accepts only softcopy filings in a set XBRL (eXtensible Business Reporting Language) format.

### 3.4 Work safety, consumer aid and the environment

Apart from the registry court, each town or other local authority maintains a Trade Supervisory Board. Each place of business must also be registered with the local Trade Supervisory Board, which supervises operating 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 Trade Supervisory Boards 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.



# Banking and finance

# 4

## 3.5 Regulated industries and professions

In general, banks and other financial service institutions, insurance companies, securities markets and asset managers are subject to supervision by the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* or BaFin). This supervision involves frequent reviews of the financial position of the business, the risk management system, anti-money laundering and anti-terrorism financing procedures. In some cases, there are daily reporting requirements for a day-to-day supervision.

Since November 2014 all, “significant” banks are directly supervised by the European Central Bank (ECB) in cooperation with the BaFin and the German Central Bank (*Deutsche Bundesbank*). “Significant” are those banks that meet certain given criteria or are deemed significant by the ECB. All tasks and banks not assigned to the ECB continue to be regulated by the local regulators (BaFin and *Deutsche Bundesbank*).

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, such as doctors, auditors, tax consultants, engineers, architects, and lawyers are subject to supervision by their respective professional bodies. This supervision invariably extends to ethical conduct as well as technical competence. The relevant EU directives on this subject are, in practice, generally of secondary importance to the more stringent rules of the supervising professional bodies themselves.



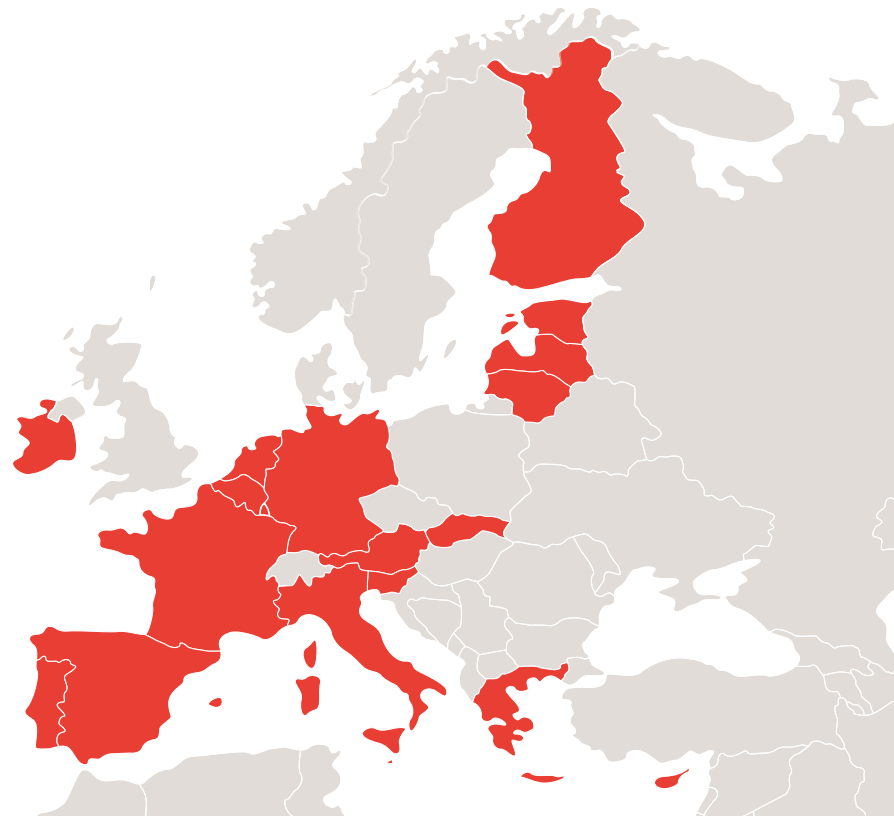


## 4 Banking and finance

### 4.1 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 the Governing Council, consisting of the Executive Board and the Governors of the National Central Banks of the nineteen countries currently participating in the so-called Euro system. 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 opted not to join. The current members are Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain. The euro is the official currency of Andorra, Monaco, San Marino and the Vatican. It also serves as the domestic currency in Kosovo and Montenegro, though without a formal agreement with the ECB.

The German Central Bank (*Deutsche Bundesbank*) is responsible for minting the German euro coins currently in circulation. Within Germany, it exercises various supervisory functions over the banking system acting in consort with the European Central Bank and the Federal Financial Supervisory Authority.



### 4.2 Banking system

Banking services are offered to the public, both to business and to private households, by a variety of different types of financial institutions. The commercial banks offer the most comprehensive services, but there is also a range of savings banks, cooperative banks, “mortgage banks”, building societies and other financial intermediaries. The commercial 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, together with the central institutions of the savings and cooperative banks, 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 commercial 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 to 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.

For further details we refer to the publication “Banking Business in Germany”, recently published in its fifth edition.

### 4.3 Capital markets

Germany operates a flourishing money market and stock exchange. The bond and stock market is one of the largest in the world. There are seven 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.



# Exporting to Germany

# 5

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 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 “Scale” segment (introduced at 1st March 2017 and replacing the former “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 for companies quoted 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, although in practice IFRS has become the accepted norm.

## 4.4 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.



# 5 Exporting to Germany

## 5.1 Import restrictions

Since the EU member states constitute a single European market, deliveries between 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 formalities for travelers or movement of sensitive goods (listed in annex IV of the EC-Dual-Use Regulation, e.g. weapons, nuclear materials etc). The terms “export” and “import” therefore technically now only refer to trade between the EU and non-EU countries (third countries).

Despite the free movement of goods and globalized trade, restrictions on the import and export of certain goods are in place in order to protect certain vulnerable areas (e.g. public security, environment, health, animals, plants, culture, trademarks etc). These special rules, which arise from both national and European law, may restrict imports, exports and transit.

Products of which the sale is prohibited in Germany will not be customs-cleared and have to be re-exported or destroyed.

## 5.2 Import duties

For all types of goods, there is - in the customs tariff of the EU – an individual tariff number including a third country customs duty rate which will apply to imports from all third countries as long as there is no exception (see below). This customs duty rate applied on the customs value determines the payable customs duty for the imported goods. The customs duty rate is zero for some goods.

Goods, which are used for a certain predefined end-use can be exempt from customs duties. Tuna for example, is exempt from customs duties if industrially processed and put in cans. The goods are placed under customs supervision until the end-use requirements are met. Exempted or reduced customs duty rates may also be applicable by using preferential treatment.

Preferential treatment apply to goods originating from certain countries and territories with which the EU has a free trade agreement or customs union. Imports from Iceland, Liechtenstein, Norway and Switzerland for example can be free of customs duties due to the European Free Trade Agreement (EFTA). For this, the customs declarant has to provide evidence (e.g. with an EUR.1, EUR-MED or declaration of origin) that the goods have preferential origin in one of the EFTA member states.

There are also customs unions which allow for duty exempt imports on condition that the privileged goods emanate from the free circulation of an exporting country with which the EU has a customs union. One major customs union is currently in place with Turkey. Many goods imported from Turkey can be exempted from customs duties if the customs declarant can provide an A.TR document proving that the goods were in free circulation in Turkey.

The EU also levies an anti-dumping duty or a countervailing duty on dumped or inadmissibly subsidised products in addition to the regular customs duty rate. This offsets any unjustified price advantages third country sellers would have in comparison to local sellers within the EU. These measures will only be adopted by the European Commission after a detailed investigation procedure was initiated. The initiation of this procedure normally requires a respective application by a concerned economic branch in the EU.

Within the framework of a tariff quota, certain goods (especially textiles, agricultural goods, meat and fish) may be imported duty-free or at a reduced rate within a fixed period (quota period) up to the level of a certain value or quantity limit (quota volume). Once the volume or value limit has been reached or the quota period has elapsed, the tariff quota ends immediately. In the case of tariff quotas, the quantities imported must be closely monitored in order to comply with the quantity or value limits. The monitoring (administration) is carried out either by means of licences (licensing contingents) or by the distribution of the contingent amounts on the basis of the First Come – First Served principle.

The customs duty rates for the individual tariff numbers can either be in form of ad valorem duty rates (percentage), specific duty rates (e.g. based on pieces, volume or weight) or a mix of both. Ad valorem duty rates – which are based on the customs value – are the most common duty rates found in the customs tariff of the EU (Combined Nomenclature).

Example for Ad Valorem duty rates	
Machine for counting coins	
Customs tariff number	8472 90 10 00 0
Customs Value	EUR 1,000.00
Customs duty rate, ad valorem (as per January 2017)	1.7%
Payable customs duty	EUR 17.00 (1,000 * 0,017)



The primary basis for the “customs value” of goods is the transaction value, that is the price actually paid or payable for the goods when sold for export to the customs territory of the EU. Broadly speaking, the basis for assessing the transaction value is usually the invoice price on the supplier’s invoice. This basis can be subject to amendment, either in response to subsequent price adjustments, or because of other charges and credits raised separately (e.g. with regard to costs of transportation) or otherwise borne by the importer. An adjustment of the declared customs value may be required in these cases. Customs auditors regularly inspect the books of German importers to establish whether they have appropriately accounted for such costs.

The administration of customs duties is for the most part completed at the point of release of the non-Union goods into the customs territory of the EU for free circulation. The release for free circulation entails e.g. the following:

- The collection of any import duty due;
- The application of commercial measures and prohibitions and restrictions insofar as they do not have to be applied at an earlier stage.

The release for free circulation changes the customs status of the non-Union goods to Union goods. Union goods can be moved within the customs territory of the EU without any customs supervision.

The customs duties imposed, together with the import VAT (*Einfuhrumsatzsteuer* – EUST) and any excise duties or other taxes levied (see Chapter 12), are typically charged back by the carrier or forwarding agent 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 required by customs or tax audits.

## 5.3 Authorised economic operator

The increasing globalization and the changed international security situation have caused the World Customs Organization (WCO) to create a global framework for modern, effective risk management in customs administrations in the form of a “Framework of Standards to Secure and Facilitate Global Trade” (SAFE).

At the European level, security aspects of SAFE were implemented through security changes in the Customs Code and the Customs Code Implementing Regulation. The provisions of the new EU Customs Code (UCC), the Implementing Regulation (IA), the Delegated Regulation (DA) and the Transitional Provisions (TDA) are now applied after the repeal of the Customs Code and the Customs Code Implementing

Regulation on 30 April 2016. The introduction of the Authorized Economic Operator (AEO) is an essential element of the EU security concept.

AEOs benefit from a special status: they are considered to be particularly reliable and trustworthy and can benefit from special simplifications and facilitations in the context of customs clearance. The status of the AEO is valid in all Member States and is not time-limited. There are two variants of the AEO:

- AEO approval “Customs simplifications” (AEO-C)
- AEO approval “Security” (AEO-S)

Companies may choose to apply for only one variant or both. Some customs approvals and simplifications either require that the applicant is in possession of an AEO-C certification or complies with certain requirements for an AEO-C. This is a new regulation established in the UCC.

## 5.4 Local representation

The import customs declaration for release into free circulation in the EU needs to be filed in the name of a declarant established within the customs territory of the EU. Most companies situated in third countries use the service of a subsidiary company, European freight forwarder or customs agent for this. This customs representative then acts in his own name, but on behalf of the one being represented (indirect customs representation), meaning he is jointly and severally liable for any customs debts. An indirect customs representative therefore bears a certain risk for which he may demand adequate compensation.

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 may meet the preconditions of a taxable “permanent establishment” in Germany, e.g. if they station their own employees in Germany or if they appoint their own German representatives. If the preconditions for a permanent establishment are fulfilled, the profit to be allocated to the permanent establishment according to the relevant provisions in tax law becomes chargeable to German income taxes (corporate or income tax and trade tax) and the foreign business is subject to German accounting and record-keeping requirements. Further there might be the obligation to register in Germany for VAT purposes.

It is also quite usual for a foreign business to establish a German sales subsidiary or branch to regularly and systematically access the German market.

# *Business entities*

# 6

## 5.5 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. Such sales are subject to German VAT if the customer is resident in Germany. There is a common EU VAT procedure in force to enable electronic service providers in one member state to meet their VAT obligations on their sales to customers in other member states. Essentially, they report all such sales to a designated authority in their state of registration – in Germany, the Central Tax Office in Bonn – to which they pay the VAT due at the various national rates. The authority then forwards the information and payment to its counterparts in the countries of the customers. Participation in this scheme is the voluntary alternative to separate VAT registration in all member states in which on-line customers are located.



# 6 Business entities

## 6.1 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.

## 6.2 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, transparency 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.

### The AG (*Aktiengesellschaft* – public limited company)

The AG is a publicly held company comparable to the Public Limited Company (plc) in the United Kingdom

Shares	Shares may be publicly traded on a stock exchange
Capital requirements	Minimum share capital of €50,000
Directors	<ul style="list-style-type: none"><li>Executive Directors meet as a management board (<i>Vorstand</i>) and take decisions collectively</li><li>If employees exceed 2,000 a labour director has to be part of the management board</li><li>A supervisory board (<i>Aufsichtsrat</i>) consisting solely of non-executive directors, has to be established; in case of employee participation specific rules apply</li></ul>
Shareholders	<ul style="list-style-type: none"><li>Shareholders may vote on the resolutions tabled at shareholders’ meetings</li><li>Under certain circumstances they may propose resolutions of their own</li></ul>

### The GmbH (*Gesellschaft mit Beschränkter Haftung* – private limited company)

The GmbH is a privately held company comparable to the Limited Liability Company (Ltd) in the United Kingdom

Shares	Shares may not be publicly traded on a stock exchange
Capital requirements	Minimum share capital of €25,000
Directors	<ul style="list-style-type: none"><li>Managing Directors (<i>Geschäftsführer</i>) meet informally and take decisions collectively or on their sole responsibility</li><li>If employees exceed 2,000 a labour director has to be part of the management board</li><li>A supervisory board (<i>Aufsichtsrat</i>) has to be established if number of employees in Germany exceed 500</li></ul>
Shareholders	<ul style="list-style-type: none"><li>Shareholders may resolve on all resolutions laid before them and may propose resolutions of their own</li><li>There is no obligation for a formal meeting</li></ul>

## 6.3 Capital requirements

An AG has a minimum share capital of €50,000 divided into ordinary shares of equal nominal value of at least €1. Share certificates may not be issued until the share capital has been fully paid up. Traditionally, most AGs issued bearer shares, although unquoted companies may no longer hand over individual share certificates to shareholders. Rather, they must deposit bearer share certificates with an authorised repository (typically one of the major banks). Share transfers do not therefore go unrecorded. 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 or she 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 only transferable by notarial deed. The articles of association may set other restrictions on share transfers, such as pre-emptive or approval rights for existing shareholders.

A special rule in the GmbH Act enables 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.

## 6.4 Shareholders, directors and officers

Both the AG and the GmbH are managed by one or more executive directors. The executive directors of an AG meet as a management 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 executive directors of both types of company are individually responsible for specified fields with a chairman of the management board (*Vorstandsvorsitzender oder -sprecher* in the AG or *Sprecher der Geschäftsführung* in the GmbH) responsible for coordinating the board and representing the company.

Either form of company must appoint a second director as “labour director” with special responsibility for all employment matters where the number of employees regularly exceeds 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 majority of shareholders of a GmbH may also give concrete instructions to the executive directors. The shareholders of a GmbH may also word the articles of association of the company to specify particular transactions or types of transaction that the directors may only conclude with their approval.

Signature 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 two directors if more than one director has been appointed.

Every AG and basically all other companies with more than 500 employees in Germany must appoint a supervisory board. The supervisory board is a separate body made up of non-executive directors. It has responsibility for the supervision of the management board including the approval of major transactions, examination of financial reporting and usually the appointment of executive directors and statutory auditors on behalf of the shareholders. The supervisory board also has to examine the separate non-financial report and the separate non-financial group report, if they have been prepared. The size and composition of the board depends on the size and legal form of the company. Employee representatives are generally included on the supervisory board when the number of employees in Germany exceed 500, and make up a third of its number. Companies employing more than 2,000 people in Germany must appoint a supervisory board with an equal number of employee and shareholder representatives, although the chairman, appointed by the shareholders, has a second, casting vote in the event of a tie.

Composition of mandatory supervisory boards					
	Number of employees in Germany				
	< 500 (only AG)	500–2,000	> 2,000	> 10,000	> 20,000
Supervisory board seats	3 or more	3 or more	12	16	20
Share of seats that falls to representatives of the employees	n/a	1/3	1/2	1/2	1/2

6.5 The European Stock Corporation

The *Societas Europaea* (SE or European Stock Corporation) is a European Union based legal form which may also be used in Germany. It basically allows the shareholders to choose between two management structures, the traditional German two tier system with a management and a supervisory board, and the Anglo-American one tier system with one board of directors (*Verwaltungsrat*).

The SE Participation Act regulates the participation of the employees in the SE. This includes both the workers’ council level and the co-determination level 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, the model foreseen by the Act becomes 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.

6.6 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 executive board (*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 now only a few examples remain in existence. It is, however, favoured by family dominated companies that want to be active in the stock markets.

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.

6.7 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 operational 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, i.e. 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 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.

A limited partnership where all the general partners have limited liability is referred to as a GmbH & Co. KG. These abbreviation, however, merely indicates that there is no ultimate unlimited liability for the partnership's debts and obligations; they are not different legal forms.

## 6.8 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).

## 6.9 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 liaison or sales support offices.

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.

## 6.10 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 restructurings can even be achieved tax free. 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 downgrading 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 is based on a set of statutory accounts drawn up not earlier than eight months before the reconstruction documents are filed with the trade register to have the possibility to use the annual financial statements (and no extra interim financial statement), and that the reconstruction itself is subject 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.



# *Labour relations and social security*

7

## 6.11 Foreign legal forms

In recent years there has been a tendency to register businesses abroad, often as a means of avoiding German bureaucracy or formal requirements. The business is then conducted in Germany through a branch of the foreign entity (often a UK Ltd). The rules of the country of incorporation must be adhered to as well as the local tax and legal provisions applicable to branches. This tends to duplicate the unavoidable formalities and also leads to difficulties in dealing with authorities, utilities and business partners unfamiliar with the foreign legal form. Operating efficiencies are rarely achieved.



## 7 Labour relations and social security

### 7.1 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 an unemployment level of 5.8%, 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.

### 7.2 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. Beside the standard employment contracts companies also have the right to work with freelancers or leased employees. This often grants more flexibility for the company. However, personnel staffing with this kind of service relations is highly regulated and often checked by German authorities (e.g. audits).

### 7.3 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 five and twenty 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 new 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 often 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 with other employees being favoured. Legislation has been passed to counter this tendency, but is still being considered by the Constitutional Court.

### 7.4 Wages and salary levels

The average monthly gross earnings of full time employees is €3,703 (2016). Compared to other countries as UK or France, Germany has a relatively homogenous compensation market with several compensation hot spots across the country. Metropolises such as Hamburg, Frankfurt am Main, Stuttgart or Munich tend to pay salary premiums of 10-15% compared to the general market. Overall, the wage level is highest in the south and lower in the east and northern part of Germany. In contrast to other European capital cities, Berlin is still not a hot spot in terms of compensation for historical reasons.

A general statutory minimum wage came into effect in Germany on January 1st 2015. The statutory minimum wage establishes a lower limit for wages. All employees performing work in Germany have to receive at least the minimum wage except for some specific employee group such as interns, trainees, apprentices and so forth. The current general minimum hourly wage is at €8.84 gross. For several industries, the German government has declared a slightly higher amount as the minimum wage (e.g building industry. labour lease, nursing).



The strong influence of workers council and trade unions lead to a large population of employees that are covered by one out of many existing bargaining agreements that exist in Germany. Depending on the industry and/or region, these bargaining agreements reflect a salary level that is usually clearly above the statutory minimum wage.

## 7.5 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 mothers returning to work. Company cars (allowing private use) 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

pension 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 if the pension fund is reinsured.

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 any 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. An exception applies for irrevocable direct insurance policies and pension funds. The Association sets the rates to cover its actual expenditure in 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 sometimes make up the difference for a not inconsiderable period thereafter, particularly to long-serving executives, although usually without a formal obligation to do so.

## 7.6 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 management 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 twenty 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 nine to thirteen 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.

### 7.7 Health and safety

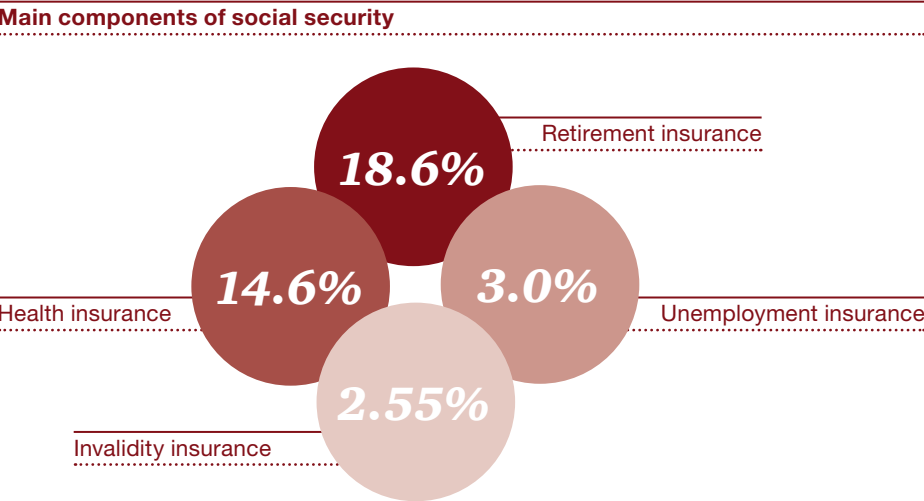
All employers are subject to health and safety regulations. These are extensive and detailed and vary by industry and type of business. The workers’ council usually has an important say in the establishment of specific procedures. This also extends to, in many cases compulsory arrangements with a local 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.

### 7.8 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, by law the employer must allow long-serving employees longer minimum notice periods (two months to the end of a calendar month for at least five years’ seniority rising to seven months after twenty years of service). Certain persons, such as expectant mothers, the disabled, data protection officers 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.

### 7.9 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 2018, the monthly



premiums are 18.6%, 3.0%, 2.55% and at least 14.6% of gross salary. Basically, the cost is split equally between employer and employee, although childless employees over 23 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 legal minimum is 14.6% split equally, but most health funds require a supplement of, typically, around 1.0% to be borne by the employee alone.

The total of these contributions amounts to a minimum of 39.75% of an employee’s gross salary (40.0% if the employee is childless), although the contributions are only due on salaries up to a certain level. In 2018, the monthly levels are €6,500.00 (€5,800.00 in the east) for contributions to the retirement and unemployment insurance, and €4,425.00 (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 €59,400.00. However, those opting out must take out private health insurance. They are also generally unable to re-join the state scheme later, unless their regular annual earnings fall below the opt-out level while they are still under 55.

The social security systems of the European Economic Area countries (EU, Iceland, Liechtenstein and Norway) and Switzerland 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 European Economic Area country and working in another.

Beyond the European Economic Area countries, mutual social security arrangements are governed by bilateral treaties. Germany has concluded social security treaties with Albania, Australia, Bosnia-Herzegovina, Brazil, Canada, Chile, China, India, Israel, Japan, Korea, Kosovo, Macedonia, Montenegro, Morocco, Philippines (comes into force 1 April 2018), Serbia, Tunisia, Turkey, United States and with Uruguay.

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 a limited period of time. 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. However, some treaties only cover certain elements of the social security system. For example, the treaty with the US only covers the retirement and health insurances. Coverage for other elements of social security may need to be arranged privately.



# Audit requirements and accounting practices

# 8

## 7.10 Working and residence permits for foreigners

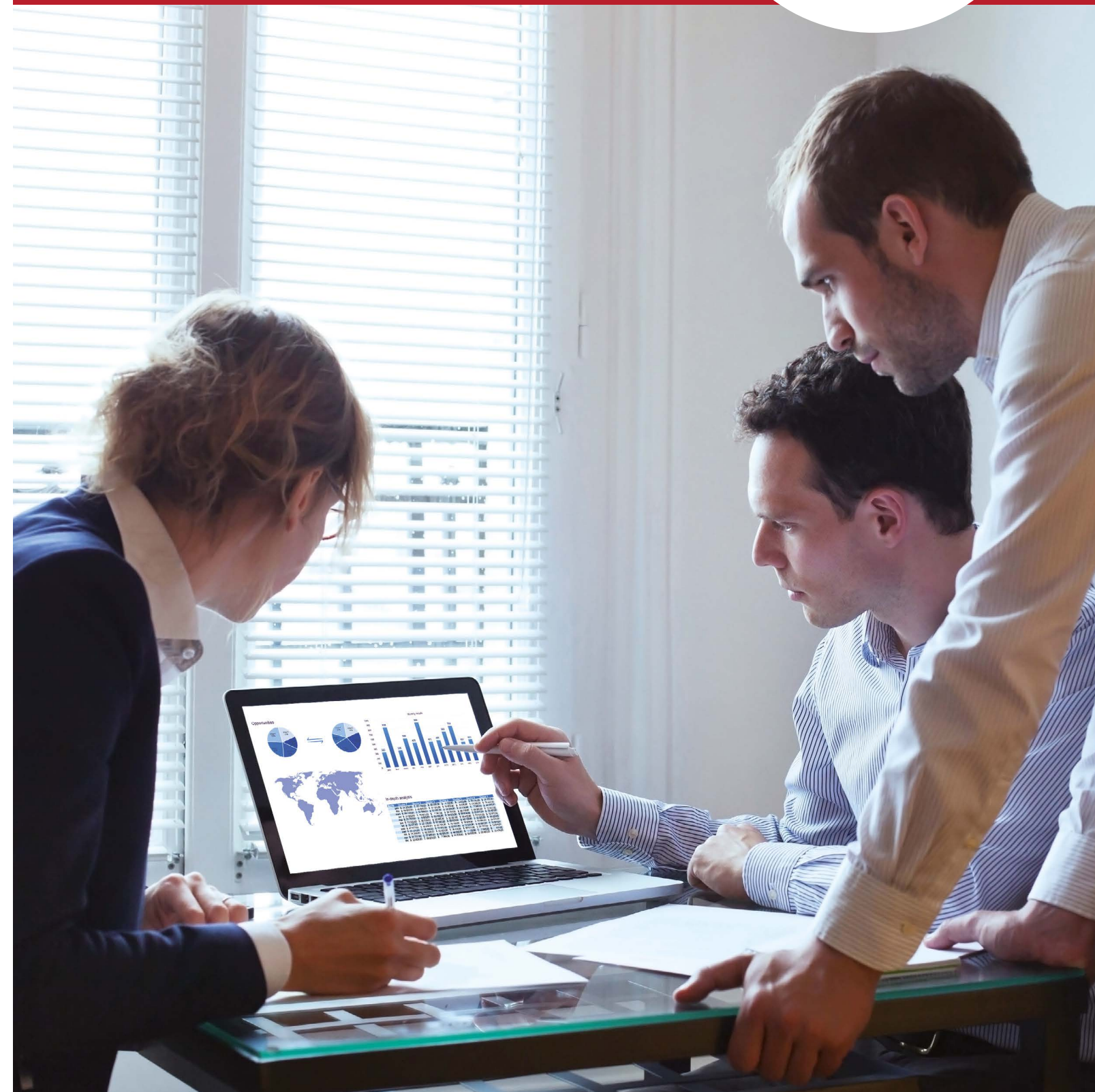
EU citizens have the right of migration to Germany. Once they have found living accommodation, they, like all other local residents need to register their address within fourteen days at the local registration office/town hall (*Einwohnermeldeamt*). Their right to take up residence in Germany may not 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.

Individuals of other nationalities moving to Germany require residence and work permits. The two permits are issued in one document under a combined procedure, which can, in some cases include a review of the local job market to ensure that there are 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 of the work permit pre-approval by the employer to the responsible employment office in Germany. The applicant then files his entry visa application with the original pre-approval and supporting documents at the responsible German mission abroad. The visa, with which the individual can begin working immediately, is generally issued for three months. He/she must then convert this into a residence permit after arrival in Germany. The residence permit can be issued for the duration of the stay or for up to four years depending on the permit type.

Citizens from Australia, Canada, Israel, Japan, Monaco, New Zealand, and the USA are privileged nationals who may enter Germany without an entry visa and apply for a residence permit with the work permit pre-approval from within Germany. They may not, however, start to work before at least a preliminary permit is granted by the local immigration authority.

A simplification of the process (Blue Card EU) applies to highly qualified individuals with a local contract, a recognised university degree and earning a specified level of salary. The same applies to jobs in so-called scarce occupations e.g. doctors and engineers, highly qualified IT staff and craftsmen and craftswomen in specific trades with a lower minimum salary level. In these cases, at work permit pre-approval is not necessary and the decision on the issuance of work and residence permission can be made directly by the German mission abroad or the immigration office in Germany (in the case of the privileged nationals). 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.



# 8 Audit requirements and accounting practices

## 8.1 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 made up in a living language. However, the annual financial statements must be drawn up in German.

The tax law and guidelines by the tax administration also contain provisions affecting accounting records. Among these are the “principles of orderly accounting and retention of books, records and documents in electronic form and of data access” (*Grundsätze zur ordnungsmäßigen Führung und Aufbewahrung von Büchern, Aufzeichnungen und Unterlagen in elektronischer Form sowie zum Datenzugriff*) as published by the Ministry of Finance; there is also a formal requirement according to tax law that the books must be prepared and retained in Germany at all times, unless the responsible tax office permits otherwise. There is a procedure for applying – under certain conditions – for tax office permission to prepare and retain electronic books and other necessary electronic records or parts thereof in another country. If the documents are not in German, the tax authorities have the right to demand a translation.

Furthermore, the accounts should be kept in such a manner as to allow a competent third party to gain an overview of the business transactions and the enterprise’s state of affairs within a reasonable period of time.

The Commercial Code also contains additional requirements for the audit and publication of financial statements of all limited companies and of commercial partnerships in which no natural person ultimately carries unlimited liability. Thus, the GmbH & Co. KG (see chapter 6), 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.

From the point of view of the audit and publication of financial statements, companies are categorised into small, medium-sized or large. The criteria and thresholds for determining which size category a company fits into are summarised in the table below. Companies fall into a category if they meet any two of the three criteria for that category. A company changes its status when it has met or fallen below two of the three criteria for the second consecutive year.

Overview of thresholds			
	Small company	Medium-sized company	Large company
Annual sales (in euro)	≤ 12,000,000	≤ 40,000,000	> 40,000,000
Balance sheet total (in euro)	≤ 6,000,000	≤ 20,000,000	> 20,000,000
Employees (average)	≤ 50	≤ 250	> 250

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-sized 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 disclosures otherwise required disclosures. Generally, companies must publish the required documents within twelve months of the balance sheet date. Large companies are subject to the full publication requirement, i.e., depositing their full annual report with the trade register and as an electronic publication with the Federal Gazette (*Bundesanzeiger*). There are additional publication requirements for companies that are listed, or issue bonds to the public, in Germany. In general these companies have to publish the required documents within four months of the year-end.

## 8.2 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 accrual accounting principle. Consistency and prudence are emphasised as principles. Financial statements must be drawn up according to the principle of a 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 and intangible assets must be recorded, liabilities must be recorded at their anticipated repayment amounts and provision must be made prudently for foreseeable financial risks.

## 8.3 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 management report (*Lagebericht*). The management report should discuss the business situation of the company and also specifically mention the expected development of the company’s business, major risks and opportunities, research and development activities and any branches it maintains. The management report is subject to audit, too.

Quoted companies must also publish a cash flow statement, a statement of changes in equity and a corporation governance statement (*Erklärung zur Unternehmensführung*) including a declaration of compliance with the Code of Corporate Governance (see chapter 6.5). Instances of non-compliance are to be explained. Moreover certain quoted companies must additionally disclose non-financial information either within the management report or as a separate non-financial report.



## 8.4 Valuation

### 8.4.1 Shareholders' equity

Shareholders' equity consists of the issued share capital, capital and other reserves and the net retained profits/net accumulated losses. Unpaid and uncalled amounts of share capital are shown as a deduction from the nominal amount of issued share capital. Amounts called up but not yet paid are presented separately under receivables. The net retained profits/net accumulated losses are net of dividends declared during the year.

If the shareholders' equity is negative because of accumulated losses, the net amount is shown on the assets side of the balance sheet as “deficit not covered by equity”.

### 8.4.2 Fixed assets

Fixed assets consist of tangible fixed assets, intangibles and long-term financial assets. No planned amortisation may be taken on the long-term financial assets 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 also be amortised over its useful life with the amortisation period being explained in the notes. This contrasts with the tax rules that allow a deduction for goodwill amortisation straight-line over a set fifteen-year period. Under certain conditions internally-generated intangible fixed 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.

### 8.4.3 Inventories

Inventories are valued at the lower of cost or realisable value. Raw materials, consumables and supplies may generally not be valued at more than their replacement cost, unless it can be proved reliably that the asset (once finished) may be sold without loss. Most generally known costing methods are acceptable for the determination of cost. The carrying amount of similar assets of inventories usage may be determined on an averaging method or by FIFO or LIFO.

### 8.4.4 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 (provisions for pensions: average market rate of interest during the past ten 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.

### 8.4.5 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.

### 8.4.6 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 historical cost or less than repayment amount respectively. Thus unrealised exchange gains on long-term foreign currency balances are not to be taken up.

### 8.4.7 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 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 included. The tax rate 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 item on the assets side of the balance sheet.



## 8.4.8 Pensions

Pension provisions are shown as a separate item under provisions and accruals. They are to be calculated on generally accepted actuarial under the rule for discounting long-term provisions using the average market rate of interest during the past ten years – see 8.4.4. Under certain circumstances, pension plan assets and liabilities are set off against each other.

## 8.4.9 Leasing

The leasing attribution rules in the tax law are almost invariably followed in the statutory financial statements. Generally leases are treated as operating leases (i.e. capitalised by the lessor) unless the lessor does not even bear a certain portion of the asset's risks or rewards. For example full pay-out leases are capitalised by the lessee if the minimum lease period is 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, such as where the ownership passes to the lessee at the end of the lease.

## 8.5 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 €48m and combined gross assets of less than €24m 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.

## 8.6 International Financial Reporting Standards

Following European law, all quoted companies must draw up their published consolidated financial statements under IFRS. German law provides non-quoted companies and other commercial entities to do this. 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.

## 8.7 Enforcement

A privately organised review board (*Deutsche Prüfstelle für Rechnungslegung* – German Accounting Review Board) was 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 suspected 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 unless the misrepresentation is a breach of criminal law. 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.

## 8.8 Auditing profession and auditing standards

The auditing profession is led by the Institute of Auditors (*Institut der Wirtschaftsprüfer*, IDW), with a membership with about 13,000 qualified German public accountants and German public audit firms (for reasons of simplification, these groups will be referred to as “auditors” and “audit firms”). Membership in the Institute is voluntary. Membership in the Chamber of Public Accountants (*Wirtschaftsprüferkammer*) is compulsory for the some 17,000 auditors and audit 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 auditors 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 Institute of Auditors 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. 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 Institute of Auditors has issued extensive guidance statements indicating how its members should draw up such reports.

# Tax system and administration

## 9

The German Bundestag adopted the EU audit legislation in May 2016. The new requirements came into force on 17 June 2016. The German legislation mainly affects public interest entities (PIEs). Essentially, these are credit institutions or insurance undertakings and all other companies whose transferable securities are admitted to trading on a regulated market. Germany has not expanded the definition of PIEs beyond the Directive 2014/56/EU.

According to the new audit legislation, audit firms will have to rotate PIE audit engagements and withdraw after a period of ten years (maximum duration). Banks and insurance companies are granted a maximum duration of ten years without the option to extend the duration. For non-financial-services companies it is possible to extend the maximum duration for a further ten years following a tender process (an extension of fourteen years is possible in the case where the incumbent auditors enter into a joint audit). There are some transitional arrangements; thus, the timing of the external rotation will depend mainly on how long the current auditors had been engaged at the time the Audit Regulation (EU) No. 537/2014 entered into force.

The new law also prescribes additional restrictions on the nature and extent of non-audit services provided by the PIE auditors or their network to the audited PIEs, to their parent undertakings and to their controlled undertakings (black list). The Member State derogation for tax services and valuation services is fully permitted in Germany. However, there is a specific provision under German law that prohibits tax services that are linked to aggressive tax planning.

The audit committee responsibilities for overseeing the audit process, selecting auditors and approving non-audit services are also prescribed in increased detail in the audit legislation.

The Key Audit Partner rotation period is seven years in Germany from the date of their appointment. Thus, Germany has not made use of the derogation to rotate key audit partners earlier than seven years provided for in the Audit Regulation (EU) No. 537/2014. In addition to the rotation of key audit partners a gradual rotation mechanism is applied with regard to the most senior personnel involved in the statutory audit, including the persons who are registered as statutory auditors.

For multinational companies the new rules in Germany have to be considered as a whole, together with often differing requirements between other territories inside and outside the EU. 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 true and fair view of the net assets, financial position and results of operations of the company.

Additionally, as a result of the implementation of the EU audit regulation in Germany in 2016, audit opinions for PIEs will be required to describe key audit matters as well as the tenure of the current auditors and disclosures about non-audit services provided by them.



## 9 Tax system and administration

### 9.1 Principal taxes

Business income is subject to two taxes in Germany, trade tax and either corporate income tax or income tax. Trade tax is levied under national rules but at rates fixed by each local authority where the business has a permanent establishment. The profit of an incorporated business is also subject to corporate income tax; the profit of an unincorporated business owned by an individual forms part of his or her income tax assessment. Both the income tax and the corporate income tax are incremented by the “solidarity surcharge” calculated as 5.5% of the relevant tax.

The major German transaction tax is VAT, levied under the harmonised EU system. Other significant transaction taxes are excise taxes, insurance tax, real estate transfer tax and inheritance and gift tax. Germany has an extensive system of withholding taxes. The most important one is the income tax deducted from employees’ salaries (the so-called “wage tax”), followed by withholding taxes of 25% on dividends, certain interest income and capital gains from investments in securities held via a custodian. As with income taxes, wage tax and other withholding taxes are incremented by the “solidarity surcharge” of 5.5% of the tax.

Except for income from capital investments of individuals, these domestic withholding taxes are not a final burden but prepayments on the income or corporate income tax liability if the taxpayer files a tax return. Any resident taxpayer may file a tax return; however, those whose only income is from a single employment are in general not obliged to do so.

For non-residents the German income tax on further types of German source income is imposed via withholding tax. Nevertheless, withholding taxes on payments made to non-residents are often restricted or eliminated by a double tax treaty or by the provisions of certain EU Directives (e.g. the EU Parent/Subsidiary Directive or the EU Interest and Royalties Directives). German domestic law foresees other tax withholdings, such as 30% on remuneration for the members of a supervisory board of a corporation and 15% on royalties and income e.g. from sporting or artistic performances, plus solidarity surcharge on each respectively. The deduction of related expenses from the respective income is only possible in certain circumstances. In the hands of non-residents, the withholding tax e.g. on dividends and royalties is generally final unless the income is part of the income of a permanent establishment. In this case a tax return has to be filed. For some types of income a tax return may be filed upon application to receive a (partial) refund of withholding taxes. There is no withholding or similar tax on the repatriation of branch profits or on most interest payments except for those paid by a bank.

### 9.2 Sources of tax law

German taxation is based on statutes enacted by parliament. Each tax is governed by its own statute. The General Tax Code (*Abgabenordnung* – AO) contains a number of general definitions and establishes the basic rights and duties of taxpayers as well as regulating the procedural questions of the tax administration.

The statutes are supplemented by guidelines issued by the Federal Ministry of Finance. These are not formal statutes and do not bind the courts. These guidelines discuss the practical application of the various provisions of the statute, often by way of example. They also contain references to relevant case law. The statutes are further supplemented by a collection of decrees and ordinances issued by various levels of the tax administration, often in response to problems arising from the application of the law.

Another source of tax law is the case law handed down from the tax courts. Cases decided by the appeal court, the Federal Fiscal Court, carry far greater weight than decisions by the local tax courts. In the German legal system, there is no doctrine of binding precedent in the Anglo-Saxon sense of the term.

### 9.3 Returns

The tax year (assessment period) is the calendar year. If a company adopts an accounting period that deviates from the calendar year, the tax return for this tax year reflects the financial statements for the accounting period ending within the calendar year. The adoption of a financial year other than the calendar year requires the consent of the tax office.

In principle, businesses must file income tax returns (income or corporate income tax return and trade tax return) by May 31 following the tax year-end. However, an extension to December 31 of the year following the tax year is usually automatically granted if a professional tax advisor prepares the return. For tax periods starting after December 31, 2017 the regular deadline will be July 31 following the tax year-end. For tax returns prepared by a professional tax advisor the deadline will be extended to the last day of February of the subsequent year.

In general the same deadlines apply to the annual VAT return. Preliminary VAT returns usually have to be filed on a monthly basis (in some cases quarterly) by the tenth day following the end of the month (or quarter). Subject to certain conditions the deadline for monthly preliminary VAT returns can be extended upon application if a special instalment is paid.

Employers have to withhold and pay wage tax on behalf of their employees. The wage tax return usually has to be filed on a monthly basis (there are exceptions where the total amount of wage tax is low) by the tenth day following the end of the month.

The tax returns of businesses usually have to be filed electronically. Trading businesses also have to file an electronic balance sheet and the profit and loss account. Furthermore, the notes to the financial statements, the management report and the audit report have to be filed with the income tax return or corporate income tax return.



## 9.4 Assessment notices

Once the tax office has reviewed the returns filed, it will issue notices of assessment. If the assessment notices do not agree with the return filed, the reason for the deviation must be stated on the assessment notice. The assessments often are “subject to re-examination“ (that is, subject to a future tax audit) or “preliminary” with respect to a specific question.

The deadline to file an appeal is one month after the tax assessment notice is issued to the taxpayer. If the appeal is refused by the tax office, the taxpayer can then file an appeal with the competent regional tax court, and, if unsuccessful at the tax court, continue litigation in front of the Federal Fiscal Court which acts as the final instance in tax matters for the whole of Germany.

The limitation period for tax assessments is generally four years. In cases of negligence the limitation period is extended to five years and in cases of tax fraud up to ten years. If the taxpayer is obliged to file a tax return, the start of the limitation period is deferred until the end of the calendar year in which it has been filed; but no longer than to the end of the third calendar year following the tax year.

## 9.5 Payments

In general income taxes are paid as quarterly prepayments during the year (on March 10, June 10, September 10, December 10 for income or corporate income tax and February 15, May 15, August 15, November 15 for trade tax) with a final adjusting payment or refund when the assessment is issued. The quarterly prepayments are based on the tax assessed for the most recent tax but may be adjusted within a certain time frame to the tax estimated for the respective year if changes are expected.

With respect to income from an employment prepayments are assessed via withholding. The employer is responsible for the withholding and payment of wage tax.

## 9.6 Audits

Tax authorities are entitled to check specific physically or electronically filed documents and execute mechanical analyses of the kept data to verify whether the tax assessments issued on the basis of the information of the taxpayer are correct. There are usually detailed field reviews of the books, records and of the other relevant documents of a company. Therefore, the taxpayer is obliged to keep the specific documents (physically or – for most documents – electronically) for a defined period of time (ten years for the most relevant documents, e.g. books, accounting records etc). In principle the companies are classified in different groups based on their revenues and taxable profit. Tax audits are conducted at

three to five-year intervals for larger companies to ensure uninterrupted auditing. If the result of the audit deviates from the tax return filed by the tax payer or if the tax auditor does not agree with a legal view the taxpayer has taken, the tax assessment notice of the corresponding tax year will be amended, given it has been issued being “subject to re-examination” or the conditions for an amendment of the tax assessment are otherwise fulfilled.

## 9.7 Interest on tax payments

The interest period does not start until 15 months after the end of the tax year. Interest is levied at 0.5% for each full month on amounts additionally assessed exceeding settled prepayments and earlier assessed amounts. Where a tax assessment reduces the tax charge, interest at 0.5% for each full month is charged on the amount originally assessed and paid in excess (i.e. the difference between the tax assessed and paid earlier, including settled payments and final assessment) in favour of the taxpayer.

## 9.8 Penalties

Late payment interest of 1% per month or part thereof is levied on amounts unpaid after a due date for payment set by statute or payment demand. Where a tax return is not filed or filed too late, the tax authorities may assess a late filing penalty up to 10% of the tax assessed, but a maximum of €25,000. For tax returns to be filed after December 31, 2018 the rules for the assessment of a late filing penalty have been amended. According to the new rules the filing of a tax return for a calendar year later than fourteen months after year-end will result in a late filing penalty of 0.25% of the payment resulting from the assessment per month or part thereof (at least €25 per month or part thereof).

## 9.9 Tax office rulings and APAs

There is a set procedure for tax office rulings on the tax consequences of a planned transaction. The application has to be filed before any steps of the planned transaction have been executed. It has to contain a detailed description of the intended transaction, 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 fee will be charged based on the amount of tax at risk (in rare situation, as an exception a fee based on an hourly rate of €50 and time actually spent by the tax office will be applicable). The scale is that applicable to court costs and the range is from €241 to €109,736. No fee is charged if the subject value is less than €10,000. Advance pricing agreements (APA) are the responsibility of the Central Tax Office. A taxpayer can request the Central Tax Office to negotiate an APA on related party



transactions with a foreign tax authority on its behalf based on a mutual agreement procedure provided for in an applicable double tax treaty. 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. There are special rules for small companies.

### 9.10 International exchange of information

For several years, Germany has been vigorous in promoting the international exchange of tax information and has either agreed obligations regarding the exchange of information in the double tax treaties themselves or concluded a Tax Information Exchange Agreement (TIEA) where no general double tax treaty has been concluded with the country concerned.

The FATCA agreement of May 31, 2013 with the United States on the automatic exchange of bank account information of each other's residents between national tax authorities has been in force since December 2013.

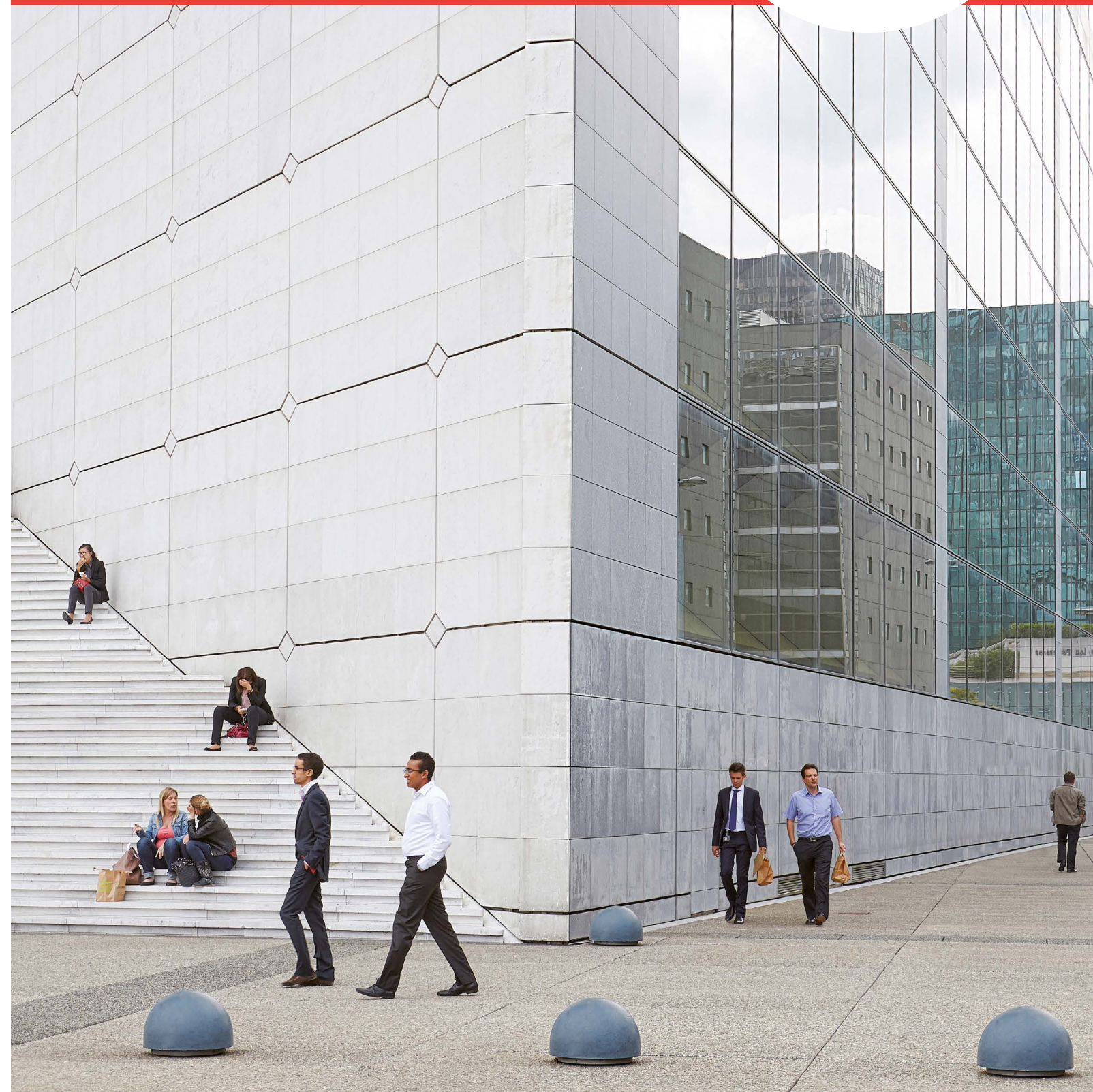
In addition Germany has signed and implemented into domestic law the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information as of October 29, 2014 which is based on the Convention on Mutual Assistance in Tax Matters (1988/2010), itself signed and implemented into domestic law by Germany.

Automatic exchange of information has further been pushed as part of the BEPS-Project of the OECD. The Multilateral Competent Authority Agreement on the Automatic Exchange of Country-by-Country Reports as of January 27, 2016 was signed by Germany and implemented into domestic law in 2016. At the level of the EU the Mutual Assistance Directive was amended and extended in 2015 respectively 2016 with respect to the exchange of information regarding Country-by-Country reports (CbCR) as well as advance cross-border tax rulings and advance pricing arrangements. Both amendments were implemented by Germany into domestic law in December 2016. The implementation of the latest extension of the Mutual Assistance Directive to anti-money-laundering information is pending.

In March 2017 political agreement was reached for a further extension of the EU Mutual Assistance Directive with respect to the mandatory automatic exchange of information regarding certain reportable cross-border arrangements which will have to be implemented into domestic law by December 31, 2019.

# Taxation of corporations

# 10





# 10 Taxation of corporations

## 10.1 Tax rates and total tax burden

Business profits in Germany are subject to trade tax levied by the local authorities (municipal tax) and corporate income tax or income tax.

Corporations (GmbH or AG) having their registered seat or actual place of management in Germany are subject to corporate income tax on their entire worldwide income (“unlimited tax liability”). Further the income is subject to trade tax except for income derived from a permanent establishment located outside Germany. Actual taxation of income from abroad might be restricted due to an applicable double tax treaty.

The statutory corporate income tax rate is 15%, plus a solidarity surcharge of 5.5% on the corporate income tax assessed, resulting in a combined rate of 15.825%.

The trade tax rate is a combination of a uniform tax rate of 3.5% (base rate) and a municipal tax rate (*Hebesatz*) depending on where the permanent establishments of the business are located. Currently, municipalities with at least 80,000 inhabitants levy trade tax at a rate of between 12.6% (*Hebesatz* of 360%) and 20.3% (*Hebesatz* of 580%).

Accordingly, the overall effective tax rate for a German corporation ranges between 28.425% and 36.125%.

A non-resident corporation, whose registered seat and place of management are located outside Germany, is subject to corporate income tax only on income derived from German sources. Income from German sources could include income from operations in the country through a branch or other permanent establishment, including a permanent representative. A non-resident corporation will be subject to trade tax on trading income arising from a permanent establishment located in Germany.

## 10.2 Taxable income – corporate income tax

### 10.2.1 Deviations between German GAAP accounts and tax accounts

The taxable income is generally determined based on a tax balance sheet which in turn is based on the statutory accounts according to German GAAP. There are certain specific tax law and accounting adjustments to be made to the statutory accounts and additional accounting options are available. Common tax adjustments are, e.g. (N.B. this enumeration is non-exhaustive and business-specific):

- intangibles,
- provisions for expected losses,
- pension provisions,
- amount of annual depreciation on certain assets (such as acquired goodwill),
- interest-free liabilities and certain accruals with a term of at least twelve months.

### 10.2.2 Off-balance-sheet-adjustments

To calculate the taxable income further adjustments have to be made besides the accounting adjustments.

There are limitations on the deductibility of certain current business expenses. Non-deductible or partially deductible business expenses are, for example, the following items:

- income taxes, i.e. corporate income tax and trade tax, as well as the supplementary charges on these taxes,
- gifts to non-employees in excess of €35 per year/per person
- 30% of entertainment costs,
- non-deductible interest exceeding the so-called interest-capping limitation (please refer to 10.2.4),
- from 2018 onwards: expenses for the assignment of use or the right to use rights (royalty payments) as far as the deductibility is restricted by the royalty limitation rule (please refer to 10.2.5),
- donations exceeding certain amounts.

### 10.2.3 Participation Exemption

Subject to certain prerequisites, dividends and hidden profit distributions (deemed dividends) from qualified shareholdings (shareholdings of at least 10%) and capital gains from the sale of shares are generally 95% tax exempt for corporate income tax purposes if the recipient of the dividend is a corporation and insofar as the dividends or deemed dividends have not reduced the income of the distributing corporation. For the exemption of dividends for trade tax purpose further conditions have to be considered and different qualified holding thresholds are applicable for corporate income and trade tax purposes. 5% of the dividends/deemed dividends and capital gains are treated as non-deductible business expenses and are thus subject to corporate income tax and trade tax. At an assumed overall tax rate of 30% (including corporate income tax and trade tax), the resulting effective tax rate is 1.5%.

Capital losses with respect to shares held by corporations, such as, e.g., capital losses from the sale of shares, write-downs on shares or losses on certain shareholder loans (i.e. in cases of shareholdings of more than 25%) are non-deductible in their entirety.

Subject to specific conditions the 95% tax exemption with respect to dividends from qualified shareholdings and capital gains from the sale of shares is not available to certain companies as recipients of a dividend, e.g. financial institutions.



### 10.2.4 Interest limitation rule

The interest limitation rule restricts the maximum amount of net interest expense a business entity may deduct to 30% of the relevant profit after adding back the interest expense and the depreciation and amortization and after deducting the interest income (EBITDA available for set off).

The interest limitation rule applies both to intercompany financing and to third party financing, even if there is no recourse to an affiliated company or related person.

For the purpose of the interest limitation rule each entity must be viewed separately, although, all members of a tax group (*Organschaft*, see 10.5) are considered as one business. The interest limitation rule does not apply if one of the following three exceptions apply:

- the amount of net interest expense is less than €3m or
- the business does not belong, or only partially belongs, to a group (group clause), or
- the business belongs to a group and its equity ratio (i.e. the proportion which the shareholder's equity bears to the balance sheet total) as of the preceding balance sheet date is equal to, or more than, that of the group. A failure to reach the equity ratio of the group by less than two percentage points is disregarded (*equity test or escape clause*).

For corporations the *group clause* and the *escape clause* only apply if it can be demonstrated that no detrimental shareholder debt financing as defined by law exists.

#### **EBITDA carry-forward**

Any excess of the EBITDA available for set off (30% of EBITDA) over the net interest expense is to be carried forward for the following five business years (EBITDA carry-forward). This allows for an additional interest expense deduction in future years where the net interest expense is in excess of the EBITDA available for set off in the current year.

#### **Interest carry-forward**

Non-deductible interest expense of one year may be carried forward without time limit (interest carry-forward). It increases the interest expenditure of those business years and is still subject to the 30% EBITDA threshold.

It should be noted, however, that the interest carry forward may (partially or completely) be forfeited under certain conditions (e.g. change of shareholders or restructurings etc).

The Federal Fiscal Court has held the interest limitation rule to be in breach of the constitution and has asked the Constitutional Court to give a definitive ruling. Only the Constitutional Court is in a position to decide whether the regulation is unconstitutional.

It should be emphasised that the interest limitation rule is additional to, and not instead of, the transfer pricing requirement that related-party finance must be at arm's length.

### 10.2.5 Royalty limitation rule

Following and beyond the OECD recommendations on Action 5 of the BEPS-Project, Germany has introduced a restriction on the deductibility of certain royalty payments to related parties applicable from 2018 onwards to counter so-called harmful preferential tax regimes. According to the royalty limitation rules, expenses arising after 31 December 2017 for the assignment of use or the right to use rights, in particular of copyrights and industrial property rights, and for the assignment of use or the right to use trade, technical, scientific and similar know-how, knowledge and skills, for example plans, designs and processes, may not be a deductible business expense or may only be partially deductible.

The limitation will apply where:

- The recipient of the income from the assignment of rights is a related party vis-à-vis the debtor/assignee.
- The income in the hands of the (direct or indirect) recipient is subject to a special preferential regime, which does not correspond to the OECD Modified Nexus Approach; and
- the income received for the assignment of the rights is taxed at a rate less 25% (low taxation) at the level of the (direct or indirect) recipient.

If the conditions of the provisions are met, the expenses in question will become proportionately non-deductible. The non-deductible portion of expenses is calculated as follows:

$$\frac{(25\% - \text{Income tax burden in } \%) }{25\%}$$

### 10.2.6 Amortisation and depreciation

Movable assets are in general depreciated on a straight line basis over the asset's anticipated useful life. The German Ministry of Finance publishes guidelines, the so-called depreciation tables, listing its estimates of the useful lives of movable fixed assets of different types used in different industries. These tables are for guidance only and it is open to a taxpayer to argue that the actual or intended use of the assets concerned justifies a shorter depreciation period. Intangibles are amortised on a straight-line basis over their estimated useful lives. Goodwill is amortised over fifteen years. Buildings are depreciated under a variety of straight-line or reducing-rate systems designed to reach full write-down after between 25 and 50 years, depending on the age of the building, the type of use and on whether the taxpayer is its first owner.

An exception exists for movable fixed assets with a value of up to €800 (exclusive of VAT). These may be deducted in full immediately. Alternatively, if the acquisition or production costs exceed €250 but are not more than €1,000, the acquisition or production costs can be aggregated for each period and depreciated as a pool over five years.

Fixed and intangible assets may be written down whenever a permanent loss in value becomes apparent. There is, however, a write-back requirement should the value subsequently appreciate.

### 10.2.7 Inventories

Inventory is basically valued at acquisition cost or production cost, unless the fair market value (replacement costs or net realisable value) is impaired permanently. 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, the treatment must be maintained in subsequent years, unless the tax office agrees otherwise.

### 10.2.8 Liabilities

Liabilities with a remaining term of twelve months or more on the 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.

### 10.2.9 Provisions

In general, most provisions established under German GAAP are accepted for tax purposes. Nevertheless, some types of provisions may not be deducted for tax purposes (e.g. provisions for anticipated losses) and, for certain other types of provisions restrictions are applied, e.g. provisions for anniversary bonuses and acquired provisions. Provisions have to be discounted by 5.5% unless the duration of the provision is less than twelve months.

Pension provisions must be computed actuarially according to specific and detailed rules (e.g. a discount rate of 6% is applied).

## 10.3 Taxable income – trade tax

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

### 10.3.1 Add-backs for trade tax purposes

The trade tax base is the business profit determined according to the German Income Tax Act (*Einkommensteuergesetz* – EStG) and German Corporate Income Tax Act (*Körperschaftsteuergesetz* – KStG), adjusted by off-balance-sheet, add-backs and deductions for trade tax purposes.

Inter alia, 25% of the following business expenses are subject to the add-back insofar as the total amount exceeds €100,000:

- Interest and similar expenses,
- profit share of a silent partner,
- 20% of the rent or leasing fees paid for the use of movable fixed assets,
- 50% of the rent or leasing fees paid for the use of immovable fixed assets,
- 25% of the costs for the temporary use of rights (in particular licence fees).

### 10.3.2 Deductions for trade tax purposes

The deductions for trade tax purposes comprise, for example:

- 1.2% of the taxable value of real estate held as a business asset not exempted from German real estate tax,
- the portion of the total trade profit derived from permanent establishments outside of Germany, and
- dividends from qualified shareholdings under specific conditions (the qualified holdings-threshold is different from the one applicable for corporate income tax purposes) minus related expenses (for dividends exempted for corporate income and trade tax purposes the taxable 5% are also taxable for trade tax purposes).

The trade tax base is assessed centrally by the tax office responsible for the company’s German taxation (at the place of management of the entity). The tax office then allocates this base between the various municipalities where the company has business establishments, generally in proportion to the total wages paid to the employees in each location (there are deviating rules in certain cases).

## 10.4 Loss relief

### 10.4.1 Loss carry-forward

Tax losses are carried forward without time limitation. Unlike loss carry-backs, loss carry-forwards are not restricted to corporate income tax but also apply to trade tax. The set-off against income in future tax years is, however, subject to certain restrictions. Only the first €1m of annual taxable profits may be offset in full against the tax loss carry-forwards. Beyond the threshold of €1m, only 60% of the annual taxable profits are available for loss utilisation. The remaining 40% are subject to immediate taxation (so-called “minimum taxation”).

## 10.4.2 Loss carry-back

Alternatively, for the purpose of corporate income tax (however not for trade tax), tax losses up to the amount of €1m may be carried back to the tax year directly preceding the tax year in which they were incurred. Insofar as tax losses were not utilised, they will be carried forward.

## 10.4.3 Forfeiture of tax loss carry-forwards for corporations

Additional restrictions apply to the loss utilisation by corporations. Whenever more than 50% of the shares or voting rights in a corporation are transferred within a period of five years to one acquirer or a group of acquirers acting in concert, the accrued tax loss carry-forwards as well as current losses of the ongoing financial year accrued until the date of the harmful share transfer are forfeited. If such a “harmful share transfer” involves more than 25% but not more than 50% of the shares, the tax loss carry-forwards are merely reduced in proportion to the shares transferred.

Due to a decision of the Constitutional Court of March 29, 2017 the German legislator is obliged to amend the rules for share transfers of more than 25% but not more than 50% retroactively for the period January 1, 2008 to December 31, 2015. It is well possible that the amended rules will also cover the period after December 31, 2015 and share transfers of more than 50%. Currently the full forfeiture of losses in the case of a harmful share transfer of more than 50% is also the subject-matter of a case pending before the Constitutional Court.

### ***No forfeiture of tax loss carry-forwards in the case of intra-group reorganizations***

Harmful share transfers in the course of intra-group reorganizations do not trigger the forfeiture of tax loss carry-forwards under the following conditions: (i) the acquirer directly or indirectly holds 100% of the shares in the transferring company, (ii) the transferor directly or indirectly holds 100% of the shares in the acquiring company, or (iii) the same person directly or indirectly holds 100% of the shares in both the transferring and the acquiring company.

### ***Tax losses protected by hidden reserves***

Tax loss carry-forwards are not forfeited (>50%) or proportionally forfeited (>25–50%) insofar as they are matched or proportionally matched by hidden reserves subject to tax in Germany respectively. For the purpose of this exception, “hidden reserves” refers to the difference between the equity or proportional equity and the fair market value of the corresponding shares. In the case of negative equity, the term “hidden reserves” refers to the difference between the equity or proportional equity and the fair market value of the business assets of the corporation.

### ***Exemption for share transfers for the purpose of restructuring***

Sec. 8c para. 1a CTA holds an exemption from the forfeiture of tax loss carry-forwards for share transfers for the purpose of restructuring the respective corporate entity. However, in a 2011 decision, the European Commission deemed the said provision to constitute state aid incompatible with the internal market. The decision is currently subject of two proceedings before the European Court of Justice. The application of Sec. 8c para. 1a CTA has been suspended until the question as to whether the provision constitutes illegal state aid is finally decided.

## 10.4.4 Continuance-bound loss carry-forward

For harmful share transfers occurring after December 31, 2015 an application may be made under a new provision to avoid the forfeiture of the tax loss carry-forwards. Relief may be available, where the company has maintained exclusively the same business during a specified observation period and during this period no “harmful event” has occurred. In this context, harmful events include for example, the discontinuance of the business, the commencement of an additional business, a change in activity/business sector. Where the conditions are fulfilled and the company has made the application, all tax loss carry-forwards available at the end of the period of assessment, in which the harmful share transfer occurred, will be classified as so-called “continuance-bound” loss carry-forwards (*Fortführungsgebundener Verlust*), which are to be setoff against future profits in a particular order and within the limits of the so-called minimum taxation rules. The occurrence of one of the harmful events as set out in the provision will result in the forfeiture of the continuance-bound loss carry-forwards last assessed to the extent that the continuance-bound tax loss carry-forwards are not matched by hidden reserves under the hidden reserve exception.

## 10.5 Group taxation and group relief

Legally, each German corporation 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. Nevertheless, under certain conditions a parent and its subsidiary/subsidiaries may pool profits and losses. However, they do not eliminate intercompany profits. This type of group is referred to in Germany as an *Organschaft*.

The basic concept of a tax group is that all profits and losses of the group entities are pooled at the level of the parent. In principle only the parent has to pay corporate income-tax and trade tax. Nevertheless, the subsidiary still qualifies as a tax subject. For trade tax purposes, the subsidiary is treated as a permanent establishment of the parent. Where the *Organschaft* parent is a partnership income is charged to corporate income tax or income tax in the hands of each partner (charged to income tax where the partner is an individual and charged to corporate income tax where the partner is a corporation). The *Organschaft* subsidiary must only pay tax on income in the amount of 20/17 of any compensation payments made to outside minority shareholders where applicable.



It should be noted that negative income of the parent or of the subsidiary will not be deductible for German tax purposes, to the extent that such losses are deductible in a foreign state with respect to the taxation of the parent, the subsidiary or another person.

The conditions for a tax group for corporate income and trade tax purposes are:

- The subsidiary is financially integrated; in effect the parent must have held shares in the subsidiary without interruption from the beginning of its business year at a level sufficient to give it a majority of the voting rights in the subsidiary.
- The parent of an *Organschaft* must be an individual, a trading partnership or a non-exempt corporation, association or estate.
- The investment in the subsidiary must – from a functional point of view – be attributable to a German branch of the parent and the income of the branch must be subject to German tax and not be exempt under a double tax treaty.
- The subsidiary must be a corporation having its place of management in Germany and its registered office in an EU/European Economic Area member state.
- The parent and the subsidiary must have concluded a profit and loss pooling agreement (PLPA) to run for at least five years. The PLPA must be consistently applied throughout the term of the agreement. Under the PLPA the subsidiary surrenders its entire income to the parent. Conversely, the parent is obliged to compensate the losses incurred by the subsidiary throughout the term of the agreement.

## 10.6 Related-party transfer pricing

Germany has extensive related party transfer pricing rules. Indeed, transfer pricing issues are often one of the most important components of any tax audits of German subsidiaries of multinational concerns. The German transfer pricing rules are to a larger extent 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 related parties should trade at arm's length, i.e. as though each unit involved was an independent entity. To demonstrate this, all important cross-border intercompany relationships and each charge for services (anything other than the delivery of goods, e.g. IP-related transactions) should be regulated through a written agreement concluded in advance. Charges for specific transactions or series of transactions may be based upon a transfer pricing method, e.g. the comparable uncontrolled price, the resale price, or the cost-plus method (the so-called standard methods). 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. 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 of what was agreed in advance. Thus, the rule in practice in Germany is not “substance over form”, but “substance and form” as two distinct tests.

In terms of transfer pricing documentation, the regulations according to Sec. 90 para. 3 General Tax Code oblige a taxpayer to record all cross-border transactions with related parties. The requirements comprise the obligation to provide information in writing on the economic and legal background, which is relevant to the determination of transfer pricing and other business terms and conditions vis-à-vis related parties. The obligation to prepare German transfer pricing documentation (in the format of local file and a master file for financial years beginning after December 31, 2016) is subject to certain volume criteria. The taxpayer would only be obliged to prepare the local file documentation, if either intercompany supplies of goods exceed €6m or services or other transactions exceed €500,000 per year. A master file needs to be provided where the sales (intercompany as well as with third parties) of the local branches amounted to at least €100 million in the previous financial year.

There are specific penalty rules relating to documentation requirements. Failure to provide the necessary records and documentation in a satisfactory state within 60 days (30 days in the case of extraordinary transactions) of a request by the tax authorities leads to the following sanctions, in addition to any correction of taxable income:

- Refutable presumption that the relevant taxable income has been under-reported; the tax authorities may then, for example, adjust the income to the less favourable end of an arm's length range.
- Penalties of 5–10% of the additional income but not less than €5,000.
- Delayed provision of records will be penalised by at least €100 per day, rising to a maximum fine of €1m.

Transfer pricing specific penalties can be avoided by preparing documentation in line with the German documentation rules. In addition, interest on tax adjustments may become due. The interest rate on tax adjustments is set at 0.5% per month and starts to accrue 15 months after the year-end for which taxes are levied. Where the adjustment is linked to gross negligence or wilful misconduct, additional penalties may be imposed.

A third transfer pricing documentation element, is the Country by Country Reporting (CbCR), which is to be prepared and filed by the ultimate parent company of the group/partnership in the country where the parent company is registered, provided the consolidated sales of the previous financial year amount to at least €750m. The CbCR is to be filed for each financial year beginning after December 31, 2015 within 12 months after the financial year-end (i.e. by December 31, 2017 for the financial year 2016 for the first time). Failure to provide the CbCR could trigger a penalty of up to €5,000.

Another relevant transfer pricing element is the so-called transfer of function (*Funktionsverlagerung*). Such a transfer of function is defined as the transfer of assets and other advantages, together with the related risks and opportunities from Germany to a related party abroad to perform the same function. The transfer is to be valued as a so-called transfer package valuation based on the profit expectations of both parties at the time of transfer. There is a rebuttable presumption that – in cases of uncertainty – independent third parties would have agreed on a price adjustment clause, should their expectations later turn out to have been misplaced. In all cases, the taxpayer is required to identify the intangibles attaching to the function.

## 10.7 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 fundamental change in the German Foreign Transaction Tax Act, adopting the “authorised OECD approach” (“AOA”) 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 (already applicable before the AOA had been implemented) – in respect of all routine or unusual transactions with its counterpart abroad (including notional dealings). For this purpose, a twofold approach is required: In a first step, the permanent establishment is to be defined by reference to the functions performed by its staff (so-called “personnel functions”), the assets they use, the risks and opportunities attaching to or derived from their activities, and the provision of an adequate branch capital. In a second step, the identified notional dealings need to be priced at an arm’s length basis applying transfer pricing principles.

The German Foreign Transaction 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.

## 10.8 Foreign Tax Credit

If foreign source income is not exempted from German taxation, a credit will be given for the foreign tax actually paid and not otherwise recoverable. However, the credit is limited to the corporate income tax on the net income after deducting the related expenses (a per-country limitation applies). No credit is given for underlying income or corporate income tax and any unused foreign tax credit (e.g. amounts exceeding the maximum amount to be credited) cannot be carried forward, nor can it be applied against the tax on domestic-source or third-country income.

## 10.9 Anti-abuse provisions

### 10.9.1 General

Germany has a number of anti-abuse provisions designed to prevent the abuse of legal forms, the use of tax havens, treaty-shopping or the use of proxies. A number of these measures give the tax authorities the right to ignore artificial circumstances and relationships which are seen as abusive. The entitlement to a reduction of German withholding tax under a double tax treaty is tied to certain substance requirements. Relationships with foreign entities subject to “low-tax regimes” are subject to special provisions in the German Foreign Transaction Tax Act charging a supplementary tax on the indirect German owners of income accumulated abroad.

### 10.9.2 Requirements of substance and anti-treaty shopping rules

Full or partial relief from German withholding tax on dividends, interest and royalties under a double tax treaty or applicable EU directive is only granted if certain conditions are met (namely providing evidence of substance).

The evidence of substance must be provided by the foreign company to the extent its own direct or indirect shareholders would not have been entitled to the refund or exemption, if they had received the income directly. Relief from withholding tax will only be granted (pro-rata approach)

- to the extent the gross earnings in the year in question arose through the foreign company’s own genuine business activity,
- where earnings do not arise through its own genuine business activity, only in so far as it can be shown that with respect to these earnings there are business or other good reasons for involving the foreign company and the company did participate in an active business activity with a business establishment suitably equipped for its business purpose.



# Taxation of individuals

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If a company does itself not meet the income test, it can under certain conditions be indirectly entitled to relief insofar as its shareholders would have their own entitlement, if they were to earn the income directly (test of indirect entitlement of the shareholders).

## 10.9.3 German CFC rules (Sec. 7–14 FTTA)

Pursuant to the German CFC taxation rules regulated in the Foreign Transaction Tax Act (FTTA – *Außensteuergesetz*) certain income, referred to as passive income generated by a CFC, shall be subject to German tax at the level of the German shareholder provided the CFC is deemed to be a so-called “intermediate company” (*Zwischengesellschaft*) and the German ownership criterion is fulfilled.

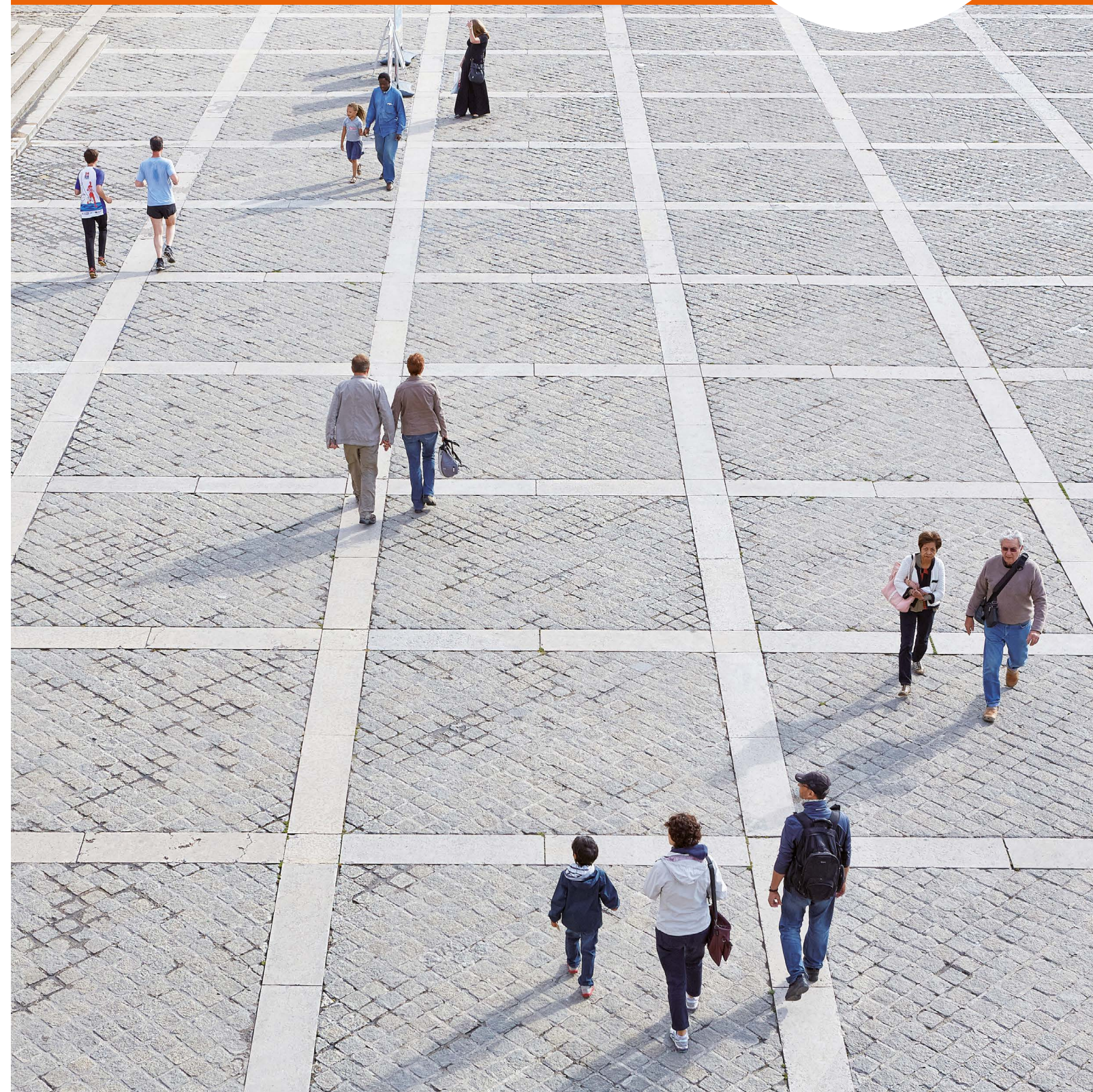
An “intermediate company” within the meaning of the FTTA is defined by law as a foreign corporation which

- has neither its place of management nor its registered office in Germany and is not tax exempt,
- receives income from certain so-called “passive business activities”, (Passive Income Criterion), and
- is subject to a low taxation (less than 25%) on its passive income in the foreign country (Low Taxation Criterion).

Passive income generated by a CFC which qualifies as intermediate company will be attributed to the German shareholder regardless of whether it is actually distributed or not (CFC-income).

Under certain conditions an EU/European Economic Area subsidiary will not be regarded as an intermediate company for specific income as far as the specific income is derived from a genuine economic activity of the foreign company and the state of residence provides administrative assistance in the area of taxes (exchange of information).

Further, with effect from the 2017 period of assessment, certain passive income arising to a foreign permanent establishment will be deemed to have been earned by a domestic permanent establishment for trade tax purposes, resulting in this income being subject to trade tax as opposed to the standard exemption of income from a permanent establishment outside of Germany.





# 11 Taxation of individuals

## 11.1 Territoriality and residence

Individuals resident in Germany are subject to income tax plus solidarity surcharge. As a further surcharge church tax is assessed for members of acknowledged churches imposing such a tax.

Resident individuals are taxed on their worldwide income (provided that there are no restrictions due to the application of a double tax treaty). Non-resident individuals are taxed (often by withholding) on their German-source income only.

Domestic law defines individuals to be resident in Germany

- if they have a residence in Germany they use or that is available to them or
- if they have an habitual abode in Germany. An habitual abode is assumed in cases of an unbroken stay of not less than six months' duration either within one calendar year or over the year-end from the beginning of such stay.

Nationality is not a criterion for residence or tax liability.

Taxable income covers income from the following seven categories:

- agriculture and forestry,
- trade or business,
- independent professions,
- employment,
- capital investment,
- rents and royalties,
- other income.

Losses from one of the seven income categories can – with some exceptions, e.g. relating losses/income from capital investment and other income as well as certain losses from abroad – fully be offset against income from another income category.

## 11.2 Income determination

### 11.2.1 Employment 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. Salaries paid under the German payroll are subject to wage withholding tax, which is withheld by the employer and credited against the final annual income tax charge. Salaries which are paid by a non-resident employer but recharged to the German company may also be subject to wage withholding tax.

### 11.2.2 Equity compensation

Stock options are basically taxable when exercised. Taxable income is computed at the time of exercising the option, normally as the difference between the market price of the shares and the exercise price. A tax exemption may be granted if during

the period between grant and vesting, work was not performed in Germany and thus the employment income was not taxable in Germany. In this case the stock option benefit is sourced based on workdays between grant and vesting. A favourable tax rate may apply if the period between grant and exercise exceeds twelve months and if the employee is employed with the grantor company for this time.

Shares provided free of charge or at a low-price may be tax-free up to an amount of €360 per annum. This relief is granted for shares of the employing company and of the parent company controlling and consolidating its subsidiary.

### 11.2.3 Income from capital investments

Investment income, defined as dividends, interest and capital gains on the sale of securities purchased on or after January 1, 2009 is in general taxable at a flat rate of 25% (26.375% including the solidarity surcharge). The tax may be withheld at source (e.g. interest payments received from a domestic bank, dividends, capital gains from securities held via a domestic custodian bank) or is assessed (e.g. other interest income, capital gains from certain shares not held via a domestic custodian bank).

Nevertheless, the flat rate does not apply where the investment is held as a business asset or for capital gains from the sale of the shares in a corporation in which the seller holds or has held a significant interest within the last five years (i.e. 1% or more). Further there are certain exceptions and options for interest income and dividend income in the case of qualifying shareholdings depending on the capital ownership percentage. Dividends and gains from the sale of shares included in the income taxable at the personal scale rate are partially (40%) exempt from income tax.

The amount of investment income actually charged to flat rate taxation in the hands of an individual is reduced by a personal “saver's allowance” of €801 (€1,602 for a married couple) whereas related expenses cannot be deducted.

Other capital gains are taxable in Germany at individual progressive rates only if the sale is within one year (for movable non-business assets) or ten years (real estate – there are exemptions if used for residential purpose) after the purchase date. Such capital gains are tax-exempt if the total profit is less than €600 in one calendar year.

### 11.2.4 Business Income

Tax on net income from professional activities or from carrying on a trade or business is collected by assessment at the personal income tax rate. Quarterly instalments are assessed on an estimated basis and credited against the final income tax burden.

The income determination is generally based on the balance sheet according to German GAAP or – if there is no obligation to produce a balance sheet according to German GAAP – a tax balance sheet. Only small businesses have the opportunity to determine their taxable profit by deducting the business expenses from the revenues and other business income.

Some business expenses may not be deductible or only partially deductible (please refer to chapter 10.2.2). Income from trading business derived from a permanent establishment located in Germany is further subject to trade tax. The trade tax base is the business profit determined according to the German Income Tax Act (*Einkommensteuergesetz*, “EStG”), adjusted by off-balance-sheet add-backs and deductions for trade tax purposes (please refer to chapter 10.3.1 and 10.3.2 for examples). There is a tax free amount for individuals and partnerships of €24,500. The trade tax rate is a combination of a uniform tax rate of 3.5% (base rate) and a municipal tax rate (*Hebesatz*) depending on where the permanent establishments of the business are located. Currently, municipalities with at least 80,000 inhabitants levy trade tax at a rate between 12.6% (*Hebesatz* of 360%) and 20.3% (*Hebesatz* of 580%).

## 11.3 Deductions

### 11.3.1 Income related expenses

Income related expenses if properly documented may in general – with exceptions for some income categories be deducted by an individual from the related gross earnings, unless they are – in cases of employment relationship – reimbursed by the employer. Costs of travelling to and from work are recognized with a lump-sum allowance based on distance. There is a blanket employee allowance of €1,000 annually. To the extent actual employment connected expenses exceed the lump sum of €1,000 they are deductible.

### 11.3.2 Personal deductions

There are some expenses that may be (partially) deducted from the taxable income while not related to any income, such as social security contributions and certain insurance premiums which can be deducted up to specified limits. Some of these expenses may only be deducted by resident taxpayers or the deduction is restricted for non-residents to expenses paid within a time period an employee receives employment income taxable in Germany.

The basic personal allowance is a lump sum “general allowance” of €9,000 (2018) 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. The basic amount for children under eighteen or in schooling is €7,428 (2018) for a married couple for each child.

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

### 11.3.3 Losses

Losses not set off in the year in which they occur may in general be carried forward without time limitation. The set-off against income in future tax years is, however, subject to certain restrictions. Losses from one source which may not be set off against income from another source in the year in which they are incurred may only be set off against certain income. Further, only the first €1m (for married couples filing joint returns: €2m) of annual taxable income may be set off in full against the tax loss carry-forwards. Beyond the threshold of €1m, only 60% of the annual taxable income is available for loss utilisation. The remaining 40% is subject to immediate taxation (so-called “minimum taxation”). Alternatively, for the purposes of income tax (however not for trade tax), tax losses up to the amount of €1m (for married couples filing joint returns: €2m) may be carried back to the tax year directly preceding the tax year in which they were incurred. Insofar as tax losses were not utilised, they will be carried forward. For trade tax purposes losses of one business may not be set off against losses from another business. Trade tax loss carry-forwards may only be set off against future profits in a specific year, where (i) the trading business existing in that year is identical to the trading business existing in the year in which the losses were generated (Identity of business) and (ii) where the entrepreneur incurred the losses himself (Identity of entrepreneur).

## 11.4 Tax credits

Full credit is granted for all withholding tax deducted from German-source employment income. Foreign taxes not recoverable on income from abroad and not tax exempted are usually credited against the applicable German income tax on the specific income after deducting related expenses up to a defined maximum amount (a per country limitation is applicable), unless the relevant tax treaty specifies otherwise. There are special rules with respect to foreign tax credits on income from capital investments. Employment income taxable abroad is often exempt from German taxation in the hands of a German resident, while most treaties declare a German resident’s foreign investment income (interest, dividends etc.) to be taxable in Germany but allow a credit for the foreign withholding tax actually paid. No credit is given for underlying income or corporate income tax and any unused foreign tax credit (e.g. amounts exceeding the maximum amount to be credited) can be neither carried forward, nor applied against the tax on domestic-source or third-country income.

## 11.5 Tax returns and assessments

All resident taxpayers must file an annual income tax return, unless their only income is taxable employment income from a single employer. In this case the filing of an income tax return is optional.

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 total income tax is calculated as if each spouse earned half of the total taxable income (so-called “splitting”-tax rate).



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## 11.6 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. Additionally, a so-called solidarity surcharge of 5.5% on the income tax due is imposed.

Rate scale (2018)	
Taxable income in euros	Tax rate
€0–9,000 (basic allowance)	0
€9,001–54,949	14% to ca. 26%
€54,950–260,532	42% less €8,621.75
€260,533 and over	45% less €16,437.70

## 11.7 Other taxes on income

Gift and inheritance tax in Germany is a single tax levied on the current market value of assets transferred without consideration, that is, mainly 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. As a general rule these allowances can be made use of every ten years.

Where neither the donor nor the beneficiary is tax resident in Germany the entitlement is restricted to a reduced allowance of €2,000, although the European Court of Justice has held this not to be in line with EU law. A change of the relevant provisions in the law may be expected.

In general, transfers are subject to German unlimited 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 or, of shares in a German company by a holder of at least 25% of the issued capital are subject to limited gift and inheritance tax, even where neither donor nor beneficiary are resident. In these cases the general allowance will be proportionally reduced as far as property transferred is not subject to German gift and inheritance tax. Under certain conditions international double taxation can be avoided by a crediting method either according to the double tax treaties (France, Greece, Switzerland, Denmark, Sweden and the US) or according to a unilateral provision within the German Gift and Inheritance Tax Act.





## 12 Taxation of Partnerships

### 12.1 General taxation of partnerships in Germany

Partnerships with trading income (trading partnerships) or partnerships whose income is requalified as trading income (deemed trading partnerships) are subject to German (municipal) trade tax on their total income. Income tax (in the case of individuals) or corporate income tax (in the case of corporations or other legal entities subject to corporate income tax) is levied at the level of the partner according to the relevant provisions, i.e. for income tax or corporate income tax purposes respectively a partnership is treated as transparent. This applies to the taxation of operating income as well as income from the disposal of an interest in a partnership.

### 12.2 Special business income and expenses of partners at the level of the partnership

Due to the principle of tax transparency applicable to partnerships, i.e. taxation of profits of a partnership at the level of its partners, remuneration received by a partner from the partnership for services or loans (i.e. interest) or leasing of assets (i.e. rental income) is treated as part of the profit of the partnership. Such remuneration, being an expense at the level of the partnership, increases the profit share of the partner according to German tax law. Thus, due to the resulting increase of the profit of the partnership, overall, there is no profit reduction. Assets held by a partner with respect to the above mentioned remuneration, but also certain other assets owned by the partner which serve the business of the partnership, are treated as business assets of the partnership for tax purposes (so-called special business assets, *Sonderbetriebsvermögen*).

Likewise, the profit of the partnership is increased or decreased by income and expenses which are derived from the special business assets or which are incurred in connection with the partnership investment (so-called special business income and special business expense, *Sonderbetriebseinnahmen und -ausgaben*), especially e.g. refinancing costs in connection with the partnership investment.

With effect from the 2017 period of assessment, in certain cases the deductibility of special business expenses is restricted to the extent that the relevant expenses reduce the tax base in another state.

## Transaction and Excise Taxes

# 13



# 13 Transaction and Excise Taxes

## 13.1 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, in general, 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 to destinations outside the EU are, as a general rule, “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. Special provisions apply e.g. to air travel. A number of specific goods and services, including especially banking services and insurance premiums, are exempt from VAT, disallowing an input VAT deduction at the same time. Generally, the provision of cross border supplies of services is subject to VAT in the country the customer is established, in which case the customer not the supplier is liable to VAT within the framework of the reverse charge procedure.

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. To purchase goods free of VAT in any Member State of the EU, the EU buyer must offer proof of his registration as a VAT-paying business in another member state (the so-called “VAT identification 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.

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. Consequently, attempts to reduce the not inconsiderable VAT accounting and other compliance burdens by taking “short-cuts” frequently prove to be false economies. Moreover, over the last years, the combat against tax evasion and tax avoidance has been intensified, and was expanded even to persons who knew, or ought to have known, that a transaction forming part of the supply chain concerned was connected with fraud.

## 13.2 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. Typically, 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.

## 13.3 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 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 federal states have the power to levy the tax at a different rate on transfers of property within their territory. Only two federal states still charge the tax at the basic rate of 3.5% – Bavaria and Saxony.

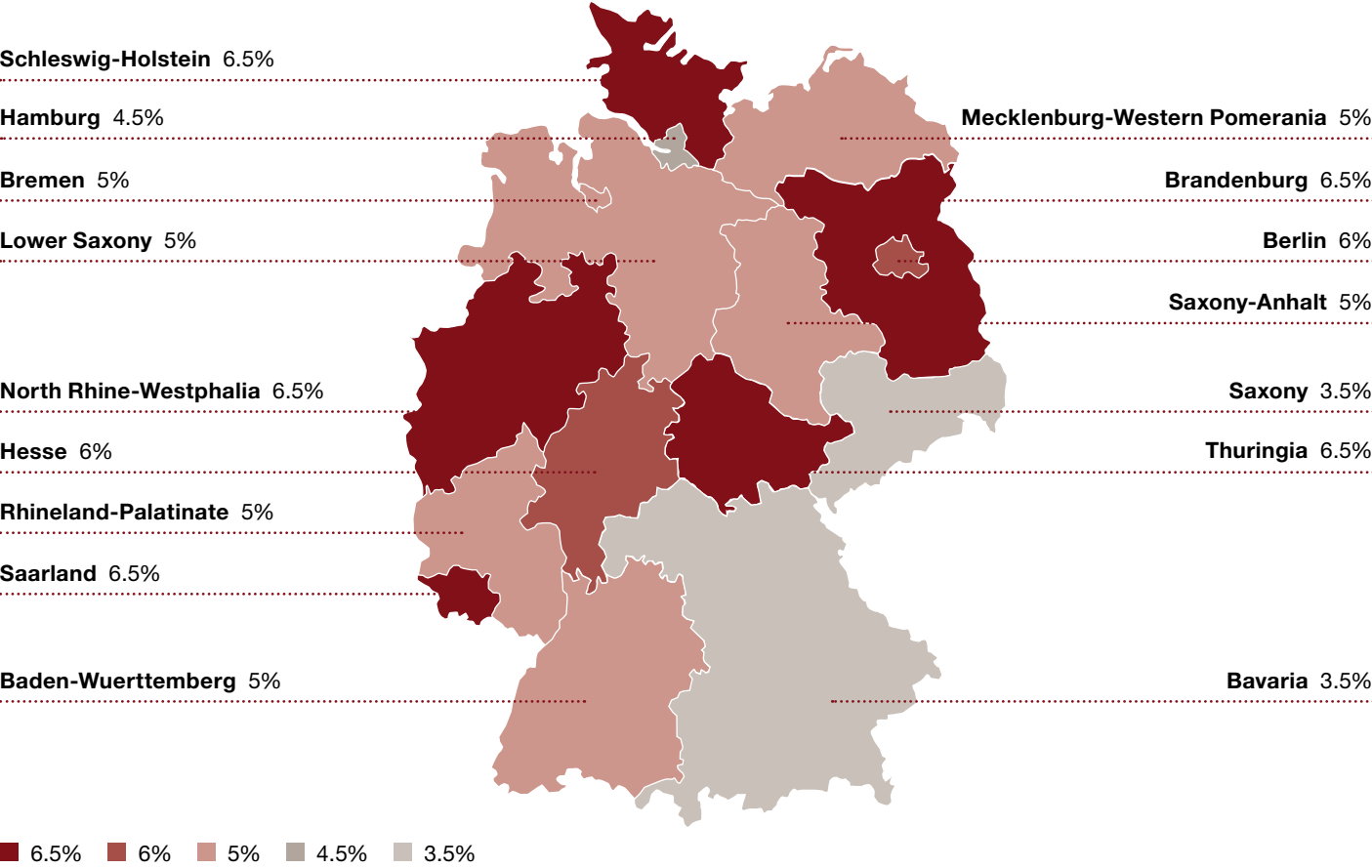
All other provinces charge higher rates (currently: Hamburg: 4,5%; Baden-Wuerttemberg, Bremen, Mecklenburg-Western Pomerania, Lower Saxony, Rhineland-Palatinate, Saxony-Anhalt: 5%; Berlin, Hesse: 6 %; Brandenburg, Schleswig-Holstein, North Rhine-Westphalia, Saarland, Thuringia: 6,5%).

Legally, as a basic rule both parties are jointly and severally liable to pay the tax, although traditionally contracts for the sale of real estate almost invariably pass the burden on to the buyer. Some exceptions to the aforementioned basic rule exist: in case of transfer of at least 95% of interest in a partnership that directly or indirectly holds German real estate the partnership itself is the tax payer. Where the buyer unifies in total at least 95% of shares but less than 95% from a single buyer, the taxpayer is the buyer alone.

Real estate transfer tax qualifies for the buyer of real estate as part of the costs of acquisition in case of an asset deal. 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.



Real estate transfer tax rates in Germany



Nevertheless, RETT paid upon acquisition of shares in a corporation or partnership might under certain circumstances be deductible expenses at the level of the tax payer.

From the corporate restructuring point of view, what was originally intended as an antiavoidance measure often has an unfortunate effect. Tax is also levied on indirect changes in the ownership of real estate following direct or indirect transfer of currently 95% or more of the shares in companies (or partnerships within a five year period) 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.

According to Sec. 6a Real Estate Transfer Tax Act some relief for group reorganisations (especially for restructurings under the Reconstructions Act, e.g. mergers, as well as contributions of shares in a property holding entity in exchange for shares or similar restructures according to the laws of a EU/European Economic Area Member State, is available if certain conditions are met (so-called group privilege). The exemption is only granted if one controlling entity and one or more controlled companies are involved. For that purpose, at least 95% of the shares in the subsidiaries must be held directly or indirectly by the parent for at least five years before and after the transfer. The Federal Fiscal Court has referred a case to the European Court of Justice (CJEU) and asked the CJEU for a preliminary ruling on the question whether the *group privilege* according to Sec. 6a Real Estate Transfer Tax Act constitutes illegal state aid according to European state aid rules (decision of May 30, 2017, II R 62/14). Should Sec. 6a Real Estate Transfer Tax Act constitute illegal state aid according to Art. 107 para. 1 TFEU, the *group privilege* could not be applied anymore until the European Commission decided upon the compatibility with the Internal Market. Should the European Commission decide that the *group privilege* was not compatible with the Internal Market, state aid granted within the past ten years would have to be paid back including interest.

In addition, certain RETT relief might be available for transfers from or to a partnership by the immediate partner to the extent that the partner participates in the partnership's property transferred. However, certain requirements must be met: inter alia a holding period (claw back period) in the partnership of five years before (in case of transfer from the partnership) or after (in case of transfer to the partnership) the transaction is a prerequisite. Furthermore the relief is only available for direct partners. Change of form of the partnership within the claw back period can also trigger RETT retroactively.

Where the tax is levied on a share or interest transfer, or no consideration has been agreed (e.g. in case of a merger where the property ownership is changed), that is, where the consideration is not directly linked to the real estate, the basis of assessment will be determined by calculating a special tax value of the underlying property according to the valuation principles applied for inheritance tax purposes. For this the value of the land and the value of the building are of relevance. The calculation of the value of the building depends on the type of building. In many cases a statutory formula (so-called: gross receipts method) should be applied taking into account the annual rent or the comparative rent (without operating costs) and the remaining useful life of the building. In most cases the tax value of the underlying property comes close to its market value.

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.

### 13.4 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 corporate income 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 whether to “rent or buy”.

## *Appendix: Withholding taxes*



Withholding tax (WHT) rates			
Recipient of German-source income	WHT (%) (each plus solidarity surcharge)		
	Dividends <sup>1</sup>	Interest <sup>1</sup>	Royalties
Resident corporations and individuals	25	0/25 <sup>2</sup>	0
Non-resident corporations and individuals <sup>1</sup>			
EU corporations <sup>4, 5</sup>	0/25	0/25 <sup>3</sup>	0/15
Non-treaty corporations	25	0/25 <sup>3</sup>	15
Non-treaty individuals	25	0/25 <sup>3</sup>	15

<sup>1</sup> 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% plus solidarity surcharge, regardless of any further relief available under a treaty.

<sup>2</sup> Generally, only interest paid by banks to a resident is subject to a withholding tax. A 25% tax (plus solidarity surcharge) is also withheld from income on certain convertible or profit-sharing bonds.

<sup>3</sup> Interest paid to non-residents other than on certain convertible or profit-sharing bonds and over-the-counter transactions 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.

<sup>4</sup> Where the EU 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.

<sup>5</sup> 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 25%.

Withholding taxes – treaties			
Withholding tax rates (%)			
Recipient of German-source income	Maximum WHT (%) allowed		
	Dividends <sup>1, 4</sup>	Interest <sup>1, 2, 3</sup>	Royalties
Albania <sup>5</sup>	5/15	5	5
Algeria <sup>5</sup>	5/15	10	10
Argentina <sup>5, 8</sup>	15	10/15	15
Armenia <sup>5, 6</sup>	7/10/15	5	6
Australia <sup>5, 8, 10</sup>	0/5/15	0/10	5
Austria <sup>5</sup>	5/15	0	0
Azerbaijan <sup>7, 8</sup>	5/15	0/10	5/10
Bangladesh <sup>5</sup>	15	10	10
Belarus <sup>7</sup>	5/15	0/5	3/5
Belgium <sup>5, 8</sup>	15	0/15	0
Bolivia <sup>5</sup>	10	15	15
Bosnia-Herzegovina <sup>5, 9</sup>	15	0	10
Bulgaria <sup>5</sup>	5/15	5	5
Canada <sup>7, 8</sup>	5/15	0/10	0/10
China, People's Republic of <sup>5, 8</sup>	5/10/15	0/10	10
Costa Rica <sup>5, 8</sup>	5/15	0/5	10
Croatia <sup>5</sup>	5/15	0	0
Cyprus	5/15	0	0
Czech Republic <sup>11</sup>	5/15	0	5
Denmark <sup>5</sup>	5/15	0	0
Ecuador <sup>8</sup>	15	10/15	15
Egypt <sup>5, 7</sup>	15	15	15/25
Estonia <sup>5, 8</sup>	5/15	0/10	10
Finland <sup>7</sup>	15	0	0
France	5/15	0	0
Georgia <sup>5</sup>	0/5/10	0	0
Ghana <sup>5, 8</sup>	5/15	0/10	8
Greece	25	10	0
Hungary <sup>5</sup>	5/15	0	0
Iceland	5/15	0	0
India <sup>5</sup>	10	10	10
Indonesia <sup>5, 7</sup>	10/15	10	10/15
Iran	15/20	15	10
Ireland, Republic of <sup>5</sup>	5/15	0	0
Israel <sup>5, 8</sup>	5/10/15	0/5	0
Italy <sup>5, 7, 8</sup>	15	0/10	0/5
Ivory Coast <sup>5</sup>	15	15	10
Jamaica <sup>8</sup>	10/15	10/12.5	10
Japan <sup>5</sup>	0/5/15	0	0

Recipient of German-source income	Maximum WHT (%) allowed		
	Dividends <sup>1,4</sup>	Interest <sup>1, 2, 3</sup>	Royalties
Kazakhstan <sup>5, 8</sup>	5/15	0/10	10
Kenya	15	15	15
Korea, Republic of <sup>5</sup>	5/15	10	10
Kosovo <sup>5, 9</sup>	15	0	10
Kuwait <sup>5</sup>	5/15	0	10
Kyrgyzstan <sup>5</sup>	5/15	5	10
Latvia <sup>5</sup>	5/15	10	10
Liberia <sup>7, 8</sup>	10/15	10/20	10/20
Liechtenstein <sup>5</sup>	0/5/15	0	0
Lithuania <sup>5</sup>	5/15	10	10
Luxembourg <sup>5</sup>	5/15	0	5
Macedonia <sup>5</sup>	5/15	5	5
Malaysia <sup>5</sup>	5/15	10	7
Malta <sup>5</sup>	5/15	0	0
Mauritius <sup>5</sup>	5/15	0	10
Mexico <sup>5, 8</sup>	5/15	5/10	10
Moldova <sup>5, 6</sup>	15	5	0
Mongolia <sup>5</sup>	5/10	10	10
Montenegro <sup>5, 9</sup>	15	0	10
Morocco	5/15	10	10
Namibia <sup>5</sup>	10/15	0	10
Netherlands <sup>5</sup>	5/10/15	0	0
New Zealand <sup>5</sup>	15	10	10
Norway <sup>5</sup>	0/15	0	0
Pakistan <sup>5, 8</sup>	10/15	10/20	10
Philippines <sup>5</sup>	5/10/15	10	10
Poland <sup>5, 8</sup>	5/15	0/5	5
Portugal <sup>5, 8</sup>	15	10/15	10
Romania <sup>5</sup>	5/15	0/3	3
Russia <sup>5</sup>	5/15	0	0
Serbia <sup>5, 9</sup>	15	0	10
Singapore <sup>5</sup>	5/15	8	8
Slovakia <sup>11</sup>	5/15	0	5
Slovenia <sup>5</sup>	5/15	5	5
South Africa	7.5/15	10	0
Spain	5/15	0/15	0
Sri Lanka <sup>5, 8</sup>	15	0/10	10
Sweden <sup>5</sup>	0/15	0	0
Switzerland <sup>5</sup>	0/15	0	0
Syria <sup>5</sup>	5/10	0/10	12
Taiwan <sup>5</sup>	10	10	10

Recipient of German-source income	Maximum WHT (%) allowed		
	Dividends <sup>1,4</sup>	Interest <sup>1, 2, 3</sup>	Royalties
Tajikistan <sup>5</sup>	5/15	0	5
Thailand <sup>7, 8</sup>	15/20	10/25	5/15
Trinidad and Tobago <sup>7, 8</sup>	10/20	10/15	0/10
Tunisia <sup>7</sup>	10/15	10	10/15
Turkey <sup>5</sup>	5/15	10	10
Turkmenistan <sup>5</sup>	5/15	10	10
Ukraine <sup>5, 7, 8</sup>	5/10	5	0
United Arab Emirates <sup>5</sup>	5/10/15	0	10
United Kingdom <sup>5</sup>	5/10/15	0	0
United States <sup>5, 10</sup>	0/5/15	0	0
Uruguay <sup>5</sup>	5/15	10	10
Uzbekistan <sup>5, 7</sup>	5/15	5	3/5
Venezuela <sup>5</sup>	5/15	5	5
Vietnam <sup>5</sup>	5/10/15	10	10
Zambia	5/15	10	10
Zimbabwe <sup>5</sup>	10/20	10	7.5

- <sup>1</sup> 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% plus solidarity surcharge, regardless of any further relief available under a treaty.
- <sup>2</sup> Generally, only interest paid by banks to a resident is subject to a withholding tax. A 25% tax (plus solidarity surcharge) is also withheld from income on convertible or profit-sharing bonds.
- <sup>3</sup> Interest paid to non-residents other than on certain convertible or profit-sharing bonds and over-the-counter transactions 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.
- <sup>4</sup> The lower rates on dividends apply under certain conditions (minimum shareholding, specific shareholders, in some cases minimum holding period).
- <sup>5</sup> The treaty does not limit the taxation of certain profit-based interest income which is deducted by the debtor from his tax base; thus, the domestic rate (plus solidarity surcharge) applies.
- <sup>6</sup> The USSR treaty continues in force with Moldova
- <sup>7</sup> The applicable maximum withholding tax rate on royalties depends on the type of royalty (film and television royalties, trademarks, patents, franchises etc).
- <sup>8</sup> The lower rate on interest income applies under certain circumstances (e.g. for certain recipients such as banks or pension funds or for interest paid in connection with certain purchases on credit).
- <sup>9</sup> The Yugoslav treaty continues in force with Bosnia-Herzegovina, Kosovo, Montenegro, and Serbia.
- <sup>10</sup> The dividend exemption applies under certain conditions to corporate shareholders with at least 80% throughout the previous 12 months.
- <sup>11</sup> The Czechoslovak treaty continues to apply to the Czech Republic and to Slovakia. Interest on profit-sharing bonds is taxed as a dividend.

New treaties or protocols amending existing treaties with Armenia, Finland and Turkmenistan are applicable from 1 January 2018 onwards.

Treaties or protocols amending existing treaties signed but awaiting for ratification: Oman, Macedonia, South Africa.



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