

Taxation of Profits in Germany

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Introduction

Generally, all German resident companies and entrepreneurs with commercial activities in Germany are liable for taxation. There is only limited tax liability for non-resident companies. Depending on their organizational form, they may be liable to pay taxes on business activities conducted in Germany solely.

Germany applies a profit taxation to all businesses operating in Germany by raising business taxes, such as, for example, corporate tax, trade tax and VAT. However, there are tax reliefs and special regulations, which should be taken into consideration when, amongst others, founding corporations, planning certain transactions, making decisions within the group or operating on an international basis (e. g. locational choice, dividend distribution, formalities etc.).

The *S·K· Profit Taxation Guide for Germany* gives a useful overview with regard to business taxes and special rules for businesses on profit taxation in Germany by providing general information and covering the most important regulations, also for groups operating cross-border.

For further advice, please find our contact details on the pages 19 and 20 of this booklet or on our homepage: www.sk-berater.com

We are looking forward to assisting you in doing business in Germany.

Frankfurt am Main, February 2021

Lothar Boelsen
-Managing Partner-

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Business Taxes

I. Overview

All businesses in Germany, regardless of their organizational form, are principally liable for taxation. Currently, there are two types of taxes on business profits. While trade tax is levied on the corporation's basic trade activities, corporate tax applies to the earnings of a corporation. Furthermore, solidarity surcharge is added to the corporate tax.

Overall Tax Liability for Corporate Enterprises in Germany

The overall tax liability may be as low as 25% in certain regions where trade tax is levied at a lower rate, but in strong economic regions the rate for business taxes usually varies from 29% to 34%.

Type	Tax Rates	Total
Corporate income in EUR		100,000.00
Trade tax (3.5 % x Multiplier) in EUR (German Average Municipal Multiplier 411%*)	14,39%	14,390.00
Corporate Tax (15 %) in EUR	15%	15,000.00
Solidarity Surcharge (5.5% on Corporate Tax)	5.5%	825.00
Net Income in EUR		69,785.00
Overall Tax Liability		30.22 %

* DIHK 2020, considering municipalities with at least 20,000 inhabitants

In addition, handling the extensive rules for > *Value Added Tax (VAT – Umsatzsteuer)* that is levied on each stage of the production and distribution chain is a major issue for most businesses. Other taxes applicable to companies operating in Germany include real estate tax, real estate transfer tax as well as customs and excise duties.

II. Corporate Tax

> *Corporate tax (Körperschaftsteuer)* is an income tax for legal entities, i. e. companies like *AG*, *GmbH* or *European Company* and other organized groupings (such as associations) and conglomerations of assets (such as foundations). It is imposed at the level of the company that generated the profit and applies to all taxable earnings, i. e. retained and distributed profits earned during the tax year.

Resident corporations are subject to corporate tax on their worldwide income. In practice, however, double tax treaties generally provide that taxed income from a foreign country remains tax-free in Germany. Non-resident companies are subject to German corporate tax only on German-source income.

Business activities can also be performed as an independent branch or permanent establishment (PE). In principle, the profits earned, both, by a PE and a branch in Germany are subject to limited tax liability in Germany. Most double tax treaties agree that the profits earned in Germany are either exempt from taxation in the country of the parent company or the taxes paid in Germany are deductible from or creditable against the tax burden in the country of origin.

In an ownership chain of companies, there may be a tax exemption for dividend income from holdings, as, in principle, profit distributions within a chain of companies are not added to the taxable income of the

stake-holding company. The detailed rules for chains of companies, however, are very specific, requiring a careful review and assessment of each individual case and ruling out general advice. Furthermore, the German government and the OECD are working on further plans and regulations to avoid base erosion and profit shifting. It is therefore important to build solid structures in order to distribute dividends to foreign countries.

Corporate tax is levied at the rate of 15% on the profit earned during the calendar year. Solidarity surcharge is added on the corporate tax (5.5%), resulting in a combined tax rate of 15.825%.

What constitutes taxable income with regard to corporate tax and how it is to be determined, is regulated in the Income Tax Act (*Einkommensteuergesetz*) with specific provisions in the Corporate Tax Act (*Körperschaftsteuergesetz*).

III. Trade Tax

> *Trade tax (Gewerbesteuer)* is directed at businesses' real earning capacity. As a non-personal tax, it is charged on the earnings generated by a business regardless of the personal circumstances of any of the owners.

Trade tax is levied by the local municipalities totaling a minimum of 7%, with the average usually ranging from 14% to 17%.

Basis for the trade tax is the 'basic federal rate', fixed at 3.5% of the business profits. This basic rate is then multiplied by a mandated municipal rate of at least 200%. As one of the decisive location factors, this multiplier differs from municipality to municipality and usually ranges between 300% to 450% in active and successful business and industrial areas.

All businesses that operate and have a permanent establishment in Germany are charged with trade tax, regardless of their actual activities. The taxpayer is the business entity under whose name the business is carried out. This may be a sole trader, a corporation or a partnership.

Individual entrepreneurs and partnerships qualify for a tax-free deduction of EUR 24,500.00 on their business profits. Sole traders and partners can also claim a tax deduction in their personal tax assessment reflecting the trade tax they have paid. Corporations do not qualify for the tax-free allowance.

If a business maintains establishments in several municipalities during the year of assessment, the basic tax amount will be divided among them, normally using the wages paid by the business as a yardstick.

Agricultural and forestry businesses as well as freelance work and other forms of self-employment are not subject to trade tax.

IV. Special Rules for Partnerships

The determination of the taxable income of a partnership is assessed at the level of the partnership and subsequently at the level of the partners, whereby the income of the partnership is allocated to the partners in accordance with their participation.

As the individual partners carry all rights and obligations in a partnership, general and limited partnerships (OHG and KG) themselves are not taxable entities. Both, undistributed and distributed profits of a partnership, are calculated at the level of the partner according to their share.

The taxable income of the partner is subject to > *Income Tax (Einkommenssteuer)*. It is levied at a minimum of 14% for income that exceeds the annual personal exemption of EUR 9,408.00 and progressively increases to a top rate of 45% for income exceeding EUR 270,501.00. Solidarity surcharge of 5.5% is added to the corresponding rate of income tax. Additionally, partners of a partnership can offset trade tax against payable income tax.

V. Valued Added Tax (VAT)

As a tax on consumption, > *Value Added Tax (VAT – Umsatzsteuer)* is levied at each stage of the production and distribution chain. It operates in the same way as a general excise duty and is chargeable in principle on all public and private consumption (i. e. goods and services purchased by final consumers). Since it would not be technically feasible to collect VAT from consumers, however, the business is liable for the VAT and any administrative effort.

The standard VAT rate in Germany of 19% is below the European average. For basic goods (e. g. food, books or public transportation for short distances), a reduced tax rate of 7% normally applies.¹ Exempt from VAT are, in general, lease of buildings for residential purposes, insurance and medical services as well as any transaction subject to German Real Estate Transfer Tax.

VAT paid by entrepreneurs (so-called Input VAT) may be deducted from the VAT payable from their own turnover, if the turnover is not generally exempt from VAT. Thus, VAT is often neutral within a chain of entrepreneurs entitled to deduct input VAT.

According to German tax law, businesses are required to issue invoices for all taxable sales. Most importantly, all invoices have to indicate separately the charges for VAT.

Businesses, whose turnover from the previous year (excluding VAT payable thereon) exceeded EUR 22,000.00, are required, without exception, to pay VAT. Consequently, they are entitled to deduct input VAT and have to issue invoices separately detailing VAT amounts.

The same applies to businesses whose turnover did not exceed the EUR 22,000.00 threshold in the previous year but is expected to exceed EUR 50,000.00 (excluding VAT payable thereon) in the current calendar year.

In cases where non-resident businesses provide taxable supplies of work and/or materials or other taxable services to other VAT liable entrepreneurs in Germany, the recipient becomes liable for VAT (so-called reverse charge system).

Calculation of Taxable Income

In principle, the taxable income of any business is determined on the basis of the results of the annual accounts in the year of assessment.

¹ Due to the Corona-crisis, a temporary reduction of the VAT rates until December 31, 2020 was agreed on. Accordingly, the standard tax rate is to be reduced from 19% to 16% and the reduced tax rate from 7% to 5%.

The taxable income from business and, as a first step for corporate tax purposes, is calculated with the respective tax balance and income statement, usually included in the financial statements (according to German Accounting Principles, if applicable). The taxable income for trade tax purposes is calculated based on the taxable income for corporate tax purposes considering add-backs and deductions.

I. Simplified Scheme

Calculation of taxable income for corporate tax purposes

	Annual profit according to German GAAP
+/-	Adjustments to tax regulations (certain write-downs, provisions etc.)
=	Annual profit according to tax law (profit according to the tax balance sheet)
-	Tax free income (investment subsidy, foreign profits, dividend income, capital gains, indemnification etc.)
+	Hidden profit distribution
-	Constructive equity contribution
+	Non-deductible business expenses (such as 30% of business entertainment, presents, interest barrier etc.)
+	Certain contributions/grants
=	Taxable profit
-	Deductible contributions
=	Overall income
-	Loss carry over
=	Taxable income (corporate tax)

Calculation of taxable income for trade tax purposes

	Taxable income (corporate tax)
+	Add backs
-	Deductions
=	Relevant trade earnings
-	Trade loss carry over
=	Residual trade earnings (<i>rounded down to full hundreds</i>)
-	Tax-free amount of € 24,500 (not for corporations)
=	Trade earnings
*	Tax ratio (<i>3.5%</i>)
=	Trade tax assessment base
*	Municipal rate fixed by the municipality
=	Trade tax

II. Deductibility and Tax Relief

When calculating the taxable income, many factors are taken into account, allowing deductions and tax reliefs. In general, any expenses related to the company's business operations and not to tax-exempt income are deductible. These deductible expenses include the *costs of foundation* of a corporation or the *increase of its capital, repair and maintenance expenses* or *remuneration for shareholders* and *interest payments*. Most of the expenses are only deductible in the year they incurred.

Depreciation is generally allowed on all tangible and intangible fixed assets with a useful life of more than one year. These include investments in plant and office equipment, motor vehicles, patents, trademarks and goodwill amortization. Depending on their worth, these assets may be either depreciated during their useful life or entirely in the year of acquisition or over a period of five years according to the straight line method.

Losses are generally offset against gains for computing the taxable income. Losses that cannot be offset in the same year may be carried forward indefinitely or carried back one year with certain limitations. Under certain conditions, capital gains from the sale of real estate may be offset against the acquisition costs of a new, similar asset (so-called *roll-over relief*).

The creation of *provisions* for certain liabilities or anticipated losses will be discounted by 5.5% for tax purposes. Companies may generate accruals for surety obligations, warranties, damage claims, litigation expenses or future pensions to employees.

In cases where corporations are integrated financially, organizationally and economically in another, e. g. corporation or partnership, these enterprises may form a **> Fiscal Unity (Organschaft)**. In a tax group, the profit and losses of controlled companies and the controlling company are offset against each other for corporate income and/or trade tax purposes. Different rules apply for forming a tax group for VAT purposes.

Special Regulations

I. Intercorporate Privilege

In tax law, the intercorporate privilege is defined as the privilege to reduce investment income from corporations under certain conditions for the purposes of corporate income tax or trade tax.

If the participation in the corporation is in a commercial business asset, the dividend income is operating income and increases the profit from commercial operations. The intercorporate privilege is an instrument to avoid a multiple or double income or substance taxation that arises from the nesting of corporations. In case of subsidiary companies, profits or the value of investments are excluded from the tax base of the respective tax type. This is not a privilege created for the beneficiary companies, but a necessary correction to avoid multiple taxation.

If a corporation receives a profit distribution from another corporation in a classic parent-subsidary constellation, then this is in principle tax-free. Dividend income is tax-free for corporate tax purposes as the profits underlying the dividend distribution are subject to corporate tax on the level of the company that generated them.

However, the legislator has inserted a small restriction in the tax exemption. This is because it considers administrative costs incurred by holding the investments to be tax-relevant. Therefore, 5% of the dividends are considered as non-deductible business expenses. Consequently, only 95% of the dividends are exempt from taxation. This regulation stipulates that instead of the administrative costs actually incurred, a lump sum of 1.5% of the profit must be assessed for tax.

The so-called extended intercorporate privilege for corporate tax purposes also exempts gains from the sale of shares in a corporation from corporate tax because in the partial income procedure, capital gains from shares and dividends from the corresponding shares are treated equally.

A precondition of the regulations is that a corporation must hold at least a 10% interest in another corporation at the beginning of the tax year, but not that the recipient or seller of the dividends is an individual. A certain minimum holding period is no longer required.

Every business that receives dividends from another corporation is entitled to the trade tax intercorporate privilege. However, only if the share at the beginning of the year is at least 15%.

In the case of foreign subsidiaries, the following has to be considered:

- Participation in EU-based corporation: The trade tax intercorporate privilege is granted from a shareholding of 10%. It is not required that the 10%-limit is reached during the entire tax assessment period, but only at the beginning of the assessment year.
- Participation in non-EU corporations: A minimum participation of 15% applies continuously since the beginning of the tax assessment period. As a further prerequisite for the reduction is that the subsidiary either almost exclusively pursues an active business.
- In the case of shares in foreign companies which are resident in a Double tax treaty (DTT) state, a minimum participation rate of 15% also applies, unless the DTT stipulates a lower limit than 15%, then this rate is applied.

II. Interest Deduction Limitation (Thin Capitalization)

Definition

The interest deduction limit (so-called interest barrier) regulates that interest expenses of a company can be considered tax-reducing in the amount of the interest income of the same financial year. Within the meaning of the interest barrier rule, all interest expenses are covered irrespective of, for example, the businesses legal forms, the lender's and borrower's residency and the timeline of the loans (short-term vs. long-term).

If the balance of interest expenses and interest income is negative (negative interest balance), the deductibility of the interest balance is limited to 30% of the taxable profit before interest income, interest expenses and depreciation and amortization (so-called offsettable EBITDA = Earnings before Interest, Taxes, Depreciation and Amortization).

Calculation of the tax EBITDA

	Taxable income (corporate tax)
+	Interest expenses
-	Interest income
+	Depreciation
+	Amortisation
=	Tax EBITDA

As shown in the chart on page 7, the taxable profit, which is decisive for the amount of interest expenses, is to be determined in accordance with the provisions of the Income Tax Act before application of the interest barrier. In the case of corporations, it is not the taxable profit that is the starting point, but the relevant taxable income, which is determined in accordance with the provisions of the German Income Tax Act and the German Corporation Tax Act before application of the interest barrier and before deduction of losses and donations.

Interest expenses that are not deductible due to the restrictions under the interest barrier must be added off-balance sheet in the year in which they arise, thus increasing taxable profit or taxable income.

The interest expenses that are not deductible in the current fiscal year can be carried forward to the following years, i.e. a so-called "interest carryforward" arises. The interest expenses carried forward reduce the taxable profit or the taxable income in the following fiscal years to the extent that they can then be recognized as tax-reducing within the scope of the interest barrier regulation.

The interest barrier rule applies to any business generating profit income. Corporations with unlimited tax liability in Germany have a business as defined by the interest barrier. By contrast, corporations with limited tax liability only have a business if they actually earn income within the meaning of §§ 13 to 18 EStG (as income from agriculture and forestry, from trade or from independent work). This applies analogously to partnerships, with the consequence that asset-managing partnerships do not have a business for the purposes of the interest barrier regulation.

Exemptions

The restrictions on the deduction of interest expenses under the interest barrier do not apply if one of the following exceptions applies:

- **€ 3m-threshold:** The interest barrier rule is not applicable if the sum of interest income and interest expenses is negative (*debt interest overhang/net interest expense*) and amounts to less than € 3m in the financial year of origin. This is an exemption limit, so that if this limit is exceeded, the entire debt interest surplus is subject to the interest cap regulation. This means that interest deduction is limited to 30% of the taxable profit or taxable income. In the case of tax groups, the exemption limit can only be applied once at the level of the controlling company, as the group of companies is considered to be a business for the purposes of the interest barrier.
- **Group Clause:** There is an exemption from the restrictions of the interest barrier if the business of a sole proprietor, a partnership or a corporation does not belong to a group or only belongs to it proportionately. If the group clause applies, all interest expenses are generally deductible.
- **Escape-clause:** According to the so-called escape clause, the interest barrier rule does not apply and thus all interest expenses are in principle fully deductible if the business belongs to a group whose equity ratio, however, at the end of the previous reporting date is at least equal to the equity ratio of the group (2% deviation is acceptable) and if neither the entity nor any other member of the group is harmfully shareholder debt financed.

According to the tax law, shareholding financing is deemed to be harmful, if

- more than 10% of any entity's net interest expense are paid to shareholders outside the consolidation group; and
- the shareholder is a substantial shareholder (holding directly or indirectly more than 25% of the shares in the interest-paying entity).

Interest Carry Forward

Interest expenses that are not deductible in the year in which they arise can be carried forward to subsequent fiscal years and reduce taxable income in subsequent fiscal years, provided that they are then tax deductible under the interest barrier rule.

Interest carried forward can generally be used if there is a change in the ratio between interest expense and the relevant taxable EBITDA. This can be achieved, for example, by increasing EBITDA or reducing interest expenses. Alternatively, the interest carryforward can be used if one of the exemption provisions from the interest barrier is applied in the future.

The interest carry forward has to be assessed separately for each individual company and is linked to this company.

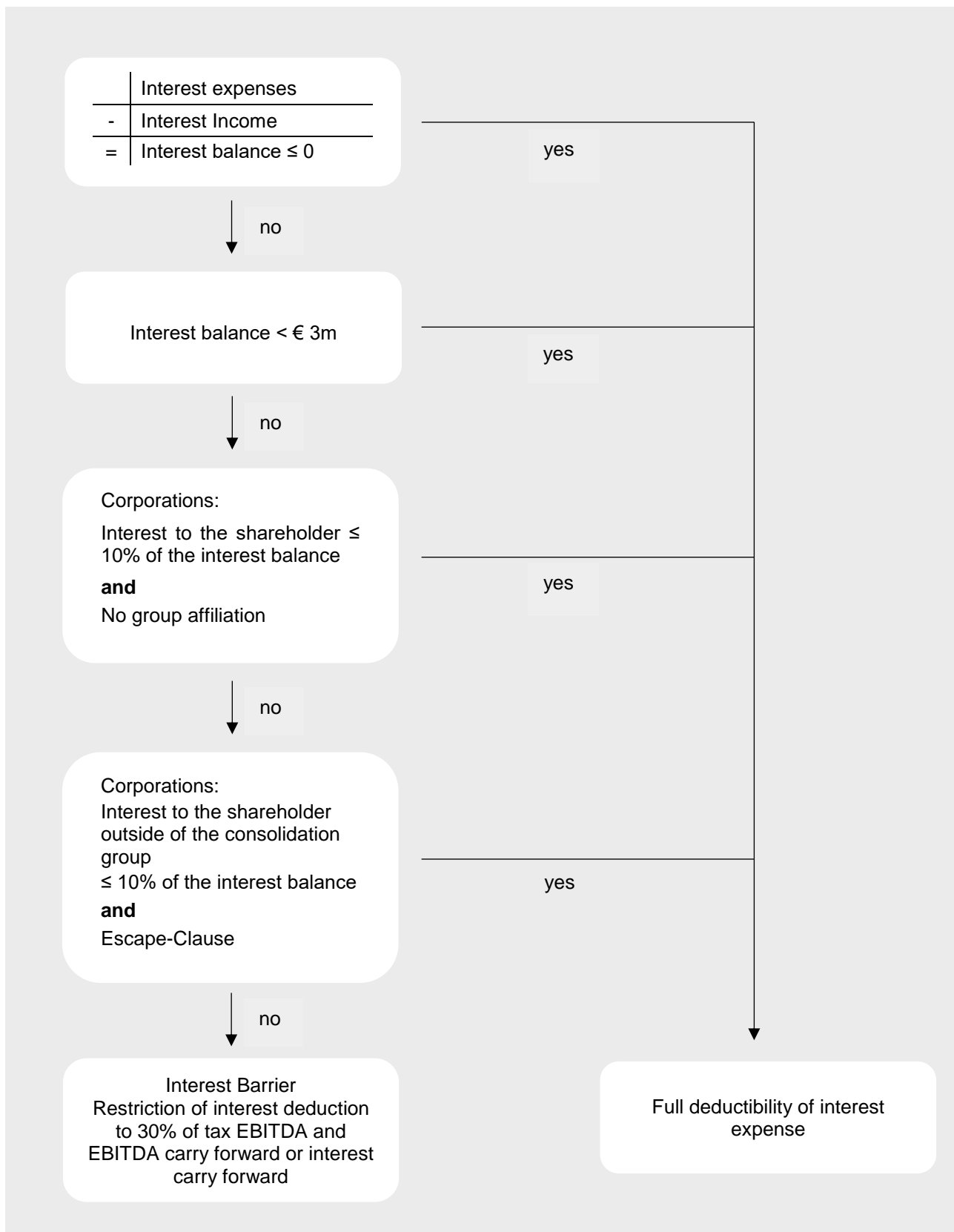
EBITDA Carry Forward

If the deductible interest expense is less than 30 percent of EBITDA, this leads to the so-called EBITDA carry forward. It can be carried forward over the following five years. If the EBITDA carry forward is not used during this period, it expires.

The EBITDA carry forward generally increases the deductibility of interest expenses in the subsequent years. However, this only applies to the extent that the EBITDA for the current fiscal year do not already allow a full deduction of interest expenses. It should be noted that the oldest EBITDA carried forward must be used first.

The EBITDA carried forward must be determined separately.

Summary



III. Loss off-setting

In General

Losses or negative income can be offset with positive income from the same tax year. If there is still a loss after the loss compensation, it can be carried back to the previous year or it can be used for subsequent calendar years.

The loss carry back is particularly interesting if high profits were generated in the previous year. However, the maximum amount for a loss carry back amounts to € 1 m. There is an option whether the maximum amount is used in full, less than € 1 m is carried back or the loss carry back is completely waived.

Remaining losses can be carried forward without limitations as to time and amount.

Loss utilization for Corporations²

According to the German tax law, there are two main regulations for corporations governing the loss utilization for corporations.

- **Loss Carry Over**

If more than 50% of the shares in a corporation are directly or indirectly transferred to a purchaser or acquiring party within five years (harmful event), the corporation loses its corporate tax loss carry forwards and the losses from the current fiscal year, unless an exception applies.

Trade tax losses are also lost proportionately or in full. The same applies if the corporation has an interest in a joint venture) for an unused interest carryforward within the scope of the interest barrier.

A harmful acquisition of shares is deemed to exist if, within five years, more than 50% of the subscribed capital, membership rights, participation rights or voting rights in a corporation are directly or indirectly transferred to an acquirer or a person closely associated with an acquirer, or a comparable situation exists.

Example:

In 2016, 50% of the shares in a GmbH will be transferred. In 2017, losses are incurred for the first time, which are carried forward into 2018. In 2018, further 2% of the shares will be transferred to the same buyer. This leads to a full forfeiture of the entire loss offset potential in 2018, since this is the first time that more than 50% of the shares have been transferred together.

- **Loss Carry Forward**

According to the law, the loss carry forward of a corporation is partially or completely lost if more than 25% of the shares in the corporation are transferred to an acquirer within five years (so-called shell purchase). This is to prevent companies from minimizing their taxes by using "foreign" losses. Exceptions apply to share transfers within a group and to corporations that have hidden reserves in the amount of the affected loss carryforward.

² This topic is subject to constant changes by the legislation. Therefore, it has to be reviewed in detail if the regulations are applicable and how and if the loss can be used.

However, this regulation is obstructive to newly established companies which need new capital due to the admission of new shareholders. In such cases, a share transfer of more than 25% can occur easily. Thus, the following regulation (option) is currently in place:

In the three years preceding the beginning of the year in which the transfer of shares took place and until December 31st of the year of the transfer of shares, the corporation must have maintained the same business and, to put it short, business operations must not have been suspended or discontinued, there must be no change of industry and no additional business operations must have been started. Moreover, in general, the corporation may not have been involved in a partnership as a co-entrepreneur, nor may it have been the controlling company within a fiscal unity. Furthermore, no hidden reserves may have been transferred to the corporation, i.e. assets at a value below the fair market value (e. g. in case of change of corporate form). These are all considered harmful events within in the meaning of the corporate tax law. Harmful in particular are substantial changes in business operations.

The new regulation applies to both, corporate income tax and trade tax loss carryforwards; in addition, the so-called interest carryforward is also recognized.

The corporation had to file an application as per its tax return if they want to make use of the option. The application may only be exercised uniformly for corporation tax and trade tax.

The loss carry forward will be assessed separately for each year by the tax office upon the application within the tax return.

There are certain cumulative requirements to sustain the loss, which are listed simplified as follows:

- The existence of a harmful acquisition of an equity interest that is not covered by the group clause
- submission of an application by the loss-making corporation
- The business operations of the corporation may not have been discontinued or suspended before January 1, 2016
- The corporation must have maintained exclusively the same business operations since its formation or at least since the beginning of the third assessment period preceding the assessment period of the harmful acquisition of the investment
- No harmful event according to the corporate tax act may have occurred during the observation period
- At the beginning of the observation period, the corporation may not be a controlling company or have a stake in a joint venture

The loss carried forward is lost if, for example, business operations are discontinued in any subsequent year or the corporation becomes a co-entrepreneur in a partnership (or any other harmful event within in the meaning of corporate tax law).

There is no deadline for this. Therefore, discontinuation of business operations even after twelve years would be harmful. However, the event is harmless if the loss carried forward has already been fully offset against profits and thus fully used.

If a damaging event occurs and the loss carried forward linked to the continuation of the business has not yet been completely used, the loss carried forward is retained, provided that the corporation had hidden reserves on 31 December of the year preceding the damaging event.

Furthermore, in case of merger and acquisitions, losses can become partly or fully unusable.

IV. Fiscal Unity

What is a Fiscal Unity?

A tax group is an association of companies and allows profit and loss pooling for corporate and trade tax purposes.

In general, four conditions must be met in order to establish a fiscal unity:

1. A commercially active **controlling company** is required.
2. A corporation subordinate to it is necessary as **controlled company**.
3. The controlling company **controls** the controlled company (**financial incorporation**).
4. A **profit and loss transfer agreement** between the controlling company and the controlled company has to regulate the transfer of the profit before taxes. This way, the taxes of the controlled company only accrue at the level of the controlling company and profits and losses of the two companies can be offset.

A **controlling company** is a commercially operating company. The following types of companies, for example, are permitted as controlling companies:

- GmbH
- AG
- Partnerships

The only requirement for a **controlled company** is that it has to be a corporation with its management in Germany. Therefore, it is always subject to unlimited tax liability. In particular, the following types of companies are permitted:

- GmbH
- AG
- European Company (Societas Europaea)

It is not required that the controlled company is commercially operating. The activity may also be limited to holding assets or investments.

Profit and Loss Transfer Agreement

As a close financial integration between the controlling company and the controlled company is required to form a fiscal unity, a corresponding contractual arrangement between the two companies has to be concluded. This agreement has to stipulate that the controlled company must transfer its profits and losses to the controlling company.

The profit and loss transfer agreement has to be concluded for a period of at least five years. In certain cases, a shortening of this period is permissible. For example, the sale or conversion of shares in the Controlled Company or the Controlling Company are recognized as legitimate reasons. However, it should be noted that the reason leading to the shortening of the time limit only occurs after the creation of the fiscal unity. Otherwise, this will lead to retroactive regular taxation of the affiliated companies as well as their shareholders.

The profit and loss transfer agreement must be drawn up in writing and, in most cases, additionally be entered in the commercial register. It becomes then effective as of the date of entry.

Advantages and Disadvantages

The advantage of the fiscal unity is that

- offsetting profits and losses between the Controlled Company and the Controlling Company is possible, thus fiscal unity has the effect that the fiscal unity is in principle to be treated as a taxable entity. The taxes of the affiliated companies are paid by the controlling company alone.
- the companies itself do not lose their independence per civil or tax law.
- Tax exemptions of the controlled company are transferred to the controlling company.
- Profits are transferred and not distributed.
 - Avoidance of capital gains tax
 - Share-related expenses remain fully deductible.
 - Problems associated with the interest barrier can be avoided.
 - Prevent hidden profit distributions or hidden contribution by transferring the profits and losses

The structure of the fiscal unity is indirectly responsible for the fact that possible losses of the controlled company have to be compensated by the controlling company due to the profit and loss transfer agreement. As the controlled company must be a corporation, the liability is limited to its assets. However, under the profit and loss transfer agreement, the Controlling Company is ultimately also liable for all debts of the Controlled Company. This means that a major purpose and advantage of the limitation of liability for the Controlled Company is eliminated. Instead, the controlling company now assumes liability. Depending on the choice of legal form, this may have serious financial consequences. However, this risk can be avoided by using a corporation as the controlling company.

Fiscal Unity for VAT Purposes

A fiscal unity for VAT purposes can also be established under certain conditions in order to make use of VAT advantages as the turnover of the controlled company is taxed at the controlling company.

Other Taxes Applicable to Businesses and Entrepreneurs

An annual > *Real Property Tax* is imposed on all immovable property, regardless of whether the property is held as a business asset or for private use. The tax base is assessed according to the value of the real estate, usually estimated much lower than the market value. The effective tax rate depends on the intended use of the property and is calculated using a multiplier which varies by municipality.

Any transfer of real estate located within the territory of Germany to a new owner is subject to > *Real Estate Transfer Tax (RETT)*. Taxable transfers for the purposes of RETT are defined broadly and may also be triggered when real estate-owning businesses are restructured or transfer shares. RETT is set at state level and ranges from 3.5% to 6.5% of the agreed remuneration for the transfer or the assessed value of the real estate.

Importers are obliged to declare all goods intended for commercial use to customs, even if they are duty-free. The rates for > *Customs Duties* differ depending on the imported goods and their source. Defined rates, uniform across the EU, are applied to all imported goods released for free circulation. *Excise duties* are levied on various items, including tobacco, alcohol, petrol, oil and heating oil.

The *withholding tax on investments* currently amounts to 26.375%, including solidarity surcharge, and is retained at source, usually by a bank. Non-resident companies are granted a refund on application with the Federal Central Tax Office according to Anti-Treaty Shopping Rules.

The statutory withholding tax rate on *Royalty and Lease Payments* on movable property is 15.825% (including solidarity surcharge) for non-resident corporations. Withholding tax on royalties may be reduced according to a double tax treaty or the EU interest and royalties directive (*Council Directive 2003/49/EC*).

Other Tax Matters for International Businesses

I. Double Tax Treaties and Tax Relief

Double tax treaties (DTT) ensure tax relief for internationally operating corporations and taxpayers with foreign-source income, allowing the income to be to be basically taxed only once, either at its source or where the recipient is resident.

In both, non-treaty and treaty situations, German taxpayers with foreign-sourced income may offset the foreign taxes paid with the German tax liability, if foreign taxes are comparable to German taxes. Alternatively, the taxpayer may deduct foreign taxes paid as a business expense.

Most DTTs follow the OECD model treaty. Germany has concluded treaties with about 90 countries.

II. Anti-avoidance Rules

Aimed at the prevention of tax avoidance or evasion, the Foreign Tax Act (*Außensteuergesetz*) sets a number of anti-abuse provisions, specifically with regard to the transfer of income to low-tax regimes abroad or treaty shopping.

In general, taxpayers are free to handle their affairs in a way that allows the minimum taxation as long as this is by legal means. The abuse of certain tax planning schemes, however, is deemed inappropriate, when a legal option is chosen merely for tax-minimizing purposes without further justifiable business reasons.

In line with General Anti-Avoidance Rule (GAAR) statutes, German tax law contains several specific anti-avoidance rules, e.g. regarding thin capitalization and controlled foreign companies as well as an extensive set of transfer pricing rules.

III. Related-party Transfer Pricing

Cross-border transactions between *related parties* are regulated by extensive transfer pricing rules and may contain the risk of a double taxation. These rules do not only establish methods to determine transfer prices, but also include comprehensive rules in respect to transfer pricing documentation, which can be of major concern in tax audits. Accordingly, foresighted tax planning may be very beneficial for related companies with regard to any transactions, the allocation of income, intercompany service charges or the secondment of staff.

German transfer pricing rules are based on recommendations by the OECD and must meet the arm's length principle. The choice of which standard transfer pricing method is used to determine a reasonable price is left to the business:

- With the *comparable uncontrolled price method*, transfer prices are based on comparable prices for third parties.
- Calculation of transfer prices with the *cost plus method* is based on the actual costs of the producer or service-provider and its pricing policy towards third parties.
- The *resale price method* defines transfer prices according to the activities of the reselling company and the usual market margin for such activities.

If none of these methods is reasonably applicable, other methods may be accepted under special circumstances.

About S-K

S-K assists you in organizing your strategy for doing business in Germany and fulfilling the legal and economic requirements of your investment. By mapping out the details of your plans and assessing the resources required, we can help you to increase your business in Germany smoothly and with lasting success.

Reliability for your Decisions over 30 years

Cooperating with our professional colleagues of the Leading Edge Alliance (LEA), we are well equipped to keep up to requirements resulting from the internationalization of the economic and legal systems. Within these networks, we keep track of any legal changes and their repercussions and share international economic know-how and contacts with companies and chambers throughout the world.

Our experienced auditors and tax consultants, lawyers and M&A specialists are looking forward to accompanying your enterprise in Germany, whether regarding a business start-up, expansion or relocation plans. Please get in touch with us directly or visit our website www.sk-berater.com

Our Experts



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- Assisting family-owned enterprises
- Auditing and advising not-for-profit organizations of all legal forms
- International tax law
- Restructuring consulting
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Disclaimer

The S·K· Taxation of Profits Guide for Germany is issued by S·K· Steuerberatungs GbR in Frankfurt in February 2021. The information contained in this present guide has been assembled in 2020 and is based on present law and current available information.

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