

# The International Comparative Legal Guide to: Corporate Tax 2012

A practical cross-border  
insight to corporate tax work

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# The International Comparative Legal Guide to: Corporate Tax 2012

# GLG

Global Legal Group

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# Germany

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## 1 General: Treaties

### 1.1 How many income tax treaties are currently in force in Germany?

Income tax treaties with 90 countries were in force on January 1, 2011. Moreover, negotiations on first-time treaties are carried on with 10 countries in Eastern Europe, South America, Asia and Africa. 38 treaties are going to be amended in the near future. A treaty with Liechtenstein has been signed for the first time and will come into force soon.

### 1.2 Do they generally follow the OECD or another model?

Germany's tax treaties are usually based on the OECD model. Therefore, the official commentary to the OECD model may be used for the interpretation of most provisions in the German treaties. However, some of the treaties, especially those with developing countries, incorporate elements of the UN model treaty. The treaty between Germany and the United States reflects many peculiarities of the United States treaty policy.

### 1.3 Do treaties have to be incorporated into domestic law before they take effect?

According to German constitutional law, treaties must be incorporated into national law by the federal legislator. This requires the consent of both chambers of the parliament in the form of a federal law. Therefore, the federal law implementing tax treaties must be approved by the *Bundestag* and the *Bundesrat* and is finally signed by the Federal President (*Bundespräsident*) and promulgated in the Federal Law Bulletin (*Bundesgesetzblatt*).

This legislative procedure has to be distinguished from the process of ratification of the treaty by exchanging documents in which (in case of Germany) the Federal President declares that the requirements for the internal applicability of the treaty have been met. Only upon such ratification does the treaty become binding under international law.

### 1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

In general, Germany's tax treaties did not include anti-treaty shopping rules. However, such rules have been adopted, in particular in many of the more recent treaties. Several treaties contain general anti-abuse clauses that may be interpreted in a way

to permit the application of domestic anti-abuse rules within the scope of the treaty provisions. If the application of such anti-abuse clauses leads to double taxation, some of the treaties oblige the countries to open the mutual agreement procedure. This type is represented by about 13 treaties, especially the one with Switzerland.

Upon consultation between the parties, several treaties allow the application of the tax credit method instead of the exemption method to avoid a double tax exemption of income or to counter arrangements that lead to an abuse of the treaty (e.g. the treaties with Austria, Denmark, India, Mexico, Norway, Pakistan, Poland, Russia, Singapore, Sweden, United Kingdom, Ukraine, USA, Venezuela, and Vietnam). Furthermore, some treaties exclude the application of reduced withholding tax rates for dividends, royalties or interest payments if such treaty benefits are claimed without reasonable economic justification (e.g. Ghana, Korea, Kazakhstan, Mexico, Russia, United Kingdom, and Uzbekistan).

A detailed and very complex limitation-on-benefits clause is part of the treaty between Germany and the United States. This clause has become even more rigid as of 2008 after the new protocol amending the U.S./Germany treaty has become effective.

### 1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

In principle, tax treaties incorporated into German law prevail over statutory law, as provided for in the German General Tax Code. However, this conflict rule, like tax treaties after their implementation, has the status of ordinary statutory law and competes against the general "*lex specialis*" and "*lex posterior*" rules. Tax treaties are not superior to ordinary law and, therefore, domestic legislation may override a tax treaty that was concluded previously if it is expressly aimed at abrogating the treaty provision by establishing a deviating rule. Treaty overrides have been used by the German tax legislator for about 20 years, mainly in order to combat tax structures and schemes that it suspected of being abusive. Notwithstanding the effective priority, constitutional admissibility and legality of such a "*lex posterior*" under domestic German law, treaty overriding by the legislator constitutes an infringement of international law, which can only be invoked by the other treaty state.

## 2 Transaction Taxes

### 2.1 Are there any documentary taxes in Germany?

Germany does not levy any stamp duties on transactions and has abolished the capital transfer tax.

### 2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

The German Value Added Tax Act is based on the EC Directive 2006/112/EC, i.e. on the common system of value added tax (the former Sixth EC Directive). The standard rate of VAT is currently 19% (as of 2007); a reduced rate of 7% applies to a limited number of supplies of goods or services.

### 2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

There are several tax exemptions for certain supplies of goods or services. The most relevant of these exemptions apply to:

- financial services by banks or other financial institutions (waiver of tax exemption possible);
- the transfer of shares in a corporation or interest in a partnership (waiver possible);
- the transfer of real property (waiver possible); and
- the lease of real property (waiver under certain conditions possible).

The waiver of a tax exemption is allowed only if the respective services are rendered to a taxable party ("entrepreneur") for its respective business. The transfer of a business as a going concern, however, is not only tax-exempt but is not a taxable event at all. The sale of a real property that is leased out generally constitutes a transfer of a business as a going concern that is not taxable.

### 2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Input VAT on supplies is fully recoverable by an "entrepreneur" if the respective supplies are wholly used to render taxable supplies that are not tax-exempt. Input VAT on supplies that are used to render tax-exempt supplies is, in principle, not deductible. However, especially for several cases of tax-exempt cross-border supplies, the deduction of input VAT is allowed. If an "entrepreneur" renders both taxable and tax-exempt services, input VAT on supplies for both has to be split up according to the respective percentage of taxable supplies to determine the deductible part of input VAT.

The most notable restriction concerns the letting of real property: on such a supply, a waiver of the tax exemption is permitted only if the lessee uses (or intends to use) the property exclusively for supplies subject to tax on its part. This rule results in a loss of input VAT to lessors letting real property, e.g. to banks, insurance companies or doctors or for residential purposes.

### 2.5 Are there any other transaction taxes?

The transfer of German real property is subject to German Real Estate Transfer Tax at a rate of 3.5% up to 5% of the purchase price, or – in case there is no consideration – of the property's value. The basic tax rate is 3.5% but has been increased by many German

states recently (4% for real property located in Saarland; 4.5% for real property located in Berlin, Hamburg, Sachsen-Anhalt, Niedersachsen and Bremen; 5% for real property located in Brandenburg, Thüringen, Nordrhein-Westfalen and Schleswig-Holstein; increases by further German states are expected). Real Estate Transfer Tax also becomes due if 95% or more of the interests in a partnership owning German real property are transferred within a period of five years or if 95% or more of the shares in a corporation owning German real property are acquired by the same party (or affiliates of such party).

### 2.6 Are there any other indirect taxes of which we should be aware?

German Insurance Tax applies at a standard rate of 19% on the payment of insurance premiums for several types of insurance contracts. Excise duties are levied on certain kinds of goods, e.g. on fuel.

## 3 Cross-border Payments

### 3.1 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

The general withholding tax rate for dividends paid by a German corporation to non-resident shareholders was raised to 25% as of 2009 (20% until 2008). Non-resident corporations, however, may generally apply for a refund of 40% of the tax withheld on the dividends received. Thus, their effective withholding tax rate will equal the general Corporate Income Tax rate in Germany (15%). Moreover, a further refund or total relief from the withholding tax on dividends may be available according to a tax treaty or the EC parent-subsidiary directive, however this is subject to Germany's anti-treaty shopping rules which provide for certain substance requirements (currently subject to EU dispute resp. unilateral reduction of some of the substance requirements).

### 3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

Royalty payments by a local company to non-residents are, in principle unilaterally, subject to a 15% withholding tax on the gross amount. Under most German tax treaties, the withholding tax on royalty payments is reduced to between 0% (in particular in treaties with OECD countries) and 10%. Within the European Union no withholding tax is due on royalties paid by a German company (or a European company that has a German branch) to an associated company in another Member State of the EU, according to the EC Interest and Royalties Directive 2003/49/EC, as incorporated into German law.

However, any reduction or exemption (by treaty or EC Directive) is granted only upon prior application.

### 3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

No withholding tax on interest payments to non-residents is levied, unless the amount of the interest depends on the profits of the borrower or the terms and conditions of the loan are not at arm's length and, therefore, result in treatment of the interest as constructive dividends.



### 3.4 Would relief for interest so paid be restricted by reference to “thin capitalisation” rules?

As of 2008, a general limitation to the deduction of interest payments was introduced regarding both shareholder loans and all third party loans. According to the so-called interest deduction ceiling (“Zinsschranke”), interest expenses exceeding interest earned (net interest) will only be deductible up to 30% of the corporation’s EBITDA. The interest deduction ceiling will apply:

- (a) if the overall net interest exceeds €3m; and
- (b) in case the corporation does not belong to a group of companies:
  - if “harmful debt financing” occurs, i.e. debt financing by shareholders, related parties or third party lenders with recourse to such shareholders, and interest paid/owed for such debt exceeds 10% of the overall net interest; or
- (c) in case the corporation belongs to a group of companies:
  - if “harmful debt financing” occurs in any group company and the financing shareholder, related party and/or third party who have recourse to a shareholder or related party is not part of the group; or
  - the equity ratio of the tax-paying company is lower than the one of the consolidated group.

Net interest that is not deductible under these rules becomes deductible, however, up to the amount of EBITDA carried forward from the preceding five years. The remainder of non-deductible net interest is carried forward into the following years.

### 3.5 If so, is there a “safe harbour” by reference to which tax relief is assured?

The interest deduction ceiling is only applied (and then to all interest) if the overall net interest charge of the borrowing corporation exceeds €3m. To the extent by which the net interest charge does not exceed 30% of the corporation’s EBITDA, the interest deduction ceiling does not apply and interest expenses are fully deductible.

### 3.6 Would any such “thin capitalisation” rules extend to debt advanced by a third party but guaranteed by a parent company?

The interest deduction ceiling (in force as of 2008) extends to loans granted by third parties, anyway. A guarantee given by a parent company with respect to a third party loan may have an additional negative effect insofar as it may be considered as “harmful debt financing” and, therefore, prevent the application of an “escape clause” (see question 3.4 above).

### 3.7 Are there any other restrictions on tax relief for interest payments by a local company to a non-resident?

There are no such restrictions (except treatment as a constructive dividend, as mentioned in question 3.3 above).

### 3.8 Does Germany have transfer pricing rules?

Generally, transactions between related parties with German corporations involved must comply with the dealing-at-arm’s-length principle. Apart from tax treaties, this principle is also part of domestic German law, which, as of 2008, provides for much more detailed rules according to which an “acceptable” market

price has to be computed for tax purposes. Also, more detailed documentation requirements were introduced over the past years with regard to cross-border transactions.

## 4 Tax on Business Operations: General

### 4.1 What is the headline rate of tax on corporate profits?

The aggregate tax burden of corporations was reduced from almost 40% to just around 30% by the Corporate Tax Reform 2008.

As of 2008 the German Corporate Income Tax rate went down from 25% to 15%. In addition, Solidarity Surcharge of 5.5% is levied on the amount of Corporate Income Tax due, resulting in an aggregate tax rate of 15.825%.

German corporations are also subject to Trade Tax. The basic Trade Tax rate is 3.5% as of 2008; it is supplemented by the application of a multiplier fixed by the respective municipality that varies from a minimum rate of 200% (prescribed by federal law), up to around 500% in the large cities. Therefore, the effective Trade Tax rate ranges from 7% to around 17.5%. As of 2008, the amount of Trade Tax due is not treated as business expense anymore and, therefore, cannot be deducted from the Corporate Income Tax base as well as the Trade Tax base itself. As a result, corporations are subject to Corporate Income Tax (including Solidarity Surcharge) and Trade Tax at a combined rate of at least 22.825% and up to 33.325%.

### 4.2 When is that tax generally payable?

Both Corporate Income Tax and Trade Tax are assessed on an annual basis. However, the determination of the corporation’s taxable income may refer to a 12-month period deviating from the calendar year. In addition, corporations are obligated to quarterly pre-payments of Corporate Income Tax and Trade Tax, based on an estimate of the current year’s tax amount due.

### 4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

In principle, the corporation’s net income determined according to German commercial accounting principles is also the Corporate Income Tax base. However, tax law provides for several adjustments for tax purposes, e.g. restrictions on the deduction of certain business expenses or 95% exemptions for dividends received or capital gains derived from the sale of shares in other corporations.

The corporation’s net income for Corporate Income Tax purposes also serves for the computation of the Trade Tax base, which is, however, subject to further specific adjustments. There are several add-backs and also exclusions for Trade Tax purposes exclusively, e.g. the add-back of 25% of interest payments on debt, the add-back of 12.5% of lease payments for immovable fixed assets, 5% for movable fixed assets and 6.25% for royalties.

### 4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

For tax purposes, the commercial accounting principles are overruled by several tax accounting provisions, mainly to restrict accounting options allowed by commercial law to prevent taxpayers from influencing their tax base. For example, tax rules with regard to the valuation and depreciation of assets or the accumulation of accruals have been tightened and restricted repeatedly over the past years.

As of 2009, tax accounting options may be exercised independently from the commercial balance sheet. As a consequence, assessments in the tax balance sheet may deviate from those in the commercial balance sheet.

#### **4.5 Are there any tax grouping rules? Do these allow for relief in Germany for losses of overseas subsidiaries?**

German tax grouping rules for Corporate Income Tax purposes (*Organschaft*) require a more than 50% shareholding in a subsidiary and a profit and loss absorption agreement according to German commercial law concluded by the group parent company and the subsidiary and executed for a period of at least five years. As a result, the subsidiary's net income is attributed to the group parent company for Corporate Income Tax and Trade Tax purposes. However, only subsidiaries in the legal form of a German corporation or European Stock Corporation (SE) who have their legal seat or place of management in Germany can be part of such tax group. Therefore, a German tax group cannot have foreign group members and does not allow cross-border use of losses as losses from foreign subsidiaries cannot be offset within the tax group.

#### **4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?**

Under the rules of the current shareholder relief system (in force since 2002 and staying on as of 2008), the corporation's Corporate and Trade Tax rate is not reduced in case of profit distributions.

#### **4.7 Are companies subject to any other national taxes (excluding those dealt with in "Transaction Taxes") - e.g. tax on the occupation of property?**

The German Property Tax (Net Worth Tax) has not been levied any more since 1997 for constitutional reasons.

Real Estate Tax is levied on German real estate; the respective tax rate is fixed by the municipalities and is applied to the value of the real property.

The transfer of property including business assets and participations in partnerships and corporations by way of succession or donation is subject to German Inheritance and Gift Tax. Although the valuation rules have been completely revised by the recent reform of the Inheritance and Gift Tax Act (as of 2009), business assets are still subject to favourable valuation rules if certain conditions are met.

#### **4.8 Are there any local taxes not dealt with in answers to other questions?**

No significant local taxes apply to corporations (apart from the right of the municipalities to fix the multiplier applicable to the Trade Tax rate; see question 4.1 above, and to the Real Estate Tax rate).

### **5 Capital Gains**

#### **5.1 Is there a special set of rules for taxing capital gains and losses?**

In principle, capital gains are included in the tax base of Corporate Income Tax and Trade Tax. However, the German Corporate Income Tax Act provides for a 95% tax exemption of capital gains

received by corporations on the disposition of shares in German or foreign corporations. The tax exemption applies irrespective of a minimum shareholding or a minimum holding period. In return, losses from the sale of such stakes are disregarded for tax purposes and not deductible from the tax base.

Capital gains received by individuals on the sale of shares in corporations are taxable if the shares belonged to a business or if the individual's participation in the corporation exceeded a threshold of 1% of the capital. In these situations, 40% of such capital gains are tax-exempt. Capital gains received by individuals from the sale of shares (<1%), which were held as private assets, are subject to a flat tax of 25% as of 2009, irrespective of the holding period. Until 2008, such capital gains were taxable (to the extent of 50%) only if the respective shares had been held less than one year.

#### **5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?**

Capital gains received by corporations are not subject to a special tax rate but to a partial tax exemption. The same applies to capital gains received by individuals if the participation was held among their business assets or exceeded 1% of the capital (for the extent of the respective tax exemption, see question 5.1). Capital gains received by all other individuals, however, are subject to a special flat rate of 25% as of 2009 (see question 5.1). In principle, this tax rate will apply to all kinds of capital income of individuals.

#### **5.3 Is there a participation exemption?**

The 95% tax exemption for capital gains also applies to dividends received by a corporation. A minimum shareholding or a minimum holding period is not required for Corporate Income Tax purposes, whereas for Trade Tax purposes the 95% tax exemption of dividends (not that of capital gains) requires a minimum shareholding of 15% as of the beginning of the respective fiscal year.

#### **5.4 Is there any special relief for reinvestment?**

A rollover relief is available if capital gains from the disposition of certain assets (especially real property) are reinvested in the acquisition of similar assets within a period of four years. Due to the extensive capital gains exemption (see question 5.1), no rollover relief is available upon the disposition of shares by corporations.

### **6 Local Branch or Subsidiary?**

#### **6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?**

The formation of a subsidiary is not subject to any special taxes in Germany.

#### **6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?**

No special taxes would be incurred, but notary fees on the notarisation of the articles of incorporation would become due on the formation of a German limited company (*GmbH*) or stock corporation (*AG*).

### 6.3 How would the taxable profits of a local branch be determined?

For tax purposes, a branch located in Germany is treated like an economically separate entity, although it is legally a part of the parent company. Thus, the taxable profits of the branch are determined according to the direct method. In order to separate the proper earnings of the branch from those of the parent company, separate tax accounting including the attribution of capital, assets, business expenses and income to the branch for tax purposes is required. However, the separate entity approach does not include the exchange of goods and services between branch and parent company, which is disregarded for tax purposes.

The German branch of a foreign head office in the legal form of a corporation is subject to German Corporate Income Tax and Trade Tax as if it were a German corporation. It is, therefore, for example, entitled to the 95% exemption of dividends received from other corporations and of capital gains derived from the sale of shares in other corporations in the same way as a German corporation (see questions 5.1 and 5.3).

### 6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

The taxable income of a branch is, in principle, computed according to the same rules as they are applicable to any other German business taxpayer.

There is no branch profits tax in Germany; the remittance of profits by the branch to its head office is irrelevant for German tax purposes.

### 6.5 Would a branch benefit from tax treaty provisions, or some of them?

The head office, but not the branch itself, is entitled to treaty benefits because a branch is legally a part of its head office and not a resident for tax treaty purposes. However, non-discrimination clauses in tax treaties usually oblige the contracting states to treat branches like corporations resident in their jurisdiction. For European Union Member States, a discrimination of branches would also be prohibited by the freedom of establishment.

### 6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No withholding tax applies to the remittance of profits by a German branch to its head office.

## 7 Overseas Profits

### 7.1 Does Germany tax profits earned in overseas branches?

Profits earned in foreign branches are not subject to German Trade Tax (see question 4.1) but included in the Corporate Income Tax base of German corporations. However, these profits are usually exempt from German income taxation under Germany's tax treaties or subject to a credit system provided for by a tax treaty or by German national law.

### 7.2 Is tax imposed on the receipt of dividends by a local company from a non-resident company?

Foreign dividends received by German companies are subject to the general exemption system for dividends, providing for a 95% exemption for dividends received by a corporation (see question 5.3).

### 7.3 Does Germany have "controlled foreign company" rules and if so when do these apply?

The German "controlled foreign company" rules apply to foreign corporations that are subject to low taxation (an income tax rate below 25%) and controlled by shareholders resident in Germany holding more than 50% of the capital or the vote of the foreign corporation. Then, passive income earned by these foreign corporations is treated as taxable income of the German shareholders. Passive income is all income that is not active income, as defined by the German Foreign Tax Act. These rules do not apply to controlled foreign companies resident in EU/EEA Member States if the shareholders provide evidence for economic substance of the foreign corporation in the respective Member State.

## 8 Anti-avoidance

### 8.1 Does Germany have a general anti-avoidance rule?

The German General Tax Code provides for a general anti-avoidance rule with respect to all kinds of taxes. This rule allows the German tax authorities to disregard the legal form of a transaction agreed upon among the parties, if such transaction is regarded as an abuse of legal arrangements without valid reasons other than tax savings not intended by the respective tax act.

### 8.2 Is there a requirement to make special disclosure of avoidance schemes?

There is no special disclosure rule for avoidance schemes. However, the burden of proof for the above-mentioned valid reasons rests with the taxpayer. In 2007, a legislative initiative by the German government to introduce a disclosure rule that would oblige taxpayers to disclose avoidance schemes in advance to the Federal tax authorities failed.

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