

KEY POINTS

What is the issue?

German law provides a wide range of challenges to individuals wishing to move to Germany. A conscious examination of the main issues presented will help to avoid unpleasant surprises.

What does it mean for me?

Without planning ahead, relocation to Germany may give rise to unforeseen challenges.

What can I take away?

After reading this guidance, advisors will be able to identify the key issues when immigrating to Germany and so be better positioned to assist their clients.

Immigrating to Germany

ERIK MUSCHEITES AND MARCUS NIERMANN OUTLINE ISSUES TO BEAR IN MIND WHEN RELOCATING



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Whether for private or work reasons, moving to Germany and potentially establishing German tax residence may give rise to a number of issues. This article is a brief overview of the issues to be borne in mind when considering a relocation to Germany.

RESIDENCE

As a German tax resident, one will be subject to both income tax on one's worldwide income and inheritance and gift tax (IGT) on worldwide assets. An individual will be deemed to be a German tax resident (for both taxes) if they have a dwelling that they use or is at least available to them (e.g., they have possession of a key) or if they have a habitual abode in Germany. Citizenship or a domicile (as understood under common

law) are not, in themselves, criteria for residency. German tax law stipulates a low threshold for the finding of a dwelling (see s.8 of the *German Fiscal Code*). This may also apply in cases where, for example, there is only a vacation home. The German tax authorities have the necessary instruments to determine these facts. Without certainty on whether there is an unlimited tax liability due to a residence in Germany, there is always a risk of unrecognised tax liability. Particularly in the arena of IGT, this can lead to a rude (if late) awakening.

NECESSARY VISA

EU citizens generally do not require any documentation to move to Germany. Non-EU citizens generally need a visa or residence permit if they intend to work or stay for a longer period of time. A visa programme specifically targeted at high-net-worth individuals does not exist in Germany. This means one must fulfil the necessary immigration requirements.

BANKS IN GERMANY

In Germany, many banks may require German residence in order to open a bank account. Especially for persons who are still a resident or citizen of the US, it may be hard to find a German bank

because of banks' fear of the associated compliance requirements (e.g., the *Foreign Account Tax Compliance Act*). Having a non-German bank and brokerage account, on the other hand, may result in additional compliance efforts for German tax purposes. German tax law provides for rules that may require a recalculation of income, especially when it comes to investment funds or capital gains tax (CGT). A German bank would provide the applicant with an annual tax certificate, which already forms the basis for German tax reporting.

INVESTMENT FUNDS

Germany applies a deemed distribution regime on investment funds. That means even if one's investment fund does not pay out any distributions, a portion of the increase in value may be subject to German taxation annually. Such deemed distribution may be credited in case of a sale of the investment fund; if one has already left Germany at that point of time, however, a portion of the capital gain might be double taxed if the foreign country does not provide a credit or allow a step-up in basis.

TRUSTS AND FOUNDATIONS

Settlers and beneficiaries of trusts or foundations may be subject to adverse tax rules in Germany. Additional tax reporting obligations may be applicable. Further, the income of the trust or foundation might be attributed to German beneficiaries or remaindermen, regardless of actual distributions being made. Practitioners advising clients moving to Germany should review existing trust or foundation agreements.

NO STEP-UP IN BASIS

The assets held when moving to Germany are not normally revalued with regard to their acquisition costs. Special rules may apply if the individual was subject to an exit tax before relocation. Consequently, a so-called step-up in basis does not typically apply. This can lead to CGT if assets are sold while the individual is tax resident in Germany. It may be recommendable to step up the basis in the assets to the current market value before moving to Germany if the tax rate in the home country is below the German tax rate. One way of achieving this result is to sell the assets and then repurchase them at market value. The repurchase price would then form the basis for German taxation. It should be noted that compliance with any applicable foreign law, such as US 'wash sale' rules, should be secured and, if in doubt, appropriate advice should be sought.

HOLDING COMPANIES AND CFC RULES

In Germany, controlled foreign corporation (CFC) rules (*Hinzurechnungsbesteuerung*)

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exist, which can cause income of a foreign corporation (without distribution) to be taxable for a German shareholder. Advisors should be aware of these rules if their clients own holding companies. Whereas holding companies may have tax benefits in certain tax jurisdictions, such rules can become a major disadvantage under these circumstances. Therefore, if a client holds assets through a holding company, the issue should be tackled in more detail with individual German tax advice.

PLACE OF MANAGEMENT

A corporation may be subject to German corporate tax if the company has a fixed place of business or a place of management in Germany. Working for a foreign business while residing in Germany may result in adverse tax consequences for the company. This is because, in addition to the possibly higher tax burden, German tax declaration obligations and a separate determination of profits for permanent establishment apply. If the individual moving to Germany holds the position of a director of a holding company, there is a risk that the company itself acquires German residency for corporate income tax purposes due to the establishment of a place of management in Germany.

INCOME TAX

Income (e.g., wages, capital income) is in principle taxable when it is paid to the taxpayer. This, in turn, means that the time of receipt (and so the time of taxation) can be controlled to a certain extent. This will also be relevant, for example, when determining the progressive income tax rate. However, timely planning in every case is absolutely necessary.

EXIT TAX

Individuals who have been subject to unlimited tax liability in Germany for a total of at least seven years within the previous 12 years and who have held an interest of at least 1 per cent during the past five years in a corporation will be subject to an exit tax when leaving Germany. The fair

market value at the date of relocation will be considered to be the sale proceeds. Careful planning is therefore required and having a German tax advisor is especially important if the client has such an interest in a corporation. A different form of exit tax may also arise, depending on the specific circumstances, if the individual leaving Germany holds an interest in a partnership.

SUCCESSION PLANNING

When moving to Germany, clients should review their testamentary dispositions. Unless a choice of law has been made, German law will generally be applicable to the succession if the deceased had their habitual residence in Germany at the time of death. The law applicable to the succession may therefore change by relocating to Germany, from a German law perspective. This means that German law can unintentionally apply in the event of succession.

INHERITANCE AND GIFT TAX

Successions and gifts are subject to taxation, even between spouses (depending on the marital property regime). Taxation is primarily linked to the residence or habitual abode of either the transferor or transferee. German nationals who have not resided abroad permanently for more than five years without maintaining a residence in Germany are also subject to an unlimited IGT liability. In cases falling within the scope of the double taxation agreement (DTA) concluded with the US, this period is extended to ten years. The worldwide inheritance or the gift are subject to German IGT. Germany has concluded only a few DTAs in this area.

BE COMPLIANT

Under German tax law, there are various tax return and notification obligations to the tax authorities. For example, an income tax return must be filed annually, whereas successions and gifts must be reported within 30 days. These obligations also apply to German citizens who are subject to an extended unlimited German income or IGT for ten years after departure.¹ There is also an obligation to report the establishment or acquisitions of businesses, permanent establishments and partnerships abroad, as well as in foreign corporations and asset pools under specific circumstances. Failure to report income or other taxable transactions to the competent tax authority in Germany should be avoided under any circumstances.

**#GERMANY #INTERNATIONAL CLIENT
#RESIDENCY OR DOMICILE #TAXATION**

¹ See ss.2 and 4 of the German Foreign Transaction Tax Act – *Außensteuergesetz*