PKF

# Germany

## Tax Guide

# 2016/17

## FOREWORD

A country's tax regime is always a key factor for any business considering moving into new markets. What is the corporate tax rate? Are there any incentives for overseas businesses? Are there double tax treaties in place? How will foreign source income be taxed?

Since 1994, the PKF network of independent member firms, administered by PKF International Limited, has produced the PKF Worldwide Tax Guide (WWTG) to provide international businesses with the answers to these key tax questions.

As you will appreciate, the production of the WWTG is a huge team effort and we would like to thank all tax experts within PKF member firms who gave up their time to contribute the vital information on their country's taxes that forms the heart of this publication.

The PKF Worldwide Tax Guide 2016/17 (WWTG) is an annual publication that provides an overview of the taxation and business regulation regimes of the world's most significant trading countries. In compiling this publication, member firms of the PKF network have based their summaries on information current on 30 April 2016, while also noting imminent changes where necessary.

On a country-by-country basis, each summary such as this one, addresses the major taxes applicable to business; how taxable income is determined; sundry other related taxation and business issues; and the country's personal tax regime. The final section of each country summary sets out the Double Tax Treaty and Non-Treaty rates of tax withholding relating to the payment of dividends, interest, royalties and other related payments.

While the WWTG should not to be regarded as offering a complete explanation of the taxation issues in each country, we hope readers will use the publication as their first point of reference and then use the services of their local PKF member firm to provide specific information and advice.

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- Taxation;
- Forensic Accounting; and,
- Hotel Consultancy.

In addition to the printed version of the WWTG, individual country taxation guides such as this are available in PDF format which can be downloaded from the PKF website at www.pkf.com

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## BASIC FACTS

| | |
|---|---|
| Full name: | Federal Republic of Germany |
| Capital: | Berlin |
| Main languages: | German |
| Population: | 81.9 million (2016 PRB) |
| Major religion: | Christianity |
| Monetary unit: | 1 Euro (EUR) = 100 Cents |
| Internet domain: | .de |
| Int. dialling code: | +49 |

## KEY TAX POINTS

- Companies resident in Germany are subject to tax on all of their income. Non-resident

companies are subject to tax on German-source income.
- Business enterprises operating in Germany are also subject to a trade tax on business income, as assessed by each municipality.
- There is no separate capital gains tax - broadly, capital gains from business assets are taxed at the ordinary tax rate. Capital gains realised by a corporate shareholder on the sale of shares held in an enterprise are tax free.
- VAT is applied on the supply of goods and services in Germany by a taxable person, subject to exemptions.
- Profits of foreign companies may be attributed to German shareholders under a controlled foreign companies (CFC) regime.
- A transfer pricing regime imposes record-keeping requirements and provides for income to be adjusted on an arm's length basis.
- Capital gains realised by individuals or partnerships are added to annual income, subject to a 40% participation exemption on the sale of shares held as business assets. Roll-over relief may be available where gains are reinvested in shares.
- Dividends paid to residents and non-residents are subject to a 25% withholding tax, although this is reduced to nil in certain circumstances under the EC Parent/Subsidiary Directive or a Double Tax Treaty.
- Both personal and corporate income taxes carry a surcharge at the rate of 5.5% of the tax.
- Income tax is payable by German resident individuals on their worldwide income. Non-resident individuals are only required to pay tax on German-sourced income.
- Assets transferred by gift or inheritance are subject to tax. Other taxes include an annual real estate tax, an insurance tax and a church tax.

## A. TAXES PAYABLE

### COMPANY TAX

German-resident companies are subject to tax on their worldwide income. Non-resident companies are required to pay tax in various forms on income derived from German sources. Resident companies are those that are incorporated in Germany or have their place of management and control in Germany.

The corporation tax rate is 15%. In addition, a solidarity surcharge is levied at the rate of 5.5% of the corporation tax. The tax year in Germany is the calendar year. Companies are required to make quarterly prepayments of tax based on the previous year's income. Corporation tax returns should be submitted by 31 May of the following year. An automatic extension of seven months (31 December) is granted for returns prepared by a tax consultant. Tax balance sheets have to be handed in electronically following a special tax account mapping.

### TRADE TAX

Trade tax is applied only to business income. All business enterprises operating in Germany are subject to this tax. The trade tax rate is assessed independently by each municipality. The effective tax rates range from 7% to 19.25%. Individuals may deduct trade tax as a block credit to a certain extent against individual income tax. No tax relief by deduction or credit will be available to companies.

### CAPITAL GAINS TAX

There is no special or separate capital gains tax. For privately held shares a flat withholding tax of 25% plus solidarity surcharge of 5.5% of the tax due has been introduced (for details see below under 'Capital gains and losses').

### BRANCH PROFITS TAX

There is no separate branch profits tax in Germany. Trading profits and capital gains of a German

branch of a foreign company are calculated and taxed on the same basis as those of a German resident company.

## SALES TAX / VALUE ADDED TAX (VAT)

This is a tax on the supply of goods and services, other than exempt supplies and services, rendered in Germany by a taxable person. The tax rates are as follows:
- Standard rate: 19%
- Reduced rate: 7%

## FRINGE BENEFITS TAX

For some services provided to its employees (e.g. canteen food, office outings, transportation of employees, accident insurances and payments to retirement funds), the company has the option to pay the income tax on account for the employee. The tax is paid at a flat tax rate which varies depending on the service provided, from 15% to 25% of the given value.

## OTHER TAXES

In Germany a net wealth tax is not levied. Other taxes include real estate transfer tax (RETT) at a rate of 3.5% to 6.5% and insurance tax (excluding life insurance and private medical insurance) at 19%. RETT is not only due on the transfer of real estate but may also apply in cases of a transfer of shares in companies owning real estate. Certain exemptions for RETT on intra-group restructurings may apply.

# B. DETERMINATION OF TAXABLE INCOME

The taxable income of a company is determined by ascertaining assessable income and then subtracting all allowable deductions. Business expenses are generally deductible for tax purposes, although there are some exceptions such as entertainment expenses which are only 70% deductible. Special rules apply in respect of the categories listed below.

## DEPRECIATION

Tangible fixed assets, other than land, are written off over their estimated useful lives at rates prescribed by the tax law or an administrative regulation. Generally the straight-line method of depreciation is used. In the case of a long-term devaluation of assets, an extraordinary depreciation is allowed. This write-down has to be reversed if the value of the asset increases again. Assets with purchase costs from EUR 150 to EUR 1,000 exclusive of VAT can be pooled every year. The pool for each year has to be written off in five years. Taxpayer may elect for an immediate write-off of goods with a value of less than EUR 410.

## STOCK/INVENTORY

Inventory includes raw materials, work-in-progress, finished goods and payments on account. Each item of inventory must be valued at acquisition cost or cost of production. Accepted valuation methods include 'last in, first out' (LIFO) and average cost.

## CAPITAL GAINS AND LOSSES

In principle, capital gains from business assets are taxed at the ordinary tax rate. Profits on the sale of land and buildings may be reinvested tax-free (roll-over relief). Where the shareholder is a corporation, capital gains relating to the sale of shares held in an enterprise (German or foreign) are tax-free. Correspondingly, a write-down of participation does not have tax consequences. Losses arising from the sale of such a stake will not be recognised. However, a lump sum of 5% of the gains

is added back to taxable income representing non-deductible business expenses.

Where the shareholder is an individual or a partnership, capital gains arising from the sale of shares held as business assets are taxable, but only 60% of the capital gain is added to the individual's/partner's annual gross income. The remainder is tax-free (40% participation exemption). Correspondingly, only 60% of the losses are deductible. Capital gains realised by partnerships may be tax-free if reinvested in shares within two years (roll-over relief).

Where the shareholder is a private individual, capital gains arising from the sale of privately held shares bought after 31 December 2008 are subject to a 25% flat withholding tax plus a solidarity surcharge of 5.5% of the tax due if the participation is below 1%. Capital gains arising from the sale of privately held shares bought before 31 December 2008 are generally not taxed. If the participation is 1% or more, the rules for shares held as business assets apply. Losses from the sale of privately held shares may be deducted only from gains arising on privately held shares. Non-deductible losses may be carried forward.

Capital gains arising from the sale of other privately held movable assets are not taxed unless the assets are sold within one year. Capital gains arising from the sale of privately held land and buildings are not taxed unless the assets are sold within ten years.

## DIVIDENDS

Dividend income is subject to 25% withholding tax plus a solidarity surcharge of 5.5% of the tax due. The withholding tax rate may be reduced in accordance with tax treaties or EU regulations (Parent-Subsidiary Directive). Where the shareholder is a corporation, the dividend income is tax-free (100% participation exemption). However, a lump sum of 5% of the gross dividends is added back to taxable income representing non-deductible business expenses, irrespective of the actual expenses incurred by the company. This applies to dividends received from both German and foreign enterprises. Recently a minimum participation requirement of 10% for corporate tax purposes (trade tax: 15%) as at the beginning of the calendar year was introduced.

Where the shareholder is a partnership, only 60% of the dividend income is added to the partner's annual gross income. The remainder is tax-free (40% participation exemption). Correspondingly, only 60% of the expenses directly connected to the dividend are deductible. A resident taxpayer may credit the withholding tax which has been deducted by the corporation against his own individual tax liability. Corporation tax cannot be credited against the individual tax.

Where the shareholder is an individual, dividends are subject to a 25% flat withholding tax plus a solidarity surcharge of 5.5% of the tax due. However, if the withholding tax rate exceeds the marginal income tax rate of the shareholder, the shareholder may opt to report the dividend in his income tax return instead. Economically connected expenses such as financing fees are not deductible.

## INTEREST DEDUCTIONS

Interest is deductible to the extent that it is payable on credits raised to generate taxable income. Where interest is paid in order to finance a participation in another company, the above mentioned special provisions concerning business expenses which are directly related to tax-free dividends apply.

In order to combat abusive transfers of profits, an "interest barrier" limiting the deductibility of interest payments as business expenses has been introduced. Interest payments are generally deductible if they do not exceed interest income for the period. The excess amount is only deductible up to 30% of EBITDA as defined for tax purposes. An 'exemption threshold' for interest payments of less than EUR 3,000,000 p.a. applies. An EBITDA carry-forward mechanism also exists.

The interest barrier is only applicable for companies belonging to a group. Such a group is deemed to exist if a German company may be consolidated with other companies. The interest barrier does not apply to companies that are part of a group if, under IFRS, the ratio of equity to total assets of the company is equal or higher than the ratio of equity to total assets for the group as a whole. In addition,

a shortfall of up to 2% compared to the group ratio is permissible. This escape clause will not be applicable for corporations if more than 10% of the interest expenses are on related party debt, i.e. to shareholders with participations of 25% or more.

### LOSSES

In the year in which losses are incurred, they may, in principle, be deducted without restrictions. Remaining losses may be carried back to the preceding accounting period up to an amount of EUR 1,000,000. Excess losses may be carried forward indefinitely to future years. However, in each future year, the deduction must not be more than EUR 1 million. Profits in excess of this may be set-off only in an amount of 60% by a loss carry-forward. Loss carry-forwards may be forfeited by certain share transfers or corporate restructurings. For trade tax special rules apply.

### FOREIGN SOURCED INCOME

Foreign sourced income is generally taxable. In addition, Germany has a controlled foreign company (CFC) regime. Its objective is to ensure that profits of German controlled companies are not transferred to, or generated in, low tax jurisdictions. A low tax jurisdiction is deemed to be any country which taxes income at a rate of less than 25%. Where German residents hold more than 50% of the shares or the voting rights of an intermediate corporation with passive income, the income is deemed to be distributed to the German shareholders and taxed at their level if the intermediate corporation is located in a low tax jurisdiction. Under certain conditions, a participation of 1% in the foreign intermediate corporation is sufficient to trigger the CFC taxation.

Profit distributions by corporations and capital gains arising from the sale of these participations are deemed to be active income. Income derived by foreign holding companies is thus effectively exempt from CFC tax.

### INVESTMENT ALLOWANCE/INCENTIVES

Qualifying investment aids are tax-free and available in selected areas from local authorities for the improvement of the regional economic structure. Investment grants are provided by the tax authorities for the acquisition of new buildings or depreciable, new movable assets in the new federal states.

## C. FOREIGN TAX RELIEF

Even in the absence of a tax treaty, foreign tax on income derived by a German resident may be credited against his income or corporation tax liability. The tax relief must not exceed the German tax charged on the same profits. Alternatively, the foreign tax may be deducted from the income of the German resident.

## D. CORPORATE GROUPS

Profits and losses of German group companies may be pooled for corporate tax and trade tax purposes, if the requirements of the so-called 'Organschaft' are met. The controlling company must hold, directly or indirectly, the majority of the shares of the controlled company and there must be a profit and loss pooling agreement between the two companies.

## E. RELATED PARTY TRANSACTIONS

Inter-company pricing between affiliated companies must be carried out on an arm's length basis. If this is not the case, the income of both companies is adjusted for tax purposes. Arbitration proceedings are available within the European Union. Legislation is in force that specifies the duty to document the way in which a taxpayer arrives at the transfer prices on transactions with foreign closely related persons/enterprises. The documentation must encompass the nature and contents of the business relationship and the economic and legal basis underlying the arm's length prices.

Specific legislation applies to a "transfer of functions" between intra-group companies.

## F. WITHHOLDING TAX

Under domestic law, all dividends, regardless of whether they are paid to a resident or a non-resident, are subject to a 25% withholding tax plus a solidarity surcharge of 5.5% of the tax due as a flat tax. This is reduced to nil in the case where the shareholder satisfies the conditions of the EU Parent Subsidiary Directive (broadly that the shareholder is an EU resident company with a 10% or more interest in the company paying the dividend). Interest is subject to 25% withholding tax plus a solidarity surcharge of 5.5% of the tax due if it is paid to a resident. Interest paid to a non-resident is not subject to withholding tax. Royalties paid to a non-resident are subject to 15% withholding tax plus a solidarity surcharge of 5.5% of the tax due. Certain German tax treaties provide for an exemption or a reduced rate (see below).

## G. EXCHANGE CONTROL

There are no exchange control requirements.

## H. PERSONAL TAX

Income tax is payable by German resident individuals on their worldwide income. Non-resident individuals are only required to pay tax on German-sourced income. Individuals are deemed resident if they have a residence in, or their customary place of abode is in, Germany. The latter is the case if the individual has spent more than 180 consecutive days in Germany.

Income tax is payable on assessable income less allowable deductions. Assessable income includes business income, income from agriculture and forestry, income from self-employment, income from employment, certain capital gains, capital investment income, and rental and royalty income. Allowable deductions include personal allowances, deductions for business/professional expenses and contributions to specified (insurance) bodies.

Tax instalment payments are withheld from employees' salaries by their employers. Self-employed individuals and those with non-salary income have to pay instalments on a quarterly basis with reference to the income realised in the previous year. The tax rates effective for single taxpayers are as follows:

| Taxable Income (EUR) | Tax Payable (EUR) |
|---|---|
| Less than 8,652 | Nil |
| 8,652 to 52,881 | Progressive rates of between 14% and 42% |
| 52,882 to 250,730 | 42% |
| More than 250,731 | 45% |

The highest tax rate is 45% for taxable income of individuals that exceeds EUR 250,731 (EUR 501,462 for married couples). Retained profits from a trade or business, agriculture or self-employment generated by individually-owned firms or partnerships are taxable upon application at a reduced tax rate of 28.25%. When profits are withdrawn, the amount withdrawn is subject to a further tax charge (tax rate 25%) in the assessment year of the withdrawal but is reduced by taxes already paid on the profits distributed.

Interest and dividend income is subject to a 25% flat withholding tax plus solidarity surcharge of 5.5% of the tax due only. Expenses connected with the receipt of investment income are not deductible but a lump sum of EUR 801 can be deducted. The shareholder may opt to report the interest in his income tax return if the withholding tax rate exceeds his marginal income tax rate. If the taxpayer is married, the income of the taxpayer can be combined with the income of the spouse. Then the tax on

50% of the combined income is doubled correspondingly. In addition to the personal income tax, a solidarity surcharge is levied at the rate of 5.5% of the personal income tax.

Social security contributions are withheld from employees' salaries and wages. The employer and employee each generally contribute 50% of the total social security contributions. Members of the Roman Catholic, German Protestant, Lutheran and Jewish churches have to pay church tax. The tax rate amounts to about 8% or 9% of the annual income tax liability and varies according to the district of residence. It is a deductible expense for income tax purposes. Assets transferred by gift or inheritance are subject to tax. If either the transferor or the recipient is resident in Germany, all transferred assets are taxed wherever situated. If neither party is a German resident, the tax is limited to property located in Germany. The Federal Republic of Germany keeps tax treaties with six countries for these purposes: Denmark, France, Greece, Sweden, Switzerland and USA

The tax rates and exemptions for Inheritance and Gift Tax vary according to the relationship between the transferor and the recipient and the value of the assets. Where children or the spouse are the recipients, the rates range between 7% (where the assets have a value of EUR 75,000 or less) and 30% (where the assets have a value of more than EUR 26,000,000). The rates for brothers and sisters have been reduced and vary between 15% and 43%. If the transferor and the recipient are unrelated, the rates vary between 30% and 50% respectively. The spouse of the transferor is granted a personal allowance of EUR 500,000 and the children of the transferor are granted an allowance of EUR 400,000.

## I. TREATY AND NON-TREATY WITHHOLDING TAX RATES

| | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Non- treaty countries | 25 | 0 | 20/15[11] |
| **Treaty countries:** | | | |
| Albania | 15/5[1] | 0 | 5 |
| Algeria | 15/5[3] | 0 | 10 |
| Argentina | 15 | 0 | 15 |
| Armenia | 15/5[3] | 0 | 0 |
| Australia | 15 | 0 | 10 |
| Austria | 15/0[6] | 0 | 0 |
| Azerbaijan | 15/5[1] | 0 | 10/5[5] |
| Bangladesh | 15 | 0 | 10 |
| Belarus | 15/5[2] | 0 | 5/3[5] |
| Belgium | 15/0[6] | 0 | 0 |
| Bolivia | 10 | 0 | 15 |
| Bosnia-Herzegovina[8] | 15 | 0 | 10 |
| Bulgaria | 15/0[6] | 0 | 5 |
| Canada | 15/5[3] | 0 | 10/0[5] |
| China | 10 | 0 | 10 |
| Croatia | 15/0[6] | 0 | 0 |
| Cyprus | 15/0[6] | 0 | 0 |
| Czech Republic | 15/0[6] | 0 | 5 |
| Denmark | 15/0[6] | 0 | 0 |

| | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Ecuador | 15 | 0 | 15 |
| Egypt | 15 | 0 | 25/15[5] |
| Estonia | 15/0[6] | 0 | 10/5[5] |
| Finland | 15/0[6] | 0 | 5 |
| France | 15/0[6] | 0 | 0 |
| Georgia | 0/5/10[7] | 0 | 0 |
| Ghana | 15/5[3] | 0 | 8 |
| Greece | 25/0[6] | 0 | 0 |
| Hungary | 15/[06] | 0 | 0 |
| Iceland | 15/5[1] | 0 | 0 |
| India | 10 | 0 | 10 |
| Indonesia | 15/10[1] | 0 | 15/10/7.5[5] |
| Iran | 20/15[1] | 0 | 10 |
| Ireland | 15/0[6] | 0 | 0 |
| Israel | 25 | 0 | 5/0[5] |
| Italy | 15/0[6] | 0 | 5/0[5] |
| Ivory Coast | 15 | 0 | 10 |
| Jamaica | 15/10[1] | 0 | 10 |
| Japan | 15/10[1] | 0 | 10 |
| Kazakhstan | 15/5[1] | 0 | 10 |
| Kenya | 15 | 0 | 15 |
| Korea | 15/5[1] | 0 | 10/2[5] |
| Kuwait | 15/5[3] | 0 | 10 |
| Kyrgyzstan | 15/5[1] | 0 | 10 |
| Latvia | 15/0[6] | 0 | 10/5[5] |
| Liberia | 15/10[1] | 0 | 10/20[5] |
| Liechtenstein | 0/5/15 | 0 | 0 |
| Lithuania | 15/0[6] | 0 | 10/5[5] |
| Luxembourg | 15//0[6] | 0 | 5 |
| Macedonia | 15/5[3] | 0 | 5 |
| Malaysia | 15/5[3] | 0 | 7 |
| Malta | 15/0[6] | 0 | 0 |
| Mauritius | 15/5[3] | 0 | 10 |
| Mexico | 15/5[3] | 0 | 10 |
| Moldova | 15/5[3] | 0 | 0 |
| Mongolia | 10/5[3] | 0 | 10 |
| Montenegro[8] | 15 | 0 | 10 |

| | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Morocco | 15/5[3] | 0 | 10 |
| Namibia | 15/10[3] | 0 | 10 |
| Netherlands | 15/[06] | 0 | 0 |
| New Zealand | 15 | 0 | 10 |
| Norway | 15/0[1] | 0 | 0 |
| Pakistan | 15/10[2] | 0 | 10 |
| Philippines | 15/10/5[4] | 0 | 10 |
| Poland | 15/0[6] | 0 | 5 |
| Portugal | 15/0[6] | 0 | 10 |
| Romania | 15/5[3] | 0 | 3 |
| Russia | 15/5[3] | 0 | 0 |
| Serbia[8] | 15 | 0 | 10 |
| Singapore | 15/5[3] | 0 | 8 |
| Slovak Republic | 15/0[6] | 0 | 5 |
| Slovenia | 15/[06] | 0 | 5 |
| South Africa | 15/7.5[1] | 0 | 0 |
| Spain | 15/0[6] | 0 | 0 |
| Sri Lanka | 15 | 0 | 10 |
| Sweden | 15/0[6] | 0 | 0 |
| Switzerland | 15/0[3] | 0 | 0 |
| Syria | 10/5[3] | 0 | 12 |
| Tajikistan | 15/5[3] | 0 | 5 |
| Taiwan | 10 | 0 | 10 |
| Thailand | 20/15[1] | 0 | 15/5[5] |
| Trinidad and Tobago | 20/10[1] | 0 | 10/0[5] |
| Tunisia | 15/10[1] | 0 | 15/10[5] |
| Turkey | 15/5[1] | 0 | 10 |
| Turkmenistan | 15/5[3] | 0 | 0 |
| Ukraine | 10/5[2] | 0 | 5/0[5] |
| United Arab Emirates | 10/5[3] | 0 | 10 |
| United Kingdom | 15/0[6] | 0 | 0 |
| United States | 15/5[3] | 0 | 0 |
| Uruguay | 15/5[3] | 0 | 10 |
| Uzbekistan | 15/5[1] | 0 | 5/3[5] |
| Venezuela | 15/5[4] | 0 | 5 |
| Vietnam | 15/10/5[4] | 0 | 10/7.5[5] |
| Zambia | 15/5[1] | 0 | 10 |

| | Dividends (%) | Interest (%) | Royalties (%) |
|---|---|---|---|
| Zimbabwe | 20/10[1] | 0 | 7.5 |

NOTES:

1 Lower rate applicable where recipient holds an interest of at least 25%.
2 Lower rate applicable where recipient holds an interest of at least 20%.
3 Lower rate applicable where recipient holds an interest of at least 10%.
4 Lower rates applicable where recipient holds an interest of at least:
  (a) 25% or 70% (Vietnam; Philippines); or,
  (b) 15% (Venezuela).
5 The tax rates vary with the nature of the royalty/dividend.
6 The dividend is tax free within the EC where the recipient corporation holds an interest of at least 10% (Parent/Subsidiary EC Directive and domestic law).
7 The 5% rate applies where the dividend is paid to a company which holds directly at least 10% and has invested more than EUR 100,000 in the capital of the distributing company. The 0% rate applies where the dividend is paid to a company which holds directly at least 50% and has invested more than EUR 3 million in the capital of the distributing company.
8 The Treaty between Germany and ex-Yugoslavia is still applicable.

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