

German tax forms including 'Ergänzende Angaben zu den Vorsorgeaufwendungen' (Supplementary information on provision expenses) and 'Anleitung zur Einkommensteuer' (Instructions for income tax). The forms contain numbered sections (31-66) and various text boxes for tax-related information.

# 5 The Tax System

Company Taxation

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Customs

Germany has reformed its system of company taxation. Several changes reduce the average tax burden for corporations and the trade tax burden for all businesses. "Tax neutrality" has been established, treating partnerships and corporations equally when it comes to taxation. Read more about tax and customs issues in Germany in the following chapters.

## Company Taxation

Companies in Germany are usually taxed on two levels.

On the first level, corporations - such as the stock corporation (*AG*) and limited liability company (*GmbH*) - are subject to corporate income tax (*Körperschaftsteuer*), whereas partnerships are subject to personal income tax (*Einkommensteuer*). Both taxes are levied by the federal government.

On the second level, all business operations - corporations and partnerships alike - are subject to the trade tax (*Gewerbesteuer*), which is imposed by local municipalities (i.e. the town or city where the company is based).

Our model calculation shows how the overall tax burden for corporations and partnerships is determined.

### Corporate Income Tax for Corporations

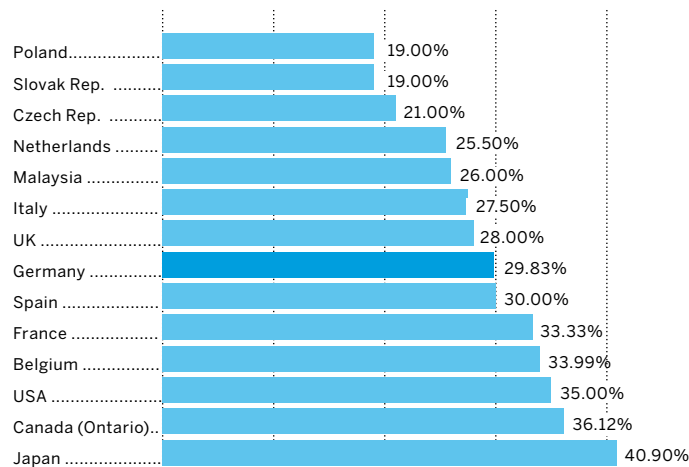
Corporate income tax (*Körperschaftsteuer*) applies to all corporations such as the limited liability company (*GmbH*) or the stock corporation (*AG*).

#### CORPORATE INCOME TAX RATE

On January 1, 2008, Germany's reform of company taxation came into effect reducing the tax burden for all companies.

The reform's core element is a nearly one-quarter reduction of the average tax burden for corporations. The standard corporate income tax rate has been reduced by ten percent from 25 percent to 15 percent on all corporation taxable earnings resulting in an overall tax burden of less than 30 percent.

#### INTERNATIONAL COMPARISON OF THE AVERAGE CORPORATE TAX BURDEN (2008)



Source: German Federal Ministry of Finance. bfai

FINAL WITHHOLDING TAX  
(ABGELTUNGSSTEUER)

Corporate income tax applies to both retained and distributed profits. However, once profits are distributed to shareholders, the shareholders must, in turn, pay final withholding tax (*Abgeltungsteuer*) at a rate of 25 percent (as of 2009) on these profits (i.e. dividends).

WITHHOLDING TAX  
(KAPITALERTRAGSTEUER)

If a German subsidiary pays out dividends to a foreign parent corporation, generally a withholding tax (*Kapitalertragsteuer*) of 25 percent is due. In case there is a double taxation agreement between Germany and a foreign state, this withholding tax can be refunded to a certain extent, according to the rules set out in the double taxation agreement (There usually is a reduction concerning the tax rate, e.g. tax rate of only 5, 10 or 15 percent.)

As of 2009, a refunding of 2/5 of the deducted withholding tax will be possible irrespective of any existing double taxation agreement.

SOLIDARITY SURCHARGE  
(SOLIDARITÄTSZUSCHLAG)

In addition to corporate income tax, the solidarity surcharge (*Solidaritatzuschlag*) is also added. This was introduced in 1995 to finance German reunification. The surcharge is 5.5 percent of the assessed amount of corporate and personal income tax. Accordingly, the solidarity surcharge is 5.5 percent of the 15 percent corporate income tax, adding up to a combined corporate income tax + solidarity surcharge burden of 15.825 percent.

### Personal Income Tax for Partnerships

Partnerships such as the civil law partnership (*GbR*), the general commercial partnership (*oHG*) or the limited partnership (*KG*) are not separate legal entities but associations of partners, with the partners themselves generally being subject to all rights and obligations.

PERSONAL INCOME TAX RATES

Accordingly, partnerships are not subject to corporate income tax (*Körperschaftsteuer*) but to personal income tax (*Einkommensteuer*), with the individual tax rate applicable to each shareholder.

The personal income tax rate starts at:

- 14 percent for an annual income exceeding the tax-free allowance of EUR 8,004.
- It rises progressively to a maximum personal income tax rate of 42 percent which is applicable to annual income of EUR 52,881 or more.
- An increased tax rate of 45 percent applies to every euro in excess of earnings of EUR 250,731 per year.

These tax rates also apply for personal income tax for employees.

SOLIDARITY SURCHARGE

As with corporate income tax, the solidarity surcharge is also added to personal income tax. Accordingly, the solidarity surcharge is 5.5 percent of the individual personal income tax rate of every partner. If a partner has an individual income tax rate of 30 percent, the combined personal income tax + solidarity surcharge burden on the partner's share in the profits would add up to 31.65 percent.



## HARMONIZING CORPORATION AND PARTNERSHIP TAX RATES

Generally, distributed and retained earnings of partnerships are subject to personal income tax with progressively rising tax rates. In order to reduce the tax burden for partnerships (making it similar to the tax burden of corporations), the reform of company taxation introduced two options:

- Trade tax payments for both distributed and retained earnings can now be offset against personal income tax on a larger scale (see Example “Offsetting Trade Tax against Personal Income Tax”).
- To avoid a progressively rising personal income tax rate, partnerships can apply for a flat taxation rate of 28.25 percent plus solidarity surcharge on retained earnings - leading to a flat taxation rate of 29.8 percent equaling the tax burden for corporations. (If retained earnings (taxed according to flat taxation) are distributed to partners at a later date, the distributed earnings are, under certain conditions, subject to a subsequent taxation rate of 25 percent.)

## Trade Tax for all Commercial Business Operations

All commercial business operations in Germany (regardless of legal company form) are subject to trade tax (*Gewerbesteuer*) with respect to their taxable earnings.

## DETERMINING THE TRADE TAX RATE

The applicable trade tax burden depends on two factors:

- The standard trade tax base rate (according to German trade tax code)
- The trade tax collection rate stipulated individually by every municipality (called the municipal multiplier - *Hebesatz*).

The trade tax base rate has been lowered from its previous five percent level to 3.5 percent for corporations, partnerships, and all other business operations.

The resulting trade tax base amount is then multiplied by the applicable municipal multiplier (*Hebesatz*).

By law, the municipal multiplier must be at least 200 percent (resulting in a minimum total trade tax burden of seven percent). There is no statutory ceiling; therefore the municipal multiplier in conurbations can be as high as 490 percent. The average municipal multiplier is somewhere between 350 percent and 400 percent, and the municipal multiplier tends, as a rule, to be higher in urban areas than in rural areas.

**Example**

- Company A with annual taxable earnings of EUR 1,000,000 is based in city B.
- City B has stipulated a municipal multiplier of 400 percent.
- The trade tax base amount for company A is 3.5 percent of its annual taxable earnings or EUR 35,000.
- The EUR 35,000 is multiplied by the municipal multiplier of 400 percent, resulting in a total trade tax burden for company A of EUR 140,000.

Annual taxable earnings of up to EUR 24,500 are trade-tax-exempt for partnerships. **No solidarity surcharge** is levied on trade tax payments!

#### OFFSETTING TRADE TAX AGAINST PERSONAL INCOME TAX

Germany's reform of company taxation has improved the option to offset trade tax payments against personal income tax. Previously, partnerships and sole proprietorships could offset trade tax payments against their personal income tax burden with a weighting factor of 1.8. of the trade tax base amount.

Under the company taxation reform, **this weighting factor has been more than doubled to 3.8**. Accordingly, the personal income tax of a partnership or sole proprietorship can be reduced by 3.8 times the trade tax base amount.

**Example**

- Partnership A has a trade tax base amount of EUR 35,000 (3.5 percent of its annual taxable earnings).
- This trade tax base amount can be offset against personal income tax payments with a weighting factor of 3.8; amounting to EUR 133,000 (35,000 x 3.8).
- Accordingly, partnership A can offset EUR 133,000 against personal income tax payments.

### Determining the Overall Tax Burden

According to the company taxation rules outlined before, the overall tax burden is to be calculated as follows:

#### MODEL CALCULATION: OVERALL TAX BURDEN FOR CORPORATIONS AND PARTNERSHIPS

| Taxation   | Corporation   | Partnership <sup>1</sup> |
|--|---------------|--------------------------|
| Taxable Income   | EUR 1,000,000 | EUR 1,000,000            |
| Trade Tax (average rate: 400)                                      | EUR -140,000  | EUR -140,000             |
| Income Tax   | EUR -150,000  | EUR -282,500             |
| Trade Tax Payments to Be Set off Against Personal Income Tax       | -             | EUR + 133,000            |
| Solidarity Surcharge   | EUR -8,250    | EUR -8,250               |
| Net Income   | EUR 701,750   | EUR 702,250              |
| Overall Tax Burden (Income Tax + Trade Tax + Solidarity Surcharge) | - 29.83 %     | - 29.77 %                |

<sup>1</sup>Assumption: 100% of profits retained

Source: Invest in Germany

## FINAL WITHHOLDING TAX (ABGELTUNGSSTEUER)

Final withholding tax is a flat tax of 25 percent on current income from capital such as dividends from stock corporations and interests as well as income from transactions (e.g. shares of corporate companies accruing from December 31st, 2008).

Only private individuals are liable to this tax. The solidarity surcharge is also levied on final withholding tax – resulting in a total tax burden of approximately 26.4 percent.

If a bank or other financial institution pays out such income from capital, the bank or financial institution simply withholds the tax and transfers it to the responsible tax authorities.

## Taxation of Property

Every property owner in Germany is liable to pay real property tax (*Grundsteuer*). The tax rate depends on the type of real property. This is sorted into two distinct categories:

- Real property tax “A”. Real property used for agriculture and forestry.
- Real property tax “B”. Constructible real property or real property with buildings.

### Real Property Tax Rate

The real property tax burden is calculated by multiplying:

- the assessed value of the real property
- the real property tax rate
- the municipal multiplier

The assessed real property value is determined by the tax authorities according to the German Assessment Code (*Bewertungsgesetz*). The German Assessment Code refers to historical property values that are usually significantly lower than current market value.

The real property tax rate depends on the type of real property. The tax rate is e.g. 2.6‰ (0.26 percent) for property used for (semi-) detached houses with a value of up to EUR 60,000 and 3.5 ‰ (0.35 percent) for all remaining types of real property (including commercially used real property).





Similar to the municipal multiplier applied in the trade tax case, the municipal multiplier applied to real property tax is stipulated by each municipality. Municipalities determine a municipal multiplier for both real property tax “A” and real property tax “B”, with the rate for “B” usually being higher.

### Determining the Real Property Tax Burden

Real property tax burden for a commercial building in a municipality with an average real property tax “B” collection rate of 350 percent:

|                                |                      |
|--------------------------------|----------------------|
| Assessed Value                 | EUR 1,000,000 (e.g.) |
| x Basic real property tax rate | x 0.35 percent       |
| x Municipal multiplier “B”     | x 350 percent        |
| = Real property tax burden     | = EUR 12,250         |

### Real Property Transfer Tax (Grunderwerbsteuer)

When domestic real estate is sold or changes owner, a one-time real property transfer tax (*Grunderwerbsteuer*) of 3.5 percent of the purchase price is levied if the purchase price or consideration exceeds EUR 2,500. Real property transfer tax is usually paid by the buyer. In Hamburg and Berlin, the rate is 4.5%.

Real property transfer tax also applies to a real property-owning partnership if 95 percent of the shareholders change within five years.

### Value Added Tax

Companies must add value added tax (VAT) to their prices. Thus, VAT is only paid by the end user of a product or service. Companies transfer the VAT received to the tax authorities on a monthly, quarterly, or annual basis. The frequency generally depends on the level of company turnover.

The normal VAT rate of 19 percent is just below the European average. A lower rate of seven percent is charged for convenience goods and services needed on a day-to-day

basis (such as food, newspapers or public transport). Some services (including banking, healthcare, and non-profit work) are VAT exempt.

The official German term for VAT is *Umsatzsteuer*, but it was originally called *Mehrwertsteuer* and is often still referred to by this name.

### Input VAT (Vorsteuerabzug)

Companies themselves also pay VAT when they purchase goods or services. The taxes collected and paid can be balanced out in the VAT return as input VAT (*Vorsteuerabzug*).

#### Example: How Input VAT is Balanced

A car dealer has sold ten vehicles in one month, each at a gross price of EUR 17,850 (net cost EUR 15,000). For each sale, the dealer receives EUR 2,850 in VAT from the customer. At the end of the month, the dealer therefore owes the tax authorities EUR 28,500.

However, in the same period, the car dealer also bought ten cars from the car manufacturer. The net cost of each car was EUR 10,000. The car manufacturer added 19 percent VAT to this amount. The dealer therefore transferred EUR 119,000 (including EUR 19,000 in VAT) to the manufacturer.

Thus, the car dealer has received EUR 28,500 in VAT and paid out EUR 19,000 in VAT. These totals are communicated to the tax authority (Finanzamt), and only the difference of EUR 9,500 must be transferred by the car dealer to the tax authorities.

### Trade Within the European Single Market

Trade within the EU is free from customs and other restrictions. However, goods traded between different EU member states are subject to so-called acquisition tax (*Erwerbsteuer*).

Acquisition tax is payable by the recipient of the goods. If an EU company exports goods to a company located in another EU member state, the delivering company therefore neither has to pay customs or charge VAT. The company in the other EU member state receiving the goods has accordingly to pay acquisition tax.

Acquisition tax rates correspond with the VAT tax rates of the country where the recipient of the goods is located. Companies can however reclaim acquisition tax like regular VAT.

### Trade with Non-EU Member States

Goods imported from non-EU states are liable to import VAT called import turnover tax (*Einfuhrumsatzsteuer*). The import turnover tax rate equals the VAT rates of 19 percent or 7 percent and is paid to the customs authority.

However, the import turnover tax on goods imported from non-EU states can be deducted as input tax (*Vorsteuer*). As a prerequisite, the company must have the necessary import documents with customs proof of payment (import declaration).

Exports are exempt from VAT.

## Tax Deductions

The significant difference between nominal and effective tax rates in Germany is based on a series of options for tax deductions.

### Loss Carry-Back and Loss Carry-Forward

Losses for corporate income tax purposes can be carried back for one year, limited to a total loss amount of EUR 511,500.

Losses can be carried forward with no time restriction. Up to an amount of EUR 1 million loss carry-forward is possible - free from any restrictions. For sums in excess of EUR one million, at least 40 percent of the taxable income must remain subject to taxation. In other words, a maximum 60 percent of taxable earnings exceeding EUR one million can be offset against incurred losses.

### Deductibility of Interest Payments

Generally, interest payments are fully deductible as operating expenditure. However, some special rules apply for corporate groups. If the amount of interest payments exceeds the amount of interest earnings for more than EUR 3 million, these exceeding interest payments are only deductible up to an amount of 30% of the EBITDA (earnings before interest, taxes, depreciation and amortization).

### Straight Line Depreciation

Straight line depreciation for assets is a deductible expense for tax purposes. The annual depreciation is calculated by dividing the purchase price by the estimated useful life of the asset.

All depreciations have to apply the straight line method.

### Fiscal Unit Concept

The German fiscal unit concept allows profit and loss pooling to determine the profit for taxation purposes at the level of the controlling parent. Profits and losses from German subsidiaries are consolidated and subject to taxation at the level of the German parent company. Fiscal unit preconditions are:

- The controlling parent is resident in Germany.
- The parent holds more than 50 percent of voting rights of corporate subsidiary entity.
- A profit and loss pooling agreement between parent and subsidiary entity exists with a duration of five years.
- This agreement is registered with the commercial register.

## The Tax Return

Every taxpayer must submit a tax return to the tax authority (*Finanzamt*) once a year. The tax authorities are organized locally. The authority in the place of the commercial domicile of the company is responsible.

The return for the previous calendar year must be submitted by May 31 of the subsequent year, but this deadline can be extended on request. Depending on the expected amount of taxes to be paid, the tax authorities can determine the period when tax payments are due.

The tax authorities provide information on tax issues. However, companies in particular should seek the services of a tax consultant to ensure the tax return is completed as favorably as possible.

The German Association of Tax Advisers (*Deutscher Steuerberaterverein e.V.*) provides a register of German Tax Advisers.

German Association of Tax Advisers  
[www.dstv.de](http://www.dstv.de)

The tax return itself consists of individual forms for each type of income. Where applicable, documents for expenses must be included or provided at a later date at the request of the tax authority. Employees pay wage tax - the term used for personal income tax when levied from employed jobholders. Employers are required to deduct wage tax from the employee's wages and transfer it to the tax authorities.

Declarations on wage tax and VAT can easily be sent to the tax authority online. Detailed information on tax return procedures for investors is provided by the Tax Information Centre (*Steuerliches Info-Center SIC*).

Tax Information Centre SIC  
[www.steuerliches-info-center.de](http://www.steuerliches-info-center.de)



## Customs

Since the establishment of the European Customs Union, the customs regime in Germany is governed first and foremost by EU law as is the case in all other EU member states. However, customs are administered by the German Customs Administration (*Bundeszollamt*) with offices throughout Germany.

### The European Customs Union

The European Customs Union forms a single trading area based on the EU-wide community customs code (*Zollkodex der Gemeinschaften*). The European Customs Union has:

- eliminated customs duties between EU member states
- eliminated import VAT between EU member states
- created uniform customs regime - including (external) common customs tariff (CCT) rates for goods imported from non-member countries into the Customs Union area

The community customs code, including the common customs tariff, is applied by all 27 EU member states as well as by Andorra, San Marino, and Turkey; the latter countries having entered a customs union with the European Community.

CCT rates vary depending on the type and origins of the imported goods. The applicable tariff rates for goods, depending on product category and country of origin, can be researched using the EU “TARIC” online tariff database accessible via the European Commission website.

Online Tariff Database TARIC  
<http://ec.europa.eu>



A German product may be shipped to Hungary without paying any duty and without any customs control.

Alternately, a Japanese product imported into the European Customs Union is subject to customs duties only when and where it first enters the EU, for example, Germany.

Subsequent to entry and initial customs clearance, no more customs procedures and duties are necessary. The product can circulate freely within the European Single Market.

### EU Trade Agreements

The EU sets its import tariffs and other customs rules on the basis of international agreements. In principle, these apply to all imports, but the EU has trade agreements offering cut-rate entry and often duty-free access for goods from neighboring, developing, and emerging economies.



These include:

- Free trade agreements with the other countries of the European Economic Area (Iceland, Liechtenstein, Norway) and Switzerland
- Customs unions with Andorra, San Marino, and Turkey
- Trade agreements with former British, French, and Portuguese colonies in Africa, the Caribbean, and the Pacific (the ACP countries)
- Trade agreements with countries around the Mediterranean, including those of southeastern Europe

## Customs Procedures

All movable and tangible assets that can be controlled by a person can be considered “goods” for customs purposes. As an exception, electric current - though not a tangible asset in the normal sense - also falls under the category of goods for customs purposes because it is merchandised. Gases and liquids are considered goods for customs purposes only once they have been filled into vessels or discharged into a pipeline for transportation.

The import of such “goods” may have different purposes: goods may be meant, for example, for direct sale, assembly, or temporary use. Depending on the reason for import, different customs procedures apply.

The three most common customs procedures are:

### **1. Release for Free Circulation (Überführung in den freien Verkehr)**

- The imported goods are subject to normal customs duties and import taxation.
- The importer pays the duties and may dispose of the goods freely.

### **2. Inward Processing (Aktive Veredelung)**

- Third country goods are imported into the Customs Union for processing within a period of time defined by the customs administration, and subsequently re-exported.
- The imported goods are usually exempt from customs duties or taxes.



### 3. Outward Processing (Passive Veredelung)

- Counterpart of inward processing
- An entrepreneur temporarily exports community goods to third party countries for the purpose of processing, repairing, or working abroad.
- The processed goods are re-imported into the Customs Union area within a granted time period.
- Duties and taxes are calculated based on the differential or the clearance of the added value at the time of re-importation.

For information on other existing customs procedure such as customs warehousing (*Zollagerverfahren*), temporary importation (*Vorübergehende Verwendung*) and processing under customs surveillance (*Umwandlungsverfahren*), please contact NRW.INVEST or the Customs Info Center (*Zoll Info Center*).

#### Customs Declaration

Effective processing of the customs declaration can only commence once the goods are on EU/Customs Union territory and have been presented at the customs office. Products imported into the European Customs Union are subject to customs duties only when and where the product first enters the EU (for example Germany).

The German Customs Administration (*Bundeszollamt*) is responsible for the administration of the joint customs procedures in Germany. All information and documentation material relevant to the chosen customs procedure have to be submitted along with the customs declaration.

The Customs Info Center provides certain standard customs declaration forms in English on its website.

Customs Information Center  
[www.zoll.de](http://www.zoll.de)