The background of the entire page is a stylized, wavy American flag. The top left corner features the blue field with white stars, while the rest of the image is composed of horizontal stripes in red, white, and blue. The flag appears to be waving, creating a sense of movement.

Gray, Gray & Gray's Guide to Conducting Business in Germany

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Introduction



With one of the most productive and influential economies in Europe, Germany is an attractive option for U.S. companies seeking to enter overseas markets. As such, there are many important issues to consider when establishing a business in Germany. This guide is designed to help provide you with an overview of some of these key issues regarding German business operations and taxation matters.

Gray, Gray & Gray, LLP
International Practice Group





Starting a Business in Germany

Foreign companies wishing to conduct business in Germany do not need to convert to a German legal entity. However, a Germany-based independent branch of a foreign entity must register with the Chamber of Commerce. A foreign company may also operate through a partnership with a German corporation.

There are no special restrictions on foreign investors doing business in Germany. A foreign company or individual can select from several legal business forms (typically a partnership or corporation format) or may choose to operate in Germany through a branch.

Branch Operations

A branch is typically a permanent establishment of a company from which business operations are carried out. Under German corporate law, independent branches must be registered in the commercial register and the local municipality must be informed about where the branch is to be opened. This information is shared with the local tax office. An advantage of operating through a branch is that it is much easier to set up or later liquidate than a partnership or corporation.

Corporations

German law recognizes several different types of corporations, each of which possesses "legal personality." Typically the corporation's liability is limited to the value of the corporate assets, while the owner of a corporation is not personally held liable for its debts. The two most common types of corporations are the stock corporation (AG) and the limited liability company (GmbH). Below are additional details about common types of corporations.

GmbH

The GmbH (Gesellschaft mit beschränkter Haftung) is the most common form of business entity in Germany. A GmbH can be formed by one or more individuals or companies. The company's articles of incorporation and founding act must be notarized, and the GmbH registered in the commercial register in order to obtain legal status.





Starting a Business in Germany

Under German corporate law a GmbH must have a minimum share capital of 25,000 euros, half of which must be raised before registering the company in the commercial register. One or more managing directors must be appointed to represent the company in legal matters. A managing director does not have to be a shareholder.

If a GmbH has more than 500 employees, a supervisory board must be established, consisting of at least 3 members.

Starting in 2008 Germany established a new type of GmbH known as an entrepreneurial company (UG). Forming a UG has fewer legal requirements and a minimum registered share capital of just one euro. However, once established the UG must accumulate 25% of its yearly profits until it reaches a share capital level of 25,000 euros.

AG

An AG stock corporation can be listed on a stock exchange, although that is not a requirement. The process of forming an AG is more involved than setting up a GmbH. A minimum registered share capital of 50,000 euros is required, with at least 25% paid in by the date of registration in the commercial register. The AG may issue share certificates either with a par value (minimum value of one euro) or without par value.

The AG is managed and represented legally by a board of managing directors. They do not have to be shareholders. A supervisory board is mandatory, with at least three members up to a maximum of 21 members. The supervisory board's function is to oversee and supervise the board of managing directors. An annual meeting must be held each year within eight months of the end of the AG's financial year.

KGaA

A third form of corporation (although less frequently used) is the limited partnership with share capital (KGaA). This is similar to an AG, but one or more of the general partners is personally liable for the company's debts.





Starting a Business in Germany

Partnerships

As in the U.S., partnerships have an important place in German economic activity. Like other business entities, all partnerships must be registered in the commercial register. The most common forms of partnership in Germany are general partnerships known as OHG (Offene Handelsgesellschaft), and limited partnerships, known as KG (Kommanditgesellschaft).

Other, less frequently used forms of partnerships are GbR (Gesellschaft bürgerlichen Rechts) civil law associations, which are not required to be registered, but in which all partners are jointly and severally liable for the partnership's debts; and silent partnerships (stille Gesellschaft), in which an individual holds a financial participation in an existing company on a contractual basis, sharing in its profits.

To create a partnership in Germany, a partnership agreement between all partners is required. Typically, one or more of the partners are general partners with personal unlimited liability. However, the partnership's internal operation may be set up to meet the individual needs of the partners.

In an OHG, all partners are jointly and severally liable for all business debts. In a KG, at least one general partner is liable, while the liability of the limited partners is limited to their contribution to the partnership, which must be registered in the commercial register.

Both OHG and KG partnerships are managed and represented by the general partners. Limited partners are generally precluded from participating in management unless the partnership agreement includes power of representation for them.

Corporate law in Germany allows forms of corporation to be mixed. For example, a common entity form is a GmbH & Co. KG – a limited partnership with the GmbH acting as general partner. This allows a company to take advantage of the benefits of a partnership with limited liability advantages of a corporation.





Taxation

Taxation in Germany depends on which form of corporation or partnership you establish. Typically, taxes you may face include personal income tax, corporate income tax, trade tax and solidarity surcharge.

Income Tax

Income tax applies only to individuals, and is based on residency (not citizenship) of the individual reporting income. You may be subject to income tax liability if you have a permanent domicile in Germany, or if you reside in Germany for more than six consecutive months.

Non-resident individuals may also choose to be treated as residents if at least 90% of their income is subject to Germany's income tax; or if taxable income not subject to German income tax does not exceed EUR 8,354.

Germany residents are subject to income tax on all earnings, whether from German sources or worldwide. Non-residents pay income tax only on their income from sources within Germany. This includes (but is not limited to) income from agriculture or forestry, commercial business activity within Germany, income from self-employment conducted in Germany, dividend income from a company based in Germany, capital gains on the sale of shares in a German corporation, and rental income on property within Germany.

Income tax is levied at progressive tax rates, currently (2015) ranging from 14% to a top rate of 45%. For German residents there is a tax-free allowance of EUR 8,354. The top rate is applied to income of EUR 250,731 or more (EUR 501,462 for married taxpayers filing a joint return).

In addition to income tax, a solidarity surcharge of 5.5% is imposed, which boosts the top tax rate to 47.5% (45% plus 5.5% on the 45%). The solidarity surcharged was first imposed in 1995 to help finance the reunification of Germany.

If a German resident is also a member of a church in Germany, a church tax of 8-9% is also levied.





Taxation

Individual income generated from commercial business activities is subject to a trade tax. This trade tax can be credited against income tax liability. No trade tax is levied on income from self-employment.

Corporate Income Tax

A business based in Germany is subject to corporate income tax on its worldwide income. Companies doing business inside Germany but based outside the country are subject to corporate income tax only on revenues generated from German sources. This income may include revenues from a branch, factory, point of purchase sale, warehouse, retail location, or use of a permanent representative.

Business entities (other than partnerships) are also subject to a 5.5% solidarity surcharge on their tax rate. A non-resident corporation is also subject to the solidarity surcharge if it maintains a permanent location in Germany. Partnerships are not taxable entities for corporate income tax purposes.

The corporate income tax rate is 15%. Adding the 5.5% solidarity surcharge creates an effective rate of 15.825%.

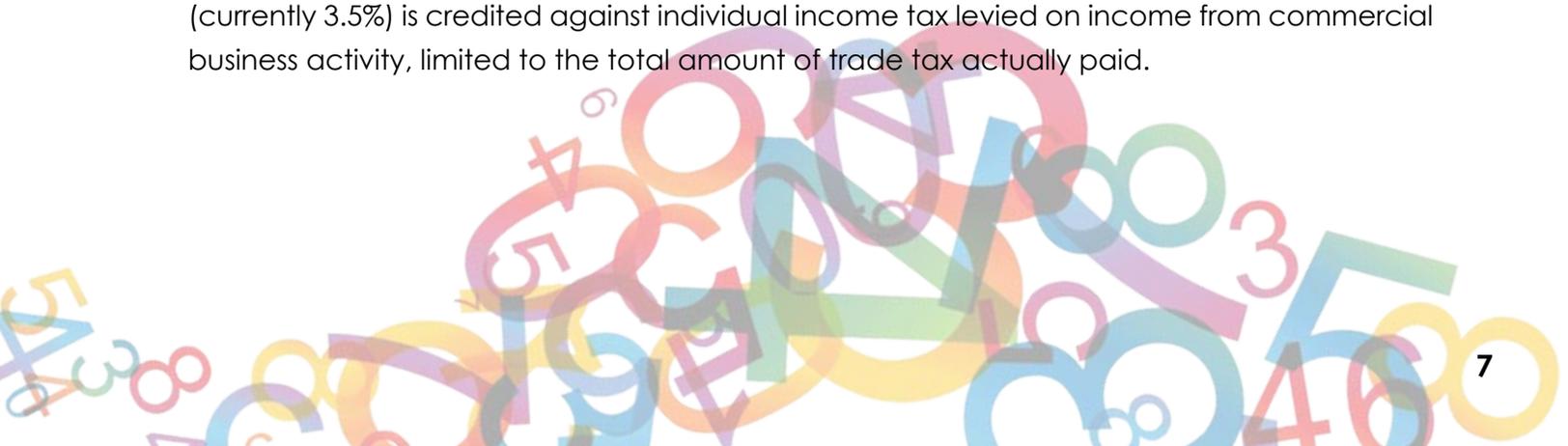
Trade Tax

In addition to national taxes, all commercial businesses (including most partnerships) are subject to a local municipal trade tax. The trade tax is based on a 3.5% tax rate, which is then subject to a local multiplier that varies on the municipality. The multiplier typically ranges from 200% up to 490%. The resulting effective trade tax rate can range up to 17.5%.

Partnership Taxation

Much as U.S. partnerships are “pass through” for tax purposes, German partnerships fall under a “transparency principle” that precludes paying a corporate income tax.

Partnerships are still generally subject to the municipal trade tax. However, to prevent the burden of double taxation, an amount equal to 3.8% times the trade tax base amount (currently 3.5%) is credited against individual income tax levied on income from commercial business activity, limited to the total amount of trade tax actually paid.





Taxation

Determining Taxable Income

Germany recognizes seven distinct categories of income:

- Income from agriculture and forestry
- Income from commercial business activity
- Income from self-employment (including income from professional services such as doctor, attorney, architect, etc.)
- Income from employment
- Income from capital investment
- Rental income from real estate and other tangible property and royalties
- Special types of other income (including annuities and certain capital gains)

Income from one or more of these categories can be combined. The income from each category must be calculated separately before being combined. It is also important to note that income that does not fall into any of the categories is not taxable (for example, lottery winnings).

Income from agriculture and forestry, commercial business activity and self-employment is calculated by deducting business expenses from gross income. Personal expenses are generally not deductible unless they are incurred for reasonable business purposes.

Income from employment, rental income and certain other income is determined by deducting income-related expenses from earnings. There is a standard annual deduction of up to EUR 1,000 for income-related expenses without requiring proof.

Higher amounts of income-related expenses may be deducted if itemized.





Taxation

Investment Income

Income from private capital assets, dividends, gains on the disposal of capital assets, etc. is generally income-tax free up to EUR 801 (EUR 1,602 for married couples filing a joint return).

Above that, an income tax liability of 25% is discharged in the form of a withholding tax, which is withheld by the payer. In general, the withholding tax is a final tax, so income from capital investment does not have to be declared in the income tax return. If your tax rate is below 25% you may declare investment income on your income tax return to obtain the lower tax rate.

Tax Relief

Certain expenses may be deducted from aggregated income:

- Special expenses (private, not business related)
- Extraordinary financial burdens
- Child-related expenses

Deductible special expenses may include health care premiums, nursing care insurance premiums, and provident expenses, such as retirement plan contributions up to a maximum of EUR 20,000.

Families are allowed a tax-free child allowance of EUR 2,184 per child (EUR 4,368 for married taxpayer filing a joint return), with an additional allowance of EUR 1,320 per year, per child for child care (EUR 2,640 for married couples).

Corporate Income Tax

Taxable income for corporations is based on the annual financial statement filed with tax authorities. All assets with a useful life of more than one year must be capitalized. Acquired goodwill must be capitalized and amortized on a straight line basis over 15 years. Acquired intangible assets must be amortized over their useful life. But self-created intangible assets may not be capitalized.





Taxation

Depreciation is based on production costs or acquisition costs of an asset, and must be calculated using the straight line method.

After taxable income has been determined, adjustments may be made to calculate the income for corporate tax purposes. Some adjustments include:

- Interest expense is generally deductible for tax purposes
- 95% of dividends received by a corporation are deductible
- Business gifts in excess of EUR 35 per person, per year are not deductible
- Corporate income tax and trade tax are not deductible

Trade Tax

While trade income is determined based on the taxable income for income tax or corporate tax purposes, it is modified by additional allowances and deductibles. For trade tax, 25% of the following amounts must be added, to the extent that payments exceed an exemption amount of EUR 100,000:

- Interest
- Recurring payments (annuities)
- Shares in the profit of a silent partner
- 20% of rental and lease payments for moveable fixed assets
- 50% of rental and lease payments for immovable fixed assets
- 25% of royalty payments provided for a limited period

The following must be added entirely:

- Dividends excluded in the income for corporate income tax purposes
- Shares in the loss of domestic or foreign partnerships





Taxation

Deduction of Tax Losses

When it comes to income tax purposes, tax losses can be fully offset in the current year against gains realized from other income categories. (Special loss consideration rules apply for certain income categories.) Tax losses that cannot be offset between the different income categories in the same year may be carried back to the previous year or carried forward.

For the purpose of income taxes, the overall maximum loss carryback amount is EUR 1 million (EUR 2 million for married taxpayers filing jointly). Remaining losses after the loss carryback may be fully carried forward up to an amount of EUR 1 million (EUR 2 million for married taxpayers filing jointly). Over and above this amount, up to 60% of annual taxable profits in excess of EUR 1 million (EUR 2 million for married taxpayers filing jointly) may be offset.

For corporate income tax purposes, tax losses may be carried back one year up to a maximum of EUR 1 million; or carried forward (with no time limit) up to a maximum of EUR 1 million. For trade tax purposes, no loss carryback is available, but losses may be carried forward.

Changes in ownership of corporations may lead to forfeiture of losses for corporate and trade tax purposes.

Dividends

Regarding individual shareholders holding shares as private assets, dividends received are generally subject to a withholding tax of 25% and solidarity surcharge of 5.5%. However, for individuals who hold shares as business assets or in a partnership, 60% of the dividends are taxable (with 40% exempt).

For corporations holding shares, the dividend income is generally exempt from corporate income tax, but 5% of the dividends received are treated as a non-deductible expense, effectively making 95% of dividends received tax exempt. For trade tax purposes, the tax exemption applies if the shareholder has a minimum shareholding of 15% in the corporation paying the dividend.





Taxation

Capital Gains

Private capital gains from sale of real estate by an individual are subject to tax if the holding period is less than 10 years. The total net gain from the sale is tax-free if it exceeds an amount of EUR 600 in a calendar year.

Capital gains of privately held shares by individuals are subject to tax. If the individual holds a participation of at least 1% in a corporation over the last five years, the individual is deemed to hold a substantial interest in the corporation and 60% of the capital gains are subject to income tax at the regular rate, plus a solidarity surcharge of 5.5%. For individuals holding less than 1% of a corporation, capital gains are subject to a 25% withholding tax plus solidarity surcharge of 5.5%.

With capital gains from the sale of shares held as a business asset by an individual, 40% of the capital gains are tax-exempt and 60% of the gains are subject to tax at the regular progressive rate, plus a solidarity surcharge of 5.5%.

Capital gains from the sale of shares by a corporation are exempt from corporate income tax and trade tax, but 5% of the dividends received are treated as a non-deductible expense, effectively making 95% of dividends received tax exempt.

Tax Group

Under German tax law, for a group of companies (Organschaft) the profit or loss of a controlled company is attributed to the controlling company. This requires that the controlled company be financially integrated into the controlling company.

Exit Taxation

Exit taxation is incurred for transactions that preclude or restrict German tax authorities right to tax gains received from an asset sale across national borders, or for when a German corporate entity moves its headquarters or assets out of Germany. Exit taxation triggers immediate taxation of an asset's hidden reserves. Exit taxation may also be applied to an individual who has been subject to German taxation for at least 10 years, or if the individual holds a substantial share (1% or more) in a German corporation.



Taxation

Anti-Avoidance Rules

The German Controlled Foreign Company rules are considered when a German resident taxpayer (individual or corporate) holds an investment in a foreign company. The rules are in place to discourage residents from shifting income to jurisdictions with lower tax rates. The German Controlled Foreign Company rules apply when a shareholder who is a resident of Germany holds more than 50% of the shares or voting rights in a foreign corporation, the foreign corporation receives passive income, and the passive income is subject to an effective tax rate lower than 25%.

Thin Capitalization Rules

Under thin capitalization rules, interest expense is completely deductible from the tax base only to the extent that the taxpayer earns positive expense income, and is limited to 30% of tax EBITDA. The rules apply to all types of debt financing for sole proprietorships, partnerships and corporations.

Double Taxation Relief

Companies domiciled in Germany (and German residents) are subject to tax on income from foreign sources. To prevent potential double taxation Germany has a tax treaty network with some 90 countries. In general, the tax treaty prevents double taxation by either allowing the country where the income was earned to tax the income, or by allowing a foreign tax credit.

Withholding Taxes

A German corporation paying dividends must levy a withholding tax at a rate of 25% plus a 5.5% solidarity surcharge. For non-resident corporations, this withholding tax is generally a final tax. Resident shareholders may credit the withholding tax against their own tax liabilities.

Germany does not generally levy withholding tax on interest paid to non-resident taxpayers. Royalties paid to foreign corporations are generally subject to a 15% withholding tax plus 5.5% solidarity surcharge.





Taxation

Tax Administration

For individuals, the tax year is generally the calendar year. Tax returns must be filed by May 31 for the preceding calendar year, but an extension may be granted to December 31 if a licensed tax consultant prepares the tax return. For non-employment income, advance quarterly payments are required.

Regarding a company, the tax year is also the calendar year but, with the consent of tax authorities, a resident company may elect its own fiscal year to be its tax year. Annual tax returns must be filed by May 31 of the year following the company's tax year, with extensions to December 31 generally allowed.

With regards to corporate income and trade tax, these are assessed on an annual basis. Quarterly advance payments of corporate income tax are required (due on March 10, June 10, September 10 and December 10). Advance payments on trade tax are due February 15, May 15, August 15 and November 15.





Value Added Tax (VAT)

Value Added Tax (VAT) is a general tax on consumption of goods and services, and is charged at every stage of production and distribution. Businesses that collect the VAT are required to pay the VAT amount to the tax authorities. VAT taxes paid by one company to another can be deducted from taxes, so the final burden of the VAT rests on the consumer.

Taxpayer Definition

The taxable person under German VAT law is the entrepreneur, meaning anyone who performs a commercial or professional activity on an independent basis. This means the VAT applies to sole proprietors and self-employed professionals, as well as commercial entities, although certain small businesses may be exempt from VAT.

A foreign entrepreneur with taxable transactions in Germany is subject to German VAT law, and is thus required to register for VAT purposes at the responsible German tax office.

Tax group rules for controlling and controlled entities. For VAT purposes the controlling company is considered to be the sole VAT entrepreneur of the tax group, and submits a single VAT return for all members.

Taxable Transactions

VAT law covers the following types of transactions:

- Supply of goods and other services
- Importation of goods (from inside or outside the European Union)
- Intra-community acquisitions (transfer of goods within an enterprise)

Place of Supply

The transactions above are subject to VAT only if their place of supply is deemed to be in Germany. The “place of supply” is generally the place where the transportation of goods begins. This applies to importation and intra-community transfers as well. In the case of services, the place of supply is considered where the entrepreneur runs his or her enterprise. For an intra-community transfer, the VAT is usually paid by the recipient in the destination location at the applicable rate for that country.





Value Added Tax (VAT)

Some exceptions to the general rules about place of supply are:

- Distance selling, in which the place of supply is where transportation ends
- If the place of supply is where the work is rendered
- Restaurant and catering services, in which the place of supply is where the business physically carries out the service
- Land, in which the place of supply is considered the location of the land itself

Exemptions

Exemptions from VAT may be granted for the following types of transactions:

- Exports
- Intra-community supplies
- Financial services (banking, insurance, investment services)
- Rental and sale of real estate
- Medical services
- School and educational services

Deduction of VAT

An entrepreneur may deduct VAT paid in the following circumstances:

- VAT invoiced and payable on supplies or other tax services performed by other entrepreneurs for the entrepreneur's enterprise
- VAT on an intra-community acquisition of goods or on importation of goods for the entrepreneur's enterprise

Deductions require detailed invoices, including complete name and address, tax number, details of goods supplied, etc.





Value Added Tax (VAT)

VAT Rates

Two VAT rates apply in Germany. The standard VAT rate is 19%. A reduced rate of 7% applies to certain privileged products such as printed books, newspapers and foodstuffs.

Reverse Charge

Under the reverse charge procedure, VAT liability may be transferred to the recipient of goods and services. This procedure may apply if a foreign entrepreneur conducts other taxable services or supplies taxable goods to another entrepreneur in Germany. In such instances, the foreign entrepreneur is not required to obtain a VAT registration nor collect and pay VAT tax to authorities. The recipient must calculate VAT obligations and include this in his or her German tax return.

Administration

Entrepreneurs subject to VAT must calculate their VAT liability and file preliminary VAT returns on a monthly basis. The normal deadline for filing a return and payment of VAT taxes is the 10th of the month, but this may often be extended for one month. An annual VAT return, summarizing VAT payments and correcting any errors, must be filed by May 31 for the previous year.





Other Taxes

Excise Duty

Excise duties are levied on the utilization and consumption of certain commodities, including alcohol, tobacco, coffee, beer and electricity. The excise duties are levied indirectly through the selling price of the goods.

Energy Tax

An energy tax is charged to the end user of coal, natural gas, gasoline, diesel oil, light heating oil and heavy heating oil. Energy tax rates vary with the amount used.

Real Estate Tax

Real estate tax is imposed annually on real property, and is levied by local municipalities. The basic tax rate is 0.35% of the assessed value of the property. A local multiplier is applied to the base rate to determine the final real estate tax. Local multipliers typically range from 150% to 600%, depending on the location and type of the property (i.e. industrial vs. agricultural).

Real Estate Transfer Tax

Sale of real estate in Germany is taxable at a rate of 3.5% to 6.5%, depending on the location of the property. Some examples:

- Bavaria - 3.5%
- Hamburg - 4.5%
- Berlin - 6.0%
- Saarland - 6.5%





Summary

This guide is intended to be an introduction and overview of the steps necessary to conduct business in Germany. It is not a complete guide or handbook, and information contained herein is subject to change. The information contained in this document is believed to be accurate as of January, 2016. However, it should not be used as a substitute for professional guidance, legal guidance or for tax advice purposes.

For more information or assistance in setting up a business in Germany, contact Gray, Gray & Gray's International Practice Group at (781) 407-0300, or visit our website (www.gggcpas.com).





Going Global: International Business

When it comes to commerce the world truly is “flat,” with business transactions taking place across international borders at an ever-increasing rate and volume. Companies of all size are taking advantage of global markets to seek new customers and additional revenues.

Doing business around the world requires the support and expertise of an accounting firm that understands the market, customs and regulations of targeted countries. At Gray, Gray & Gray, we work with individuals as well as public and private companies that conduct business in countries around the globe. Our dedicated and highly skilled International Practice Group goes beyond the numbers to provide the depth and breadth of services to meet your growing global needs.

This includes companies seeking to enter the U.S. market, as well as American companies expanding overseas. We help with everything from establishing cross-border business relationships to navigating the tax landscape, to providing sound advice on foreign financial transactions.

We are large enough to offer the expertise of a national firm, yet small enough to know our clients personally. This allows us to provide tailored solutions that address your specific needs.

Our clients operate in a wide range of jurisdictions, including the United States, Germany, Colombia, Australia, Canada, United Kingdom, Netherlands, Brazil, Mexico, Argentina, China, Russia, and Ireland, among others. Because we are active members of CPAAmerica International, Inc., an exclusive international organization of independent certified public accounting firms, Gray, Gray & Gray is able to make important connections and provide quality, knowledgeable, worldwide service to our clients at virtually any point on the globe.

Why Gray, Gray & Gray for Global Business?

Here are five reasons to choose Gray, Gray & Gray for international tax and business consulting services:

1. Our people are experienced tax and accounting professionals with extensive connections in the international community
2. We have a dedicated practice group that is focused exclusively on issues like international tax compliance, foreign bank account reporting, and cross-border business activities
3. We have strong overseas representation to assist in dealing with local tax and business authorities
4. We can assist with complex issues such as foreign bank account reporting (FBAR), foreign account tax compliance (FATCA), and the IRS Voluntary Disclosure Program
5. We have a track record of helping our clients succeed in international business ventures

Gray, Gray & Gray, LLP provides the following international accounting, tax and advisory services:

- Planning and compliance
- Choice of entity
- Setting up entities in overseas markets
- Assistance with entrance into overseas markets
- U.S. source income
- Tax reporting
- Tax withholding
- Exemptions and tax treaties
- More!

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