



## P R E F A C E

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This profile is designed to provide information on a number of subjects important to those contemplating investing or doing business in Germany.

Baker Tilly International is the 10th largest network in the world by fee income and is represented by 107 firms in 59 countries, with 17,000 staff worldwide. Its member firms are high quality, independent accountancy and business services firms, all of whom are committed to providing the best possible service to their clients, both in their own marketplace and across the world.

This guide is one of a series of country profiles compiled for use by Baker Tilly International's clients and professional staff, which may be obtained from any of our international offices.

Doing Business in Germany has been designed for the information of readers. Whilst every effort has been made to ensure accuracy, information contained in this booklet may not be comprehensive and recipients should not act upon it without seeking professional advice.

Up-to-date advice and general assistance on matters in Germany can be obtained from our two independent member firms in Germany - Baker Tilly Deutschland GmbH and Dr. Clauss, Dr. Paal und Partner. Please see their details in the back cover of this booklet.

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## 1 INTRODUCTION

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### 1.1 *Geography*

Germany is located in the heart of Europe. After the reunification it has become an even greater link between East and West, but also between Scandinavia and the Mediterranean. As an integral part of the European Union, Germany is a bridge to the countries of Central and Eastern Europe.

Through this central position in the European continent, Germany allows its investors to reach the entire market of the European Union and the markets of Central and Eastern Europe.

Sole Traders, partnerships and companies from all over the world are welcomed in Germany to experience the stability, flexibility and the sense of tradition in the modern business climate that the country offers the investors.

### 1.2 *Population*

Germany has a population of approximately 81.8 million, the largest in Western Europe.

### 1.3 *Political System*

Germany is a democratic federal republic. The authority to enact and enforce the law is divided between the federal state (Bund) and the sixteen 'states' (Bundesländer).

The German Bundestag is the federal state parliament. The Federal Government (Bundesregierung) consists of the Federal Chancellor and the Federal Ministers. The Federal Chancellor determines the general policy guidelines. The Federal Council (Bundesrat) is composed of members of the governments of the states.

## **1.4 Language**

German is the language throughout Germany.

## **1.5 Currency**

Germany is part of the Euro Land. The monetary unit is the Euro (€), divided into 100 cents.

## **1.6 Economy**

The main sectors of the economy are industry, commerce, banks, services, energy and agriculture. German industries are among the world's largest and most technologically advanced producers.

As a leading industrial country and as the world's second largest trading nation, it is more deeply integrated in the global economy than virtually any other country.

## 2 BUSINESS ENTITIES AND ACCOUNTING

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Investors can choose any type of legal form for their business. The most common forms are:

Public Limited Liability Company	(see 2.1)
Limited Liability Company	(see 2.1)
General Commercial Partnership	(see 2.2)
Limited Commercial Partnership	(see 2.2)
Partner with Limited Liability	(see 2.2)
Branches	(see 2.3)

### 2.1 Companies

An advantage of establishing a company is that the liability of the shareholders is restricted to their contribution into equity.

#### *Public Limited Company (Aktiengesellschaft - AG)*

A public limited company is the appropriate form of organisation for large enterprises with many shareholders. The shares can be traded on the stock exchange.

Strict legal requirements govern the formation and operations of AG. The financial requirement to establish an AG is a share capital of at least €50,000. This share capital can be held by individuals or corporations.

There is a total separation between management and the shareholders. The executive bodies of an AG are the board of directors (Vorstand), the supervisory board (Aufsichtsrat) and the shareholders' meeting (Hauptversammlung).

Important steps to establish an AG:

- Appointment of supervisory and managing boards
- Contribution of capital
- Founders' report
- Audit of the foundation by the supervisory board and an external auditor (in specific instances)
- Execution of deeds of formation and by-laws
- Notification and entry into the Commercial Register
- Notification of the local Chamber of Commerce

The business of the AG is conducted through the members of the board of directors.

*Private Limited Company (Gesellschaft mit beschränkter Haftung - GmbH)*

For German and foreign businesses it is more common to operate in a GmbH than an AG because the GmbH's structure is more flexible, less formal and subject to less legislative regulations than an AG-structure.

The GmbH has to be formed by one or more people at a minimum equity of at least €25,000. The minimum share capital is €100 per share. Every agreement to transfer shares must be notarised in order to be valid.

The managing directors (Geschäftsführer) are too restricted in their powers to represent the company imposed by the by-laws or by shareholders' resolutions. Restrictions on the right to represent the company have no legal effect so far as third parties are concerned.

Important steps to establish a GmbH:

- Appointment of manager(s)
- Payment of capital contributions
- Execution of the deeds of formation and by-laws
- Notification and entry into Commercial Register
- Notification of the local Chamber of Commerce.

## **2.2 Partnerships**

In Germany the law recognises various forms of partnerships.

### *General Commercial Partnership (Offene Handelsgesellschaft – OHG)*

The OHG consists of at least two unlimited partners which both have an unlimited liability for the debts and obligations of the firm. This means that the liability of the partners is extended to their entire private assets. Even if the partnership is solvent the creditors can request the partners for payment of the liabilities.

### *Limited Commercial Partnership (Kommanditgesellschaft – KG)*

The KG is founded by one or more limited partners (Kommanditisten) together with at least one general partner (Komplementär) being unlimitedly liable for the debts of the KG. The limited partners' liability is limited by the amount of their capital contribution.

### *Partnership with Limited Liability (GmbH & Co. KG)*

In Germany there also exists a type of combined form of a partnership and a limited liability company. In this case the general partner is a GmbH which itself has a limited liability. This company is called a GmbH & Co. KG.

## **2.3 Branches**

A branch is not similar to a subsidiary company because it is not a separate legal entity distinct from the parent company.

To establish a branch, there are only a few formalities and no requirements for a minimum capital in Germany. Branches must be entered in the commercial register. It is the easiest way for foreign companies to do business in Germany.

## **2.4 Accounting and Audit Requirements**

All businesses need to maintain proper accounting records. They need to retain the records, vouchers and associated documents for no less than 10 years.

The Commercial Code requires an audit of the annual financial statements for all companies and partnerships which do not have at least one unlimited liable private individual as a general partner and which meet two of the following requirements in two consecutive years:

- annual turnover exceeds €6,875million
- balance sheets total exceeds €3,438million
- average number of employees in excess of 50.

The annual financial statements and the management report of these firms must be audited by a qualified public accountant.

## **2.5 Filing Requirements**

All companies must file annual financial statements, comprising of a balance sheet, a profit and loss account, notes to the financial statements and a management report, to the commercial register (Handelregister). Small corporations may only file in an abbreviated form. The legal representatives must report in the Federal Gazette (Bundesanzeiger), without undue delay after filing these records, at which commercial register and under which number these documents have been filed.

The legal representatives of any company, which is requested to prepare consolidated financial statements, must publish the consolidated financial statements and the consolidated management report in the Federal Gazette.

## 3 EMPLOYMENT REGULATION AND SOCIAL SECURITY CONTRIBUTIONS

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### 3.1 *Work Permits*

European Union citizens do not need a visa of work permit. When they have started work they need to apply for a residence permit (Aufenthaltsgenehmigung) from the local Foreign Nationals Authority. Citizens from Norway, Ireland and Liechtenstein enjoy the same rights as EU citizens. For citizens from Switzerland there are some relieved conditions according to the foreign workers agreement.

Citizens from outside the European Union, including citizens from USA, Canada, Australia and New Zealand need a work permit. For these a registration certificate, a residence permit and a certificate from the employer are necessary.

### 3.2 *Engagement and Dismissal*

The written contract of employment must include as a minimum the following:

- Gross salary/gross hourly rate and working hours
- Paid holiday entitlement (minimum 24 working days, in general 30 days)
- Paid sick leave entitlement (in general 6 weeks)
- Minimum notice period for termination of employment

A probationary term of one to six months is customary in Germany.

### 3.3 *Trade Unions and Worker Councils*

For many years German companies have gained from the good industrial relations between management and labour force. Union membership is not compulsory. The degree of unionisation varies, but averages less than 50%.

A works council may be formed in companies with 5 or more employees. The members of the works council are elected by fellow employees. These work councils are not authorised to conduct wage negotiation, but must be informed of terminations before the actual dismissal of an employee.

### 3.4 Social Security Contributions

The social security costs for employees is very high in Germany. In old age the employees receive a pension from the state and in some cases also a pension from the company, depending on the company they have worked for. The state also supports unemployed citizens.

In Germany the social security contributions are paid at an equal share by employers and employees. These contributions are as follows:

Type of Social Security	Employer's Share (%) of the Standard Salary	Employee's Share (%) of the Standard Salary	Sum (%) of the Standard Salary
Unemployment	3.25	3.25	6.50
Pension	9.55	9.55	19.10
Healthcare	7.20	7.20	14.40
Insurance for disability and old age	0.85	0.85	1.70

Social security contributions currently amount to between 20.85% to 22% of a typical gross salary.

## 4 TAXATION

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### 4.1 *Income Tax*

Individuals, sole traders and members of partnerships who are resident in Germany are liable to German income tax independent of their nationality. Non-residents are in general only liable to the tax on certain German-sourced income (see 5.1).

Resident individuals are subject to income tax on their worldwide income according to seven income categories (income from agriculture and forestry, trade or business, professional services, employment, capital investment, rental income from immovable property, royalties and other income). The taxable income from business profits will be determined according to accounting standards. For the other categories, the related expenses will be deducted from the gross income (accounting on a cash basis). The results of all categories will be aggregated. This aggregated income, less the personal deduction, is the taxable base to which the allowances and the rates (see appendix 1) are applied.

Capital gains are generally subject to income tax, especially if resulting from participation in business with shares and bonds or with real estate.

### 4.2 *Corporation Tax*

Companies (corporations) which have their place of management or their legal base in Germany, will be taxed on their worldwide profits in Germany.

Companies that do not incorporate in Germany and neither have their place of management nor their legal base in Germany but have a branch or an agency, are liable to corporation income tax on any domestic trading profits. If there is a double taxation treaty between Germany and the other country in which a company is based then its terms may modify the extent to which the company is liable to corporation tax in Germany.

Foreign companies are also liable to German tax on other sources of income derived from Germany, subject to the terms of any relevant double taxation treaty.

A company will be charged on the company's income and capital for each accounting period. The accounting period is normally 12 months. Thus, the taxable income of a company is the total amount of income whether from domestic or foreign sources after deduction of business expenses.

The trading profits of the financial year are subject to 25% corporation income tax, independent whether the profits are retained or distributed (26.375% including solidarity surcharge).

Dividends received from another company are generally exempt from income corporation tax. The dividends received by private shareholders must be included in their income tax return. Only one half of this income is taxable by the shareholder according to the "half-income" system (see table below).

The ultimate tax burden on dividends (ignoring the withholding tax and solidarity surcharge) is as follows:

At the company level:	
Profit after trade tax	100
Corporation tax (25%)	(25)
Profit after tax/gross dividend	75

At the shareholder level:	
Dividend income received	75
Dividend income subject to tax (50%)	38.5
Income tax (e.g. at 48.5%)	(18.2)
Income net of all taxes	56.8

## **4.3 Trade Tax on Income**

In general every company and partnership that carries on a business in Germany is subject to a local trade tax.

The taxable income for trade tax is generally the same basis of assessment as for corporate or income tax, subject to certain adjustments. The effective rate of trade tax depends on the federal rate and a multiplier. The federal rate of 5% will be applied to the taxable business income from which a basic tax amount results. After that the multiplier will be applied to the basic tax amount to determine the actual tax burden. The multiplier varies in different municipalities according to their financial needs. (For examples see appendix 3).

The trade tax on income is deductible from its own base and also for corporate income tax purpose.

## **4.4 Withholding Tax (*Kapitalertragsteuer*)**

On dividends, other profit distributions and interest from convertible bonds, profit sharing bonds and participation loans the company must withhold withholding tax of 20%. This rate increases to 21.1% for the solidarity surcharge. Most of the German tax treaties with other countries provide a reduced rate of withholding tax which depends on whether the shareholder is a natural person or a company. Qualified dividends paid to another European corporation under the terms of the EU Parent/Subsidiary Directive are not subject to a withholding tax at all. (Examples are given in appendix 2).

These above-mentioned withholding taxes are creditable against the final corporate or individual income tax liability of the recipient. In the tax treaties with different countries, there are regulations for avoidance of double taxation.

Royalties paid to non-residents are also subject to withholding tax at a rate of 20% increased by 5.5% for solidarity surcharge. In different tax treaties the rate may be reduced or there will be no withholding tax. (Examples are given in appendix 2).

#### **4.5 Solidarity Surcharge**

The solidarity surcharge was introduced because of the reunification of Germany. It is levied on corporate and individual income tax as well as on withholding tax. The rate is 5.5%, thus the corporate income tax of 25% will be increased to 26.375% and the maximum rate of the income tax from 48.5% to 51.17%.

#### **4.6 Value Added Tax (VAT)**

Value added tax (Umsatzsteuer) is a general tax on the consumption of goods and services in Germany. VAT is levied in accordance with the harmonised European Union System.

All entrepreneurs are taxable including persons exercising a liberal profession or importers who supply goods or services in Germany.

In the computation of the final tax liability the tax paid on purchases of goods and services may be deducted from the VAT on goods and services provided by the entrepreneur (prepaid VAT), if the prepaid VAT exceeds the VAT from sales/services, then the excess amount will be refunded by the tax authorities. Thus, only the value added by the company will be taxed.

For certain transactions the VAT law provides exemptions. The most common exemptions are, for example, for export sales, banking activities, insurance activities and the sale and rental of immovable property.

The standard VAT rate is 16%. For different goods or services it will be reduced to 7%. Exports are generally VAT exempt, except where they are made to a person in the EU in a private rather than a business capacity.

A foreign entrepreneur can obtain a refund of the German VAT if

- he does not recognise taxable revenues in Germany
- he recognises only taxable supplies to which the reverse charge rules apply or
- carries on only zero-rated cross-border transportation.

## **4.7 Other Taxes**

### *Inheritance and Gift Tax*

Inheritance and gift tax is imposed on acquisitions by the way of inheritance or gift or on donations encumbered with a charge for a particular purpose. The liability to pay the inheritance or gift tax is incurred at the time of death of the deceased and for gifts it is at the time when they are made.

Gifts and inheritances are subject to the same tax rates between 7% and 50%. The rates depend on the allowances of the relationship between the transferor and transferee and also on the value of the estate or gift. Germany has concluded tax treaties covering inheritance tax with Austria, Denmark, Greece, Sweden, Switzerland and the United States. The treaties with Denmark, Sweden and the United States also cover gifts.

### *Real Estate Transfer Tax*

Real estate transfer tax is levied on all real estate transactions. The tax amounts to 3.5% of the purchase price.

### *Real Estate Tax*

Real estate tax is levied annually by the municipalities on immovable property whether held as a private or business asset. It is imposed on the fiscal value at a rate between 0.98% and 2.1% (the rate is a combination of a federal rate multiplied by a municipal co-efficient). The average rate is around 1.5%. The real estate tax is deductible for corporate income tax and trade tax purposes.

### *Church Tax*

All individuals who belong to a church and who are subject to unlimited tax liability, have to pay a church tax at a rate of 8% or 9% on their taxable income, depending on the state in which the taxpayer is resident. The church tax is collected by the tax authorities. The church tax is deductible for income tax purposes.

### **5.1 Taxation of German Source Income**

Foreign Businesses who establish a company or branch in Germany often send employees from their business to work in Germany, for a certain period of time. If the employee moves his place of residence or habitual abode to Germany, then he will be treated as a German resident. Thus he will be liable to German income tax with his German-source income. The income outside of Germany will be assessed or not assessed according to the tax treaty with the respective country. Otherwise it will be taxed according to the German tax law.

If the employee does not have his place of residence or habitual abode in Germany, and works not longer than 183 days of the year in Germany and gets paid by his company abroad, then he will be liable to tax in the foreign country according to most tax treaties regulations. If this does not apply the employee will be taxable in Germany.

The same tax rates apply for non residents as for the residents (see appendix 1), except that for non-residents the minimum tax rate is 25% of the income. The tax will be increased by 5.5% solidarity surcharge.

### **5.2 Social Security Contribution**

Germany has reciprocal social security agreements with many countries under which the employees may continue to pay the contributions to the home country for a certain period of time.

An employee of a member state of the European Community who is assigned to work for his employer in another member state is liable to pay the contribution to his home country if the period of assignment lasts no longer than 12 months.



## APPENDIX 1

### Income tax rates

A basic allowance (Grundfreibetrag) will be deducted from the taxable base. From 1 January 2002 the basic allowance granted to every resident is €7,235 for a single person and €14,471 for jointly assessed spouses.

For single taxpayers:

Annual taxable income (€)	Marginal rate <sup>1</sup> (%)	Tax payable (€)
Up to 7,235	0	0
7,236 – 9,251	19.9 – 23.0	10 – 436
9,251 – 55,007	23.0 – 48.5	444 – 16,798
Over 55,007	48.5	

For jointly assessed spouses:

Annual taxable income (€)	Marginal rate <sup>1</sup> (%)	Tax payable (€)
Up to 14,471	0	0
14,471 – 18,503	19.9 – 23.0	20 – 872
18,504 – 110,015	23.0 – 48.5	888 – 33,596
Over 110,015	48.5	

<sup>1</sup>The income tax rates are on a rising scale, progressive in the sense that the level of the income determines the rate to be applied to the income. Only the highest rate on the scale has the character of a “top marginal rate” in the sense that any further income earned or accrued will be taxed at that rate.



## APPENDIX 2

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### Withholding taxes on interest payments

Interest payments are normally subject to 20% withholding tax. The following table shows countries with reduced rates according to the tax treaties with Germany. A prior authorisation must be obtained from the Bundesamt für Finanzen (German Federal Tax Office) before applying the reduced rate provided by the treaty.

Country	Individuals, Companies (%)	Qualifying Companies <sup>2</sup> (%)	Country	Individuals, Companies (%)	Qualifying Companies <sup>2</sup> (%)
Australia	15	15	Luxembourg	15	10
Austria	15	5	Mexico	15	5
Belgium	15	15	Netherlands	15	10
Canada	15	15	New Zealand	15	15
China	10	10	Norway	15	0
Denmark	15	5	Portugal	15	15
Finland	15	10	South Africa	15	7.5
France	15	5	Spain	15	10
India	10	10	Sweden	15	0
Ireland	10	10	Switzerland	15	5
Italy	15	15	United Kingdom	15	15
Japan	15	15	United States	15	5

<sup>2</sup> Usually a 25% holding is decisive for the reduced rate, but the particular treaty should be consulted. On request, no German withholding tax is levied on dividends distributed to companies resident in the EU Member States if the conditions from the EC Parent-Subsidiary Directive are met.

# Doing business in Germany

## Withholding taxes on royalty payments

Royalty payments are normally subject to 20% withholding tax. The following table shows countries with reduced rates according to the tax treaties with Germany. Since the definitions of royalties often differ in treaties it would be helpful to consult the provision of the applicable treaty.

Country	(%)	Country	(%)
Australia	10	Luxembourg	5
Austria	0	Mexico	10
Belgium	0	Netherlands	0
Canada	0 or 10	New Zealand	10
China	7 or 10	Norway	0
Denmark	0	Portugal	10
Finland	0 or 5	South Africa	0
France	0	Spain	5
India	10	Sweden	0
Ireland	0	Switzerland	0
Italy	0 or 5	United Kingdom	0
Japan	10	United States	0



## APPENDIX 3

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### Trade tax multiplier by the municipalities

In the table below some multipliers for different municipalities are listed. This multiplier is applied to the basis of the taxable business income and the federal rate:

Communities between 100,000 to 500,000 inhabitants	Effective Rate (%)	Communities with over 500,000 inhabitants	Rate (%)
Bonn	450	Berlin	410
Darmstadt	425	Bremen	420
Dortmund	450	Dortmund	450
Dresden	450	Düsseldorf	455
Koblenz	420	Duisburg	450
Leipzig	440	Essen	470
Leverkusen	450	Frankfurt/Main	490
Pforzheim	380	Hamburg	470
Rostock	420	Hannover	460
Schwerin	390	Köln	450
Wiesbaden	460	München	490
Wolfsburg	360	Stuttgart	420

# Doing business in Germany



## NOTES

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## MEMBER FIRM CONTACT DETAILS

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Baker Tilly International is represented in Germany by two independent member firms - Dr. H Clauss, Dr. Paal und Partner in Münster and Baker Tilly Deutschland GmbH through its network of offices. Baker Tilly Deutschland GmbH, together with its affiliates, Allrevision Dornhof Kloss und Partner GmbH, LPS Leistner Pokoj Schnedler and Abstoß & Wolters OHG, specialise in providing an integrated range of services to small, medium and large enterprises, associations, and non-profit organisations; management and finance services, auditing and accounting services, personal and corporate tax and VAT consulting.

Contact: Dr. Claus-Michael Allmendinger

**Baker Tilly Deutschland GmbH\***

Escherheimer Landstrasse 60-62, D-60322 Frankfurt am Main

Tel.: +49 69 97 14 57 0 Fax: +49 69 97 14 57 50

E-Mail: [Allmendinger@allrevision.de](mailto:Allmendinger@allrevision.de) [www.bakertillydeutschland.de](http://www.bakertillydeutschland.de)

Frankfurter Strasse 92, D-65760, Eschborn/Frankfurt

Tel.: +49 61 96 93 34 0 Fax: +49 61 96 93 34 30

E-mail: [epokoj@lps-wp.com](mailto:epokoj@lps-wp.com)

Moenckebergstrasse 18, D-20095 Hamburg

Tel.: +49 40 32 91 00 0 Fax: +49 40 32 91 00 49

E-mail: [allmendinger@allrevision.de](mailto:allmendinger@allrevision.de)

Wallstrasse 20, D-41061 Moenchengladbach

Tel.: +49 21 61 92 30 Fax: +49 21 61 92 31 23

E-mail: [straaten@abstoss-wolters.de](mailto:straaten@abstoss-wolters.de)

Nockherstrasse 2, D-81541 München

Tel.: +49 89 624 080 Fax: +49 89 624 08 444

E-Mail: [allmendinger@allrevision.de](mailto:allmendinger@allrevision.de)

Contact: Dr. Helmut Clauss

**Dr. Clauss, Dr Paal und Partner**

Achtermannstrasse 11, D-48143 Münster

Tel: +49 251 899 990 Fax: +49 251 8 999 999

Email: [dr.h.clauss@clauss-paal.de](mailto:dr.h.clauss@clauss-paal.de) [www.clauss-paal.de](http://www.clauss-paal.de)

\*In addition to the main offices there are branch offices in 6 other German cities.



## MEMBER FIRM CONTACT DETAILS

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### **Baker Tilly International World Headquarters**

2 Bloomsbury Street,  
London  
WC1B 3ST,  
United Kingdom

Tel.: +44 (0) 20 7314 6875

Fax: +44 (0) 20 7314 6876

E-mail: [info@bakertillyinternational.com](mailto:info@bakertillyinternational.com)

[www.bakertillyinternational.com](http://www.bakertillyinternational.com)

Contact: Geoff Barnes