General Overview

- The German Tax System in General
- Personal Income Tax
- Corporate Income Tax
- Foreign Tax Act, Treaty Policy
- Business Tax
- Tax administration and procedure.
Principles of German Tax System

- Principle of ability to pay
- Substance over form
- The Role of Law
  - Principle of proportionality
  - Ban of retroactivity.
Principle of ability to pay

- Principle not mentioned in the constitution
- Federal constitution guarantees equal treatment Art. 3(1) GG
  - does not preclude any deviations from equal treatment;
    but: they must be justified
  - Indicators for equal treatment: income, consumption, wealth.

Substance over form

- Tax law is public law
- But: also closely linked to civil law
- Nevertheless: legal - economic owner, limitation of loss deduction if change in ownership rule applies.
The Role of Law

- No abuse of State power
- Basic rights and freedom
- Separation of powers
- Principle of proportionality
- Ban of Retroactivity.

Direct and Indirect Taxes

- Personal and Corporate Income tax
- Business Tax
- Transaction Taxes
- Motor vehicle Tax
- Dog Tax.
- VAT
- Consumption Taxes
- Air transport tax.
Federal System

- Legislative powers
- Allocation of revenue
- Administrative powers.

Local Trade tax

Personal Income Tax

- Residents and non-residents
- Particular categories of income
- Methods of computing taxes
- Offsetting losses
- Tax rates.
Residents

- Regardless of the nationality
- Worldwide income is liable to tax
- Domicile in Germany
  - home or
  - dwelling at the disposal of the taxpayer and maintained long term.
- Habitual place in Germany.
  - location where an individual is physically present for a continuous period of more than 6 months.

Non-residents

- German-source income is liable to tax
  - As explicitly listed in the law (sec. 49 EStG)
  - Genuine link is necessary (e.g. PE or property situated, debtor resident in Germany)
  - The same applies on corporations (sec. 1 (1, 2) corporate income tax act).
Particular categories of income

- Private income – non-business income
  - Labour income
  - Rental income (immovable property)
  - Income from private capital investment.
- Business income
  - Agriculture and forestry
  - Trade or business
  - Independent professional services.
- Other income.

Work-related costs (examples)

- Commuting home to work and back
  - Standardized 0.30 Euro/km (one way)
  - Regardless means of transport
  - Max. 4.500 Euro annual.
- Taxpayers office at home
- Travel and moving expenses
- Contributions to professional or trade associations
- Two households, if necessary
- Working tools and clothes.
Private capital investment

- Dividends and interest
- Typical silent partnerships
- Capital gains (since January 2009).

- Final flat withholding tax: 25%
- Expenses are not deductible (exception to the rule!)
- Lump-sum of 801 Euro deductible
- Offsetting of losses is limited.

Business capital investment

- Dividends and interest + Capital gains.

- Shareholder is liable to PIT:
  - Partial-income system: 40% tax free
  - Expenses are deductible pro rata
  - Progressive tax rate (PIA).

- Shareholder is liable to CIT
  - min. 10% of the capital:
  - Intercorporate dividends 95% tax free
  - Intercorporate capital gains 95% tax free
  - Flat tax 15% (CIA) + local trade tax.
Substantial participation

- Sec. 17 PIC
- Substantial participation (min. 1% shares)
- Within period of 5 years
- Capital gains are due to tax
- They are treated as business income.

Exit taxes on substantial participation

- Sec. 6 German Foreign Tax act
  - Individuals after 10 years unlimited liability
  - Substantial participation: min. 1% shares or voting rights (sec. 17 PIC)
  - Hidden reserves are **deemed to be realized**
  - Deferral pro rata for 5 years can be granted.
Extended limited liability

- Sec. 2 German Foreign Tax act
  - Individuals after 5 years unlimited liable during the last 10 years
  - Moving to a low tax country (< 2/3 tax burden) or having no residence any more
  - With substantial economic interests in Germany (e.g. entrepreneur, partnership, dividend, interest, royalties paid by resident debtors)
  - Taxable in Germany for a period of another 10 years.

Trade or business

Partnerships

- Transparency principle
  - partnership is not subject to tax itself
  - income is calculated on the level of the partnership
  - afterwards it is allocated to the partners.
Methods of computing

- Depends on category of income
- net worth comparison method
  - taxable income is the difference between the net worth of the assets at the end of the business year and that at the end of the preceding business year
- net income method
  - taxable income is computed by reducing the gross income by related expenses in accordance with the cash receipts and disbursement method.

Offsetting losses (PIT)

- Unlimited in current year
- Loss carry backward
  - Only preceding year
  - Max. 1 Mio. €
- Loss carry forward
  - set off of losses against the first 1 Mio. € of net income in a given year without restrictions
  - any remaining loss may be set off up to 60% of the net income exceeding this limit.
  (Example on slides CIT).

So called “minimum Taxation”
Tax rates

- **Progressive tax rate**
  - Starting with 14%
  - Top rate: 42% (45% for reach people)
  - Plus 5,5% solidarity surcharge on tax due
  - Individual subsistence minimum is tax free (9,000 since 2018)
  - Spouses deemed to earn half of their joint total income.

- **Final flat withholding tax rate 25%** (26,38% including 5,5% solidarity surcharge) for private capital investment.

Corporate Income Tax

**table of content:**

- Persons subject to tax
- 1 category of income - 1 tax rate: 15%
- Interest + royalty deduction limited
- Offsetting losses limited
  - Carry forward/back = PIT
  - Transfer of shares – change in ownership
- Group taxation limited
- GAAR + SAARs
- Treaty Policy.
General remarks

- Classical system since 1 January 2001:
  - Corporate profits taxed at the level of the company and
  - dividends taxed in the hands of individual shareholders without imputation credits.
- Economic double taxation mitigated for
  - Individual shareholders by partial-income system (40% tax free) or final flat withholding tax (tax rate 25%)
  - Intercorporate dividends from qualifying shareholders (at least 10% of capital) are 95% tax free - 5% representing non-deductible business expenses.

Persons subject to tax

- Corporations e.g.:
  - Stock companies
  - Limited liability companies
  - Limited partnerships with shares
- Not: Partnerships!
  - Liable to Personal Income Tax!
Residence

- Legal seat or
- Place of management.

By the way:
- Germany does not follow the incorporation theory but the seat-of-management rule as far as non-EU-corporations are concerned (ECJ Centros and Cartesio).

Object to tax

- Worldwide income
- Based on PIT
- 1 category: Business income

Corporate profits taxed at level of company
- Individual shareholders (PIT)
  - Private: Final flat withholding tax (25%)
  - Business: partial income tax free (40%).
- Intercorporate gains near-complete tax free (95%), dividends as well, if qualifying participation (at least 10%).
Tax Rate

- Corporate income tax: 15%
- Local business tax (ca. 14%)
- Plus solidarity surcharge: 5.5% on tax due.

Non-resident companies

- Subject to CIT if deriving German-Source business income from:
  - PE in Germany (exemption for intercorporate dividends applies)
  - Sale or leasing of German-situs immovable property/rights
  - Sale of shares in a German company (at least 1% of capital during preceding 5 years)
  - Investment income (dividends + interest)
  - Rents + royalties.
Non-resident companies

- Same tax rates as resident companies
- Have to file a tax return each year
- Subject to business tax as well if PE
- If no PE: withholding tax on gross payment
  - no deduction of related expenses!
    - Dividends 25% (26.38% incl. Solid. Surcharge)
    - But no withholding tax as far as EU Parent-Sub Directive applies (at least 10% of capital + at least 12 months)!

Non-resident companies

- Interest payments generally not subject to withholding tax
- Exemptions for:
  - Convertible bonds, profit-sharing bonds, participation loans, silent partnerships
  - Bearer bonds not credited to a bank account.
- Not as far as EU Interest and Royalties Directive applies (associated company 25%, no hidden profit distributing, no profit participation loan, not exceeding arm’s length).
Resident companies (table of content)

- Capital gains, intercorporate dividends
- Business expenses, depreciation
- Limitation of interest deduction
- Offsetting losses limited
  - Carry forward/back = PIT
  - Transfer of shares – change in ownership
- Group taxation
- GAAR – SAARs
- Treaty Policy
- Business tax.

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Capital gains

- In general fully taxable
- **Exemption** for:
  - certain fixes assets
    - especially land and buildings, if replaced by similar assets, that belonged to a **resident PE** for at least 6 years (roll over relief)
    - Carrying forward as investment reserve for max. 4 years (6 years with regard to buildings)
    - If not used the taxable amount is increased by 6 % of each year the reserve existed.
  - Intercorporate gains (except 5% representing non-deductible business expenses).

As far as the PE is located in a EU member state a 5-year tax deferral is granted.

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Business expenses:

- Not deductible,
  - if directly linked to exempt income (e.g. increase of capital reserves)
  - Hidden profit distribution
  - 5% with regard to intercorporate dividends and intercorporate gains.
- 50% of fees paid to members of the supervisory board not deductible
- various limits for personal expenses e.g. gifts, guest houses etc. (CIT=PIT).

Depreciation (CIT = PIT)

- In general: straight-line-method
- For movable assets a general table of the Ministry of Finance gives the number of years over which the asset is written off.
- Buildings: usually 2% (2,5% if built before 1925)
Incentives by special depreciation rules

- Accelerated depreciation in respect of renovation of buildings (up to 9% for 8 years and 7% for the next 4 years)
- Additional depreciation for small and mediumsized companies with respect to movable property (up to 20% in sum spread over a period of 5 years).

Interest deduction

- Until 2007: Thin capitalisation rule
  - Dept/equity ration 1,5/1
  - Lankhorst-Hohorst (ECJ C-324-00)
- Since 2008: interest “barrier”
  - Interest expense – interest income = balance
  - Interest balance deductible up to 30% of EBITDA = earnings before interest, taxes, depreciation and amortisation
  - Safe haven 3 Mio. Euro.
- Applies to all interest, whether the debt is granted by a shareholder, related party or a third party
- Applies to group companies only!

Consequences:

- If the interest expenses do not exceed the interest income, they are fully deductible
- If the interest expenses exceed the interest income (balance positive), the deduction is limited:
  - 3 Million Euro (safe haven) plus
  - 30% of EBITDA.
Example:

- Interest expenses 7 Mio.
- Interest income 2 Mio.
- Balance: 5 Mio.
- safe haven: 3 Mio.

- EBITDA: 6 Mio.
- Exceeding amount fully deductible.

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Example:

- Interest expenses 7 Mio.
- Interest income 2 Mio.
- Balance: 5 Mio.
- safe haven: 3 Mio.

- EBITDA: 5 Mio.
- Limit: 5 Mio. x 30% = 1,5 Mio.
- Exceeding amount not fully deductible!
0,5 Mio. interest has to be carried forward.

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Example:

- Interest expenses 7 Mio.
- Interest income 2 Mio.
- Balance: 5 Mio.
- safe haven: 3 Mio.

- EBITDA: 50 Mio.
- Limit: 50 Mio. x 30% = 15 Mio.
- Exceeding amount fully deductible
- EBITDA 50 Mio. – 6 Mio. = 44 Mio. ???

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Carry forward of unused EBITDA

- Unused EBITDA potential must be carried forward for up to five years to cover future excess interest cost.
- This carryforward is otherwise subject to the same principles as the loss carryforward, including curtailment on change of shareholder(s).
So carry forward twice:

- Non-deductible **interest** expenses may be carried forward indefinitely
- Unused **EBITDA** must be carried forward for a maximum period of 5 years.

Note:

- **only** group related companies! *(stand-alone-clause)*
  - may be consolidated with other companies, or
  - the financial or business decisions of the German company may be uniformly controlled together with those of other companies.
- But: does **not** apply to companies that are part of a group of companies if the **ratio of equity** to total assets of the company is **equal or higher** than the same ratio for the group *(escape clause)*.
Special requirements for substantial shareholder:

- the net amount paid to any one shareholder of more than 25% (or a related party) is no more than 10% of the total = No “harmful shareholder debt financing”!
- depends on the demonstration that the equity to gross assets ratio of the company is no more than 2% below that of the group as a whole!

Tax Deduction of Royalties

- 2017: Act against Harmful Tax Practices with regard to the licensing of rights
- Aim: tackling the harmful use of license boxes (IP box) and preferential tax regimes
- Realizes BEPS project’s “Nexus Approach” limiting deductibility of royalties as business expenses if:
  - creditor and debtor are related parties
  - payment is qualified as royalty and
  - is subject to a preferential tax regime (lower 25%, deviating from standard taxation).
Consequences

- Tax deduction partially prohibited
- The higher the taxation of the creditor’s royalty revenue, the higher the percentage of royalty fees deductible by the debtor (y).
- Calculation:
  - tax percentage on royalty income paid by the creditor (x) is subtracted from 25%
  - the difference is divided by 25%.

\[
\frac{25\% - x\%}{25\%} = y \%
\]

Examples:

- IP Box 5%:
  \[
  \frac{25\% - 5\%}{25\%} = 80\% \text{ non-deductible}
  \]

- IP Box 15%:
  \[
  \frac{25\% - 15\%}{25\%} = 40\% \text{ non-deductible}
  \]
Offsetting losses (CIT = PIT)

- Unlimited in current year
- Loss carry backward
  - Only preceding year
  - Max. 1 Mio. Euro.
- Loss carry forward
  - set off of losses against the first 1 Million € of net income in a given year without restrictions
  - any remaining loss may be set off against up to 60% of the net income exceeding this limit.

So called „minimum Taxation" = PIT

Example:

- Profit in 01: 5 Mio.
- Loss in 02: 9 Mio.
- Profit in 03: 6 Mio.

- Loss-carry-back to 01 unlimited.
- Remaining loss 4 Mio.
  - 1 Mio. carried forward to 03 plus
  - 3 Mio. x 60% = 1,8 Mio. carried forward to 03
  - Remaining profit in 03: 3,2 Mio.
  - Remaining loss-carry forward: 1,2 Mio.
Foreign losses

- Restrictions for following types of losses
  - Loss from a foreign PE with passive income
  - Write-down of participation to its lower going-concern-value
  - Disposal of participation held in a foreign country
  - Liquidation or capital decrease of a foreign company.

Restriction

- Sett of against income only
  - from a similar activity
  - in the same country
  - in the current year.

- No restriction if EEA country and EU Mutual Assistance Directive is signed.
Further restriction (DTA)

- Resident head office
- PE in a treaty country
- Profits not taxed in Germany because of:
  - Distribution of profit is tax exempt under DTA-provision/
  - Tax relief is granted under national law

\[\text{\(\Rightarrow\)}\]

Losses not deductible + no carry over!

Change of ownership: Loss limitation

- Availability of losses limited when there is a \textbf{material} direct or indirect change in ownership!
- From civil law perspective (formal point of view) the \textbf{change in ownership} has no influence on the legal “personality“ of the corporation!
- But from an economic point of view?
Forfeiture rule:

- Sec. 8c CIT
  - A company is not allowed to carry over losses if, within 5 years, more than 50% of the capital or participation, membership or voting rights in that company, are transferred directly or indirectly to a purchaser or a person related to the purchaser.
  - The loss carry-forward will be disallowed pro rata for transfers of shares or voting rights between 25% and 50% within 5 years.
  - This rule does not comply with the principle of equal treatment!

Sec. 8d CIT

- Entered into force 1.1.2016
- Change of shareholders will not result in a forfeiture of loss carry forwards if business operations remained unchanged at least since the beginning of the third business year preceding that in which the harmful acquisition took place.
- Maybe this brings sec. 8c CIT in line with the principle of equality?
No way out by ...

- related persons or a group with **aligned interests** instead of one single purchaser
- If change-of-control occurs in several steps, the separate acquisitions are **added together** if they take place within a five year period.

No limitation

- if, after a direct or indirect transfer of shares, the **same** person or company (corporation or partnership) owns directly or indirectly 100% of the loss-making company (group internal reorganisation without effect on the single ultimate shareholder.)
- to the extent that existing losses exceed the **hidden reserves (built in gains)** of the loss-making company which are taxable in Germany on realisation.
Starting point: one single person on top
(8c I No. 3 CIT)

Vendor owns acquiring company (8c I No. 2 CIT)
Reorganisation clause

- forfeiture rules do not apply to share acquisitions in connection with the recovery of a troubled business (reorganisation in order to rescue a company).
  - 26 January 2011 European Commission: State Aid
  - April 2010 German government suspended rule
  - Germany lost an action for annulment because of a missed deadline, but supports a number of companies in their own actions.
Further open questions:

- 5 years period may start **before** losses are incurred (opinion of the MoF)?
- Purchase of 25% of the shares (only) **in sum** – but never ever more that 25% in hand at **the same time** because of selling parts of them in the meantime?

Clarified: "midyear transfer"

- Tax loss carry forward to offset current-year taxable profits generated **before** the „harmful“ change in ownership permitted (Federal Fiscal Court – I R 14/11)
- Before MoF argued with **technical operation** under which losses occur at **year end** and therefore **after** the triggering event.
Ministry of Finance:

- In the financial year during which the change in ownership was triggered a "split" is allowed:
  - Any profit generated prior to the triggering event can be offset against losses carried forward from prior years.
  - And: Minimum taxation rule has to be applied to the net operating profit until closing; the maximum amount of loss carry-forward equals Euro 1 Mio. + 60% of the profit of the entire fiscal year!

By the way:

Ministry of Finance (MoF)

- Issues detailed decrees on interpretation of tax provisions
- Binding for the administration
- Not binding for the Courts!
Group taxation = Organschaft

- German parent holding **more than 50%** of the voting rights in a domestic subsidiary,
- a formal, five-year, court-registered profit **pooling agreement** may be concluded.
- the ensuing relationship is then referred to as an *Organschaft*.

Consequences:

- Effectively, the annual results of an *Organschaft* are pooled in the accounts and tax returns of the parent.
- Profits and losses within a group can therefore be offset, but there is no provision for the elimination of intra-group profits from the total tax base.
Premises:

- Controlled company must:
  - Be incorporated under the law of an EU/EEA Member State
  - Have its place of effective management in Germany.

- Cross-border grouping is only possible if the controlling company maintains a permanent establishment in Germany. In this case, the profit or loss is allocated to the permanent establishment and taxed accordingly.

Further premises:

- Controlled company must be financially integrated into the controlling parent
  - majority of voting rights
  - must be in place at the beginning of the financial year of the controlled company for which group taxation is sought.

- Parent can be an individual, company or a partnership

- VAT grouping: financially, economic and organizational integration necessary.
Result:

- Pooling of profits and losses: losses of each company may be set off against profits realised within the group.
- But: The subsidiary must first be considered on a **stand-alone-basis** before considering the allocation of its taxable income to the parent!
- **No** wipe out of intergroup-results
- Losses incurred **before** pooling agreement becomes effective are not deductible.

**Group taxation and Loss forfeiture**

- Direct or indirect detrimental change-of-control at the level of the parent regularly also results in an indirect change-of control at the level of the sub.
- Forfeiture rule shall apply **separately** on the level of the parent and the sub!
- Positive income of a sub generated prior to the transfer date can not be set off with losses of the parent or another sub
- Because of pooling the annual result, losses can not be carried forward at the level of the sub.
Group taxation and Loss forfeiture

- Remember: No forfeiture to the extent that existing losses exceed the **hidden reserves (built-in gains)** of the loss-making company which are taxable in Germany on realisation.
- But “mismatch”-problem (MoF):
  - any tax losses of the subsidiaries accrue at the level of the parent
  - and the parent typically does not have “taxable” built in gains (because of exemption regime)!

This is:

Following the MoF, built-in gains can only be used to shelter sub´s **own pre-organschaft** losses, if and when the sub is **leaving** the group!
GAAR

- A structure is disregarded for tax purposes if there is an abuse of law
- An abuse of law is assumed if an inappropriate legal structure leads to a tax advantage for which the taxpayer cannot provide significant non-tax reasons.
- Problems: Inappropriate? Significant?

SAAR (examples)

- Regarding tax treaty benefits
  - subject to tax clauses
  - switch over clauses.
- Transfer pricing
  - arm’s length principle
  - comparable uncontrolled price method, resale price method, cost-plus method.
- Thin capitalization (since 2008 interest "barrier")
- Change in ownership rule (see above)
- CFC rules.
CFC rules in Germany

- aim at passive income sheltered abroad and taxed at less than 25%
- the income is added to that taxable in Germany in the regular manner against a credit for the foreign tax actually paid and not recoverable by either the foreign entity or its shareholder.

Four types in theory:

1. **Fair value approach** (value of the shares increases if the interposed company earns income) – contrary to realization principle
2. **Attribution** of income earned by the interposed company to the shareholder – contrary general income attribution rules
3. **Piercing the veil approach:** interposed company treated as a transparent entity
4. **Deemed dividend approach:** corporate status of the interposed company untouched.
Germany in between 3./4.

- Wording: “deemed dividend”
- Taxes paid by the interposed company are **not deductible** from the attributed income of the shareholder!
- The income is added to that taxable in Germany in the regular manner against a credit for the foreign tax actually paid

CFC rules do not apply:

- Active business income,
  - except from tourism and the arms trade, is generally exempt from the CFC net,
  - provided it is earned through a properly established facility of a scale appropriate to the activity concerned.
- Treaty and EU directive rules exempting foreign income are respected, although taxpayers do have to demonstrate their treaty entitlement.
CFC rules – conditions:
Sec. 7 German Foreign Tax act

- More than 50% of the non-resident company’s capital or voting power is owned by resident companies and/or resident individuals, alone or together with related persons, directly or indirectly
- the non-resident company is subject to foreign tax at a rate lower than 25% and
- the non-resident company generates passive income.

CFC rules – consequences:

- A resident company or individual is deemed to have received a dividend paid out of the profits of a non-resident company
- neither the general exemption for corporate shareholders nor the partial-income system or final flat withholding tax for individual shareholders applies.
CFC rules – exemptions:

- Profits are deemed to be distributed; if actually distributed or if the shares in the controlled foreign company are sold, such distributions and gains are exempt in the hands of resident corporate shareholders.
- Generally exempt also in the hands of resident individual shareholders; however, if the period between the deemed and actual dividend distribution is more than 7 years, the actual dividend receipt is taxable under the partial-income system.

CFC rules – investment income:

- Passive income with investment character triggers CFC rules, if one German resident holds at least 1% of capital or voting power.
- Also if less than 1% but
  - Non-resident company derives exclusively or almost exclusively passive income and
  - Shares are not traded regularly on a recognized stock exchange.
- No relief under DTT available!
CFC rules – more exemptions:

- Do not come into operation if the passive gross income does not exceed 10% of the non-resident company’s total gross income.
- Re-exemptions do apply if the attributable income of a controlled foreign company exceeds 80,000€ or if the income attributable to one shareholder from several controlled foreign companies together exceeds this amount.

CFC rules – EU law:

- CFC rules do not apply, if
  - the controlled foreign company is resident in EEA and carries out economic activity (active income) or
  - Passive income
    - is derived in connection with such economic activity and
    - EU Mutual Assistance Directive is applicable.
CFC rules – treaty override?

- Maybe ... but:
- OECD MA Commentary states that CFC rules are in line with the tax treaty provisions and do not have to be mentioned explicitly in a country’s tax treaty (Art. 1 (23) OECD MA Com.)!

Treaty policy

- Mainly follows the OECD-Model
- In general **exemption** method
- But remarkable number of provisions to which foreign tax is credited against German tax on income:
  - Dividends, not subject to participation exemption
  - Director’s fees.
- Follows AOA.
German Model Tax Treaty 2014

- basis for negotiation
- improve efficiency by offering consistent and uniform wording
- in line with OECD model treaty
  - there shall be no withholding taxes on interest or royalties
  - dividend withholding tax on distributions to a corporation with at least 10% of the share capital is set at 5%.

Activity restriction!

- List of income deemed „active“ for the purpose of the treaty (sec. 8 para. 1 German Foreign Tax Act)
- Suspension of the exemption method only „to the extend“ the income is „passive“.
Major goal:

- avoidance of double taxation but also of double non-taxation
- Integration of traditionally unilaterally used anti-abuse provisions (e.g. dividends of German REITs or Investment Funds are to be excluded from participation exemption)

Open questions:

- Adjustment of the taxation of the parent company if the company’s PE’s profits where later taxed in the other contracting state – principle of correspondence?
- Hybrid Entities?
  (but: nr. I para. 2 protocol DTA-NL!)
Transfer pricing

- Extensive rules in respect of all transactions with foreign related parties are in force.
- The basic principle is that all trading should be at arm's length, but the documentation requirements go far beyond the level of documentation normally found sufficient to demonstrate a conscientious approach to true third party business.

Consequences:

- Failure to meet the transfer pricing rules exposes the company to
  - serious risk of penalties as well as
  - unfavourable estimates by the authorities.
AOA

- Implemented in domestic tax law
  (sec. 1 (5) Foreign Tax Act) + MoF decree
- Purpose is to regulate the cross-border profit allocation between a PE and the rest of the enterprise.
- **Functionally separate entity approach**
  applies to cross-border profit determination of PEs (two-step procedure)!

1st step: function + risk analyses

- Determination of the (relevant) personnel functions to be attributed to the PE
- On that basis the assets, opportunities and risks, the dotation capital as well as the remaining liabilities are attributed
- Business transactions with third parties and with closely related persons are attributed
- Determination of the deemed contractual relationships (dealings) maintained by the PE with the rest of the enterprise.
2st step: comparability analysis

- On the basis of a comparability analysis, transfer prices are to be determined in consideration of the arm’s length principle for the business relationships and dealings of the PE.
- MoF decree is applicable to fiscal years beginning after 31 December 2014.

Profits included that would

- have been generated by a PE if it was an independent legal entity
- active in the same or a similar business
- taking into account the functions taken over
- the economic assets held and
- the risks born for the corporate group or its subs by the PE.
Business Tax

- Merchants, traders and dealers are believed to impose a greater burden on the infrastructure of a community than the learned professionals (e.g. doctors, lawyers, accountants).
- For this reason, municipal trade tax is imposed on trade or business income – but not on professional service providers.

Business Tax

- In general every company is subject to business tax
- income from a foreign branch or partnership is not charged to business tax
- Taxable income calculated in the same way as income for tax purposes
- But: certain adjustments:
  - Interest
  - Financial costs
  - PE abroad
  - Profit shares of a partnership.
Adjustments in detail:

- 25% of all interest payments and financing exceeding a threshold of 100,000 Euro costs are not deductible
- Profits attributed to a PE abroad are deductible
- Profit shares derived from a domestic or foreign partnership are deductible
- Dividends,
  - if participation is less than 15%
  - from non-resident passive companies.

Rates:

- Effective rate depends on a federal rate and multiplier
- Multiplier is fixed by the municipalities (200% - 490%, Berlin 410%, FFM 460%, Hamburg + Munich 490%)
- Business tax is not deductible for CIT but for PIT (to some extent).
Tax administration + procedure

- General Fiscal Code
- Taxpayer has to file a tax return
- Mutual agreement on facts possible
- Advanced ruling possible (strict procedure)
- Tax audit has to be signalized
- Fixing by assessment notice
- Judicial review guaranteed.

Exchange of Information

- Oct. 29, 2014 Germany agreed a "multilateral competent authority agreement on automatic exchange of financial account information with 50 other states.
- includes name, address and tax number of the accountholder, the account balance at year end and the amounts of investment income.
Bank secrecy

- in reaction to the Panama Papers the bank secrecy was abolished in 2017
- instead: further obligations to cooperate with the German tax administration
- German tax administration has been granted more powers of investigation to obtain more information about trade and business relationships with letter-box companies in tax havens.

Country-by-country Reporting

- should provide national tax authorities with further information about cross-border group structures
- should enable tax authorities to audit the allocation of income of international companies
- key subject of BEPS action 13
- introduced into domestic law (sec. 138a fiscal code).
Scope:

- international companies with consolidated accounts that include German entities or PE
- revenues amounted to 750 Mio. or more in the past financial year
- has to be filled annually and must be submitted within the following financial year
- must provide complete recording of all international business activities (all places, turnovers, profits and taxes paid).

Thank you for your attention!