TAX MANAGEMENT PORTFOLIOS™

FOREIGN INCOME

Business Operations in Germany

by

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TAX MANAGEMENT PORTFOLIOS™

FOREIGN INCOME

Business Operations in Germany

PORTFOLIO DESCRIPTION

Tax Management Portfolio, *Business Operations in Germany*, No. 7140-2nd, contains information enabling foreign businesses to determine the best method of conducting their operations in Germany from both the tax and general legal points of view. The Detailed Analysis discusses the practical problems that confront foreign businesses operating in Germany. In particular it examines in detail the statutory and procedural framework of German income taxation as applied to individuals and corporations. The Detailed Analysis also covers many of the other legal details vital to the organization of a German company. In addition to an in-depth explanation of the German system of income taxation (*Einkommensteuer, Koerperschaftsteuer*), the Portfolio discusses the trade tax (*Gewerbesteuer*), the value added tax (*Umsatzsteuer*), the inheritance tax (*Erbschaftsteuer*) and the real estate transfer tax (*Grunderwerbsteuer*).

The Worksheets include Model Articles of Incorporation for a wholly-owned GmbH, the corporate income tax return for both resident and nonresident corporations, the trade tax and value added tax returns and various forms relating to withholding taxes.

This Portfolio may be cited as Schmidt, 7140-2nd T.M., *Business Operations in Germany.*

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TABLE OF CONTENTS

PAGE

DETAILED ANALYSIS

I. Germany — The Territory, Its Government and Legal System A-1

- A. Tax System Overview A-1
  - 1. General A-1
  - 2. Corporations A-2
  - 3. Individuals A-3
  - 4. Other Taxes A-3
  - 5. Administrative A-3
- B. Germany — General Background A-4
  - 1. The Country A-4
  - 2. Political Organization A-4
- C. Sources of Law A-4
  - 1. Statutes A-4
  - 2. Court System A-4
  - 3. Arbitration A-5

II. Operating a Business in Germany A-7

- A. Foreign Investment Regulation A-7
  - 1. In General A-7
  - 2. Investment Incentives A-7
  - 3. Business Registration A-7
- B. Currency and Exchange Controls A-7
  - 1. Currency A-7
  - 2. Exchange Controls and Indexation A-8
- C. Trade and Commerce Regulation A-8
  - 1. Imports and Exports A-8
    - a. Licenses and Quotas A-8
    - b. Custom Duties and Other Taxes A-8
    - c. Documentation A-9
    - d. Carbon Border Adjustment Mechanism A-9
  - 2. General Regulation of Business A-9
    - a. Antitrust and Public Procurement Regulation A-9
      - (1) In General A-9
      - (2) Agreements and Concerted Practices A-9
      - (3) Market Domination A-10
      - (4) Mergers and Other Combinations of Enterprises A-10
      - (5) European Antitrust Law A-11
    - b. Unfair Trading Practices A-12
    - c. Price Controls A-12
    - d. Securities Regulation A-12
    - e. Supply Chains A-13
    - f. EU Whistleblower Directive A-14
    - g. EU Artificial Intelligence Act (EU AI Act) A-14
  - 3. Licensing and Franchising A-15
    - a. In General A-15
    - b. Intellectual Property Rights A-15
      - (1) Patents A-15
      - (2) Petty Patents A-15
      - (3) Designs A-15
      - (4) Trademarks and Service Marks A-16
    - c. Industrial Know-how A-16
    - d. Copyrights A-16
- D. Employment of Aliens A-16
  - 1. In General A-16
  - 2. Residency A-16
  - 3. Work Permits A-17
- E. Labor Relations A-17
  - 1. In General A-17
  - 2. Employment Law A-17
  - 3. Collective Bargaining A-18
  - 4. Worker Representation on Corporate Boards A-18
    - a. Coal and Steel Co-Determination Act of 1951 A-18
    - b. One-Third Participation Act of 2004 A-19
    - c. Co-Determination Act of 1976 A-19
    - d. Works Constitution Act of 1952 A-19
      - (1) Works Council A-19
      - (2) Economic Committee A-20
      - (3) Female Quotas for Supervisory Boards and Leadership Positions A-20
- F. Financing the Business A-20
  - 1. Shareholder Financing A-20
    - a. Equity Capital A-20
    - b. Debt Financing by Shareholder Loans A-21
    - c. Hybrid Shareholder Financing A-21
      - (1) Subordination of Shareholder Loans A-21
      - (2) Waiver of Shareholder Loans A-21
      - (3) Conditional Waiver of Shareholder Loans A-21
      - (4) Participating Loans A-22
      - (5) Silent Participation Arrangements A-22

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PAGE

(6) Atypical Silent Participation Arrangements A-22
(7) Participation Rights A-23
d. Currency Risks A-23
e. Thin Capitalization A-23
2. External Financing A-23
G. EU Corporate Sustainability Reporting Directive A-23

III. Forms of Doing Business in Germany A-25

A. Principal Business Entities A-25
1. Sole Proprietorship A-25
2. Limited Liability Company A-25
3. Stock Corporation A-25
4. Partnerships A-26
5. Branch of a Foreign Corporation A-26
6. Other Types of Business Entities A-26
7. European Union Business Structures A-26
a. Societas Europaea A-26
b. European Economic Interest Grouping A-27
c. Societas Cooperativa Europaea A-27
8. Classification of Foreign Business Entities A-27
B. Limited Liability Company A-27
1. Formation A-27
a. Purpose Clause A-27
b. Corporate Name A-27
c. Incorporators A-27
d. Articles of Association A-28
e. Share Capital A-28
f. Incorporation Procedure A-28
g. Costs of Incorporation A-29
2. Operation A-29
a. License A-29
b. Amendments to the Articles of Association A-29
c. Alterations of Share Capital A-29
d. Contribution of Additional Capital A-29
e. Share Buybacks A-29
f. Redemption and Cancellation of Shares A-30
g. Management A-30
h. Shareholders' Meetings A-30
i. Supervisory Board — Advisory Council A-31
j. Books and Records A-31
k. Financial Statements A-31
l. Dividends and Other Distributions of Profits A-31
m. Reserves A-31
3. Dissolution and Liquidation A-32
4. Reorganizations A-32

PAGE

a. Mergers A-32
b. Corporate Spin-Offs A-33
C. Stock Corporation A-33
1. Formation A-33
a. Purpose Clause A-33
b. Corporate Name A-34
c. Incorporators A-34
d. Articles of Association A-34
e. Share Capital A-34
f. Incorporation Procedure A-34
g. Costs of Incorporation A-35
2. Operation A-35
a. License A-35
b. Amendment to the Articles of Association A-35
c. Alterations of Share Capital A-35
d. Share Buybacks A-35
e. Redemption and Cancellation of Shares A-36
f. Board of Directors A-36
g. Supervisory Board A-36
h. General Meeting of Shareholders A-36
i. Books and Records A-37
j. Financial Statements A-37
k. Dividends and Other Distributions of Profits A-37
l. Reserves A-37
3. Dissolution and Liquidation A-37
4. Other Corporate Reorganizations A-37
D. Partnerships A-37
1. In General A-37
2. Formation A-38
3. Dissolution A-38
4. Partnership Law Reform A-38
E. Branch of a Foreign Corporation A-38
1. Registration A-38
a. Commercial Register A-38
b. Business Registration A-38
2. Liability A-38
3. Books and Records A-39

IV. German Tax Law — An Overview A-41

A. Sources of Authority in Tax A-41
1. Legislative A-41
a. Organization of the Tax Law A-41
b. Other Legislative Documents That Can Be Used to Interpret the Law A-41
c. Legislative Process A-41
d. Constitutional Challenges A-41
2. Administrative A-42
3. Courts A-42
B. Principal Taxes A-42

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PAGE

1. Individual Income Tax A-42
2. Corporate Income Tax A-42
3. Income Tax Surcharge A-43
4. Net Worth Tax A-43
5. Trade Tax A-43
6. Value Added Tax A-43
7. Inheritance and Gift Tax A-43
8. Municipal Taxes A-43
9. Church Tax A-44
10. Real Estate Transfer Tax A-44
11. Energy Windfall Profits Tax A-44
12. Social Security Contributions A-44

C. Tax Measures Currently Announced by the New Government A-45

V. Taxation of Resident Corporations A-47

A. What Is a Resident Corporation? A-47
B. Corporate Income Tax A-47
1. Taxation of Worldwide Income A-47
2. Corporate Income Taxation A-47
a. Contributions to Capital A-47
(1) Increases in Stated Equity Capital A-47
(2) Other Contributions to Capital A-48
b. Key Aspects of the Taxation of German Subsidiary Corporations A-48
(1) Constructive Dividends A-48
(2) Interest Deduction Limitation (Interest Barrier Rule) A-48
(3) Interim Dividends A-49
(4) Net Operating Losses A-50
c. Liquidation A-50
d. Repayment of Informal or Constructive Contributions to Capital A-50
3. Accounting A-50
a. In General A-50
b. Accounting Period A-51
c. Accounting Methods A-51
d. Methods of Valuation A-51
(1) Depreciable Fixed Assets A-51
(2) Other Assets A-51
(3) Liabilities A-52
(4) Provisions A-52
(5) Contributions In-kind A-52
(6) Distributions In-kind A-52
e. Consolidated Returns A-52
4. Calculation of Gross Income A-52
a. In General A-52
b. Capital Gains A-52
(1) General Rule A-52
(2) Exemption for Involuntary Realization A-52

PAGE

(3) Voluntary Conversions A-53
(4) Reorganization Aspects A-53
(5) Transfer of Assets Abroad A-53
(6) Capital Gains from Sales of Shares in Domestic or Foreign Corporations A-53
c. Dividends A-54
d. Foreign Income A-54
e. Other Exclusions from Income A-55
(1) Contributions to Capital A-55
(2) Premiums on Shares Issued A-55
5. Business Expenses and Other Allowable Deductions A-55
a. In General A-55
b. Incorporation Costs A-55
c. Travel and Entertainment A-55
d. Interest and Royalties A-55
e. Rents A-55
f. Repairs and Maintenance A-56
g. Insurance Premiums A-56
h. Taxes A-56
i. Amortization of Fixed Assets A-56
(1) In General A-56
(2) Basis and Methods of Depreciation for Movable Fixed Assets A-56
(3) Basis and Methods of Depreciation for Buildings A-57
(4) Other Depreciation Rules A-57
j. Obsolete Equipment A-57
k. Charitable and Other Contributions A-57
l. Reserve Accounts A-57
(1) Liability Reserves A-57
(2) Contingency Reserves A-57
(3) Reserves for Loss Contingencies A-57
(4) Reserves for Future Acquisitions or Production A-57
m. Bad Debts A-58
n. Casualty Losses A-58
o. Salaries A-58
p. Employer's Social Welfare Expenses A-58
(1) Pension Reserves A-58
(2) Pension Funds A-58
(3) Relief Funds A-58
(4) Jubilee Benefits A-58
q. Inter-Company Charges A-58
r. Business Gifts A-58
s. Non-deductible Expenses A-58
6. Capital Expenditure A-58
7. Deductibility of Foreign Losses A-58
8. Loss Carryforward and Carryback A-59

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PAGE

a. In General A-59
b. Anti-Loss Trafficking Rules A-60
c. Transfers of Net Operating Losses in Statutory Mergers A-60
9. Tax Credits A-60
a. Domestic Withholding Tax A-60
b. Foreign Tax Credit A-61
c. Investment Tax Credit A-61
d. Other Credits A-61
10. Group Consolidation A-61
11. Tax Rate A-63
12. Assessment and Filing A-63
a. Tax Returns A-63
b. Tax Payments A-63
c. Audits A-63
d. Statute of Limitations A-64
e. Interest A-64
f. Additions to Tax A-64
g. Advance Rulings A-65
13. Incentives A-65
14. Reorganizations A-65
a. In General A-65
b. Change in Legal Form A-65
c. Statutory Mergers and Consolidations A-65
(1) General Rule A-65
(2) Tax-Free Reorganizations A-66
d. Cross-Border Reorganizations A-66
e. Liquidations A-66

VI. Taxation of Nonresident Corporations A-67

A. What Is a Nonresident Corporation? A-67
B. Determination of Taxable Income A-67
1. Business Profits A-67
2. Capital Gains on Sales of Shares A-67
3. Income from Capital Investment A-68
a. In General A-68
b. Interest A-68
c. Dividends A-68
4. Rents and Royalties A-68
5. Real Estate Capital Gains A-69
C. Tax Assessment and Rates A-69
1. Assessment A-69
2. Tax Rates A-70
D. Subsidiary vs. Branch A-70
1. Tax Rates A-70
2. Inter-Company Charges A-70
3. Reorganization of a Branch A-70
4. Non-Tax Considerations A-70
E. Tax Classification of Foreign Legal Entites A-71

VII. Taxation of Partnerships A-73

A. Scope of Income Taxation A-73

PAGE

1. Income Allocation A-73
2. Qualification as a Partnership A-73
B. Partnership Income A-73
1. In General A-73
2. Transactions Between Partners and Partnerships A-74
3. Partnership Losses A-74
4. Partnership Law Reform A-75
C. Asset Transfers Between Partners and Partnerships A-75
D. "Check-the-Box" Option A-75

VIII. Taxation of Resident Individuals A-77

A. In General A-77
B. Tax Residence A-77
1. Definition of Residence A-77
2. Elective Residency A-77
a. Section 1(3) of the Income Tax Act A-77
b. Section 1a of the Income Tax Act A-77
C. Determination of Gross Income A-77
1. In General A-77
2. Business Income A-78
a. Gross Income A-78
b. Business Expenses and Other Allowances A-79
3. Dependent or Independent Services A-79
a. Employment Income A-79
(1) In General A-79
(2) Withholding (Source) Tax A-80
b. Independent Services A-80
c. Relief Provisions A-80
(1) Back Pay A-80
(2) Termination Pay A-80
4. Capital Investments A-80
a. Interest A-80
b. Withholding Tax A-81
(1) Withholding Agents A-81
(2) Exemption A-81
c. Dividends A-81
(1) In General A-81
(2) Constructive Dividends A-81
(3) Stock Dividends A-81
(4) Investment Funds A-82
(5) Participation Certificates A-82
(6) Real Estate Investment Trusts A-82
5. Capital Gains A-82
a. In General A-82
b. Private Capital Gains A-82
c. Sales of Shares A-83
D. Calculation of Taxable Income A-83
1. In General A-83
2. Special Expenses A-83

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PAGE

3. Hardship Allowance A-84
4. Family Allowances A-84
a. Child Support A-84
(1) Child Benefit A-84
(2) Child Allowance A-84
b. Old Age Exemption A-84
E. Tax Rates A-84
1. Standard Tax Rates A-84
2. Preferential Tax Rates A-84
a. Capital Gains A-84
b. Retained Profits A-84
F. Assessment and Filing A-85
G. International Secondment A-85

IX. Taxation of Nonresident Individuals A-87

A. In General A-87
B. Business Income A-87
C. Personal Services Income A-88
1. Employment Income A-88
2. Independent Services A-89
D. Investment Income A-89
1. Interest A-89
2. Dividends A-89
E. Rents and Royalties A-89
F. Capital Gains A-90
1. Sales of Shares in Domestic Corporations A-90
2. Private Capital Gains A-90
G. Assessment A-90
H. German Expats in Low Tax Jurisdictions A-90
1. In General A-90
2. Retention of Substantial Ties A-91
3. Scope of Liability A-91
4. Deemed Disposals of Shares in Domestic Corporations A-91
5. Deemed Disposals of Shares Held in Funds A-92
I. Taxation of Foreign Expatriates A-92

X. Trade Tax A-93

A. Scope of Provision A-93
B. Trade Tax on Trade Profits A-93
1. In General A-93
2. Additions to Taxable Income A-93
3. Deductions from Taxable Income A-94
4. Net Operating Loss Deduction A-94
C. Assessment and Filing A-94

XI. Value Added Tax A-95

A. Scope of Taxation A-95
B. Entrepreneurs A-95
C. Taxable Events A-96
1. Goods Delivered in Germany A-96

PAGE

2. Services Rendered in Germany A-96
a. General Rule — Place Where the Entrepreneur Rendering the Service Conducts Business A-96
b. Place Where the Entrepreneur Receiving the Service Conducts Business A-97
c. Situs of Real Property A-97
d. Place of Transportation A-97
e. Place Where an Activity Is Carried Out A-97
f. Location of Recipient of Services A-97
g. Use or Exploitation of Services in Germany A-98
3. Importation of Goods from Non-EU Member States A-98
4. Intra-EU Delivery of Goods A-98
a. Acquisitions Between Taxable Persons A-98
b. Acquisitions of New Vehicles A-98
c. Sales to Private Individuals A-98
D. Exemptions A-98
E. Input VAT A-99
F. Method of Assessment A-99
G. Registration Threshold A-100
H. Reverse Charge Mechanism A-100
I. Refunds A-100
J. Fiscal Agent A-101
K. EU VAT E-Commerce Rules A-101
L. Obligatory Electronic Invoices as of January 1, 2025 A-102

XII. Real Estate Transfer Tax A-105

A. In General A-105
B. Tax Rates A-105
C. Scope and Application A-105

XIII. Inheritance and Gift Tax A-107

A. In General A-107
B. Estates and Gifts of Residents A-108
C. Estates and Gifts of Nonresidents A-109
D. Tax Rates A-110
E. Procedures A-110
F. Tax Treaty Aspects A-110

XIV. Transfer Pricing A-113

A. Adjustment of Intercompany Prices A-113
1. In General A-113
2. Scope of the Provision A-113
3. Determination of Arm's-Length Price A-114
a. Intra-Group Loans A-114
b. Intra-Group Licensing A-115
c. Hybrid Financing Structures A-116
B. Documentation and Reporting Requirements A-116

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PAGE

1. In General A-116
2. Basic Documentation A-116
3. Master File and Local File A-116
4. Non-compliance A-116
5. Country-by-Country Report A-116

C. Business Restructurings A-117

D. Advance Pricing Agreements A-118

XV. Special Provisions Relating to Multinational Operations A-119

A. Treaty Shopping A-119
1. Section 50d(3) — The Anti-Treaty Shopping Provision A-119
2. Section 50j — Refusal of Relief from Capital Gains Tax in Certain Cases A-120
3. ATAD III Proposal — Prevention of Misue of Shell Entities A-120

B. Controlled Foreign Corporations A-120
1. In General A-120
2. Definition of a CFC A-121
3. Income of a CFC A-121
4. Counterevidence Rules A-122
5. Low Taxation A-122
6. Computation of Attributable Tainted Income A-123
7. Passive Income with a Capital Investment Character A-123
8. Tainted Income of Lower-Tier Subsidiaries A-123
9. The Investment Tax Act A-123

C. Foreign Family Foundations A-123

D. Administrative and Mutual Assistance in Tax Matters A-124
1. Exchange of Information A-124
a. Requests for Information A-124
b. Spontaneous Exchanges of Information A-124
c. EU Directives on Information Exchange A-124
d. U.S. FATCA Information Exchange A-125
e. Multilateral Competent Authority Agreement on Automatic Exchange of Information A-125
f. Bilateral and Multilateral Joint Audits A-125
g. Mandatory Disclosure of Reportable Cross-Border Arrangements (DAC 6) A-126
h. Reporting Obligations of Digital Platform Operators (DAC 7) A-127
i. Reporting Obligations of Crypto-Asset Service Providers (DAC 8) A-128
j. EU-wide Centralized Filing Mechanism for the Top-up Tax Information Return — DAC 9 A-128

PAGE

k. International Compliance Assurance System A-129
2. Mutual Assistance in Collection A-129
3. Mutual Agreement Procedure A-130

E. Prevention of Tax Avoidance and Unfair Tax Competition A-130

F. Hybrid Mismatches A-130

G. BEPS 2.0: Pillar One and Pillar Two A-131
1. In General A-131
2. Pillar One A-132
3. Pillar Two A-133

H. Global Minimum Tax A-134
1. The EU Pillar Two Directive A-134
2. The Minimum Tax Act A-135
a. Basic Rules A-135
(1) Qualifying Multinational or Domestic Group A-135
(2) The IIR A-136
(3) The UTPR A-136
(4) The QDMTT A-136
b. Computation of Top-up Tax A-136
(1) Qualifying Income or Loss A-136
(2) Adjusted Covered Taxes A-136
(3) Effective Tax Rate and Top-up Tax A-137
c. Reporting Obligations A-137
d. Transitional Rules A-138
e. Outlook A-138

XVI. Avoidance of Double Taxation A-139

A. In General A-139

B. Foreign Tax Relief A-139
1. Credit Method A-139
a. Foreign Source Income A-139
b. Foreign Income Taxes A-140
2. Deduction Method A-140

C. Tax Treaties A-140
1. Income Tax Treaties and Estates and Gift Tax Treaties A-140
a. In General A-140
b. Income Tax Treaties A-140
c. Inheritance and Gift Tax Treaties A-141
d. Treaty Interpretation A-141
2. Taxation of Business Income A-142
a. Permanent Establishment A-142
b. Industrial and Commercial Profits A-143
3. Investment Income A-143
a. Dividends A-143
b. Interest A-143
c. Royalties A-144
d. Capital Gains A-144
e. Other Income A-144
4. Procedure for Claiming Tax Treaty Benefits A-144

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PAGE

a. Income Subject to Withholding Tax A-144
b. Income Not Subject to Withholding Tax A-144
5. Treaties Between Germany and the United States A-144
a. Germany-United States Tax Treaty A-144
b. 2006 Protocol to the Germany-United States Tax Treaty A-146
(1) Direct Investment Dividends A-146
(2) “Triangular” Provision A-146
(3) Mandatory Binding Arbitration Mechanism A-146
(4) Other Provisions A-146
c. Germany-United States Estate, Inheritance and Gift Tax Treaty A-147
D. OECD Multilateral Instrument A-147
E. Exchange of Information A-148

PAGE

XVII. Income Tax Surcharge A-149
A. In General A-149
1. Taxpayers Covered A-149
2. Basis for Surcharge A-149
B. Impact of Tax Treaties A-149
1. Dividends A-149
2. Interest A-149
3. Royalties A-149
4. Corporate Board Members A-149
5. Artists, Entertainers and Athletes A-150

XVIII. COVID-19-Pandemic and Other Instances of Legal and Tax Assistance A-151
A. Tax Relief Measures A-151
B. The Stabilization and Restructuring Framework A-152

TABLE OF WORKSHEETS B-1

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DETAILED ANALYSIS

I. Germany — The Territory, Its Government and Legal System

A. Tax System Overview

1. General

Revenue Authority	Bundeszentralamt für Steuern, BZSt (Federal Central Tax Office) (Section IV.A.2.)
Type of Tax System	• Residents: Worldwide system. (Corporations: Section V.B.1.; Individuals: Section IX.A.) • Nonresidents: Certain German-source income. (Corporations: Section VI.A.; Individuals: Section X.A.)
Residence	Corporations: A company is tax resident in Germany if it has its statutory seat or its principal place of management in Germany. (Section V.A.) Individuals: An individual is tax resident in Germany if: • He or she occupies a place of residence in Germany under circumstances that indicate an intent to remain and not merely to use the residence temporarily; • He or she has a customary place of abode in Germany, meaning physical presence in Germany for an extended period of time in circumstances that indicate the stay will not be merely temporary; or • He or she is (i) a German citizen employed by German public authorities who does not reside in Germany and is only taxed in his or her country of residence on income from sources within that country; or (ii) a dependent of a person described in (i). (Section IX.B.1.)
Basic Domestic Nexus Rule for Foreign Corporations	A company not resident in Germany is subject to corporation tax in respect of taxable profits from carrying on a trade in Germany through a permanent establishment in Germany or through the activities of a permanent representative stationed in Germany. Non-German tax resident companies may also be subject to corporation tax on rental income and capital gains from the sale of German real property as well as royalty income from the exploitation of IP rights registered in Germany. (Section VI.B.)
Treaty Network	Germany has tax treaties with nearly 100 countries, including the United States, that largely follow the OECD Model Tax Convention. (Section XVII.C.1.b.) MLI signatory: Yes. (Section XVII.D.) For the texts and status of Germany's tax treaties, see International Tax Treaties.

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2. Corporations

Corporate Income Tax Rate	Flat rate of 15%. Taking into account the solidarity surcharge of 5.5% on the corporate tax rate, i.e., 0.825%, and the trade tax at the level of the municipality (non-deductible for corporate income tax purposes), the overall average corporate tax burden in Germany is approx. 30%. (Section V.B.11.)
Withholding Tax Rates on Payments to Non-resident Companies	Dividends: 25% (plus 5.5% income tax surcharge). (Section VI.B.3.c.) Interest: 25% (plus 5.5% income tax surcharge). (Section VI.B.3.b.) Royalties: 15% (plus 5.5% income tax surcharge). (Section VI.B.4.) For the rates of source country taxation applying under Germany's domestic law and tax treaties and the context for their application, see the Withholding Tax Chart.
Net Operating Losses Carryback/Forward	Carryback: Two years. The tax loss amount carried back may not exceed one million euros. Carryforward: Unlimited. A remaining net operating loss may be deducted in future assessment periods up to an amount of one million euros per year. A loss in excess of that limit may be deducted to the extent of up to 60% of net income only. (Section V.B.2.b.(4))
Restrictions on Deductibility of Interest Expenses	Yes, generally limited to 30% of a company's or group's EBITDA. (Section V.B.2.b.(2))
Anti-hybrid Mismatch Rules	Yes. (Section XVIII.)
Incentives (major)	• R&D: Yes, for certain R&D activities. (Section V.B.13.) • Patent box: N/A • Enhanced depreciation/capital allowance: Yes, for certain assets. (Section V.B.4.i.) • Environmental: N/A • Other: N/A
Participation Exemption (or Similar Regime)	Investment income realized by a holding company from the sale of a subsidiary, for the most part, is not subject to corporation tax and trade tax. (Section V.B.4.b.) Subject to exceptions, dividends are 95% tax-exempt in the hands of corporate shareholders. (Section V.B.4.c.)
Tax Consolidation	The consolidated assessment of groups of corporations or the filing of consolidated returns is not possible. However, if certain requirements are met, an income tax grouping (an "Organschaft") provides group relief broadly equivalent to consolidation for tax purposes. (Section V.B.10.)
M&A Regime	• Tax-free or tax-privileged transaction: Various types of domestic and cross-border reorganizations may be affected tax-free using a roll-over method, provided certain requirements are met. (Section V.B.14.b. and c.) • Stamp duty/share transfer taxes: N/A • Limitation on pre-deal NOL carryforwards: See Anti-Loss Trafficking Rules (Section V.B.8.b.) and Transfers in Statutory Mergers (Section V.B.8.c.)
OECD Pillars One and Two	Legislation enacted on aspects of Pillar Two on December 15, 2023. (Section XVI.G.)
Controlled Foreign Company Regime	Yes. (Section XVI.C.)
Transfer Pricing Regime	Yes. (Section XVI.A.) Country-by-country report: Yes. (Section XVI.A.3.) See also Chapter 55 of 6950 T.M., Transfer Pricing: Rules and Practice in Selected Countries (E–G).
General Anti-avoidance Rule	Yes. (Section XVI.B.)
Mandatory Disclosure Regime	Yes. (DAC 6 (Section XVI.E.1.g.), DAC 7 (Section XVI.E.1.h.)).
Foreign Tax Relief	Relief may be granted: • Unilaterally, by way of credit or as a deduction in computing the profits of a business. (Section XVII.B.); or • Under the terms of a tax treaty, by way of exemption or credit. Some of Germany's tax treaties provide for tax-sparing credits.

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3. Individuals

Personal Income Tax Rates	Progressive income tax rates ranging from 14% (for income in excess of the standard exemption of 10,632 euros for 2023 and 10,992 euros for 2024) to a maximum of 45% (plus income tax surcharge of 5.5% and church tax, if applicable) on the taxable income of an individual exceeding 277,826 euros. (Section IX.E.1.)
Equity Incentives	Yes. (Section IX.C.2.a.(1))
Foreign Tax Relief	Yes. (Section XVII.)
Wealth Tax, Estate/Inheritance Taxes, Gift Tax	No wealth tax. Inheritance and gift tax not imposed on an estate, but on the beneficial share of each heir or legatee. The tax rates are graduated and depend on the degree of kinship between the decedent and the beneficiary. They vary within a range of 7% to 50%. (Section IV.B.7. and Section XV.)
Exit Taxes	Yes, tax on gains on deemed disposals of certain shareholdings that is payable immediately on departure from Germany but maybe deferred. (Section X.H.4.)

4. Other Taxes

VAT/GST/Sales Tax	VAT is charged at a standard rate of 19% (a reduced rate of 7% is charged on certain supplies). (Section XIII.) For further research on Germany's VAT system, see also the VAT Navigator.
Digital Services Tax	No.
Local Taxes	Trade tax (Section XII.), real estate tax (Section IV.B.8.), real estate transfer tax (Section XIV.) It should be noted that these taxes are federally regulated but collected locally, with the rates varying from municipality to municipality or state to state.

5. Administrative

Standard Tax Return Filing Dates	Corporate Income Tax Return: by July 31 of the year following the taxable calendar year, unless prepared by tax advisers, in which case the return must generally be filed by the end of the following February (i.e., 14 months after the year-end). • The deadline for filing the 2023 tax returns was extended to September 2, 2024, and for returns prepared by tax advisers to June 2, 2025. • The deadline for filing the 2024 tax returns has not been extended and ends on July 31, 2025, and for returns prepared by tax advisers April 30, 2026. (Section V.B.12.a.) Individual Income Tax Return: by July 31 of the year following the taxable calendar year, unless prepared by tax advisers or extensions are granted. (Section IX.F.)
Limitations Period for Assessment	Assessment: four years from the end of the calendar year in which the return is filed, but not later than the end of the third calendar year following the calendar year in which the tax liability arose. Collection: five years from the end of the calendar year in which the corporate income tax was assessed. (Section V.B.12.d.)
Advance Tax Rulings	Yes. A ruling may be requested from a competent tax office if the taxpayer can demonstrate that a transaction/investment in question is likely to have significant tax consequences. The applicable fee is generally based on the amount of tax at risk if the planned transaction was executed. The amount of tax at risk is capped at 30 million euros and the maximum fee for a binding ruling is 109,736 euros. Ruling requests are generally processed within six months. No ruling will be provided with regard to simple questions of fact, structures designed to avoid taxes or transfer pricing issues (however, APAs may be concluded). (Section V.B.12.g.)

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B. Germany — General Background

1. The Country

Following the collapse of the Soviet bloc in 1989, Germany achieved reunification on October 3, 1990,[1] with the State Treaty of May 18, 1990, which brought about the economic, monetary and social union of the Federal Republic of Germany and the German Democratic Republic, effective July 1, 1990. Under the Unification Treaty of August 31, 1990,[2] the German Democratic Republic ceased to exist on October 3, 1990. Its former territory was subdivided into five new states, which acceded to the Federal Republic of Germany as of that date.

Since 1999, the Federal capital has been Berlin, but the economic and political life of the Federal Republic is decentralized and concentrated in several industrial and commercial centers, including Dusseldorf, Frankfurt am Main, Hamburg, Munich, and Stuttgart. Some of the most important administrative government agencies are located outside Berlin. The Federal Constitutional Court is in Karlsruhe, the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*) is in Frankfurt am Main and Bonn, the Federal Patent and Trade Mark Office (*Deutsches Patent-und Markenamt*) is in Munich, the Federal Criminal Office (*Bundeskriminalamt*) is in Wiesbaden and the Federal Antitrust Authority (*Bundeskartellamt*) is in Bonn. The European Central Bank, which, among other things, sets interest rates for the Euro Bloc, is also headquartered in Frankfurt.

As one of the six founding member countries of the first European Community in 1951, Germany was also a founding Member State of the European Union in 1992. Germany has adopted the euro as its national currency, which replaced the Deutschmark on July 1, 2002.

2. Political Organization

The Federal Republic of Germany is a parliamentary democracy under a constitution dating from May 23, 1949.[3] It comprises 16 states (*Bundeslaender*). Parliaments and courts exist at the level of each of the States as well as the federal level. In addition, within each state, there are intermediate administrative organizations, as well as municipalities.

The federal political structure is headed by a president (*Bundespraesident*), who has a largely ceremonial role. Executive power is vested in the Chancellor (*Bundeskanzler*) and the members of his or her cabinet, who serve from the time they are appointed by the Chancellor until he or she dismisses them. The Chancellor is elected by the Federal Parliament (*Bundestag*) and may be dismissed only if the Bundestag elects his or her successor by a majority of its members. Members of Parliament are elected by the electorate for terms of four years. Every German citizen aged 18 or older is entitled to vote in such elections. Legislative power is vested in the *Bundestag* and, with respect to certain matters, in the *Bundesrat* representing the *Bundeslaender.* The passing of laws that impact public finances requires the latter's consent.

[1] Federal Law Gazette (*Bundesgesetzblatt* — BGBl.), 1990 II, 537.

[2] BGBl. 1990 II, 889.

[3] Constitution (*Grundgesetz* — GG).

C. Sources of Law

1. Statutes

Germany is a civil law country. The major source of law is statutes enacted by Parliament. At the federal level, bills may be introduced in Parliament by the federal government, by the members of Parliament and by the second chamber of Parliament, the *Bundesrat*, which is comprised of representatives of the 16 States. In some areas of law, federal statutes must also be passed by the *Bundesrat.* All statutes must be signed by the president and the competent minister, and published in the Federal Statutory Gazette, the *Bundesgesetzblatt.* Similar provisions govern the enactment of statutes and regulations under state and municipal law. Most important areas of legislation are governed by federal law and apply on a national level. This is true, in particular, of tax law, as all major taxes are regulated by federal law. The states retain certain marginal legislative authority with respect to some local taxes. The municipalities are limited to fixing the tax rates for municipal trade tax and real estate tax, and to regulating some minor local taxes. On the other hand, except in relation to customs, state monopolies and certain value added tax matters, there is no federal local tax administration. Most taxes are administered, assessed and collected by state tax offices. A few functions, however, have been centralized in specific federal tax offices. Thus, the Federal Central Tax Office (*Bundeszentralamt fuer Steuern*) has been charged, *inter alia*, with all matters involving the exemption, reduction or refund of German withholding taxes under Germany's tax treaties, cross-border tax issues, DAC6 notifications and the cross-border exchange of information.[4] See further under IV.A., below.

Under the Federal Constitution, a federal law may authorize a government officer or a subordinate government agency to promulgate ordinances (*Rechtsverordnungen*) to supplement a federal statute, if the statute itself defines the purpose, scope and contents of such ordinances.[5] These ordinances have the force of law and normally prescribe detailed rules for the implementation of specific statutory provisions.

In addition, federal and state ministries and other public authorities issue administrative regulations on various matters. These constitute instructions for subordinate officials, but do not constitute law and do not bind the courts.

Court decisions have also become an important source of law. This is particularly true in areas such as labor law and tax law. Furthermore, decisions of the Court of Justice of the European Union (CJEU) in Luxembourg increasingly influence the interpretation of German statutory as well as case law.

2. Court System

The Federal Constitutional Court in Karlsruhe is the court of last resort in Germany, where a complaint can be filed if constitutional rights are infringed by an action on the part of a public authority or by a court decision.[6] In addition, there are federal supreme courts for specific areas of the law, such as the

[4] *See* http://www.gesetze-im-internet.de/fvg_1971/__5.html.

[5] GG, Art. 80(1).

[6] GG, Art. 93.

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German Federal Court of Justice in Civil and Criminal Matters (*Bundesgerichtshof*) in Karlsruhe, the Federal Labor Court (*Bundesarbeitsgericht*) in Erfurt, the Federal Social Matters Court (*Bundessozialgericht*) in Kassel, the Federal Tax Court (*Bundesfinanzhof* — BFH) in Munich, and the Federal Administrative Court (*Bundesverwaltungsgericht*) in Leipzig. These federal supreme courts are the courts of final appeal against decisions of the lower state courts. Thus, for instance, a taxpayer may file a suit against a tax assessment in the state tax court of the state in which the tax office that issued the assessment notice is located. In matters concerning judgments of the tax court, the taxpayer may be entitled to appeal to the BFH. The decisions of the superior federal courts are published in official reporter series cited by volume and page. Selected lower court decisions are reported in specialized periodicals. The more important court decisions are also unofficially reported in numerous legal periodicals.

3. Arbitration

Arbitration in Germany is primarily governed by the Tenth Book of the German Code of Civil Procedure (Zivilprozessordnung, ZPO), specifically Sections 1025 to 1066. These sections are closely aligned with the UNCITRAL Model Law on International Commercial Arbitration, which provides a standardized legal framework used internationally. Arbitration is possible for pecuniary claims.

Arbitration in Germany typically involves the following steps: (i) Arbitration agreement: Parties must have an agreement to submit disputes to arbitration, usually stipulated in their contract; (ii) Arbitration panel formation: Parties select arbitrators, commonly one or three, depending on the agreement; (iii) Submission of claims and responses: Each party submits their claim or defense, including evidence and legal arguments; (iv) Hearings: Arbitration may involve one or more hearings for presentation of evidence and oral arguments; and (v) Arbitral award: The panel delivers a decision, which is binding and enforceable, similar to a court judgment.

The main advantages of an arbitration compared to court procedures are: (i) Confidentiality: Arbitration proceedings are private, whereas court hearings are generally public; (ii) Speed: Arbitration can be faster than court litigation, especially in overloaded judicial systems; (iii) Choice of arbitrator: Parties can choose arbitrators with specific expertise relevant to their dispute; (iv) Flexibility: Procedures can be tailored to the needs of the parties, potentially making the process more efficient; (v) International enforcement: Awards are generally easier to enforce internationally than court judgments, under treaties like the New York Convention. The disadvantages include: (i) Costs: Arbitration can be expensive due to arbitrators' fees, which might exceed regular court fees; (ii) Limited appeal options: Arbitration awards are final and generally not subject to appeal, which limits recourse in case of an unsatisfactory decision; (iii) Risk of bias: While arbitrators are expected to be neutral, there is a risk of perceived bias, especially if the arbitrator is chosen by one party; (iv) Lack of precedent: Decisions in arbitration do not create legal precedents, which can contribute to uncertainty in similar future disputes. Thus, arbitration in Germany offers a viable alternative to traditional court litigation, and is especially beneficial for confidential, expert-led, and potentially quicker resolution of disputes. However, the costs and finality of the process can be significant drawbacks. Whether arbitration is preferable depends largely on the specific circumstances and priorities of the disputing parties.

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II. Operating a Business in Germany

A. *Foreign Investment Regulation*

1. *In General*

Since its formation in 1949, the Federal Republic of Germany has adhered to the principle of freedom of trade and investment. There are very few areas in which foreign direct/indirect investment in Germany is subject to rules different from those applicable to domestic investment. In recent years, foreign investment control rules have been constantly amended to extend the government's screening rights significantly. The latest developments[7] occurred on July 17, 2020, when new foreign trade regulations to implement the European Union (EU) Screening Regulation became effective. The regulation provides for certain rules to unify the approach to investment screening throughout the European Union and a cooperation mechanism between the EU Member States and the European Commission. Based on the regulation, the German government widened the scope of companies potentially subject to foreign investment screening. Previously, investment screening was only possible when acquisitions of companies and company divisions by foreign non-EU/European Economic Area (EEA) investors could pose an "actual threat" to the public security and order of the Federal Republic of Germany. Now, a "probable impairment" of the public security and order of Germany or another EU Member State provides sufficient cause for the German Ministry for Economic Affairs and Climate Action (*Bundesministerium fuer Wirtschaft und Klimaschutz* — BMWK) to investigate an acquisition. No transaction that has to be notified to the BMWK can be completed and become legally binding without the BMWK's permission.

Despite some structural problems in its economy and inflexibility in its political system, which have delayed adjustments designed to accommodate globalization, and despite the European Union's search for a new balance among its Member States, between its Member States and institutions, and within the euro zone where there are large discrepancies in the economic performance and the respective budget deficits of the Member States that have introduced the euro as their domestic currency, Germany remains an attractive location for investment. Germany is highly industrialized and is one of the financial centers of Europe. Its membership in the European Union, as well as its central location in Europe, enhances Germany's position as a business center.

A new challenge now, especially for the energy-intensive industry in Germany (metal industry, chemical industry, coking plant, mineral oil processing, production of glass, paper, cardboard and ceramics), is the EU plan to fully decarbonized by 2045, which will impact Germany even harder than other countries due to its phase-out of both nuclear power (underway since mid-April 2023) and coal-fired power (by 2038 at the latest). The decarbonization measures that have been adopted at the EU level also increase the already comparatively high energy and electricity costs in Europe, especially in Germany, due to its decision to rely for a longer period on coal-fired power rather than CO_2-emission-free nuclear power.

[7] Foreign Trade and Payments Act (*Außenwirtschaftsgesetz* — AWG) BGBl. 2020 I, 1637.

Germany's main attractions for foreign direct investment as well as for foreign portfolio investment are:

(i) A responsible democratic government;

(ii) The strength and convertibility of the euro viewed long-term, coupled with very moderate rates of inflation;

(iii) Stable social and economic conditions;

(iv) A highly developed transportation and communication system;

(v) Skilled labor and highly trained managerial, administrative and secretarial personnel; and

(vi) The largest consumer market in Europe.

2. *Investment Incentives*

Subsidies are granted at federal and state levels, but financial assistance in major investment projects is regulated under EU legislation on state aid and must be cleared with the European Commission before it may be granted.[8] At the state level, regional promotion programs (*Regionale Foerderungsprogramme*) are available for investments in certain less-developed regions. Since 1991, the federal government has offered grants in support of the new (East German) states under the Investment Grant Act 2010.[9] Other forms of financial assistance are state guarantees, where the investor cannot provide adequate security acceptable to his or her bank, and employment incentives in the form of training grants. Furthermore, at the municipal level, land may be offered for construction at attractive prices, road and rail access may be provided, and reduced utility rates may be available.

3. *Business Registration*

The Trade Code[10] and related legislation require licenses for a number of businesses such as banking, insurance, transportation and other activities that might cause safety or pollution problems. Most other businesses need not be licensed. However, the municipal authorities must be notified that business operations have been commenced.

B. *Currency and Exchange Controls*

1. *Currency*

Since July 1, 2002, the euro has been the sole functional currency in Germany, as well as in Austria, Belgium, France, Finland, Greece, Italy, Ireland, Luxemburg, the Netherlands, Portugal and Spain. Later, the euro also became the sole currency in Cyprus, Estonia, Malta, Slovakia, Slovenia, Lithuania and Latvia. Every EU Member States that satisfies the convergence criteria[11] is obliged to introduce the euro as its sole currency, except Denmark and — as a result of the intentional nonsat-

[8] Official Journal of the European Communities No. C 107 1998 p. 7.

[9] Investment Grant Act 2010 (*Investitionszulagengesetz 2010* — InvZulG), BGBl. 2008 I, 2350.

[10] Trade Code (*Gewerbeordnung* — GewO).

[11] Maastricht Treaty, Official Journal of the European Communities No. C 191 1992 p. 1.

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isfaction of one of the convergence criteria as accepted by the EU Commission — Sweden.

2. Exchange Controls and Indexation

German residents may own foreign currency and may effect payments abroad or receive payments from abroad in euros or in a foreign currency. Conversely, nonresidents may import funds into or withdraw funds from Germany without permission from any German public authority. There are no restrictions on the opening of bank accounts by nonresidents. Both resident and nonresident parties can engage in forward exchange transactions with German banks. Under Section 244 of the German Civil Code (*Buergerliches Gesetzbuch*), a debt denominated in a foreign currency may be repaid in German funds at the exchange rate on the payment date unless payment in the foreign currency is specifically stipulated. With the introduction of the euro as of January 1, 1999, Section 3 of the Currency Act (*Waehrungsgesetz*) was repealed and replaced by Section 2 of the Price Specification and Indexation Act (*Preisangaben-und Preisklauselgesetz*), which generally outlawed automatic indexation clauses, with exceptions and authorizations being possible as provided for in the Price Indexation Ordinance (*Preisklauselverordnung*).[12] However, Section 2(1), third sentence of the *Preisangaben — und Preisklauselgesetz* provided for a complete exemption from these indexation restrictions for currency and capital market transactions, as well as for financial instruments. This meant that indexed bonds could be issued where the interest rate fluctuated with the inflation rate. The same exception applied to contracts entered into between resident businesses and nonresident parties. Though the *Preisangaben — und Preisklauselgesetz* was amended and replaced[13] by the *Preisklauselgesetz*[14] and the *Preisklauselverordnung* was abolished,[15] such indexations are still admissible. Sections 2 and 5 of the *Preisklauselgesetz* also provide for a complete exemption from indexation restrictions for currency and capital market transactions, as well as for financial instruments.

C. Trade and Commerce Regulation

1. Imports and Exports

a. Licenses and Quotas

The basic statute governing foreign trade and foreign exchange contracts is the Foreign Trade and Payments Act and the regulations promulgated under that Act.[16] In principle, most transactions are permitted except those that are specifically prohibited. Furthermore, among the more important control provisions that apply in Germany beyond that is an EU Regulation establishing an EU regime for the control of exports of dual-use goods.[17] "Dual-use" goods, within the meaning of EC Regulation 428/2009 of May 5, 2009, are goods that can be used for both civil and military purposes. This EC Regulation has been amended by a new ordinance for dual-use goods in force as of December 15, 2020.[18] The new ordinance focuses in particular on: (i) specific technology and software that can be used for the design, development, production or use of nuclear, chemical or biological weapons or their means of delivery, including all items that can be used for both non-explosive uses and assisting in any way in the manufacture of nuclear weapons or other nuclear explosive devices; (ii) technology, including software, that can be used for covert surveillance; and (iii) closer coordination among the responsible EU Member State authorities.

b. Custom Duties and Other Taxes

There are three main sources of customs law in Germany: international agreements; EU legislation; and national legislation. Germany is party to numerous international (mostly multilateral) agreements concerning customs. Most of these agreements have been adopted by the European Union, for example the General Agreement on Tariffs and Trade (GATT), which has been embedded in the World Trade Organization (WTO) since 1995. Thus, the GATT Customs Valuation Code of 1979 was negotiated and adopted by the European Union with effect for its Member States. National law has been replaced to a large degree by the Union Customs Code of October 9, 2013,[19] which became effective on May 1, 2016.

As a member of the European Union, Germany is subject to EU legislation. This legislation governs the major part of substantive customs law, including such matters as customs value and tariffs on all goods imported into EU Member States from outside the European Union, including special regulations concerning associated states and certain preferentially treated states, such as developing countries. EU legislation also includes numerous regulations and directives designed to harmonize the law in procedural areas. EU legislation has been included in the Union Customs Code referred to above.

The importation of goods into the European Union also attracts import value added tax (VAT),[20] as well as other excise taxes, which are collected on the production and importation of certain goods such as spirits, tobacco products, coffee, etc. The purpose of these import taxes is to equalize the tax burden on goods, irrespective of whether they are manufactured in or outside the European Union. The tax is paid by the importer, in addition to whatever customs duty may be due. Import VAT is not imposed on the intra-EU importation of goods. Instead, importers that participate in intra-EU commercial trade are required to file tax returns with the competent authorities on a regular basis to secure the imposition of VAT on goods imported from other EU Member States.

[12] Price Indexation Ordinance (*Preisklauselverordnung* — PrKV) of September 23, 1998, BGBl. 1998 I, 3043.
[13] BGBl. 2007 I, 2246.
[14] BGBl. 2007 I, 2101 as of September 14, 2007.
[15] BGBl. 2007 I, 2246.
[16] AWG, BGBl. 2020 I, 1637.
[17] EC Regulation No. 428/2009 of May 5, 2009.
[18] Commission Delegated Regulation (EU) 2020/1749 of October 7, 2020 amending Council Regulation (EC) Nr. 428/2009 setting up a Community regime for the control of exports, transfer, brokering and transit of dual-use items; *see* https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.L_.2020.421.01.0001.01.ENG&toc=OJ%3AL%3A2020%3A421%3ATOC.
[19] EC Regulation No. 952/2013, OJ2013 L269.
[20] Value Added Tax Act (*Umsatzsteuergesetz* — UStG), Sec. 1(1), No. 4.

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c. Documentation

In the case of goods delivered against payment on which customs duties are payable, the written customs declaration submitted by the person liable to pay the duties must be accompanied by an invoice in duplicate. This invoice must include the names and addresses of the seller and the buyer, and a precise description of the goods, their quantity and price, and the terms of delivery and payment. Further, the invoice must show the country of purchase and the country of origin of the goods. Separate certificates of origin or declarations of origin are only required for very few commodities. However, certificates of origin may be significant for preferential treatment under the customs law.

d. Carbon Border Adjustment Mechanism

The Carbon Border Adjustment Mechanism (CBAM) is a carbon tariff on carbon intensive products that initially applies to cement, iron, steel, aluminum, fertilizers, electricity and hydrogen imported by the European Union. The CBAM entered into force on May 17, 2023.[21] The CBAM is part of the European Green Deal package of measures designed to reduce the bloc's net greenhouse gas emissions by at least 55% by 2030, compared to 1990 levels. On October 1, 2023, the CBAM entered a transitional phase of operation with the first reporting period scheduled to end on January 31, 2025, for importers. Importers are required to be listed and registered as authorized CBAM declarants after December 31, 2024. On February 26, 2025, the European Commission proposed a simplification package introducing a *de minimis* threshold of 50 tonnes per year, thus exempting small importers from CBAM obligations. The European Parliament is scheduled to adopt its mandate for negotiations on the final shape of the legislation on May 22, 2025. The European Commission will assess by early 2026 whether to extend the scope of CBAM to encompass additional sectors at risk of carbon leakage. A gradual phase-out of free allowances under the EU ETS is planned from 2026 to 2034, in line with the full implementation of CBAM.

Once the permanent system enters into force, only importers being authorized declarants will be allowed to import goods into the EU. They will need to declare each year the quantity of goods imported into the EU in the preceding year and their embedded greenhouse gas emissions. They will then surrender the corresponding number of still to be acquired CBAM certificates. The price of the certificates will be calculated depending on the weekly average auction price of EU Emissions Trading System allowances expressed in euros/ton of CO_2 emitted.

2. General Regulation of Business

a. Antitrust and Public Procurement Regulation

(1) In General

The European Commission enforces the antitrust provisions in the EU Treaty and the EC Merger Regulation.[22] German antitrust law is contained in the Law against Restrictions of Competition (GWB).[23]

Cartels are regulated under the GWB by the Federal Antitrust Authority (*Bundeskartellamt*), the Federal Minister of Economics and Technology, and the competent authorities of the several states, normally the ministers of economic affairs.[24] The Federal Antitrust Authority has jurisdiction under specific provisions in the GWB, for example, Section 40(1) of the GWB in the case of mergers. The Federal Antitrust Authority also has competence to deal with cartels that affect more than one state.

The antitrust authorities may fine companies and individuals for antitrust violations and also may impose other sanctions to put an end to such violations.[25] Private plaintiffs who can show that they are affected by a violation may file lawsuits for injunctive relief or money damages.[26] Bid-rigging is a criminal offense.

German antitrust law applies to restrictions on competition that have an effect in Germany, even if they are imposed by parties, or result from actions taken, outside Germany. In addition, the statute includes provisions concerning public procurement activities.[27]

(2) Agreements and Concerted Practices

Cartels are prohibited and cartel agreements are invalid *ab initio*.[28] In 2005, the domestic provisions on the regulation of cartels and vertical restraints were harmonized with EU antitrust law. Furthermore, the German antitrust authorities and courts are obliged to apply Article 81 of the EC Treaty, now Article 101 of the Treaty on the Functioning of the European Union (TFEU), to cartels and vertical restraints that are likely to affect trade between the EU Member States.[29] Like Article 101 of the TFEU, German antitrust law prohibits all agreements between companies, decisions of associations of companies and concerted practices that have as their object or effect the prevention, restriction or distortion of competition.[30] Examples of cartels are price fixing, bid-rigging, the allocation of quotas, territories or customers, and certain exchanges of market data. Examples of vertical restraints are agreements granting exclusivity and distribution agreements.

Under a *de minimis* rule, agreements that do not have an appreciable effect on competition are not prohibited. The seventh amendment to the GWB in 2005 abolished all exemptions in effect prior to it, except for the exemption for cooperation agreements between small and medium-sized enterprises (SMEs), as well as the then-applicable notification system.[31] German antitrust law now exempts vertical restraints and some cartels from prohibition subject to the same conditions as ap-

[21] Regulation (EU) 2023/956 of the European Parliament and of the Council of May 10, 2023, L 130/52.

[22] EC Regulation No. 139/2004, OJ 2004 L24.

[23] Law against Restrictions of Competition (*Gesetz gegen Wettbewerbsbeschraenkungen* — GWB).

[24] GWB, Secs. 48–53.

[25] GWB, Secs. 32 *et seq.*, 34, 81.

[26] GWB, Sec. 33.

[27] GWB, Sec. 97 *et seq.*

[28] GWB, Sec. 1. Currently, the invalidity of cartel agreements follows not from GWB, Sec. 1 itself, but from Civil Code (*Buergerliches Gesetzbuch* — BGB), Sec. 134.

[29] GWB, EC Regulation No. 1/2003 of December 16, 2002, Art. 3(1); GWB, Sec. 22(1).

[30] GWB, Sec. 1.

[31] GWB, Sec. 3(1).

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ply under EU antitrust law.[32] It is important to note that "hard-core" cartels (for example, price-fixing and bid-rigging) will almost never be exempted from prohibition. Price maintenance arrangements are prohibited, except in the publishing business, which is exempt from the prohibition under both domestic[33] and EU law.

(3) Market Domination

The prohibition on abuse of a market dominating position has immediate effect, allowing adversely affected businesses to bring the issue to court themselves.[34] The central criterion in the definition of a "market dominating position" is the existence of a dominant market position (for example, a monopoly) or, in certain cases, of a market-dominant oligopoly, which the Federal Cartel Office has the burden to prove. Examples of potential abuses are listed in the statute, for example, impairing competitors in a manner affecting competition in the market without having an objective justification for doing so.[35]

The prohibition on discriminatory and anti-competitive practices also applies to non-dominant companies if small or medium-sized suppliers or purchasers depend on them because there are no sufficient and reasonable alternatives.[36] Furthermore, companies with superior market power in relation to small and medium-sized competitors are prohibited from using their market position to hinder such competitors in an unfair manner.[37] In particular, the sale of products and services by such companies, except on an occasional basis, for less than their original cost without any substantive grounds, is prohibited.[38]

Further, the Federal Cartel Office is able to intervene at an early stage, if competition is threatened by certain large groups. The Federal Cartel Office can preemptively prohibit certain types of conduct by companies that, because of their strategic position and resources, are of particular importance for competition across markets. Examples of such conduct include self-preferential treatment of the group's own services and obstructing the market entry of third parties by withholding certain data.[39] The legislator has also underpinned the effectiveness of the new provision by shortening the legal process. Appeals against decisions of the Federal Cartel Office made on the basis of Section 19a GWB will be decided directly by the Federal Court of Justice. Skipping the first instance in all other antitrust proceedings (the Düsseldorf Higher Regional Court) will result in considerable time savings in the proceedings and in a shortening of the legal protection. Further, the Federal Cartel Office has been authorized to intervene in the business of companies under certain conditions without them having violated antitrust law.[40] It has been entitled to order so-called remedies within 18 months after the conclusion of a sectoral enquiry if a "significant and continuing impediment to competition" is found in the course of the enquiry; such "remedies" include a wide range of measures, including the break-up of the company, even if the competition has lessened for reasons other than anti-trust violations, such as high barriers to entry, certain contractual practices or regulatory requirements, or the presence of oligopolies, monopolies or otherwise firms with particular market power.

Comment: In contrast to the former neutral concept of competition under German law, now a political distinction is to be made as to what constitutes good and bad competition.

(4) Mergers and Other Combinations of Enterprises

Mergers are examined exclusively by the European Commission if they come within the scope of the EC Merger Regulation (EMR) unless the European Commission refers the merger control proceedings to the national authorities in accordance with the EMR.[41]

The Federal Antitrust Authority must be notified of any corporate merger in advance, i.e., before the combination is consummated,[42] if the merger will result in combined worldwide sales of the participating enterprises of more than 500 million euros measured by reference to the previous fiscal year, and (as cumulative conditions) one of the companies has sales in Germany of more than 50 million euros in that fiscal year and at least one other participating party to the transaction has sales in Germany of more than 17.5 million euros in that fiscal year.[43] Further, the Federal Cartel Office is also able to require companies in certain sectors of the economy to give notice of mergers even where the turnover thresholds are not met. For this to be possible, certain requirements, including thresholds, must be met and the Federal Cartel Office must first have conducted a sector inquiry into one of the industries concerned.[44]

Under the law, the terms "merger" and "combination" include: the acquisition of all or substantially all the assets of a target company; the securing of control over the target company by means of contracts, licenses and other rights; the acquisition of shares in another enterprise if, following the acquisition, the acquiring party will hold an interest of at least 50% or 25% in the capital or the voting shares of the target company; and a combination enabling the direct or indirect exercise of a competitively significant influence.[45] The acquisition of shares by a bank or insurance company for purposes of on-selling the shares does not constitute a merger as long as voting rights attached to the shares are not exercised and the shares are being sold within one year.[46]

The Federal Antitrust Authority is required to prohibit a merger that is deemed to create a "market dominating position," as defined in Section 19(2) and (3) of the GWB (see (3), above), unless the enterprises concerned can establish that the merger will also entail improvements in competition that outweigh the disadvantages of market domination.[47] As a rule, an exception applies if the prohibition requirements are met on a

[32] GWB, Sec. 2.

[33] GWB, Sec. 30, Act on Book Price Maintenance (*Buchpreisbindungsgesetz*).

[34] GWB, Sec. 19(1).

[35] GWB, Sec. 19(2).

[36] GWB, Sec. 20(2).

[37] GWB, Sec. 20(4).

[38] GWB, Sec. 20(4).

[39] GWB, Sec. 19a (GWB Digitization Act dated January 20, 2021).

[40] The eleventh GWB amendment passed by the Parliament on July 6, 2023 and by the Second Chamber on September 29, 2023, BGBl. 2023 I No. 294.

[41] EC Regulation No. 139/2004 of January 20, 2004, Art. 1, 4(4), 9; GWB, Sec. 35(3).

[42] GWB, Sec. 39(1).

[43] GWB, Sec. 35(1).

[44] GWB, Sec. 39a.

[45] GWB, Sec. 37(1).

[46] GWB, Sec. 37(3).

[47] GWB, Sec. 36(1).

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market on which goods or commercial services have been offered for at least five years and on which the turnover in the last calendar year was less than 20 million euros.[48] The Federal Minister of Economics and Climate Action may overrule the Federal Antitrust Authority if the restriction on competition is offset by the macroeconomic advantages of a merger or if the merger is justified by an overriding public interest.[49]

As stated above, the Federal Antitrust Authority must be notified in advance of any plan for a merger that exceeds a minimum size. Less important mergers will be dealt with by the authority within one month of notification. Under the law, if the authority does not take action within one month, approval is automatically granted. In practice, an informal notice will be given if no basis for a prohibition under Section 36(1) of the GWB has been found. In more delicate cases, the authority retains the right to examine and prohibit the merger for a total of four months provided it issues to the party that filed the notification, within the one-month time limit, a notice[50] stating that it has initiated the principal examination procedure (*Hauptpruefungsverfahren*).[51] A special judicial appeal procedure[52] may void any decision to prohibit a merger as well as any conditions or obligations that may have been imposed as a prerequisite for clearance.[53]

(5) European Antitrust Law

Articles 101 to 106 of the TFEU provide comprehensive antitrust legislation that is supplemented by regulations promulgated thereunder. Article 101 of the TFEU outlaws both horizontal and vertical restrictions on competition that are capable of affecting trade among EU Member States. Furthermore, agreements violating Article 101 of the TFEU are null and void. However, agreements may be exempted if they meet the prerequisites of Article 101(3) of the TFEU. In particular, agreements may be exempted if they fulfill the conditions of a block exemption regulation.[54]

Article 102 of the TFEU outlaws the abuse of a market dominating position. The antitrust authorities may fine companies and individuals for violations of Articles 101 or 102 and may also impose other sanctions to put an end to such violations. Private plaintiffs who can show that they are affected by a violation may file lawsuits for injunctive relief or money damages. The European Merger Control Regime (EMCR) requires that notice of a planned merger, as defined in Article 3 of the EMCR, be given in advance to the EC Commission if certain turnover thresholds are met that indicate a "Community dimension."[55] The merger may not be implemented before notice has been given or before it has been cleared by the EC Commission. The EC Commission is required to prohibit a transaction if it finds that the transaction would significantly impede effective competition within the common market. Otherwise, the Commission will allow a transaction to be implemented; the Commission may, however, impose conditions on the proposed combination.

On December 15, 2020, the EU Commission published the draft Digital Markets Act (DMA),[56] which will supplement competition law and restrict the power of dominant digital groups. In the DMA, the EU Commission establishes a code of conduct for large digital companies — "gatekeepers" — that can complicate access to the market for other market participants. The compliance of such gatekeepers will be subject to the control of the EU Commission from the outset and not only after there is an abuse of market dominance, which could occur many years later and which the EU Commission would need to prove. At the same time, stricter rules will apply to central online platforms such as search engines, social networks and online brokerage services: for example, such platforms will no longer be allowed to give preferential ranking to their own offerings. Previously, comparable regulations only existed in Germany under the GWB Digitization Act, which came into force in 2021. The regulation proposed by the European Parliament and the Council of the EU entered into force on November 1, 2022,[57] and, while some parts became applicable on November 1, 2022, most parts become enforceable on May 2, 2023.[58] Agreement on the draft DMA was reached on March 24, 2022.[59] The final and binding DMA has been published on October 12, 2022.[60] The DMA applies directly in all EU Member States after a short transition period of six months from the date of entry into force. Further developments should be monitored closely.

The Digital Services Act (DSA)[61] complements and updates parts of the now 20-year-old E-Commerce Directive and will become applicable directly in all EU Member States as of February 17, 2024. It provides for uniform horizontal rules on due diligence and liability exclusions for intermediary services (such as online platforms) and is intended to contribute to a safe, predictable and trustworthy online environment and the smooth functioning of the EU single market for intermediary services. This includes ensuring that the procedures for reporting and promptly removing illegal content will in the future be standardized across Europe. Also, there will be additional due diligence requirements for very large online platforms.

[48] GWB, Sec. 36(1) No. 2.
[49] GWB, Sec. 42.
[50] This letter is called the "*Monatsbrief*."
[51] GWB, Sec. 40(1) and (2).
[52] GWB, Secs. 63 *et seq.*
[53] GWB, Sec. 40(3).
[54] EC Regulation No. 139/2004, Art. 1.
[55] EC Regulation No. 139/2004.

[56] Proposal for a Regulation of the European Parliament and of the Council on contestable and fair markets in the digital sector (Digital Markets Act) of December 15, 2020.
[57] Regulation (EU) 2022/1925 of the European Parliament and of the Council of September 14, 2022, on contestable and fair markets in the digital sector, amending Directives (EU) 2019/1937 and (EU) 2020/1828 (Digital Markets Act), Official Journal of the European Union L265/1.
[58] Article 54 Digital Markets Act.
[59] See https://www.consilium.europa.eu/en/press/press-releases/2022/03/25/council-and-european-parliament-reach-agreement-on-the-digital-markets-act/.
[60] See Regulation (EU) 2022/1925 of the European Parliament and of the Council of September 14, 2022, on contestable and fair markets in the digital sector and amending Directives (EU) 2019/1937 and (EU) 2020/1828 (Digital Markets Act).
[61] Regulation (EU) 2022/2065 of the European Parliament and of the Council of October 19, 2022 on a Single Market For Digital Services, amending Directive 2000/31/EC (Digital Services Act), Official Journal of the European Union L277/1.

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Legislative Note: On August 4, 2023, the German Ministry for Digital Affairs and Transport published a first bill for the transposition of the DSA into domestic law.[62]

On February 23, 2022, the EU Commission published its first proposal for an EU Data Act.[63] The EU Parliament agreed upon its position on June 27, 2023, which was the kick-off for the next step, the EU Council of Ministers (the EU trialogue). The EU Data Act[64] entered into force on January 11, 2024 and will become applicable on September 11, 2025. The EU Data Act addresses all those who develop products or services that generate data. The EU Data Act entails far-reaching changes that must already be taken into account in product development. In this respect, haste is called for, as development cycles for new products are usually long. Unlike the GDPR, the Data Act is not limited to personal data. It covers all types of data, for example, data from vehicles, household appliances and consumer goods, and health and lifestyle products. Products such as smartphones, servers or tablets, which were still excluded in the original draft from 2022, now also fall within the scope of the Data Act on the one hand, but also the associated digital services, including essential software. Primarily the new law facilitates data access and use for consumers and businesses. Thus, the Data Act stipulates that products must be designed and manufactured in such a way that the data generated during their use must, by default, be simple, secure and — where relevant and appropriate — directly accessible to the user. The same applies to connected services. The term "data" currently used in the draft is very broad and includes any digital representation of actions, facts or information, also in the form of sound, image or audiovisual material. Connected products within the meaning of the Data Act are those that obtain, generate or collect data about its use and can transmit it via an electronic communications service (mostly referred to as the Internet of Things or IoT). Such products can be, for example, household appliances and consumer goods, as well as medical and health products or industrial machines. The new draft also covers virtual voice assistants and chatbots. Trade secrets only need to be disclosed if all necessary measures have been taken to maintain a confidentiality of trade secrets, especially towards third parties. Furthermore, it is explicitly stipulated that the user may not use the data requested to develop a competing product. As these regulations are not yet far-reaching enough for industry, which fears that they will have an impact on the willingness to innovate, this balance of interests is likely to undergo further adjustments and ramifications. The EU Data Act again applies the market place principle. This principle, which is already known from the GDPR and the Digital Service Act, states that all providers who market their products in the EU are subject to this regulation.

The DMA, the DSA and the EU Data Act form the EU's new approach to the digital industry, which is designed to safeguard competition among market participants.

b. Unfair Trading Practices

The German Law on Unfair Competition, which dates from 1909,[65] was radically modernized in July 2004. The enforcement of this law is almost completely left to the enterprises affected by the unfair competition. Enforcement proceedings, such as an action for an injunction, however, may also be brought by specialized trade organizations.[66]

The law contains a general prohibition on unfair competition that provides that: "Unfair competitive actions in the course of trade that are apt to impair the interests of competitors, consumers and other market participants are objectionable."[67] The law specifies certain types of prohibited actions, including: false statements suggesting that the goods of a competitor are inferior;[68] over-aggressive business actions,[69] misleading advertising;[70] incorrect comparisons with competitors;[71] and unacceptable harassment of clients.[72]

c. Price Controls

There are no price controls except for restrictions prohibiting "unreasonably" high rents,[73] and price controls that may be imposed for purposes of national defense or in times of a national economic emergency.[74]

d. Securities Regulation

Germany's regulatory framework is based on EU directives and regulations. The EU actively participates in international regulatory convergence.

The main element of German banking regulation is the Banking Act (*Kreditwesengesetz* — KWG). In particular, the KWG covers licensing requirements, ownership control and supervision. As regards capital adequacy, the main law is now the Capital Requirement Regulation. Various other laws cover specialized institutions, such as mortgage banks (*Pfandbriefbanken*), building societies (*Bausparkassen*), payment institutions within the meaning of Directive (EU) 2015/2366 on payment services in the internal market (PSD2) and undertakings managing investment funds (*Kapitalverwaltungsgesellschaften*). The regulatory framework is complemented by various regulations setting out more detailed rules for specific areas of banking regulation.

As the national regulator, the *Bundesanstalt fuer Finanzdienstleistungsaufsicht* (BaFin) maintains offices in Bonn (to su-

[62] Available at: https://bmdv.bund.de/SharedDocs/DE/Anlage/Gesetze/Gesetze-20/gesetz-durchfuehrung-verordnung-binnenmarkt-digitale-dienste.pdf?__blob=publicationFile.

[63] Proposal for a Regulation of the European Parliament and the of the Council on harmonized rules on fair access to and use of date (Data Act) of February 23, 2022, as amended by the version published on July 7, 2023 (available at: https://data.consilium.europa.eu/doc/document/ST-11284-2023-REV-1/en/pdf).

[64] Regulation (EU) 2023/2854 of the European Parliament and of the Council of 13 December 2023 on harmonised rules on fair access to and use of data and amending Regulation (EU) 2017/2394 and Directive (EU) 2020/1828 (Data Act).

[65] Law on Unfair Competition (*Gesetz gegen den unlauteren Wettbewerb* — UWG).

[66] UWG, Sec. 8(3).

[67] UWG, Sec. 3.

[68] UWG, Sec. 4.

[69] UWG, Sec. 4a.

[70] UWG, Sec. 5.

[71] UWG, Sec. 6.

[72] UWG, Sec. 7.

[73] Penal Act regulating Economic Matters (*Wirtschaftstrafgesetz* — WiStrG), Sec. 5 and rent control provisions applicable in various German state based on BGB, Sec. 556d.

[74] *Wirtschaftssicherstellungsverordnung* on the basis of the *Wirtschaftsicherstellungsgesetz.*

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pervise banking and insurance) and Frankfurt am Main (to supervise securities markets). The BaFin is the single state supervisory authority in Germany.

e. Supply Chains

The new Law on Corporate Due Diligence in Supply Chains (the "Supply Chain Act") was published in the Federal Law Gazette on July 16, 2021.[75]

The Supply Chain Act initially applies to companies with more than 3,000 employees in Germany from 2023 and from 2024 to companies with more than 1,000 employees in Germany. For purposes of determining whether these thresholds are exceeded, all employees employed in Germany by group companies will be aggregated and, where the thresholds are exceeded, the German or foreign parent company of the group concerned will be subject to the obligations under the Supply Chain Act. Under the UN Guiding Principles on Business and Human Rights, companies are required to determine the extent to which their business activities may lead to human rights violations. Under the Supply Chain Act, companies are required to determine the extent to which their business activities may lead to human rights violations and environmental damages. Companies' due diligence obligations extend to their entire supply chain — from raw materials to the finished sales product. Companies must take measures to prevent violations of basic human rights standards and establish a grievance mechanism for those affected. The requirements are graded according to a company's ability to exert influence. Both internally and with their direct suppliers a company must ensure respect for human rights, for example, the prohibition on forced labor and child labor, and compliance with internationally recognized social standards, such as the International Labour Organization (ILO) core labor standards. In the event of a violation, a company must take immediate remedial action. In the case of an indirect supplier, the due diligence obligation only applies on an *ad hoc* basis. A company is required to investigate and take action only if it learns of human rights violations.

As a first step, a company must identify and assess its risks within its supply chain in order to be able to take measures on this basis. The law identifies forced labor, child labor, discrimination, violations of freedom of association, problematic employment and working conditions, and environmental damage as relevant risk areas. With respect to its indirect suppliers, a company needs only to conduct a risk analysis if it receives complaints from employees of an indirect supplier. As a consequence of the risk analysis, a company must take measures to prevent, minimize and remedy identified negative effects, and prepare documentation and an annual report to be published on its website. A company is first encouraged to seek solutions together with the supplier or within the industry. Breaking off business relations should only be the last resort in dealing with human rights violations by subsidiaries or suppliers. Affected companies are also required to issue an annual report on the actual and potential adverse human rights impacts of its corporate actions publicly. Both the obligation to conduct a risk analysis and the obligation to take follow-up measures should not be a duty to succeed, but a duty to make an effort. This means that a company is not obliged to prevent all human rights violations in its own business operations and those of its direct suppliers in all circumstances. Rather, the required risk management is based on the principle of proportionality. Which measures are appropriate and reasonable with regard to the individual company is determined in particular by the type of business activity, the likelihood of risks arising and the severity of possible damage. A company's actual ability to exert an influence within a supply chain is also relevant.

The Federal Office of Economics and Export Control (BAFA) monitors compliance with the law and sanction violations. BAFA published guidance on the required adequacy and effectiveness test, the complaints procedure, the required annual reporting and the risk analysis.[76] In particular, the guidance on the risk analysis interprets the law very restrictively to the disadvantage of companies. Firstly, BAFA bases its guidance on a broad understanding of the terms "contribute/(co-)cause" in relation to the "contribution to causation" pursuant to Section 3 (2), no. 4 of the Supply Chain Act, which is based on OECD guidelines. According to this interpretation, it should be sufficient that an act or omission by a company *in some way* permits, enables or motivates the violation of a specific duty. However, this contradicts the explanatory memorandum to the law, which requires the *sole direct causation of, or contribution to*, the creation or amplification of a risk.[77] Secondly, although the Supply Chain Act reduces due diligence obligations towards indirect suppliers, BAFA recommends proceeding proactively and also including the deeper supply chain (i.e., indirect suppliers) in the risk analysis from the outset. In addition, BAFA seems to be of the opinion — contrary to the legal system — that the event-related risk analysis to be carried out in the event of a changed risk situation encompasses the "entire supply chain," including indirect suppliers, while Section 5 (4) of the Supply Chain Act only regulates the "when," not the "how" of the risk analysis. According to Section 9 (3), no. 1 of the Supply Chain Act, an event-related risk analysis is only to be carried out for an indirect supplier if there are actual indications that make a violation of a human rights- or an environment-related obligation at an indirect supplier appear possible (substantiated knowledge). Unfortunately, BAFA does not specify in a practical manner when such substantiated knowledge is considered to exist.

In the event of a failure to comply with due diligence requirements, the Supply Chain Act provides for sanctions in the form of fines and periodic penalty payments in an amount of up to 2% of a company's annual sales. In addition, a company that has already been fined a large amount can be excluded from public contracts for up to three years. The Supply Chain Act does not provide for an additional civil law liability of the company but expands the reasons for the company's already existing civil law liability. In addition, non-governmental organizations (NGOs) and trade unions are entitled to file an action against a company for a third party that claims a breach of the company's obligations under the Supply Chain Act.

As a consequence, a company's compliance organization needs to be expanded accordingly to include sustainability and

[75] Law on Corporate Due Diligence in Supply Chains, BGBl. 2021 I, 2959.

[76] *See* https://www.bafa.de/DE/Lieferketten/lieferketten_node.html;jsessionid=A6656D27D38C3CE2EF4A7C5900481232.intranet231.

[77] BT-Drucks. 19/28649, p. 43.

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human rights aspects in the supply chain. The first step is the risk analysis, in which the risk of possible human rights violations must be assessed (based on country- and industry-specific factors). Both the United Nations (UN) Guiding Principles on Business and Human Rights and the National Action Plan serve as guidance for implementing such compliance management systems. If a company determines that risks exist within a supply chain, it must take preventive measures, for example, through appropriate agreements with suppliers in which corresponding due diligence obligations are also imposed on the supplier, according to which human rights, employee concerns and environmental standards must be complied with. It also needs to screen (existing and future) suppliers with regard to their ability to comply with due diligence obligations. It may also be advisable for supplier agreements to refer to a "code of conduct," in which the company describes its expectations for cooperation, in particular with those suppliers that are not explicitly bound by the Supply Chain Act. Thus, the limitation of the Supply Chain Act to companies with more than 3,000/1,000 employees in Germany does not protect SMEs at all, as their business partners, which are subject to such legal obligations, extend their obligations contractually to the SMEs, too, which will result in costly bureaucratic burdens.

Legislative Note: The German Supply Chain Act needs to be adapted to the EU Corporate Sustainability Due Diligence Directive (CSDDD), which was initiated in June 2020 by the European Parliament. The EU Commission had published a bill for this Directive on March 23, 2022, which was accepted after long negotiations in an amended version by the EU Member States on March 15, 2024 and the European Parliament on April 24, 2024.[78] The EU CSDDD must be transposed into the domestic laws of the EU Member States by July 26, 2027 and will become effective as of July 26, 2028. The EU CSDD will apply to all enterprises with more than 1,000 employees and a world-wide gross turnover of more than 450 million euros. On February 26, 2025, the EU Commission filed a draft Directive[79] to reduce regulatory burdens. Under the draft Directive, *inter alia*, the check on the supply chain is to be confined to the direct business partners unless there is a specific indication of risk. Further, the transposition of the CSDDD into Member States' domestic laws is to be postponed to July 26, 2027. There is now new debate, initiated by France and Germany in May 2025, that seeks to block the EU CSDDD entirely to improve the competitiveness of EU enterprises. However, this initiative has so far been opposed by significant groups in the EU Parliament.

f. EU Whistleblower Directive

The EU Directive (EU) 2019/1937 of the European Parliament and of the Council of October 23, 2019, on the protection of persons who report breaches of Union law (Whistleblower Directive) was published on November 26, 2019,[80] and had to be transformed into German domestic law by December 17, 2021. Germany did not meet this deadline. Instead, after intense public debate, the German Whistleblower Act was published on May 31, 2023,[81] under which all employers with at least one employee are required to have a whistleblower protection system in place and are subject to a fine in the event of misconduct. The system must be an internal system if the employer in principle employs at least 50 employees. In certain industries, such as those providing investment services, insurance, financial services, or data provision, the internal system needs to be established irrespective of the number of the employees. In case of a breach of this obligation, the employer can be fined up to 20,000 euros. In all other cases, using an external system, to be established and operated by the public service, is sufficient. Larger employers will have to establish such internal systems by December 1, 2023, while employers with 50 to 249 employees will have to do so by December 17, 2023.

While the Whistleblower Directive and, therefore, the Whistleblower Act, does not interfere with the client-attorney privilege (attorneys are still bound to the confidentiality obligation regarding the information disclosed by the client and, therefore, disallowed to "blow the whistle" irrespective of the Whistleblower Act), German tax advisors and their staff, who are also subject to similar confidentiality obligations, seem to be allowed to "blow the whistle," at least according to the Whistleblower Act. While the German version of the Whistleblower Directive addresses only those professionals subject to a client-attorney privilege (i.e., the lawyers), the English version thereof addresses all professionals who are subject to "a legal professional privilege." The German legislature has evidently ignored these different wordings and transformed the German version of the Whistleblower Directive into domestic law. This action would seem to conflict with Article 20 of the EU Charter on Fundamental Rights and Articles 3 and 12 of the German Constitution.

Comment: Until such time that German tax advisors are not explicitly exempted from the Whistleblower Act, from a client's perspective, information disclosed to a German tax advisor and even more so to tax advisors in other EU Member States who are less regulated than German tax advisors is not adequately protected by the confidentiality obligation of tax advisors under the current law.

g. EU Artificial Intelligence Act (EU AI Act)

The EU AI Act,[82] which is set to take effect in 2024 and shall apply generally as from August 2, 2026, but partially as from February 2 and August 2, 2025, represents a significant legislative move to regulate artificial intelligence within the European Union. This Act is structured around a risk-based approach, categorizing AI systems based on their potential soci-

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[78] Directive (EU) 2024/1760 of the European Parliament and of the Council of June 13, 2024 on corporate sustainability due diligence and amending Directive (EU) 2019/1937 and Regulation (EU) 2023/2859.

[79] Proposal for a Directive of the European Parliament and of the Council amending Directives 2006/43/EC, 2013/34/EU, (EU) 2022/2464 and (EU) 2024/1760 as regards certain corporate sustainability reporting and due diligence requirements of February 26, 2025, COM(2025) 81 final.

[80] Directive (EU) 2024/1760 of the European Parliament and of the Council of 13 June 2024 on corporate sustainability due diligence and amending Directive (EU) 2019/1937 and Regulation (EU) 2023/2859.

[81] Law for Better Protection of Whistleblowers and for the Implementation of the Directive on the Protection of Persons Reporting Infringements of Union Law (the German Whistleblower Act) of May 31, 2023, BGBl. 2023 I, No. 140.

[82] REGULATION (EU) 2024/1689 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 13 June 2024 laying down harmonised rules on artificial intelligence and amending Regulations (EC) No 300/2008, (EU) No 167/2013, (EU) No 168/2013, (EU) 2018/858, (EU) 2018/1139 and (EU) 2019/2144 and Directives 2014/90/EU, (EU) 2016/797 and (EU) 2020/1828 (Artificial Intelligence Act).

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etal risks, and imposing stricter regulations on those considered high-risk. High-risk AI systems include those integral to safety components, critical infrastructures, or that involve sensitive data processing, such as biometric recognition or profiling individuals.

The legislation explicitly bans certain AI applications considered harmful or a threat to fundamental rights. Prohibited systems include those capable of manipulative behavior alteration, social scoring, and non-consensual biometric categorization. In an effort to balance regulation with innovation, the Act also introduces "regulatory sandboxes" to facilitate the development of new AI technologies under regulatory oversight, ensuring they can be safely integrated into the market.

Significantly, the Act also establishes a new administrative infrastructure to oversee AI compliance, including an AI Office within the European Commission and a network of national supervisory authorities. These bodies are tasked with monitoring, standardizing, and ensuring compliance across member states. Non-compliance with the Act can result in substantial fines, up to 35 million euros or 7% of global turnover, depending on the severity of the infringement.

The AI Act is the first legal framework of its kind, aiming to set a global benchmark for the development and deployment of artificial intelligence, prioritizing safety, transparency, and respect for human rights.

3. *Licensing and Franchising*

a. *In General*

While licensing agreements covering intangible intellectual property (IP) rights, such as patents or know-how, are widely used by foreign businessmen who wish to have their goods manufactured in Germany, franchising is used in relatively few industries (examples are the fast food and car rental industries). Currently, there are no restrictions on entering into such agreements or on the payment of royalties to foreign licensors or franchisors, except that such agreements may not amount to a violation of antitrust law. Since a valid license requires an effective IP right, the registration of IP rights and the protection of know-how and copyright is briefly outlined below.

b. *Intellectual Property Rights*

(1) Patents

German law provides for the issuance of a basic patent on a technical invention for a period of 20 years following the effective filing date of the relevant patent application.[83] The patent offers to its holder a protection right against unauthorized commercial use by other persons in Germany, after the patent has been registered. For this, the applicant needs to file for registration of the invention with the German Patent and Trademark Office in Munich. To register a patent, the applicant must disclose the details of his or her novel invention to the public.

A one-time fee is charged for the registration of a patent. To keep a patent valid, progressive annual fees must be paid.

A wider territory of patent protection covering Germany and other EU Member States may be secured by a European patent, which is valid in multiple European countries as applied for in the application form filed with the European Patent Office in Munich, Germany, but not necessarily for all EU Member States.[84]

A special statute addresses inventions made by employees.[85] Under this statute, an employee is obliged to report immediately to his or her employer inventions made by him or her during working hours in the course of work.[86] The employer has the right to claim the invention in return for reasonable compensation.[87] Inventions made in an employee's spare time must also be reported to the employer, unless it is evident that they cannot be used in the employer's operations.[88] The inventor must offer the employer at least a non-exclusive license for the latter type of invention.[89]

Temporary protection is granted for patents, petty patents, designs and models, and for trademarked articles that have been shown at certain designated international fairs in Germany. This temporary protection allows for the exhibition, further use or later publication of these patents, etc. without impairing legal protection, provided the application for registration of the IP right is filed within six months of the opening date of the fair or exhibition.[90]

(2) Petty Patents

The law also protects new working tools or equipment to the extent they improve the work method or process for which they are designed because of their new form or structure, or the use of a new device.[91] A petty patent (*Gebrauchsmuster*) is protected for 10 years from the end of the month in which the petty patent application is filed with the German Patent and Trademark Office and the patent is registered in the petty patent register.[92]

(3) Designs

Two- or three-dimensional designs that are novel and unique may be registered with the German Patent and Trademark Office[93] in Munich for Germany and, as of 2003, with the European Union Intellectual Property Office (EUIPO) in Alicante for the EU territory.[94] The offices examine design applications for form and registrability.[95] Registration at the German office is valid for 25 years from the date of application,[96] where-

[83] Patent Act (*Patentgesetz* — PatG), Secs. 1, 16.

[84] European Patent Convention of October 5, 1973; the 17th revised edition entered into force on January 1, 2021.

[85] Law Concerning Inventions Made by Employees (*Arbeitnehmererfindungsgesetz* — ArbnErfG).

[86] ArbnErfG, Sec. 5.

[87] ArbnErfG, Secs. 6 and 9.

[88] ArbnErfG, Sec. 18.

[89] ArbnErfG, Sec. 19.

[90] For example, PatG, Sec. 3(5).

[91] Petty Patents Act (*Gebrauchsmustergesetz* — GebrMG), Sec. 1.

[92] GebrMG, Sec. 23(2).

[93] Design Act (*Designgesetz* — DesignG), Sec. 2.

[94] Council Regulation No. 6/2002 on Community Designs (EC Reg. No. 6/2002), Secs. 3–6.

[95] DesignG, Secs. 16–18; EC Reg. No. 6/2002, Secs. 45–48.

[96] DesignG, Sec. 27.

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as registration at the Alicante office is valid for five years, but may be extended for up to 25 years.[97]

(4) Trademarks and Service Marks

Trademark and service mark registrations may be obtained for the territory of Germany and for the entire European Union. In each case, registrations are valid for 10 years from the filing date and may be renewed for 10-year periods.[98] The first applicant for a trademark is entitled to register it and has the right to its exclusive use.[99] An application is examined for form, eligibility for registration and evident conflicts with prior registrations.[100] If acceptable, the application is published in order to invite objections, which must be made within three months. Objections may be made within three months from the date of publication, for example, if an application for a trademark resembles another trademark subject to a previously filed and pending application, if it resembles an existing registration or if the objecting party has acquired rights to a similar trademark in another country, and the applicant is his or her commercial agent and is applying for a registration without the objector's consent.[101] If no objections are raised, the trademark will be registered.[102]

Even after registration, however, cancellation proceedings can be brought if a prior conflicting registration exists or if a commercial agent registered the trademark without being authorized to do so. Cancellation is also possible if the business in which the trademark is used is terminated by the applicant, or if a trademark is deceptive or misleading.[103] Trademark assignments, which may be effected with or without a transfer of the business to which they relate, may be recorded in the trademark register.[104]

A registered trademark must be used within five years of its registration date or it is subject to cancellation and may not be used as a basis for opposing a subsequent application.[105]

c. Industrial Know-how

Trade secrets relating to the manufacture or distribution of industrial products that are not specifically dealt with as patents, copyrights, trademarks, designs or petty patents are deemed to be industrial know-how. Such trade secrets are protected against unauthorized acquisition, use and disclosure under the Trade Secrets Protection Act,[106] if the owner provides for sufficient protective measures.

d. Copyrights

Works of literature, science or culture are protected under the Copyright Act.[107] The authors of such works have the exclusive right to publish, distribute and exhibit them.[108] Such protection lapses 70 years after the death of the author.[109] The Copyright Act also protects computer software. If the software is developed by an employee in his or her capacity as such or under instructions issued by the employer, the employer has the exclusive rights to all monetary benefit from the software, unless there is an express stipulation to the contrary.[110] In the case of freelance personnel, an express stipulation granting exclusive rights to the principal is necessary.[111]

D. Employment of Aliens

1. In General

An alien individual who wishes to take up employment in Germany may do so only if he or she possesses a residence document entitling him or her to work in Germany. An alien in this context is any individual who does not hold German citizenship, but preferential status is granted to citizens of EU or EEA Member States over citizens of third countries. The entry and residence of citizens of EU or EEA Members States is regulated under the Free Movement Act/EU, effective January 1, 2005.[112] According to this law, no visa or other residence permit is necessary for such individual to enter and reside in Germany.[113]

2. Residency

The basic provisions controlling the residence of aliens in the Federal Republic are embodied in the Residence Law[114] and the implementing regulations thereunder, which replaced the Law on Aliens[115] on January 1, 2005. Generally, an alien may enter and reside in the Federal Republic only if he or she has received a residence permit (*Aufenthaltstitel*),[116] which is granted by the local aliens department (*Auslaenderbehoerde*).[117] The types of residence permit are as follows: a visa (*Visum*);[118] a residence permit (*Aufenthaltserlaubnis*);[119] a settlement permit (*Niederlassungserlaubnis*);[120] an EC permit for permanent residence;[121] a Blue Card EU for qualified academics;[122] and an intra-corporate transfer (ICT) Card for alien employees who will work for the same employer in Germany.[123] A permit is generally issued if, *inter alia:*

[97] EC Regulation No. 6/2002, Sec. 12.
[98] Trademark Act (*Markengesetz* — MarkenG), Sec. 47; Council Regulation (EC) 2017/1001 on the European Union Trademark, Sec. 52.
[99] MarkenG, Sec. 14(1); EC Reg. No. 40/94, Sec. 45.
[100] MarkenG, Sec. 36(1); EC Reg. No. 40/94, Secs. 36 and 38.
[101] MarkenG, Sec. 42; EC Reg. No. (EC) 2017/1001, Sec. 46.
[102] MarkenG, Sec. 41; EC Reg. No. (EC) 2017/1001, Sec. 51.
[103] MarkenG, Secs. 48–52; EC Reg. No. (EC) 2017/1001, Secs. 57–62.
[104] MarkenG, Sec. 27; EC Reg. No. (EC) 2017/1001, Sec. 51.
[105] MarkenG, Sec. 43; EC Reg. No. (EC) 2017/1001, Sec. 61.
[106] Trade Secrets Protection Act (*Gesetz zum Schutz von Geschaeftsgeheimnissen* — GeschGehG), Sec. 1, based on Directive (EU) 2016/943 on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure dated June 8, 2016.
[107] Copyright Act (*Urheberrechtsgesetz* — UrhG).
[108] UrhG, Secs. 15 to 22.
[109] UrhG, Sec. 64.
[110] UrhG, Secs. 69 a–g.
[111] UrhG, Sec. 43.
[112] Free Movement Act/EU (*Freizuegigkeitsgesetz* — FreizuegG/EU).
[113] *Freizueg*G/EU, Secs. 2(4) and 12.
[114] Residence Law (*Aufenthaltsgesetz* — AufenthG).
[115] Law on Aliens (*Auslaendergesetz* — AuslG).
[116] AufenthG, Sec. 4.
[117] AufenthG, Sec. 71(1).
[118] AufenthG, Sec. 6.
[119] AufenthG, Sec. 7.
[120] AufenthG, Sec. 9.
[121] AufenthG, Sec. 9a.
[122] AufenthG, Sec. 18b.
[123] AufenthG, Secs. 19–19b.

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(i) Maintenance is secured;

(ii) The individual's identity is confirmed; and

(iii) There is no basis for extradition.[124]

Subject to certain preconditions, no residence permit is required for experts and scientists.[125]

Citizens of certain countries, including Argentina, Australia, Brazil, Canada, SAR Hong Kong, Japan, SAR Macao, Mexico, South Korea, the United Arab Emirates, and the United States do not need a residence permit for entry into and residence in Germany, even if their stay exceeds three months.[126] However, this does not apply if such individuals intend to engage in remunerative activities in Germany. In that case, such individuals may apply for the necessary residence permit after their entry into Germany.

In certain circumstances, a "Schengen-visa" may be granted to a non-EU third-country national for a short-term stay of up to three months. The holder of a Schengen-visa may travel through all the countries that have implemented the Schengen Agreement (named after the Luxemburg town of Schengen).[127] These countries are Austria, Belgium, Bulgaria, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Italy, Latvia, Liechtenstein, Lithuania, Luxemburg, Malta, The Netherlands, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, Croatia, Spain, Sweden and Switzerland. For long-term stays, a national (German) visa, which has to be applied for before entry into Germany, is required.[128] A national visa generally entitles the bearer to enter the "Schengen states" as well.[129]

A residence permit — like a visa — is temporary but may be extended. It is granted for certain residence purposes, for example, to take up employment or to become self-employed in Germany.[130] The permit may carry certain restrictions and stipulations, providing, for example, that the alien concerned may not engage in political activities, or that he or she may not accept employment or engage in particular remunerative activities, or the permit may lapse on the termination of a particular employment relationship.

A settlement permit is an unlimited residence permit that is granted without any restrictions to an alien who has resided in Germany for at least five years.[131] It entitles the alien, *inter alia*, to engage in a remunerative activity.

3. Work Permits

An alien who is not a citizen of an EU or EEA Member State who intends to engage in a remunerative activity in Germany does not need a separate work permit. A residence permit including permission for employment is sufficient.[132] This permit is granted by the aliens department with approval from the Federal Employment Agency (*Bundesagentur fuer Arbeit*), a process known as "one-stop-government."[133]

The approval of the Federal Employment Agency depends on the situation in the German labor market. Generally speaking, approval is granted if no German, EU or EEA employee is available for the specified job.[134] Consequently, approval may be limited to a certain period of time, a certain type of job, a certain employer or a certain region.[135] The Federal Employment Agency must determine that employing the alien concerned will not have negative consequences for the job market. Furthermore, the working conditions for the alien must be no worse than those for comparable German employees. The Federal Employment Agency has discretionary power to deny its approval even if all these conditions are fulfilled.

For certain jobs, no approval from the Federal Employment Agency is necessary. These are, *inter alia*, jobs that require a high qualification such as work as: a scientist, professor, highly-paid specialist or top executive; a member of a board; a partner; or an employee who works mainly abroad.[136]

E. Labor Relations

1. In General

German labor law is extensively regulated by statutory law, case law and collective bargaining agreements. In addition to provisions in the German Civil Code (*Buergerliches Gesetzbuch* — BGB), Sections 611 through 630 of which establish general rules for employment contracts, there are specific statutory provisions such as the Protection Against Dismissal Act[137] and laws protecting certain types of employees in need of special protection (such as disabled employees or pregnant women).[138]

2. Employment Law

In Germany, an employer is generally under a legal obligation to stipulate the essential terms of an employment relationship in writing.[139] An employment agreement for a fixed term or that is to terminate in certain circumstances is enforceable only if it is in writing. Similarly, agreements with apprentices must be in writing[140] and collective bargaining agreements frequently require written form. Other types of contract need not be in writing because an employment contract concluded orally is binding on both the employer and the employee. No specific sanction applies if the employer does not reduce such a contract to writing. It is, however, advisable to put an agreement in writing to enable the terms of the agreement to be established should a dispute arise.

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[124] AufenthG, Sec. 5(1).
[125] AufenthG, Secs. 18c–18f.
[126] Ordinance concerning residence (*Aufenthaltsverordnung* — AufenthV), Sec. 17(1).
[127] AufenthG, Sec. 6.
[128] AufenthG, Sec. 6.
[129] AufenthG, Sec. 6 (1) No. 1.
[130] AufenthG, Secs. 18–21.
[131] AufenthG, Sec. 9.
[132] AufenthG, Sec. 4a.
[133] AufenthG, Sec. 39(1).
[134] AufenthG, Sec. 39(2).
[135] AufenthG, Sec. 39(4).
[136] Ordinance concerning Employment (*Beschaeftigungsverordnung* — BeschV).
[137] Protection Against Dismissal Act (*Kuendigungsschutzgesetz* — KSchG).
[138] Social Security Code IX (SGB IX); Maternity Protection Act (*Mutterschutzgesetz* — MuSchG).
[139] Evidence Act (*Nachweisgesetz* — NachwG), Sec. 2.
[140] Law Concerning Apprentices (*Berufsbildungsgesetz* — BBiG), Sec. 11.

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Since 2015, Germany has had nationwide minimum wage legislation. Under the Minimum Wage Act,[141] every employer must pay a minimum wage of 9.82 euros per hour (as of January 1, 2022) and 10.45 euros per hour (as of July 1, 2022) to an employee who is employed in Germany. Certain exceptions apply for interns, trainees and long-term unemployed people. In accordance with the wishes of the new German government, on June 3, 2022, the German Parliament passed a new law (confirmed by the *Bundesrat*, i.e., the second chamber, on June 10, 2022) under which the nationwide minimum wage has been increased again to 12.00 euros per hour, with effect from October 1, 2022.[142]

Employment contracts that do not automatically expire on a definite date may be terminated by either party, subject to a minimum prior notice period,[143] which is generally four weeks to the middle or end of a month.[144] In the case of termination by the employer, the minimum notice period will be extended, based on the employee's age and years of service.[145] However, any employment contract may be terminated for cause without any notice period.[146]

The freedom to terminate an employment contract is significantly limited by the Protection Against Dismissals Act in the case of businesses that employ the services of more than five employees (excluding apprentices).[147] An employee who works for such a business must be given notice of termination after uninterrupted service of more than six months, and the employer must demonstrate that the termination was for a justifiable cause, such as a cause related to the person or the behavior of the employee, or an operational reason in the business that prevents the continued employment of the employee.[148] If there is a works council (see II.E.4.d.(1), below), the works council must approve the dismissal of an employee.[149] Termination for mandatory operational reasons is ineffective if the employee can be employed in another part of the employer's business and/or if a "social selection" has not been observed. "Social selection" requires that the youngest employees be terminated first, followed by those with the shortest length of service, those with dependent children and the disabled last.

3. *Collective Bargaining*

Collective bargaining agreements often regulate working hours, wages, salaries, payment for overtime and night work, vacations, and bonuses.[150] Most of these agreements are negotiated between a trade union on the one side, and the appropriate employers' association or even a single employer on the other side.[151] Membership of a trade union is voluntary. There is no closed shop system, because the constitutional freedom to associate in unions includes the right not to join a union. Membership of the employers' association for its line of business is also voluntary for an employer.

Collective bargaining agreements generally are binding only on employers that are members of the employers' association that concluded the relevant agreement. The same applies with regard to employees, i.e., a collective bargaining agreement generally benefits only employees who are members of the trade union that concluded the relevant agreement.[152] Nevertheless, employers normally apply the terms of such contracts to all employees by way of reference in the employment contracts to avoid creating an incentive for employees to join a union. Furthermore, collective bargaining agreements may be declared generally applicable for a certain industry by the Federal Minister of Labor and Social Matters, in which case they are applicable regardless of whether the employer belongs to the negotiating employers' association or whether the employee belongs to the negotiating trade union.[153] Certain provisions in collective bargaining agreements concerning works council- and business-related questions, such as the daily time for the beginning and end of work, may have the same binding effect on employees.[154]

Many employees, however, have individual contracts that provide for higher wages and more favorable working conditions than those stipulated in the relevant collective bargaining agreement.

4. *Worker Representation on Corporate Boards*

Co-determination in the context of labor relations can be defined as the power of employees and/or their representatives or labor organizations to influence plant, shop and company policy beyond the mere negotiation of individual employment contracts or collective bargaining agreements. This type of co-determination allows labor representatives or unions to have a say in supervisory or other decision-making bodies on issues beyond those covered by the terms of employment, such as the determination of general corporate policies.

The most important statutory sources for co-determination at the company level are described in a. to d., below.

a. *Coal and Steel Co-Determination Act of 1951*

The Coal and Steel Co-Determination Act of 1951[155] provides for a 50/50 representation of shareholders and employees on the supervisory boards of companies in the coal and steel industries.[156] The majority of the employees' representatives must be nominated by the union. In addition, the union may object to the minority representatives elected by the employees directly.[157] Further, men and women each should hold at least 30%

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[141] Minimum Wage Act (*Gesetz zur Regelung eines allgemeinen Mindestlohns "Mindestlohngesetz"* — MiLoG).

[142] Act on Increasing the Protection Provided by the Statutory Minimum Wage and on Changes in the Area of Marginal Employment (*Gesetz zur Erhoehung des Schutzes durch den gesetzlichen Mindestlohn und zu Aenderungen im Bereich der geringfuegigen Beschaeftigung*) of June 28, 2022, BGBl. 2022 I, 969.

[143] BGB, Sec. 622.

[144] BGB, Sec. 622(1).

[145] BGB, Sec. 622(2).

[146] BGB, Sec. 626.

[147] KSchG, Sec. 23(1).

[148] KSchG, Sec. 1(2).

[149] KSchG, Sec. 1(2).

[150] Collective Bargaining Agreements Act (*Tarifvertragsgesetz* — TVG), Sec. 1(1).

[151] TVG, Sec. 2.

[152] TVG, Sec. 3(1).

[153] TVG, Sec. 5.

[154] TVG, Sec. 3(2).

[155] Coal and Steel Co-Determination Act (*Montan-Mitbestimmungsgesetz* — MontanMitbestG); as to its applicability after reorganizations, *see* decision of the Federal Constitutional Court I BvL 2/91 of March 2, 1999, BGBl. 1999 I, 372.

[156] MontanMitbestG, Sec. 4.

[157] MontanMitbestG, Sec. 6(2).

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of the seats in the supervisory board of a listed corporation.[158] The shareholders and the employees' representatives together must elect a "neutral member" to avoid a constantly tied vote.[159] In addition, the management board must have one member in charge of personnel affairs (director of labor) who may not be appointed or removed without the approval of the majority of the employees' representatives.[160]

b. *One-Third Participation Act of 2004*

The One-Third Participation Act[161] applies to stock corporations and cooperatives (not partnerships) with between 500 and 2,000 employees. Corporations with more than 2,000 employees fall under the Co-Determination Act[162] (see below).

Under the One-Third Participation Act, one-third of the members of the supervisory board of a corporation must represent the employees.[163] Men and women should be represented proportionately by the employees' representatives in the supervisory board.[164] The persons to be elected must be at least 18 years old and must have been employed by the corporation for at least one year. If more than two members represent the employees, at least two representatives need to be employees of the respective corporation. Labor representatives have the same rights as shareholder representatives, who, however, may outvote them.

c. *Co-Determination Act of 1976*

Under the Co-Determination Act of 1976, the supervisory board of, *inter alia*, any German stock corporation or limited liability company with more than 2,000 employees must consist of an equal number of shareholder and labor representatives.[165] This does not apply to other legal forms, such as partnerships, or to branches of foreign corporations.[166] However, the law expressly includes limited partnerships whose general partners are German corporations,[167] as well as groups of affiliated companies where the parents are German corporations.[168]

Labor representatives on the supervisory board are elected by the employees, i.e., either directly, in the case of companies with fewer than 8,000 employees, or indirectly via electors, unless the employees decide otherwise.[169] Elections are particularly complicated. The total size of the board depends on the number of employees. If the board has between six and eight members, two of the members, known as "union representatives," are proposed by the union. If the board has 10 members, there are three union representatives.[170] At least one of the union representatives must be from the managerial staff (managing employees).[171] Men and women each should hold at least 30% of the seats on the supervisory board of a listed stock corporation.[172]

One member, the director of labor, must be in charge of personnel and social matters.[173] Unlike the Coal and Steel Co-Determination Act,[174] the Co-Determination Act of 1976 does not require that the director of labor not be opposed by the workforce or the union, although the unions interpret the Act as doing so.

To deal with tied votes in the supervisory board, the law provides for the election of a chairman who, after completing a complicated procedure in the absence of agreement between the two sides, may come from the shareholder side with a deputy from the labor side.[175] In the case of a tie, the chairman (not the deputy) has the deciding vote.[176]

While the supervisory board may set up subcommittees, in particular to prepare its discussions and resolutions or to monitor the implementation of its resolutions, particularly sensitive matters, as enumerated in the law, may be dealt with only by the full supervisory board.[177]

d. *Works Constitution Act of 1952*

The Works Constitution Act of 1952 introduced a multitude of measures, the most important of which are summarized below.

(1) *Works Council*

Employees working for firms with five or more employees have the right to establish a works councils (*Betriebsrat*).[178] The size of the council depends on the size of the firm.[179] In firms with 200 or more employees, an increasing number of works council members are completely relieved from their usual employment duties in order to attend to their works council duties.[180] A firm must provide the council with meeting rooms, office supplies and personnel.[181] The members of the works council may generally not be dismissed except for cause.[182] However, the authority granted to the unions under this law is limited. They have the right to enter the company but must inform the company's management first. If a certain percentage of the works council members so request, the union is allowed to participate in works council meetings or in general meetings of the employees, but it has no further rights of its own.[183] Union officials may become members of the works council only if they happen to be employees of the firm concerned and are nominated and elected by the employees.[184]

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[158] MontanMitbestG, Sec. 5a.
[159] MontanMitbestG, Sec. 8.
[160] MontanMitbestG, Sec. 13.
[161] One-Third Participation Act (*Drittelbeteiligungsgesetz* — DrittelbG).
[162] Co-Determination Act (*Mitbestimmungsgesetz* — MitbestG), Sec. 1(1).
[163] DrittelbG, Sec. 4(1).
[164] DrittelbG, Sec. 4(4).
[165] MitbestG, Secs. 1(1), 7.
[166] MitbestG, Sec. 1(1).
[167] MitbestG, Sec. 4.
[168] MitbestG, Sec. 5.
[169] MitbestG, Sec. 9.
[170] MitbestG, Sec. 7(2).
[171] MitbestG, Sec. 15(2).
[172] MitbestG, Sec. 7(3).
[173] MitbestG, Sec. 33.
[174] MontanMitbestG, Sec. 13(1).
[175] MitbestG, Sec. 27.
[176] MitbestG, Sec. 29(2).
[177] Stock Corporation Act (*Aktiengesetz* — AktG), Sec. 107(3).
[178] Works Constitution Act (*Betriebsverfassungsgesetz* — BetrVG), Sec. 1.
[179] BetrVG, Sec. 9.
[180] BetrVG, Sec. 38.
[181] BetrVG, Sec. 40.
[182] KSchG, Sec. 15; BetrVG, Sec. 103.
[183] BetrVG, Sec. 31.
[184] BetrVG, Sec. 8.

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(2) Economic Committee

An enterprise with more than 100 employees that has a works council is required to also form an advisory "economic committee" (*Wirtschaftsausschuss*) whose duty is to discuss business matters with management and to inform the works council on such matters. Management is required to provide the committee with detailed advance information on the economic situation of the enterprise and to submit to it all necessary documents (including balance sheets, budgets, etc.), except documents involving trade secrets. Contemplated mergers and acquisitions or the closing of the firm must also be discussed in advance with the economic committee, which may enforce this right in court.[185]

Failure on the part of management to provide such information is subject to fines of up to 10,000 euros.[186] However, management has the right to make general business decisions in the face of opposition from the economic committee, except where the effect would be the closing of plants, mass layoffs or significant restructuring. Only in such instances, may a company be required to notify the regional labor office first and to negotiate a "social plan" as well as an implementation agreement with the works council, providing for financial compensation for all affected employees.[187] If negotiations fail, the matter will be referred to an arbitration committee (*Einigungsstelle*) consisting of an equal number of employer and works council representatives and an impartial chairman.[188] The costs of such a social plan may be substantial and normally the following facts are considered in determining the amount each employee may claim under the plan:

(i) The particularities of the industry concerned: for example, a generally high rate of fluctuation in employment, such as is characteristic of the construction industry, may result in less compensation for permanent layoffs. By contrast, highly qualified personnel (for example, watchmakers) may find it more difficult to find an adequate new job and, therefore, more compensation may be required.

(ii) The unemployment rate: the extent to which the unemployment rate in the industry concerned and/or the geographical area in which the plant is located directly affects the employees' chances of getting new jobs.

(iii) The financial status of the employer: reasons for closing (for example, rationalization measures necessary for the employer's survival) that are not the result of corporate mismanagement or the value of assets available to the employer.

(iv) Individual circumstances: the age, seniority and monthly salary of each individual employee.

These facts are then often incorporated into a points system to determine ultimately what share in the total amount of the social plan is allocable to each individual employee.

[185] BetrVG, Sec. 106.
[186] BetrVG, Sec. 121.
[187] BetrVG, Secs. 111 and 112.
[188] BetrVG, Sec. 112(2).

(3) Female Quotas for Supervisory Boards and Leadership Positions

Following a year-long debate, on March 6, 2015, the German parliament passed the "Act on Equal Participation of Women and Men regarding Leadership Positions within the Sectors of Private Economy and Public Service."[189] Publicly listed companies with 50/50 co-determined supervisory boards, i.e., boards in which half of the members are employee representatives, must be composed of at least 30% female members. In general, this requirement applies for appointments and nominations to a supervisory board on or after January 1, 2016.

In addition, all publicly listed companies, as well as all companies with co-determined supervisory boards — either 50/50 co-determined boards or one-third participation boards — needed to set (on or before September 30, 2015) their own targets regarding the proportion of women on managing boards, on supervisory boards and in upper management. These targets, deadlines, and information on target achievement, including reasons for any failure to set them, have to be publicly disclosed.

The Act to Supplement and Amend the Regulations for the Equal Participation of Women in Management Positions in the Private and Public Sectors of August 7, 2021,[190] requires that at least one woman form part of the executive board of a listed stock corporation or a co-determined corporation with more than three board members.

F. Financing the Business

1. Shareholder Financing

Shareholders of a corporation may finance its business operations in Germany by the infusion of equity capital, by shareholder loans or by some hybrid form of shareholder financing.

a. Equity Capital

Under German company law, a shareholder may infuse equity capital into a German corporation by way of a formal contribution in cash or kind to the corporation's stated share capital in consideration for the issuance of new shares of stock or by way of an informal contribution to the corporation's capital reserve without a corresponding increase in stated share capital. A formal contribution to the corporation's stated share capital requires an amendment of a corporation's articles of association[191] and must be effected in accordance with the corporate law rules. The repayment of a contribution to the corporation's stated share capital may be effected either in the course of a formal reduction of the corporation's stated share capital in ac-

[189] Act on Equal Participation of Women and Men regarding Leadership Positions within the Sectors of Private Economy and Public Service (*Gesetz fuer die gleichberechtigte Teilhabe von Frauen und Maennern an Fuehrungspositionen in der Privatwirtschaft und im oeffentlichen Dienst* — FüPoG) of April 24, 2015, BGBl. 2015 I, 642.
[190] Act to Supplement and Amend the Regulations for the Equal Participation of Women in Management Positions in the Private and Public Sectors (*Gesetz zur Ergaenzung und Aenderung der Regelungen für die gleichberechtigte Teilhabe von Frauen an Fuehrungspositionen in der Privatwirtschaft und im oeffentlichen Dienst* — FüPoG II), BGBl. 2021 I, 3311.
[191] E.g., Act on Limited Liability Companies (*Gesetz ueber die Gesellschaften mit beschraenkter Haftung* — GmbHG), Sec. 53.

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cordance with the rules of corporate law[192] or, in the case of an informal contribution, by way of a capital repayment. In both cases, any payment must be effected out of the excess of net assets over the stated capital of the corporation as shown on its financial balance sheet, irrespective of whether the excess results from current income, from retained earnings of earlier fiscal years or from paid-in surplus.[193] A specific kind of contribution to the capital of a *Gesellschaft mit beschraenkter Haftung* (GmbH), the additional contribution to capital (*Nachschuss*), is discussed at III.B.2.d., below.

b. Debt Financing by Shareholder Loans

If a shareholder loan is granted or renewed at a time when a prudent businessman would have infused equity capital instead of granting a loan, such loan (and claims arising from similar actions such as the granting of a security for a third-party loan) will only be repaid during bankruptcy proceedings, if all other creditors have been satisfied irrespective of whether the loan is to be qualified as equity.[194] Furthermore, after bankruptcy proceedings have been opened, any repayment of shareholder loans or of loans of third parties that were secured by a shareholder can be cancelled if repayment was made within a period of one year prior to the initiation of the bankruptcy proceedings.[195]

A shareholder loan should be recognized as a *bona fide* debt on the books of a corporation. The repayment of a shareholder loan does not raise the questions of corporate law associated with the repayment of share capital.[196] From a tax point of view, arm's length interest charges paid are normally allowed as proper tax-deductible business expenses for the corporation, thus reducing its taxable income (for an exception for municipal trade tax purposes, see X.B.1., below.) The thin capitalization rules are discussed at e., below.

One drawback associated with debt financing, especially by way of a shareholder loan, is that interest charges payable with respect to a loan are due irrespective of whether the debtor is able to pay or has generated sufficient profits to be able to deduct the interest charges from its taxable income. Furthermore, in recent years, the legislator and the tax authorities have been increasing the preconditions for the tax deductibility of interest charges with respect to shareholder loans.

c. Hybrid Shareholder Financing

Apart from convertible bonds, option bonds and nonvoting preferred stock, there are various forms of hybrid shareholder financing that merit specific attention, such as: the subordination of shareholder loans; the waiver of shareholder loans; the granting of participating loans; typical silent participation arrangements; atypical silent participation arrangements; and participating rights, which are explained in more detail below.

(1) Subordination of Shareholder Loans

The management of a corporation that falls within the definition of "over-indebtedness" is required to apply for bankruptcy proceedings unless the over-indebtedness is remedied within three weeks at the latest.[197] This can be achieved either by the waiver of a shareholder loan, the subordination of a shareholder loan or other actions relating to a shareholder loan.[198]

To rectify over-indebtedness, the shareholder agrees that his or her claim is subordinated to all other claims.[199] A subordination blocks repayment, even with the consent of both parties or by way of offset, unless and until the corporation is in a position to repay the loan out of future profits, liquidation surplus or other available funds.

For accounting and tax purposes, even a subordinated loan (which is repayable out of other available funds) remains a valid debt that must be reflected as such in a company's books, although, in the *pro forma* balance sheet prepared to determine whether a company is over-indebted, a subordinated loan can be disregarded.[200]

(2) Waiver of Shareholder Loans

Under corporate law, the waiver of a shareholder's loan normally is treated as a contribution to ta corporation's equity capital that must be accounted for by the corporation in a paid-in surplus (capital reserve) account. For tax purposes, the waiver is recognized as a tax-free contribution to capital only up to the fair market value of the loan at the time of the waiver. Any excess of the face value over the fair market value of the loan will give rise to taxable income at the level of the corporation.[201] Subject to very restrictive conditions, the tax authorities may abate the income tax arising on such waiver gain.[202] In addition, the waiver may give rise to a gift tax liability for the shareholders of the corporation.

(3) Conditional Waiver of Shareholder Loans

A waiver may also be granted subject to the condition that the loan concerned is reinstated as soon as the financial situation of the company concerned has improved enough to permit repayment out of funds available in excess of the company's stated equity capital. For tax purposes, the waiver extinguishes the loan, but the loan is reinstated as soon as the condition is fulfilled. At that point, interest can be paid retroactively by the company, even for the period during which the loan was waived.[203] This structure may be used as a straddle for a loss carryforward that could be in jeopardy for tax purposes under Section 8(c) of the Corporate Income Tax Act (*Koerperschaftssteuergesetz* — KStG; see V.B.8.a., below). The taxable gain realized may be offset by the tax loss carryforward and, in the subsequent fiscal year in which the debt is reinstated, the company will recognize a corresponding expense.

[192] E.g., GmbHG, Sec. 58.
[193] GmbHG, Sec. 30.
[194] Insolvency Act (*Insolvenzordnung* — InsO), Sec. 39 para. 1 no. 5.
[195] InsO, Sec. 135.
[196] GmbHG Sec. 30(1); AktG, Sec. 57(1).
[197] InsO, Sec. 15a.
[198] InsO, Sec. 19(2).
[199] InsO, Sec. 39.
[200] Federal Tax Court (*Bundesfinanzhof* — BFH), decision of November 30, 2011, BStBl, 2012 II, 332.
[201] BFH decision of June 9, 1997, BStBl, 1998 II, 307.
[202] Federal Ministry of Finance, Letter dated March 27, 2003, BStBl, 2003 I, 240.
[203] BFH decision of May 30, 1990, BStBl, 1991 II, 588.

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(4) Participating Loans

Under a participating loan arrangement (*partiarisches Darlehen*), the creditor does not receive (or at least does not exclusively receive) fixed interest payments but is entitled to share in the profits of the debtor (either in addition to or in lieu of receiving fixed interest payments). The share in the profits usually exceeds customary interest rates since, in unprofitable years, the creditor either receives no compensation at all or receives only a comparatively small fixed-interest payment.

For income tax purposes, a participating loan has the effect that, in principle, the participating creditor's profit share is a deductible item in computing the taxable income of the debtor. However, the profit share of the participating creditor is subject to withholding tax at the regular rate of 25% (plus solidarity surcharge of 5.5%; for further details refer to XVI., below) or, where applicable, a lower tax treaty rate. Because Article 10(5) of the Germany-United States tax treaty[204] does not provide for a reduced rate for a profit share on a participating loan, such a profit share paid to a U.S. resident will be subject to German withholding tax at the regular rate of 25%, plus a 5.5% solidarity surcharge if the payments are tax-deductible at the level of the debtor.

(5) Silent Participation Arrangements

The difference between a participating loan arrangement and a typical silent participation arrangement (*Stille Gesellschaft*) is that, in the latter case, the silent participant and the entrepreneur pursue a common cause, the typical feature of a partnership.[205] In essence, the silent participant agrees to contribute a stipulated amount (or an asset) to a merchant (sole proprietor, partnership or corporation) in exchange for a share in the profits (and, possibly, the losses) that the merchant may realize (or incur) during the term of the silent participation. Losses attributable to a corporate silent partner from a typical silent participation in a resident corporation may be carried back for one year and forward indefinitely but may be offset only against profits realized from the same participation agreement.[206]

Silent participation arrangements are regulated by the German Commercial Code (*Handelsgesetzbuch* — HGB).[207] Most of the relevant provisions of the HGB may be overruled by the parties to the arrangement in their agreement. While a merchant is fully liable for all debts incurred by it in operating its business, a typical silent participant is liable only to the merchant and only up to the amount of the stipulated capital contribution.[208] Furthermore, a typical silent participant has no say in the management of the business. He or she may merely request a copy of the annual balance sheet and inspect the merchant's books and records to verify their accuracy.[209] The business in which the silent participant participates is controlled and managed by the merchant. The assets of the business, including the silent participant's contribution, are owned solely by the merchant. The silent participant does not share in any appreciation of these assets. For this reason, the silent participant's share includes ordinary operating profits only, and not, for example, capital gains from the sale of fixed assets. On termination of the arrangement, the silent participant is entitled only to repayment of the amount he or she contributed and the outstanding *pro rata temporis* share in the profits minus, as applicable, the losses.[210] He or she is not entitled to claim payment for any share in the goodwill, including silent reserves.

A silent participation arrangement is automatically terminated in the event of the bankruptcy of the merchant.[211] In this event, the typical silent participant may claim repayment of his or her capital contribution as a normal unsecured creditor of the company in which he or she participated.[212] There is no maximum limitation on the duration of a silent participation arrangement. If participation in the losses is stipulated, the silent participant shares in the losses up to the amount of his or her capital contributions. However, the silent participant is not obliged to repay distributed profits if losses are incurred in subsequent fiscal years.[213] As long as his or her contribution is reduced as a result of losses, however, a silent participant's share in the annual profit must be applied against such losses and may not be distributed. Profits not paid out do not increase a silent participant's contribution unless otherwise stipulated.[214] Profits applied to reduce or eliminate a loss of the original contribution constitute taxable income, which, in the case of a nonresident silent participant, is taxed by way of withholding at the rate of 25% plus solidarity surcharge of 5.5% or a lower tax treaty rate, where applicable.[215]

(6) Atypical Silent Participation Arrangements

Under an "atypical" silent participation arrangement, the two parties to the arrangement stipulate that between themselves the silent participant will be treated as if he or she were a co-owner of the business and will share in the appreciation or depreciation of the business, including its goodwill, in proportion to his or her share in the profits or losses of the business. The parties may further stipulate that the silent participant is permitted to participate in the management of the business.

As a rule, an atypical silent participant shares in losses only up to the amount of his or her capital contribution. He or she is not obliged to repay distributed profits because of subsequent losses.[216] As in the case of a typical silent participant, annual profits may not be distributed and must be applied against prior losses as long as the participant's contribution is reduced because of such losses.[217] For income tax purposes, an atyp-

[204] Convention between the Federal Republic of Germany and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes, signed on August 29, 1989, as amended by the Protocol of June 1, 2006 (the "Germany-United States tax treaty").

[205] Such a common cause, as a rule, exists where a controlling shareholder of a German corporation grants funds to the corporation in return for a share in its profits; *see* BFH decision of June 21, 1983, BStBl, 1983 II, 563.

[206] Income Tax Act (*Einkommensteuergesetz* — EStG), Sec. 20(1) No. 4.

[207] Commercial Code (*Handelsgesetzbuch* — HGB), Secs. 230 *et seq.*

[208] HGB, Sec. 232.

[209] HGB, Sec. 233.

[210] HGB, Sec. 235.

[211] BGB, Sec. 728.

[212] HGB, Sec. 236.

[213] HGB, Sec. 232(2).

[214] HGB, Sec. 232(3).

[215] BFH decision of January 24, 1990, BStBl, 1991 II, 147.

[216] HGB, Sec. 232(2).

[217] HGB, Sec. 232(2).

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ical silent participation arrangement is treated like a partnership, with the result, *inter alia*, that the profit share does not attract withholding tax. However, losses attributable to a corporate atypical silent partner from an atypical silent participation in a corporation may be carried back for one year and forward indefinitely but may be set off only against profits realized from the same atypical silent participation.[218]

(7) Participation Rights

Participation rights (*Genussrechte*) issued by a German corporation may entitle the holder to any kind of financial benefit from the corporation, but carry no membership rights, such as voting privileges. Thus, a participation right that entitles the holder to a share in profits as well as in liquidation proceeds may be compared to nonvoting preferred stock. For tax purposes, the issuing corporation, therefore, may not deduct the share in the profits payable to a holder of a participation right as a business expense, and the distribution itself is subject to withholding tax at the ordinary rate of 25% or a lower tax treaty rate, where applicable. On the other hand, if the holder is entitled to share only in the profits and not in the liquidation proceeds of the issuing corporation, the participation right will be treated as indebtedness, and the payment of the profit share to the holder may be deducted as a business expense by the issuing corporation. In addition, payment of the profit share to the holder will attract withholding tax. Participation rights may be issued in the context of a waiver of a shareholder's loan and also in a public offering. In the latter case, they must be represented by certificates (*Genusschein*).

In the commercial balance sheet (*Handelsbilanz*), a participation right qualifies as equity if the capital transfer is subordinated to other creditors, the remuneration depends on the success of the business, the creditor participates in losses up to the full amount of the capital provided and the capital transfer has been granted long-term.[219] In principle, these criteria should apply also to the tax balance sheet (*Steuerbilanz*) due to the basic principle of the materiality of the commercial balance sheet for the tax balance sheet. However, a decree of the Federal Ministry of Finance of April 11, 2023,[220] following a decision of the Federal Tax Court[221] (not yet published in the Federal Tax Gazette and, therefore, not yet generally binding on the German tax authorities), denies this basic principle. For a tax balance sheet, a participation right qualifies as equity only if the creditor has not "seriously agreed" to a claim of repayment. Thus, the criteria applicable to tax balance sheets for a participation right's qualification as debt or equity differ from (i) those for commercial balance sheets and (ii) those for the income tax qualification as interest or dividend-like income.

d. Currency Risks

A loan granted by a parent company to its German subsidiary denominated in a foreign currency may give rise to tax problems, in particular, if currency losses are incurred. A general principle for the recognition of intercompany charges requires the management of a local subsidiary to be able to establish that it was good business judgment, from the point of view of the subsidiary, to obtain a loan in a foreign currency and that this foreign currency feature was not merely imposed on it by a decision at the shareholder level. This may be easy to establish where the subsidiary itself generates sufficient revenue in the foreign currency concerned, for example, if it bills export sales in U.S. dollars, or if it has substantial payment obligations in that foreign currency.

e. Thin Capitalization

For tax purposes, the thin capitalization rules in Section 8a of the Corporate Income Tax Act will need to be considered (see V.B.2.b.(2), below).

2. External Financing

All major U.S. banks, as well as many major banks from other countries, have established a presence in Germany via representative offices, branch operations or subsidiaries through which they compete with German commercial banks, state banks, savings banks, and a wide variety of regional and specialized banks. German commercial banks perform a wide range of services. They grant loans, hold interests in other companies, deal in foreign currencies, are members of stock exchanges, perform brokerage services, and underwrite bonds and equity securities. There is no equivalent to the U.S. proxy system. German shareholders usually grant proxies to vote their shares in German corporations to the banks with which the certificates are deposited, which explains the influence of banks in shareholders' meetings of German corporations. Both foreign and domestic banks are strictly regulated by the BaFin under the provisions of the Banking Law.[222]

German banks grant short-term loans (in particular, in the form of overdraft facilities and trade bill discounts), as well as medium- and long-term loans. For long-term corporate financing, *Schuldscheindarlehen* are of particular importance: the borrower signs an acknowledgment of debt document, which resembles, but is not, a promissory note, because promissory notes governed by German law may not normally be interest bearing.[223] Various forms of structured *Schuldschein* loans have emerged. Short-term commercial paper has been issued by numerous German companies, and in recent years financing via asset-backed securities has again become quite popular.

Comment: The European Green Deal, presented by the EU Commission on December 11, 2019, also obviously has an impact on which kind of business activities banks will finance and the terms and conditions of arrangements. For further discussion, see below.

G. EU Corporate Sustainability Reporting Directive

Large capital market-oriented companies (corporations and partnerships with a sole general partner that is a corporation) with more than 500 employees, as well as banks and insurance companies in the European Union, have been required to provide non-financial reporting, pursuant to the Non-Finan-

[218] EStG, Sec. 15(4).
[219] IDW/HFA 1/94.
[220] BMF, decree of April 11, 2023, BStBl. 2023 I, 672.
[221] BFH, decision of August 14, 2019, file no. I R 44/17, IStR 2020, 506.
[222] Banking Act (*Kreditwesengesetz* — KWG), German Solvency Regulation (*Solvabilitaetsverordnung* — SolvV).
[223] Law on Bills and Notes (*Wechselgesetz* — WG), Art. 5.

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cial Reporting Directive (NFRD), since 2017.[224] The NFRD has been transposed into German domestic law[225] and requires additional information to be provided regarding a corporation's business model and its impact on environmental and employee matters, social and human rights matters and the measures taken by the corporation to counter corruption and bribery. Such additional information forms part of the management report (*Lagebericht*) in the company's annual financial statements.

Furthermore, corporate sustainability reporting has also been introduced in connection with the "European Green Deal," under which the EU has laid out a course for more sustainable investments, for example in areas like renewable energy, biodiversity and the circular economy. The goal of the Green Deal is to reach a climate-neutral EU economy by 2050, with a reduction of 55% already implemented by 2030. To achieve these goals, the Green Deal includes an investment plan of one trillion euros over the next 10 years and intends to support investments of the private sector to achieve the Paris climate agreement. The EU taxonomy regulation to facilitate sustainable investment and the sustainable finance disclosure regulation (SFDR) were implemented to ensure equal competition and legal certainty for all companies operating within the EU. Both regulations follow the objective of the Green Deal and intend to direct capital flows to activities necessary to achieve climate neutrality, establish sustainability as part of risk management systems and encourage long-term investments and economic activity. While the EU taxonomy regulation describes a framework to classify "green" or "sustainable" economic activities executed in the EU, the sustainability of the entire business activities of each company must be reported annually pursuant to the corporate sustainability reporting directive (CSRD), which entered into force on January 5, 2023.[226] The new rules are intended to ensure that investors and other stakeholders have access to the information they need to assess investment risks arising from climate change and other sustainability issues. They should also create a culture of transparency about the impact of companies on people and the environment. The CSRD also makes it mandatory for companies to have an audit of the sustainability information that they report. In addition, it provides for the digitalization of sustainability information. The CSRD applies to insurance companies, banks, capital market-oriented companies and other companies, which fulfill two out of the following three criteria: (i) more than 250 employees; (ii) more than 40 million euros in net revenue; and (iii) more than 20 million euros in total assets. SMEs are not legally obligated to report according to the CSRD, but they likely will be forced into doing so contractually if their customers are legally obligated to do so. The first set of companies must begin to apply the rules for the first time in the 2024 financial year, for reports to be published in 2025. The last set of companies will have to apply the rules according to a phased plan, as provided for in the CSRD, at the latest in the 2028 financial year, for reports to be published in 2029. The CSRD is to be transposed into German law within 18 months by mid-2024.

Legislative Note: The German bill is still in the draft phase as of this writing. The German Federal Ministry of Justice has published the bill for the implementation of the CSRD, which includes extensive provisions adapting existing German laws, such as the Commercial Code and the Corporations Act, to align with EU requirements. This bill makes mandatory sustainability reporting and auditing applicable to large companies and certain SMEs, and stipulates staggered application deadlines starting from January 2024 for various company categories.

On February 26, 2025, the EU Commission filed a draft Directive[227] to reduce regulatory burdens. To achieve this, *inter alia,* the CSRD will apply only to companies with more than 1,000 employees, a 50 million euro turnover, or a 25 million euro balance sheet total. Further, for smaller entities, the reporting obligations will be delayed for another two years.

[224] Directive 2014/95/EU of the European Parliament and of the Council of October 22, 2014, amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (NFRD).

[225] Secs. §§ 289b ff. HGB.

[226] Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting (text with EEA relevance).

[227] Proposal for a Directive of the European Parliament and of the Council amending Directives 2006/43/EC, 2013/34/EU, (EU) 2022/2464 and (EU) 2024/1760 as regards certain corporate sustainability reporting and due diligence requirements of February 26, 2025, COM(2025) 81 final.

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III. Forms of Doing Business in Germany

A. *Principal Business Entities*

1. Sole Proprietorship

A sole proprietor is liable for the payment of his or her business debts up to the amount of his or her total assets. A sole proprietor who engages in business activities must be registered in the Commercial Register (*Handelsregister*). Even a sole proprietor who does not actually engage in business activities may have himself or herself so registered. If a sole proprietor is registered, his or her firm name must include the words "*eingetragener Kaufmann*" or a generally understandable abbreviation of that term, such as "e.K.," "e.Kfm." or "e.Kfr."[228]

2. Limited Liability Company

A *Gesellschaft mit beschraenkter Haftung* (GmbH) is a corporate structure best suited to family businesses and wholly-owned subsidiaries. It provides for the limitation of the shareholders' liability to the amount of their contribution to capital if the rather strict rules for the protection of share capital are observed. The shares of a GmbH are not represented by security instruments proper and may be transferred by notarial deed only. The management structure requires a minimum of one managing director, who may be subject to instructions issued by the shareholders. For these and a number of other reasons, the GmbH is by far the most popular form of corporate organization in Germany. The financial statements of a GmbH must be audited and published if the GmbH reaches a certain size.

With effect from November 1, 2008, the German Act to Modernize the Law Governing Private Limited Companies and to Combat Abuses (*Gesetz zur Modernisierung des GmbH-Rechts und zur Bekaempfung von Missbraeuchen* — MoMiG)[229] incorporated a number of amendments to the *Gesetz ueber die Gesellschaften mit beschraenkter Haftung* (the "GmbH Code"). The amendments related, *inter alia*, to: registration requirements; provisions regarding the division, payment or preservation of share capital; *bona fide* acquisitions of shares; and the repayment of shareholders' loans. Furthermore, the GmbH Code now provides for a new form of GmbH, the "*Unternehmergesellschaft*." An *Unternehmergesellschaft* is a GmbH incorporated with a share capital of less than the minimum share capital of 25,000 euros. Special rules apply until the share capital of such a GmbH reaches 25,000 euros. Further details are provided in B., below.

For all shareholders' resolutions in 2020, the German legislator authorized shareholders' meetings to be held other than in person, even without the prior approval of all shareholders,[230] thus allowing shareholders' resolutions to be passed in writing or by way of e-mail, telefax, etc. These reliefs had been extended until December 31, 2021,[231] on request, due to the effects of the COVID-19 pandemic in Germany. This relief has been extended again until August 31, 2022.[232] Further relief, such as the ability to hold shareholder assemblies online or by telephone or web conferences, has not been authorized. This is only permitted if the articles of association provide for such a possibility.

3. Stock Corporation

A stock corporation (*Aktiengesellschaft* — AG) is the corporate form used for public companies. A stock corporation issues share certificates that may be traded on a stock exchange. For the protection of the shareholders and the creditors, it has a mandatory two-tier management structure, with a supervisory board that oversees the activities of the board of directors. Like those of a GmbH, the financial statements of a stock corporation must be audited and published if the corporation reaches a certain size.

In 1994, the Stock Corporation Act was amended to reduce the number of formalities involved and thus to render stock corporations attractive as close corporations for family businesses ("small stock corporations"), as well as for groups of companies. In particular, a small stock corporation may be registered by a sole incorporator, and the rules for convening and holding shareholders' meetings have been simplified. Most importantly, however, the two-tier management structure is retained, but there is no longer mandatory labor participation in the supervisory board of a stock corporation formed on or after August 10, 1994, unless the corporation employs 500 or more persons. In the case of a stock corporation registered before August 10, 1994, this applies only if the corporation is a family corporation. These changes should make the small stock corporation particularly attractive as the legal form for German subsidiaries of foreign groups.

As a consequence of the COVID-19 pandemic, the German legislator allowed stock corporations to hold their general meetings virtually where the stock corporation's board so decided and without the consent of the shareholders.[233] This relief applied to general meetings called on or before December 31, 2021, if it could be proven that the request was made because of the effects of the COVID-19 pandemic in Germany.[234] This relief has been extended again to general meetings called on or before August 31, 2022.[235] Under a new bill, after August 31, 2022, the ability to convene general meetings virtually would generally be available to a company whose articles of association contain a corresponding rule that meets the new legal standards under the bill.[236] Further adjustments have been made, in

[228] HGB, Sec. 19.

[229] BGBl. 2008 I, 2026.

[230] *Gesetz zur Abmilderung der Folgen der COVID-19-Pandemie im Zivil-, Insolvenz- und Strafverfahrensrecht*, BGBl. 2020 I, 569, Art. 21 Sec. 2, which deviates from GmbHG, Sec. 48(2).

[231] *Verordnung zur Verlaengerung der Maßnahmen im Gesellschafts-, Genossenschafts-, Vereins- und Stiftungsrecht zur Bekaempfung der Auswirkungen der COVID-19-Pandemie*, BGBl. 2020 I, 2258, § 1.

[232] *Gesetz über Maßnahmen im Gesellschafts-, Genossenschafts-, Vereins-, Stiftungs- und Wohnungseigentumsrecht zur Bekaempfung der Auswirkungen der COVID-19-Pandemie* of March 27, 2020, as amended on September 10, 2021, BGBl. 2021 I, 4147.

[233] *Gesetz zur Abmilderung der Folgen der COVID-19-Pandemie im Zivil-, Insolvenz- und Strafverfahrensrecht*, BGBl. 2020 I, 569, Art. 1 Sec. 1(2).

[234] *Verordnung zur Verlaengerung der Maßnahmen im Gesellschafts-, Genossenschafts-, Vereins- und Stiftungsrecht zur Bekämpfung der Auswirkungen der COVID-19-Pandemie*, BGBl. 2020 I, 2258, Art. 1.

[235] *Gesetz über Maßnahmen im Gesellschafts-, Genossenschafts-, Vereins-, Stiftungs- und Wohnungseigentumsrecht zur Bekaempfung der Auswirkungen der COVID-19-Pandemie* of March 27, 2020 as amended on September 10, 2021, BGBl. 2021 I, 4147.

[236] Law on the Introduction of Virtual General Meetings of Stock Corporations and Amendment of the Cooperative and Insolvency and Restructuring Law Provisions of July 26, 2022 (*Gesetz zur Einfuehrung virtueller Hauptver-*

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particular, to the shareholders' right to ask questions,[237] as virtual general meetings have been found to be less interactive than in person meetings.

4. Partnerships

There are three forms of partnership in Germany: a general partnership (*offene Handelsgesellschaft* — oHG), a limited partnership *(Kommanditgesellschaft* — KG), and a civil law partnership (*Gesellschaft buergerlichen Rechts* or GbR). Every partnership, irrespective of the form, must consist of at least two partners, who may be individuals, corporations, or commercial partnerships. An oHG and a KG are suitable for business operations. All partners in an oHG and a GbR have unlimited liability. A KG must have at least one general partner with unlimited liability, but all the other partners' obligations may be limited to the amount of their contributions to capital. The sole general partner of a KG may be a small GmbH. Such vehicles are designated as GmbH & Co. KG and are widely used throughout Germany, especially for family businesses.

The Act to Modernize the Law on Partnerships (MoPeG) of August 10, 2021,[238] redefines the status of a partnership. Instead of an organization with partial legal capacity, oHG and a KG partnerships will be treated as organizations vested with full legal capacity, whereas GbRs have the option to elect to be registered as legal entities with full legal capacity.

Comment: The new legal concept of the treatment of partnerships severely interferes with the historical income tax treatment of partnerships as income tax transparent legal entities as well as the real estate transfer tax treatment of partnerships. Further developments in this area need to be closely monitored.

5. Branch of a Foreign Corporation

A branch of a foreign corporation must be registered in the Commercial Register of the local court in the district in which the branch is to be established, if it transacts essentially the same business as its head office, if it exhibits the signs of a typical business operation (such as bookkeeping, bank accounts and office facilities), and if it has a manager who performs more than mere clerical functions. The mere maintenance of a stock of merchandise or of an agent for the service of documents does not, therefore, qualify as a branch operation for purposes of the Commercial Code (*Handelsgesetzbuch* — HGB).

The existence of a branch subjects the foreign corporation of which it is a branch to the jurisdiction of the German courts with respect to business transacted by the branch.

6. Other Types of Business Entities

There are other kinds of business entities, such as public enterprises and cooperatives, but only one hybrid form of corporation is worth mentioning. The *Kommanditgesellschaft auf Aktien* (KGaA) is a corporate entity with at least one general partner with unlimited liability for the debts of the entity. However, the interests of the limited partners are represented by share certificates and, from their point of view, this vehicle is comparable to an ordinary stock corporation.

7. European Union Business Structures

There are three business structures introduced in Germany on the basis of EU Directives: the *Societas Europaea*, the *Europaeische wirtschaftliche Interessenvereinigung* and the *Societas Cooperativa Europaea.*

a. Societas Europaea

The *Societas Europaea* (SE) was introduced as a new corporate entity by EU Regulation 2157/2001 on October 8, 2004, and into German law under a statute dated December 11, 2004, together with a statute concerning the application of labor codetermination rules.[239] SEs were introduced to facilitate international business operations and mergers. However, since the stock corporation law of the EU Member State in which an SE maintains its registered seat and its head office applies in addition to the terms of the EU Regulation, an SE is not really an international corporate vehicle. Thus, SEs organized in different Member States follow different national rules. In recent years, the SE has gained significant attention in Germany. In July 2020, there were more than 669 German SEs[240] including some very prominent companies, such as Allianz and BASF. This is explained by the fact that an SE offers benefits in terms of workers co-determination and may transfer its seat from one EU Member State to another EU Member State.

In response to the COVID-19 pandemic, the German legislature has allowed stock corporations to hold their general meeting virtually if the stock corporation's board so decides and without the consent of the shareholders.[241] This relief was available until December 31, 2021, if it was proven to be requested as a result of the effects of the COVID-19 pandemic in Germany.[242] This relief was extended until August, 31, 2022.[243] Under a new law, after August 31, 2022, the ability to convene general meetings virtually would generally be available to a company whose articles of association contain a corresponding rule that meets the new legal standards under the bill.[244] Further adjustments have been made in particular to the shareholders'

sammlungen von Aktiengesellschaften und Aenderung genossenschafts- sowie insolvenz- und restrukturierungsrechtlicher Vorschriften), BGBl. 2022 I, 1166, Art. 2, No. 4, § 118a AktG.

[237] *Gesetz zur weiteren Verkuerzung der Restschuldbefreiung und zur Anpassung pandemiebedingter Vorschriften im Gesellschafts-, Genossenschafts-, Vereins- und Stiftungsrecht sowie im Miet- und Pachtrecht*, BGBl. 2020 I, 3332, Art. 11.

[238] Act to Modernize the Law on Partnerships (*Gesetz zur Modernisierung des Personengesellschaftsrechts* — MoPeG) of August 10, 2022, BGBl. 2021 I, p. 3436.

[239] BGBl. 2004 I, 375.

[240] The number of *Societates Europaeae* (SEs) registered in commercial registers in Germany as of July 1, 2020 (https://www.imu-boeckler.de/data/pb_mitbestimmung_se_2020_7.pdf).

[241] *Gesetz zur Abmilderung der Folgen der COVID-19-Pandemie im Zivil-, Insolvenz- und Strafverfahrensrecht*, BGBl. 2020 I, 569, Art. 1 Sec. 1(2).

[242] *Verordnung zur Verlängerung der Maßnahmen im Gesellschafts-, Genossenschafts-, Vereins- und Stiftungsrecht zur Bekaempfung der Auswirkungen der COVID-19-Pandemie*, BGBl. 2020 I, 2258, Art. 1.

[243] *Gesetz über Maßnahmen im Gesellschafts-, Genossenschafts-, Vereins-, Stiftungs- und Wohnungseigentumsrecht zur Bekaempfung der Auswirkungen der COVID-19-Pandemie* of March 27, 2020 as amended on September 10, 2021, BGBl. 2021 I, 4147.

[244] Law on the Introduction of Virtual General Meetings of Stock Corporations, Art. 2, No. 4, § 118a AktG.

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right to ask questions,[245] as virtual general meetings have been found to be less interactive than those held in person.

b. European Economic Interest Grouping

The European Economic Interest Grouping (EEIG) was introduced by EU Directive No. 2137/85 and transposed into German law on April 14, 1988.[246] Unless the EU Directive contains specific provisions to the contrary, an EWIV that has its registered seat in Germany is governed by the rules for general partnerships under the HGB. For tax purposes, the Directive stipulates that an EEIG may not be treated as a taxable entity as such but that its income, if any, is to be attributed to its members. This means that EEIGs are subject to the tax rules for partnerships.

c. Societas Cooperativa Europaea

The *Societas Cooperativa Europaea* (SCE) was introduced as a new corporate entity by EU Regulation 1435/2003 on July 22, 2003, and into German law under a statute dated August 14, 2006, together with a statute concerning the application of labor co-determination rules.[247] SCEs were introduced to facilitate the pan-European establishment and operation of cooperatives.

8. Classification of Foreign Business Entities

A foreign legal entity with its statutory seat in an EU/European Economic Area (EEA) Member State that moves its actual principal place of management to Germany also continues to be a corporation from a German corporate law perspective because of the EU freedom of establishment principle. However, if a foreign corporation that has its statutory seat in a non-EU/non-EEA Member State moves its actual principal place of management to Germany, the foreign corporation in principle would be reclassified as a partnership or a sole proprietorship from a German corporate law perspective,[248] unless such reclassification is prevented by an international treaty. For example, the Germany-U.S. Friendship, Commerce and Navigation (FCN) Treaty of October 29, 1954, grants a U.S. corporation that maintains its statutory seat in the United States, while it established its actual principal place of management in Germany, the legal status of a corporation also from a German corporate law perspective — at least if the U.S. corporation runs a business operation (also) in the United States.[249]

B. Limited Liability Company

1. Formation

A *Gesellschaft mit beschraenkter Haftung* (GmbH) is incorporated by a notarized shareholders' resolution of the incorporators resolving to incorporate the GmbH and its articles of association. A GmbH must also be registered with the Commercial Register. In case of a simple cash founding, the notarization can be completed online since August 1, 2022, provided further requirements regarding the identity of the founders can be met.[250]

a. Purpose Clause

German company law has never established an equivalent to the *ultra vires* doctrine. Consequently, unlike the purpose clauses in Anglo-American corporate charters, German law does not require an extensive list of all the possible activities of a GmbH. On the other hand, a clause that permits a GmbH to engage in all lawful activities is not sufficient.[251] The main purpose of the company must be stated.

b. Corporate Name

The firm name of a GmbH must be understandable to the general public and must not be misleading. Language such as "Germany," "Europe" or "International" has often been rejected unless the company concerned has been able to demonstrate that it is transacting substantial business throughout the area indicated via branch offices or subsidiaries.

Abstract names are permitted. However, meaningless words or meaningless combinations of letters (such as AAA, which might be adopted to appear first in directories, etc.) are not allowed.[252]

"*Gesellschaft mit beschraenkter Haftung*" or "GmbH" must be appended to the corporate name of any GmbH.[253] However, this does not apply to *Unternehmergesellschaften*. By contrast, "*Unternehmergesellschaft (haftungsbeschraenkt)*" or "*UG (haftungsbeschraenkt)*" must be appended to the corporate name of an *Unternehmergesellschaft*.[254]

c. Incorporators

A GmbH may be organized by one or more incorporators. The incorporators in total must subscribe to all of the GmbH's share capital. Each incorporator may subscribe to a different individual number of shares as agreed,[255] which may be useful in the event that it is intended to transfer a certain share to a third party later on. The par value of each share must be a full euro amount and at least one euro.

A GmbH may only be registered with the Commercial Register if one-fourth of the nominal value of any one of its shares to be issued for a contribution in cash has been paid in and if any contribution-in-kind has been effected in full. In addition, the total amount of the effected cash contributions plus the amount of contributions-in-kind must be at least 50% of the GmbH's share capital, i.e., 12,500 euros in case of the GmbH's minimum share capital of 25,000 euros. The share capital of an *Unternehmergesellschaft* must be paid in full as a cash contri-

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[245] *Gesetz zur weiteren Verkuerzung der Restschuldbefreiung und zur Anpassung pandemiebedingter Vorschriften im Gesellschafts-, Genossenschafts-, Vereins- und Stiftungsrecht sowie im Miet- und Pachtrecht*, BGBl. 2020 I, 3332, Art. 11.

[246] BGBl. 1988 I, 514.

[247] BGBl. 2006 I, 1911.

[248] Decision of German Federal Court of Justice dated October 27, 2008 (Ref. No. II ZR 158/06).

[249] Decision of German Federal Court of Justice dated July 5, 2004 (Ref. No. II ZR 389/02) Germany-United States Friendship, Commerce and Navigation (FCN) Treaty, Art. XXV (2).

[250] Act on the Implementation of the Digitalisation Directive (DiRUG) of July 5, 2021, BGBl. 2021 I, 3338.

[251] GmbHG, Sec. 3(1) No. 2.

[252] Court of Appeals Celle, decision of November 19, 1998, published in the periodical *Der Betrieb* — DB 1999, 40.

[253] GmbHG, Sec. 4(1).

[254] GmbHG, Sec. 5a(1).

[255] GmbHG, Sec. 5(2).

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bution.[256] In any event, the contributions effected must be at the free and unencumbered disposal of the managing director(s).

As of November 1, 2008, a GmbH may also have authorized but unissued share capital.[257]

d. Articles of Association

The articles of association of a GmbH must be adopted by the incorporators in the form of a notarial deed. The articles must indicate the name of the firm — including the designation "GmbH," "*Gesellschaft mit beschraenkter Haftung*" or, as applicable, "*Unternehmergesellschaft (haftungsbeschraenkt)*" or "UG (*haftungsbeschraenkt*)" — the statutory seat of the company, the purpose of the enterprise, and the total amount of capital subscribed by the shareholders and the numbers and nominal amounts of the shares held by each shareholder. Where a contribution-in-kind is made, the articles of association must specify the contributor, describe the property contributed and state the value at which the contribution is accepted. The articles of association may provide that shares may be transferred only with the consent of the GmbH or of the shareholders.[258] It is quite common for the articles of association also to provide for the fiscal or business year of a GmbH. The articles of association must so provide if the GmbH's fiscal year does not correspond to the calendar year.

The rights of the shareholders are primarily determined by the articles of association and the GmbH Code. The articles of association may also provide for the establishment of a supervisory board to oversee or advise the management, and they must so provide where this is required under co-determination rules (see II.E.3., above).

e. Share Capital

Unless a GmbH is incorporated as an *Unternehmergesellschaft*, its minimum share capital is 25,000 euros and the minimum par value of one of its shares is 1 euro.[259] The minimum share capital of an *Unternehmergesellschaft* is 1 euro.

Contributions to the share capital may be effected in cash or in kind. Contributions to the share capital of an *Unternehmergesellschaft* may only be effected in cash until the share capital reaches the statutory minimum of 25,000 euros.[260] Contributions-in-kind must be specified in the articles of association as to their amount and object, and the shareholders must submit to the register court a formation report that discloses all essential facts and circumstances that concern the value of contributions-in-kind and their appropriateness. The value of a contribution-in-kind may exceed the par value of the share to be issued for the contribution, but the issuance of a share at below par value is not permitted. In the case of a constructive contribution-in-kind (for example, the formation of a GmbH with a contribution in cash and a subsequent purchase of assets by the GmbH from its shareholder or an affiliate or the use of the contribution to repay a shareholder's loan), the value of such a constructive contribution-in-kind can be offset against the shareholder's obligation to effect the contribution in cash. The shareholder, however, will have to demonstrate that the value of the constructive contribution-in-kind corresponds to the contribution to be effected for the issuance of a share.[261]

A GmbH usually does not issue share certificates. Even if it does so, such certificates are not proper security instruments. Shares are transferable by notarial deed only. However, the articles of association may stipulate that a transfer of shares also requires the approval of the company or the shareholders' meeting. The Commercial Register must be notified of any share transfer and an updated shareholders' list must be filed with the Commercial Register. Since November 1, 2008, it has been possible to acquire shares by means of a *bona fide* transaction if the transferor is named in the shareholders' list.[262]

f. Incorporation Procedure

In principle, a GmbH is organized in the presence of the incorporator(s) or their representatives in a notarial deed, in which the articles of association are adopted, the incorporator(s) subscribe(s) to the share(s) to be issued by the GmbH, and the incorporator(s) conduct(s) a first shareholders' meeting at which the managing director(s) is/are appointed.[263] Since August 1, 2022, a GmbH can be organized online under certain limited preconditions.[264]

The managing director(s) then apply for the registration of the GmbH with the local Commercial Register Court. Their signatures on the application must be authenticated by a notary.[265] The managing director(s) must affirm that: one-fourth of the nominal value of any single share to be issued for a contribution in cash has been paid in; if applicable, any contribution-in-kind has been effected in full; and the total amount of cash contributions plus the nominal amount of shares to be issued for contributions-in-kind is at least 12,500 euros. The application must be accompanied by proof that the stated share capital actually has been paid in and is at the free disposal of the managing director(s). This can be achieved, for example, by submitting a confirmation from the GmbH's bank to that effect. The managing director(s) also must confirm that he, she or they has or have not been convicted in connection with late filing for bankruptcy proceedings or a fraudulent bankruptcy or fraud, or in connection with certain other offenses within the previous five years and that he, she or they has or have not been prohibited from engaging in trade or business by a court decision or an administrative order.[266] Moreover, the application must be accompanied by the articles of association, the appointment of the managing directors, a shareholders' list, which needs to be signed by all shareholders, and details regarding any contributions-in-kind. The application letter, together with the accompanying documents, must be filed in electronic form.[267] Generally, as this requires a particular tool, the notary will file the application letter and the accompanying documents. However, this is not mandatory. Further, the managing director needs to

[256] GmbHG, Sec. 5a(2).
[257] GmbHG, Sec. 55a.
[258] GmbHG, Sec. 15(5).
[259] GmbHG, Sec. 5. Until November 1, 2008, the minimum par value of a share amounted to 100 euros and had to be divisible by 50.
[260] GmbHG, Sec. 5a(2).
[261] GmbHG, Sec. 19(4).
[262] GmbHG, Sec. 16(3).
[263] GmbHG Secs. 2, 3, 6(3), (4), 8.
[264] GmbHG, Sec. 2(3).
[265] HGB, Sec. 12.
[266] GmbHG, Sec. 8(2), (3).
[267] HGB, Sec. 12.

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file for the GmbH with the transparency register the ultimate beneficial owners (UBOs) of the shares held in the GmbH, unless the UBOs are already listed in the GmbH's shareholders' list. A UBO is an individual who holds directly more than 25% of the GmbH's capital or voting rights or otherwise dominates the GmbH. If the direct shareholder is a trustee or not an individual person who is named in the shareholders' list filed with the responsible Commercial Register, the UBO is the individual person who directly or indirectly controls the direct shareholder.[268]

As of August 1, 2021, a UBO must also register with the transparency register, irrespective of whether the UBO is also registered with other national registers, for example, with the commercial register responsible for a GmbH via the filing of its shareholders' list. As of July 1, 2022, this also applies to those UBOs that had already filed with other registers before August 1, 2021.

A GmbH does not exist as a separate legal entity until it is registered with the Commercial Register. However, from the time of its incorporation by notarial deed until its registration, a GmbH is referred to as a company in formation (*Vorgesellschaft*). Actions taken on behalf of a company in formation during that period of time expose to personal liability persons who act on behalf of the GmbH or who approve of such actions; however, this personal exposure is eliminated automatically on the registration of the GmbH, provided that, on the date of registration, the value of the net assets of the GmbH is not lower than its stated share capital.[269]

g. Costs of Incorporation

The costs of incorporating a GmbH depend on the amount of its stated share capital. Where this is equal to the statutory minimum capital of 25,000 euros, the notarial fee should be about 700 euros plus German value added tax (VAT) and the fees and expenses of the Commercial Register Court should be about 200 euros plus VAT. The costs of incorporating an *Unternehmergesellschaft* may be lower.

2. Operation

a. License

Under company law, after registration, a GmbH generally is not required to obtain a license to commence business operations in Germany. However, a GmbH may be required to obtain a prior license under certain specific laws, for instance, if it operates in a field such as insurance, banking, transportation, or another trade that may cause safety or environmental problems (see II.A.3., above). However, the trade office and the fiscal authorities must be notified of the incorporation of a GmbH.

b. Amendments to the Articles of Association

Unless the articles of association of a GmbH provide for a greater majority, they may be amended at any time by a shareholders' resolution with the affirmative vote of at least 75% of the votes cast. The shareholders' resolution must be notarized and filed for registration, and the amendment is not effective until it is registered with the Commercial Register.

c. Alterations of Share Capital

The capital stock of a GmbH may be increased by way of contributions-in-kind or contributions in cash.[270] The share capital of an *Unternehmergesellschaft* may only be increased by contributions in cash until it reaches the statutory minimum of 25,000 euros.[271] Furthermore, the share capital may be increased through the conversion of reserves.[272] Each alternative entails an amendment of the articles of association by a notarized shareholders' resolution. The articles of association also may provide for authorized but unissued share capital; in that event, the managing director(s) may resolve on an increase of the share capital.[273] The managing director(s) must ensure that the contribution is at his or her (their) free disposal. In the case of a contribution-in-kind, it is necessary to establish to the satisfaction of the Commercial Register Court that the contribution-in-kind is worth at least the par value of the new shares to be issued and that it is at the free disposal of the managing director(s).[274]

A distinction must be made between an informal contribution to capital and a formal increase of the stated share capital. An informal capital contribution does not require an amendment of a GmbH's articles of association. It may be effected by a simple transfer of funds with the understanding that the funds need not be repaid. It will be reflected in the books of the GmbH in a paid-in surplus account (*Kapitalruecklage*) within the meaning of Section 272 (2), no. 4 of the HGB and no new shares will be issued.

d. Contribution of Additional Capital

If the articles of association expressly so authorize, the shareholders' meeting may resolve that the shareholders pay in additional contributions to capital (*Nachschuss*). Such contributions may be unlimited or limited in amount. If the obligation is unlimited, a shareholder may achieve a release from the obligation if he or she surrenders his or her shares to the GmbH.[275] Such additional contributions are due for payment when requested by the management based on a shareholders' resolution. They do not involve the issuance of new shares or an increase of the stated share capital. They offer a flexible means of financing and, if the funds contributed are no longer needed, they may be repaid to the shareholders out of funds available to the GmbH in excess of its stated share capital, subject to three months' previously published notice.[276]

e. Share Buybacks

A GmbH may acquire shares issued by itself if the capital contribution with respect to the shares has been fully paid in, if: the purchase price for the shares can be paid out of surplus in excess of the stated share capital as shown on the GmbH's fi-

[268] Money Laundering Act (*Geldwaeschegesetz* — GwG), Secs. 18–26a, BGBl. 2017 I, 1822 as amended by BGBl. 2020 I, 1328.
[269] GmbHG, Sec. 11.

[270] GmbHG, Secs. 53–56a.
[271] GmbHG, Sec. 5a(2).
[272] GmbHG, Sec. 57c.
[273] GmbHG, Sec. 55a.
[274] GmbHG, Sec. 8(1) No. 5.
[275] GmbHG, Secs. 26–28.
[276] GmbHG, Sec. 30(2).

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nancial balance sheet: the purchase price of the shares does not exceed their fair market value; and the GmbH can set up a reserve in its financial statements in an amount equal to the purchase price paid or payable without diminishing its stated share capital and mandatory reserves that may not be distributed.[277]

f. Redemption and Cancellation of Shares

A GmbH may not issue shares that are redeemable at the request of the holder. However, it may cancel shares if this is specifically authorized by the articles of association and the compensation payable to the shareholder does not diminish the stated share capital of the GmbH. These rules also apply to the redemption and cancellation of treasury shares. Shares may only be redeemed and cancelled against the will of a shareholder, subject to the meeting of certain requirements expressly stipulated in the articles of association and only if such requirements are admissible.

As a result of cancellation, shares cease to exist. Cancellation may be combined with a formal reduction of the stated share capital[278] or may be used to increase the par value of the remaining shares, so that the total par value of the remaining shares again equals the stated share capital. Alternatively, if it is not effected for either of these purposes, the cancellation may be effected to achieve the result that the total par value of all shares outstanding remains lower than the stated share capital provided the new stated share capital does not fall below the 25,000 euro minimum.

g. Management

A GmbH must have at least one managing director (*Geschaeftsfuehrer*). The articles of association may authorize or require the appointment of any number of managing directors. Generally, managing directors are appointed and dismissed by shareholders' resolution. However, managing directors may also be appointed by the articles of association or, if so provided for by the articles of association, by other bodies of the GmbH. Appointment and dismissal must be registered in the Commercial Register, but registration only has a declaratory effect — it serves to protect *bona fide* third parties that deal with the GmbH.[279]

Managing directors may be, but do not have to be, employees of the GmbH. Nor do they have to be German residents or nationals. Managing directors are charged with the obligation to manage the GmbH's business and have the power and authority to represent and bind the GmbH in transactions with third parties.[280] This authority is defined by statute. Where two or more managing directors are appointed, the company is represented by all managing directors jointly, unless the articles of association provide for a different authorization. Restrictions may be imposed on managing directors by the articles of association, their employment agreement or shareholders' instructions, but they are unenforceable *vis-à-vis bona fide* third parties, who may rely on the managing directors' authority as shown in the commercial register. Violations by the managing directors of restrictions imposed on them by the articles of association, their employment agreement or shareholders' resolution constitute a breach of contract that may justify their dismissal; such a breach does not, however, affect the validity of any agreements concluded by them with *bona fide* third parties.[281]

A GmbH may, but need not, have one or more *prokurists.* A *prokurist* is a signatory whose authority is defined in Sections 48 through 53 of the HGB to include all actions that concern the operations of a business, not just the particular line of business of the particular GmbH. This authority, which is, in many respects, comparable to that of a deputy managing director, thus goes far beyond representing the GmbH in day-to-day business decisions. However, it does not encompass the authority to close down or to sell the business of the GmbH. It extends to the sale or encumbrance of real estate only if this is expressly stated in the appointment. The appointment (and the termination) of a *prokurist* must be registered with the Commercial Register. The registration states whether a *prokurist* is authorized to act and sign alone, or whether he or she must act jointly with a managing director or another *prokurist.* A *prokurist* must be appointed by one or two managing directors authorized to act on behalf of the GmbH and, while they need a shareholders' resolution authorizing them to do so, that resolution does not have to be submitted to the Commercial Register.

h. Shareholders' Meetings

Unless otherwise provided in the articles of association, the shareholders' meeting approves the annual financial statements and the distribution of the profits as shown in those financial statements, payments of the shareholders' capital contributions, the repayment of informal capital contributions, the acquisition of treasury shares, the appointment and recall of managing directors and *prokurists*, measures for supervising and controlling management, and the assertion of claims of the company against shareholders and/or managing directors.[282] The articles of association can provide for further matters to require the shareholders' approval.

The shareholders' meeting is convened by the managing director(s).[283] In certain circumstances, it may also be called by a shareholder.[284] If all shareholders agree, a shareholders' resolution may be passed by written consent of the shareholders.[285]

To mitigate the adverse effects of the COVID-19 pandemic, the German legislature allowed the adoption of all shareholders' resolutions in 2020 at shareholders' meetings held other than in person, even without the prior consent of all shareholders.[286] Instead, a shareholders' resolution could be passed in writing or by way of e-mail, telefax, etc. Further reliefs, such as the holding of shareholders' assemblies online or by telephone or web conferences have not been allowed. These reliefs are only permitted if the articles of association provide for such a possibility. The relief applied until December 31, 2021, on re-

[277] GmbHG, Sec. 33.
[278] GmbHG, Sec. 58.
[279] GmbHG, Sec. 39; HGB, Sec. 15.
[280] GmbHG, Sec. 35.
[281] GmbHG, Sec. 37.
[282] GmbHG, Sec. 46.
[283] GmbHG, Sec. 49.
[284] GmbHG, Sec. 50.
[285] GmbHG, Sec. 48(2).
[286] *Gesetz zur Abmilderung der Folgen der COVID-19-Pandemie im Zivil-, Insolvenz- und Strafverfahrensrecht*, BGBl. 2020 I, 569, Art. 1 Sec. 2, which deviates to that extent from GmbHG, Sec. 48(2).

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quest, if justified by the adverse effects of the COVID-19-pandemic in Germany.[287] The relief was extended again until August 31, 2022.[288] Further relief, such as the ability to hold shareholder assemblies online or by telephone or web conferences, has not been authorized. This is only permitted if the articles of association provide for such a possibility.

i. Supervisory Board — Advisory Council

GmbHs with 500 or fewer workers and employees are not required to have supervisory boards. However, many articles of incorporation provide either for the formation of a supervisory board to oversee the conduct of a GmbH's business by the managing director(s), or some form of advisory council to advise and assist the managing director(s) in their conduct of the GmbH's business.[289] Large GmbHs with more than 500 employees are required to form supervisory boards to allow workers to participate in these boards.

j. Books and Records

A GmbH must maintain a double entry bookkeeping system based on the accrual method of accounting.[290] The records may be kept in any language currently in use, but the financial statements must be prepared in German and must be drawn up in euros.[291] Most records must be retained for 10 years[292] and must be kept in Germany or since January 1, 2023 in another EU Member State, provided the taxpayer ensures that data access is fully possible for the German tax authorities.[293]

A GmbH is not required to keep a minute book of shareholders' resolutions, but the sole shareholder of a wholly owned GmbH must record each shareholders' resolution in writing and date and sign it.[294] A GmbH does not have a corporate seal.

k. Financial Statements

Within three months of the close of a large or medium-sized GmbH's fiscal year, the management must prepare financial statements, including a balance sheet, a profit and loss (P&L) statement and an annex for the preceding fiscal year. A small GmbH (i.e., a GmbH that does not meet the criteria for medium-sized companies, described below) may take up to six months, provided this corresponds to ordinary business practice.[295] Unless the articles of association provide otherwise, financial statements are adopted by shareholders' resolution at the regular annual shareholders' meeting (see h., above).

Medium-sized and large corporations must have their financial statements audited by an independent auditor. Although small and medium-sized corporations may file short-form financial statements, the financial statements of all corporations must be filed with the Commercial Register, where they are open for inspection by the public. Medium-sized corporations are corporations that satisfy at least two of the following three criteria:

(i) A balance sheet total of more than six million euros, less a deficit item on the asset side total under Section 268(3) of the HGB;[296]

(ii) Sales of more than 12 million euros in the 12-month period preceding the balance sheet date; or

(iii) An annual average of more than 50 workers or employees.

In addition, medium-sized corporations may not satisfy more than one of the following three criteria, otherwise they will be classified as large corporations:[297]

(i) A balance sheet total of more than 20 million euros, less a deficit item on the asset side total under Section 268(3) of the HGB;

(ii) Sales of more than 40 million euros in the 12-month period preceding the balance sheet date; or

(iii) An annual average of more than 250 workers and employees.

The financial statements of a GmbH that operates a banking business must be audited and published, irrespective of the GmbH's size.[298]

l. Dividends and Other Distributions of Profits

A GmbH may declare dividends to be paid from an excess of its net assets over its stated share capital as shown on its financial balance sheet, irrespective of whether the excess results from current income, retained earnings of earlier fiscal years or paid in surplus.[299] The declaration of dividends requires a shareholders' resolution adopted at a shareholders' meeting. Interim dividends may be declared out of current-year profits if profits in the amount of the interim dividends can be expected applying the due diligence of a prudent businessman. However, if at the close of the fiscal year the interim dividend distributed is not covered by the actual profits for the year or by retained profits or reserves, the shareholders will have to repay the excess.

m. Reserves

There are no mandatory reserves for GmbHs, except GmbHs that engage in specifically regulated activities, such as banking or insurance, and *Unternehmergesellschaften*.[300] However, the articles of association of a GmbH may require it to set up reserves. A GmbH may set up voluntary reserves out of paid

[287] *Verordnung zur Verlaengerung der Maßnahmen im Gesellschafts-, Genossenschafts-, Vereins- und Stiftungsrecht zur Bekämpfung der Auswirkungen der COVID-19-Pandemie*, BGBl. 2020 I, 2258, Sec. 1.

[288] *Gesetz ueber Maßnahmen im Gesellschafts-, Genossenschafts-, Vereins-, Stiftungs- und Wohnungseigentumsrecht zur Bekaempfung der Auswirkungen der COVID-19-Pandemie* of March 27, 2020 as amended on September 10, 2021, BGBl. 2021 I, 4147.

[289] GmbHG, Sec. 52.

[290] GmbHG, Sec. 41; HGB, Secs. 238 *et seq.*

[291] HGB, Sec. 239(1).

[292] HGB, Sec. 257; General Tax Code *(Abgabenordnung* — AO), Sec. 147(3).

[293] AO, Sec. 146(2a).

[294] GmbHG, Sec. 48(3).

[295] HGB, Sec. 264(1).

[296] Under HGB, Sec. 267, a deficit not covered by shareholder's equity is shown at the end of the balance sheet on the asset side if the shareholder's equity has been used up by losses.

[297] HGB, Sec. 267 (for business years beginning after December 31, 2015).

[298] KWG, Sec. 26.

[299] GmbHG, Secs. 29 and 30.

[300] GmbHG, Sec. 5a(3).

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in or earned surplus for general or specific purposes and may resolve to dissolve such voluntary reserves if they are no longer needed.

3. Dissolution and Liquidation

A GmbH may be liquidated in the following circumstances:[301]

(i) On the expiration of its term, as specified in its articles of association;

(ii) As a result of a shareholder's resolution with the affirmative vote of 75% of the votes cast;

(iii) As a result of a civil court decision or the decision of an administrative court or administrative authority;

(iv) On the commencement of bankruptcy proceedings;

(v) On a binding decision that rejects the opening of bankruptcy proceedings because of a lack of assets;

(vi) Where substantial defects in the GmbH's articles of association have been stated by the Commercial Register Court;

(vii) By deletion of the company in the Commercial Register due to a lack of assets under Section 394 of the Act on Proceedings in Family Matters and of Voluntary Jurisdiction; or

(viii) For other reasons specified in the GmbH's articles of association (for example, on the death or bankruptcy of a shareholder).

While it is being liquidated, a GmbH remains in existence even though its purpose has changed from that of an operating company to that of a company in the process of liquidation. Thus, the words "in liquidation" ("I.L.") must be added to the firm name.[302] Unless the articles of association provide otherwise or the shareholders resolve otherwise, during the liquidation, the GmbH is run by the managing directors, who are then called liquidators.[303] The liquidators must prepare a balance sheet at the beginning of the liquidation and annual financial statements in each subsequent year.[304]

A GmbH is dissolved as soon as all of its creditors have been satisfied and all of its remaining assets have been distributed to its shareholders. To secure satisfaction of all the creditors, notice to the effect that the company is being liquidated must be published once. The distribution of assets to shareholders is not permitted until one year has elapsed following the date of such publication.[305] On the distribution of its assets, the GmbH terminates and, on termination, must be deregistered from the Commercial Register.

4. Reorganizations

In 1995, a comprehensive Reorganization Act[306] was adopted that covers, among others, the following transactions:

(i) Statutory mergers of one or more corporations or partnerships into another existing or newly formed corporation or partnership in consideration for the granting of shares or partnership interests;

(ii) Demergers of corporations or partnerships in the form of: (a) split-ups, where one company is dissolved into any number of existing or new companies, in consideration of the granting of shares in the transferee company to the shareholders of the transferor company;[307] (b) spin-offs, where a separable part of a business is transferred to an existing or a new company, in consideration of the granting of shares in the transferee company to the shareholders of the transferor company; or (c) simple drop- or hive-down transactions, where a separable part of the business of an entity is dropped down into an existing or newly formed subsidiary of the transferor entity in consideration of the granting of shares in the subsidiary to the transferor entity; and

(iii) Simple conversions from one legal form to another that do not affect the identity of the enterprise concerned.

a. Mergers

Mergers of GmbHs may be effected: (i) by way of the transfer of all of the assets of one GmbH (the merging company) in their entirety to another GmbH (the surviving company) in consideration for newly issued shares in the surviving GmbH; or (ii) by way of the incorporation of a new GmbH to which all of the assets of the merging GmbH are transferred in consideration for newly issued shares in the new GmbH. However, if a GmbH is merged into its 100% parent GmbH, shares may not be issued.[308]

Further formal and substantive requirements must be met, such as the approval of both companies by shareholders' resolution with the affirmative vote of at least 75% of the votes cast[309] and notarization of the merger agreement.[310]

A merger is not effective until it is registered in the Commercial Register with respect to the surviving company; at this point in time, the merging GmbH disappears and all of its assets and liabilities transfer *uno actu* and by operation of law to the surviving GmbH.[311]

A GmbH may also be merged into an AG or a commercial partnership.[312] Such a merger must also be approved by shareholders' resolution with the affirmative vote of at least 75% of the votes cast at the shareholders' meeting and, to be effective, must also be registered in the Commercial Register. The merger of a GmbH into an AG or the simple conversion of the legal form of a GmbH to that of an AG often is effected to prepare a company to go public.

A German corporation has to maintain its statutory seat as stated in the articles of association in the country under the laws of which it was incorporated in order to be recognized

[301] GmbHG, Sec. 60.
[302] GmbHG, Sec. 68(2).
[303] GmbHG, Sec. 66(1).
[304] GmbHG, Sec. 71.
[305] GmbHG, Sec. 73(1).
[306] Reorganization Act (*Umwandlungsgesetz* — UmwG) of October 28, 1994 (BGBl. 1994 I, 3210), as amended.

[307] UmwG, Sec. 123, para 1.
[308] UmwG, Sec. 54(1).
[309] UmwG, Sec. 50.
[310] UmwG, Sec. 6.
[311] UmwG, Sec. 20(1), no. 1.
[312] UmwG, Sec. 3.

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as a corporation in Germany.[313] A shareholders' resolution cannot move the statutory seat to a place abroad. Such a resolution would be null and void and could not be registered with the Commercial Register Court. As a result of a couple of Court of Justice of the European Union (CJEU) decisions,[314] however, a German corporation, might, in principle, move its actual principal place of management to another EU/EEA Member State or a non-EU/non-EEA Member State without the German being dissolved corporation under German corporate law; the German corporation would only need to keep a mailing address in Germany, while the foreign address would be registered as a foreign branch of the German corporation by the German Commercial Register Court. However, the characterization of the German corporation in the foreign country would depend on that country's domestic corporate law.

Comment: While moving a German corporation's actual place of management to another EU/EEA Member State should have no negative effect due to the EU freedom of establishment principle, moving the German corporation's place of actual management to a non-EU/non-EEA Member State could be treated differently, if that country were to follow the traditional "real seat" theory. In that case, the German corporation might continue to be treated in Germany as a corporation from a German corporate law perspective, while the foreign law might reclassify the German corporation as a partnership or a sole proprietorship from the foreign corporate law perspective, as the EU freedom of establishment does not apply in such cases.

Furthermore, to facilitate cross-border reorganizations, several EU Directives have been adopted and transformed into German domestic law. Council Directive 2009/133/EC of October 19, 2009 extended the scope of application of the contribution, merger and demerger rules in the German Reorganization Tax Act (UmwStG) to cross-border transactions in the European Union. Furthermore, the Act on the Modernization of the Corporate Income Tax Act (*Gesetz zur Modernisierung des Koerperschaftsteuerrechts* — KöMoG)[315] was published on June 25, 2021. This Act also makes a merger at book value under the UmwStG possible for non-EU resident corporations, if the tax transfer date is after December 31, 2021, and the relevant foreign merger regime is comparable to the tax regime under the UmwStG. In addition, the mandatory liquidation taxation that applied under Section 12 (3) of the German Corporate Income Tax Act (*Koerperschaftssteuergesetz* — KStG) where a corporate entity moves to a third country has been deleted. Further amendments for cross-border mergers have become part of the Act on the Implementation of the EU Conversion Directive as of March 1, 2023.[316] The EU Conversion Directive was to be transposed into German domestic law by January 31, 2023. This Act focuses on the details of cross-border mergers, in particular, regarding their registration, the rights of creditors, and the legal protection of the shareholders of the involved legal entities according to the EU Directive, in order to create EU wide applicable standards. Additional rules apply with respect to the co-determination rules since January 31, 2023.[317]

b. Corporate Spin-Offs

Domestic corporate spin-offs are dealt with under the Reorganization Act (*Umwandlungsgesetz* — UmwG).[318] EU Directive 2019/2121 of November 27, 2019 (the "EU Conversion Directive") provides the legal framework for a cross-border change in the legal form of a corporation, its split-up, spin-off and spin-off for new formation. This Directive was to be transposed into German domestic law by January 31, 2023. Until then, with the exception of transfer of the corporate seat of an SE under German corporate law, the transfer of a corporation's statutory seat and its actual principal place of management to another EU Member State, which preserves the corporation's legal entity (cross-border change of legal form), is only covered by the EU freedom of establishment.[319] An SE can transfer its registered office to another EU Member State without its being wound up.[320] On March 1, 2023, the Act on the Implementation of the EU Conversion Directive took effective[321] and now provides a domestic legal basis for cross-border spin-offs and cross-border changes in the legal form of a corporation; further rules apply with respect to the co-determination rules as of January 31, 2023.[322]

C. Stock Corporation

1. Formation

a. Purpose Clause

Like the purpose clause in the articles of a GmbH, the purpose clause in the articles of a stock corporation (*Aktiengesellschaft* — AG) must state the corporate purpose. The statement may not be purely general but should indicate the AG's general line of business. It is not sufficient to provide that the AG may pursue any lawful course of action.

[313] GmbHG, Sec. 4a.

[314] Court of Justice of the European Union (CJEU) decisions: *Ueberseering* dated November 5, 2002 (Ref. No. C-208/00) and *Centros* dated March 9, 1999 (Ref. No. C-212/97).

[315] Act on the Modernization of the Corporate Income Tax Act (*Gesetz zur Modernisierung des Koerperschaftsteuerrechts* — KöMoG), BGBl. 2021 I, 2050.

[316] Act on the Implementation of the EU Conversion Directive (*Gesetz zur Umsetzung der Umwandlungsrichtlinie und zur Änderung weiterer Gesetze*) of February 22, 2023, BGBl. 2023 I, Nr. 51.

[317] Act Implementing the Provisions of the Transformation Directive on Employee Participation in Cross-Border Transformations, Mergers and Demergers (*Gesetz zur Umsetzung der Bestimmungen der Umwandlungsrichtlinie über die Mitbestimmung der Arbeitnehmer bei grenzüberschreitenden Umwandlungen, Verschmelzungen und Spaltungen*) of January 4, 2023, BGBl. 2023 I, No. 10.

[318] UmwG, Sec. 123.

[319] CJEU decisions *Cartesio* dated December 16, 2008 (Ref. No. C-210/06), *Polbud* dated October 25, 2017 (Ref. No. C-106/16), and *Vale* dated July 12, 2012 (Ref. No. C-378/10).

[320] Council Regulation (EC) No. 2157/2001 on the Statute for a European company (SE), Art. 8.

[321] Act on the Implementation of the EU Conversion Directive (*Gesetz zur Umsetzung der Umwandlungsrichtlinie und zur Aenderung weiterer Gesetze*) of February 22, 2023, BGBl. 2023 I, Nr. 51.

[322] Act Implementing the Provisions of the Transformation Directive on Employee Participation in Cross-Border Transformations, Mergers and Demergers (*Gesetz zur Umsetzung der Bestimmungen der Umwandlungsrichtlinie ueber die Mitbestimmung der Arbeitnehmer bei grenzüberschreitenden Umwandlungen, Verschmelzungen und Spaltungen*) of January 4, 2023, BGBl. 2023 I, Nr. 10.

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b. Corporate Name

As a rule, the corporate name of an AG describes the business of the corporation but can, like the name of a GmbH, contain the name of one or more of its shareholders. Purely abstract names are now also permitted, except that names comprised of meaningless words or combinations of letters may be rejected by the Register Court. However, the firm name of an acquired enterprise may be adopted by an AG.[323] In addition, the name of an AG must contain the word "*Aktiengesellschaft*" or the abbreviation "AG."[324]

c. Incorporators

An AG may be formed by one or more individuals and/or corporate entities that need not be German citizens or residents.[325] The incorporators must subscribe to the entire share capital and each incorporator must subscribe to at least one share of stock. The incorporators appoint the first members of the supervisory board, who, in turn, appoint the members of the first board of directors.

d. Articles of Association

The articles of association, which must be notarized, must specify the corporate name (*Firma* with the addition of "*Aktiengesellschaft*" or "AG"), the corporation's seat (*Sitz*), its purpose and the amount of its share capital, and the par value of each share, a description of each class of shares, the number of members of the board of directors, and the form in which public announcements are to be made.[326]

Note: A major difference between German and U.S. company law is that, under German law, a German corporation may act lawfully outside the scope of its articles of association (i.e., German law does not recognize the *ultra vires* concept).[327]

e. Share Capital

The minimum authorized and issued share capital of an AG is 50,000 euros.[328] Shares may be issued as shares with par value or as shares with no par value. Par shares must have a par value of at least one euro;[329] higher nominal amounts must be in multiples of one euro. Shares with no par value do not have a nominal value but participate equally in the share capital. The proportional value of each share without par value has to be at least one euro. The corporation may not issue both shares with and shares without par value.[330]

Shares may be common or preferred, with rights determined by the articles of association.[331] Shares may be registered shares or shares issued to bearer, the latter being more common.[332] When an AG is organized, at least 25% of its stated share capital must be paid in.[333] However, bearer share certificates (*Inhaberaktien*) may not be issued until the bearer shares are fully paid up.[334] Share capital may be raised in cash or in kind. In the latter case, the articles of association must specify the name of the contributor, the description of the property contributed, and the par value of the shares or the number of shares with no par value issued.[335]

f. Incorporation Procedure

The following steps must be taken to incorporate an AG:

(i) The articles of association must be approved by a notarized resolution of the incorporators;[336]

(ii) The incorporators must subscribe to the shares in notarized form;[337]

(iii) The incorporators must appoint the first supervisory board and the auditor(s) for the first fiscal year,[338] and their appointment must be notarized; and

(iv) The supervisory board must appoint the first board of directors (*Vorstand*).[339]

Before registration with the Commercial Register, at least 25% of the share capital must be paid in.[340] Contributions in-kind must be effected in full.[341] In the case of bearer share certificates, 100% of the stated share capital must be paid in.[342] The amount paid in must be at the free disposal of the board of directors.[343]

The incorporators must prepare a written report on the incorporation[344] to be reviewed by the members of the board of directors as well as the supervisory board. The review is made available not only to the board of directors, but also to the Commercial Register Court and the Chamber of Industry and Commerce. The public has access to the files at the Commercial Register.[345]

Application for registration with the Commercial Register must be filed by all of the incorporators as well as the members of the board of directors and the supervisory board.[346] The application must be filed with the Commercial Register Court in the district in which the AG will have its statutory seat.

The application must contain, among other information, details regarding the payment of the share capital, a statement of each member of the board of directors that no circumstances exist that would prevent their appointment, and the local business address or details of the board of directors' authorization to represent the AG. Furthermore, the application must be accompanied by certain documents, such as the articles of association, the appointment of the supervisory board and the board

[323] AktG, Sec. 4.
[324] AktG, Sec. 4.
[325] AktG, Sec. 2.
[326] AktG, Sec. 23(3).
[327] Koch, Hueffer/Koch, *Kommentar AktG*, 14th ed. 2020, annotation 1 to AktG, Sec. 82.
[328] AktG, Sec. 7.
[329] AktG, Sec. 6.
[330] AktG, Sec. 8.
[331] AktG, Sec. 12.
[332] AktG, Sec. 10(1).
[333] AktG, Sec. 36a(1).
[334] AktG, Sec. 10(2).
[335] AktG, Sec. 27(1).
[336] AktG, Sec. 23.
[337] AktG, Secs. 2, 23, and 29.
[338] AktG, Sec. 30(1).
[339] AktG, Sec. 30(4).
[340] AktG, Sec. 36a.
[341] AktG, Sec. 36a(2).
[342] AktG, Sec. 10(2).
[343] AktG, Sec. 36(2).
[344] AktG, Sec. 32.
[345] AktG, Sec. 34(3).
[346] AktG, Sec. 36(1).

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of directors, or a list of the members of the supervisory board.[347] The application letter, together with the accompanying documents, must be filed in electronic form.[348] Generally, as this requires a particular tool, a notary will file the application letter and the accompanying documents. However, this is not mandatory.

The Commercial Register Court reviews the correctness and completeness of the incorporation procedure and of the application. It may refuse to register the application if the application is defective or if the reports referred to above are incomplete or incorrect.[349]

On registration with the Commercial Register, the AG comes into existence as a separate legal entity.[350]

Further, the board members must file with the transparency register, on behalf of the AG, the ultimate beneficial owners (UBOs) of the shares held in the AG. Since August 1, 2021, this has applied even if the UBOs are already listed in the AG's shareholders list. An UBO is an individual person who holds directly more than 25% of an AG's capital or voting rights or otherwise dominates the AG. If the direct shareholder is a trustee or not an individual person named in the shareholders' list filed with the responsible Commercial Register, the UBO is the individual person who directly or indirectly controls the direct shareholder.[351] UBOs who were already filed with other registers prior to August 1, 2021, were to be filed with the transparency register at the latest by March 31, 2022.

g. Costs of Incorporation

The costs of incorporating an AG are higher than the costs of incorporating a GmbH and depend on the amount of the AG's stated share capital (see III.B.1.g., above).

2. Operation

a. License

Once incorporated, an AG does not need a license under corporate law to commence business. Licenses, however, may be necessary under the laws and regulations for certain types of activities such as banking, insurance, transportation, or other trades that cause safety or environmental problems.

b. Amendment to the Articles of Association

Unless otherwise stipulated in the articles of association, amendments to the articles of association of an AG require the approval of a majority of 75% of the votes cast in a shareholders' meeting. The shareholders' resolution must be notarized and filed for registration. An amendment is not effective until it is registered with the Commercial Register.[352]

c. Alterations of Share Capital

Any formal increase of the stated share capital of an AG requires an amendment to the articles of association of the AG and, thus, a shareholders' resolution with the affirmative vote of at least 75% of the votes cast.[353] In the case of a formal increase of the stated share capital, every shareholder, at his or her request, must be offered the opportunity to subscribe to the portion of the new shares to be issued that corresponds to his or her interest in the stated capital before the share capital increase.[354] The right to subscribe in this way may be put aside partly or totally by a shareholders' resolution with the vote of 75% of the votes cast (unless a higher majority is provided for in the AG's articles).[355]

A formal increase of the stated capital must be distinguished from an informal contribution to share capital. An informal capital contribution does not require an amendment to the articles of association of an AG but may be effected by a simple transfer of the funds with the understanding that they need not be repaid.

A reduction of the stated share capital may be effected subject to the approval of at least 75% of the votes cast in a shareholders' meeting,[356] and subject to the meeting of certain requirements for the protection of the AG's creditors, such as giving them notice and waiting six months thereafter to ensure that either no creditors' claim have been filed or, if such claims are filed, that sufficient security has been provided to the creditors.[357]

d. Share Buybacks

An AG may acquire treasury shares only:

(i) If the acquisition is necessary to prevent serious and immediate damage to the AG;

(ii) If the shares are acquired for purposes of being distributed to the AG's employees;

(iii) If the shares are acquired for purposes of compensating certain minority shareholders;

(iv) If the acquisition is effected for no consideration;

(v) In the case of succession by operation of law;

(vi) If the acquisition is based on a shareholders' resolution that approved the cancellation of the shares and a corresponding reduction of the AG's stated share capital;

(vii) If the AG is a bank or finance company, based on a prior shareholders' resolution for purposes of securities trading;[358] or

(viii) If authorized by the shareholders' meeting, if the acquisition is for other purposes (but, in particular, not if it is for purposes of securities trading). The authorization of the shareholders' meeting is valid for a maximum of five years and fixes the lowest and highest prices that the AG may pay, and the portion of the stated equity capital covered by the authorization (which may not exceed 10%).

[347] AktG, Sec. 37.
[348] HGB, Sec. 12.
[349] AktG, Sec. 38.
[350] AktG, Sec. 41(1).
[351] GwG, Secs. 18–26a, BGBl. 2017 I, 1822 as amended by BGBl. 2020 I, 1328.
[352] AktG, Secs. 179 and 181.
[353] AktG, Secs. 179 and 182.
[354] AktG, Sec. 186.
[355] AktG, Sec. 186(3).
[356] AktG, Sec. 222.
[357] AktG, Sec. 225.
[358] AktG, Sec. 71(1).

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The possibility of acquiring treasury shares in the circumstances specified above in (viii) was introduced in 1998 to permit share repurchase programs where the management of an AG wishes to return excess equity to its shareholders.[359] The acquisition of treasury stock requires, further, that certain other formal and substantive requirements be met. Information must be provided by the board of directors at the next shareholders' meeting following the acquisition, formally stating the reasons for and purposes of the acquisition and the amount of the shares acquired. Such shares, together with previously acquired treasury shares, may not exceed 10% of the stated share capital of the AG. If the acquisition of the treasury shares does not meet these requirements, the members of the board of directors may be exposed to personal liability to the company, unless the acquisition is approved by a shareholders' resolution.[360]

e. Redemption and Cancellation of Shares

An AG may not issue shares that are redeemable at the request of the holder, but it may cancel shares if this is specifically authorized by the articles of association. These rules also apply to the redemption and cancellation of treasury shares. Against the will of a shareholder, shares may only be cancelled if this is expressly stipulated in the articles of association.

As a result of cancellation, shares cease to exist. In principle, a cancellation requires a formal reduction of the stated share capital.[361]

f. Board of Directors

The board of directors (*Vorstand*), which may consist of one or more individuals (who may be either nationals or aliens), is responsible for conducting the business of a corporation and for representing it *vis-à-vis* third parties.[362] The directors are appointed (and may be dismissed for cause) by the supervisory board.[363] They are appointed for terms of up to five years and may be reappointed. Where two or more board members are appointed, the AG is represented by all board members jointly, unless the articles of association provide for a different authorization. The board members' authority to represent the AG as its organ cannot be restricted.[364]

In future, at least one of the members of the management board of listed corporations with more than three members that are subject to codetermination will have to be a woman.[365] As of the time of writing, the new law had not yet been published.

Board members are responsible for preparing the financial statements, which must be submitted to the supervisory board together with their recommendations regarding the distribution of dividends. Before they are submitted to the supervisory board, if the AG satisfies the criteria for qualifying as a medium-sized or large corporation (see III.B.2.k., above), the AG's financial statements must be audited by independent public accountants.

g. Supervisory Board

The supervisory board is vested with responsibility for overseeing the conduct of an AG's business by its board of directors.[366] Although the supervisory board may not perform the functions of management, the articles of association or the supervisory board may require that certain actions of the board of directors be performed only with its approval.[367] The supervisory board must have at least three members and the total number of members must be divisible by three. The maximum number is from nine to 21, depending on the amount of the AG's stated capital.[368]

Members of the first supervisory board are appointed by the incorporators,[369] their appointment is ratified by the general meeting of shareholders and they can be dismissed by the latter at any time on a 75% vote (unless a different majority is provided for in the articles of association).[370] Subsequently, all members of the supervisory board are appointed by the general meeting with the majority of the votes cast, unless provided otherwise by the articles of association.[371] With respect to the participation of employees and males and females in the supervisory board, see II.E.4.d.(3), above.

h. General Meeting of Shareholders

The general meeting of shareholders must be held annually within eight months after the close of the fiscal year.[372] A shareholders' meeting must also be convened if the articles of association provide for it, if the holders of 5% of the outstanding stock request a meeting in writing (the articles of association may provide for a lesser percentage) or if a shareholders' meeting needs to be held for the good of the AG.[373] The meeting must be held in Germany at the seat of the corporation or such other place as is provided for in the articles of association.

Only the general shareholders' meeting may make amendments to the articles of association, resolve to liquidate the corporation, cause it to merge or consolidate, or transfer its assets to another entity. Usually, a decision is made by a majority of the stock represented at the shareholders' meeting, duly convened in accordance with the requirements laid down in the AG's articles of association. The general shareholders' meeting has the authority to resolve to distribute the profits of the AG based on the financial statements prepared by the directors and approved by the supervisory board. The general meeting also elects the auditors.[374]

To address the adverse effects of the COVID-19-pandemic, the German legislature has authorized the board of directors of an AG to decide how shareholders should participate in the annual general meetings held in 2020 and their voting by way of electronic communication without the authorization of the articles of association. Further, the board of directors may also

[359] AktG, Sec. 71(1) no. 8.
[360] AktG, Sec. 93.
[361] AktG, Sec. 237(2).
[362] AktG, Secs. 76 and 78.
[363] AktG, Sec. 84.
[364] AktG, Sec. 82(1).
[365] FüPoG II.
[366] AktG, Sec. 111(1).
[367] AktG, Sec. 111(4).
[368] AktG, Sec. 95.
[369] AktG, Sec. 30(1).
[370] AktG, Sec. 103.
[371] AktG, Secs. 119(1), 133(1).
[372] AktG, Sec. 120.
[373] AktG, Sec. 121.
[374] HGB, Sec. 318.

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decide that, in certain circumstances, the annual general meeting may be held without the physical presence of shareholders.[375] The relief applied until December 31, 2021, if requested as a result of the adverse effects of the COVID-19-pandemic in Germany.[376] The relief was extended again to general meetings called on or before August 31, 2022.[377] Under a new law, after August 31, 2022, the ability to convene general meetings virtually would generally be available to a company who articles of association contain a corresponding rule that meets the new legal standards under the bill.[378]

i. Books and Records

An AG's board of directors must ensure that it maintains the books and records required under commercial, as well as tax law. The books and records must be maintained in such a way that an expert third party is able to form a general view of the business activities and the financial situation of the AG within an appropriate period of time.[379]

The books and records must be complete, correct and timely.[380] An AG must maintain a double-entry bookkeeping system based on the accrual method of accounting.[381] The records may be kept in any language currently in use, but the financial statements must be prepared in German and must be drawn up in euros.[382] Most records must be retained for 10 years[383] and must be kept in Germany. Alternatively, as of January 1, 2023, the records may be kept in another EU Member State, provided the taxpayer ensures that the data is fully accessible to the German tax authorities.[384]

j. Financial Statements

Within three months of the close of the fiscal year, the board of directors of a medium-sized or large AG (see III.B.2.k., above) must prepare financial statements, including a balance sheet, a P&L statement and an annex for the preceding fiscal year.[385] A medium-sized or large AG must have its financial statements audited by independent public accountants[386] and published. Immediately after receiving the report of the auditors, the board of directors must submit the annual balance sheet, the P&L statement, a proposal for the application of the profits, the auditors' report and the management report to the supervisory board.[387] The supervisory board then approves the financial statements, the management report and the proposal for the application of the profits, unless the board of directors and the supervisory board resolve to submit the approval of the financial statements, the management report and the proposal for the application of the profits to the shareholders' meeting.[388]

k. Dividends and Other Distributions of Profits

The shareholders' meeting approves the distribution of the annual profits as shown on the balance sheet.[389] Shareholders are entitled to dividends out of the net profits as calculated after deduction of the statutory and other reserves. The amount of dividend that a shareholder will receive is, as a rule, determined in accordance with the par value of the shares. However, the articles may provide differently. An AG may not distribute interim dividends out of current year profits, unless otherwise provided in the articles of association.[390]

l. Reserves

An AG must build up a statutory reserve (*gesetzliche Ruecklage*) to absorb reductions in the value of assets and other losses that would convert an operating profit into a loss.[391] The statutory reserve is formed by annual allocations of an amount equal to at least 5% of the net profits per year, until the total reserve reaches 10% of the share capital. In addition, amounts received for new shares that exceed the par value of those shares, as well as amounts paid by shareholders in consideration of preferential rights received, must be transferred to the statutory reserve.

3. Dissolution and Liquidation

The reasons for which an AG[392] may be liquidated basically correspond to those for which a GmbH may be liquidated (see III.B.3., above). The liquidation procedure and the dissolution, after all of the AG's creditors have been satisfied and all of its remaining assets have been distributed to its shareholders, are also similar to those applying in the case of a GmbH.[393]

4. Other Corporate Reorganizations

The Reorganization Act, which became effective January 1, 1995, allows for corporate mergers, divisions and conversions involving stock corporations.

The discussion in III.B.4., above, regarding reorganizations of GmbHs, apply equally to AGs, including with regard to cross-border mergers, cross-border changes in the legal form of a corporation, its cross-border split-up, spin-off and spin-off for new formation.

D. Partnerships

1. In General

A commercial partnership is an association of two or more persons formed for purposes of running a commercial business in the name of the partnership, where either the liability of all

[375] *Gesetz zur Abmilderung der Folgen der COVID-19-Pandemie im Zivil-, Insolvenz- und Strafverfahrensrecht*, BGBl. 2020 I, 569, Art. 1 Sec. 1, which deviates from AktG, Sec. 118.

[376] *Verordnung zur Verlaengerung der Maßnahmen im Gesellschafts-, Genossenschafts-, Vereins- und Stiftungsrecht zur Bekämpfung der Auswirkungen der COVID-19-Pandemie*, BGBl. 2020 I, 2258, Sec. 1.

[377] *Gesetz ueber Maßnahmen im Gesellschafts-, Genossenschafts-, Vereins-, Stiftungs- und Wohnungseigentumsrecht zur Bekaempfung der Auswirkungen der COVID-19-Pandemie* of March 27, 2020 as amended on September 10, 2021, BGBl. 2021 I, 4147.

[378] Law on the Introduction of Virtual General Meetings of Stock Corporations of July 20, 2022, Art. 2, No. 4, § 118a AktG.

[379] HGB, Secs. 238 *et seq.*; AO, Secs. 145 *et seq.*

[380] HGB, Sec. 239.

[381] AktG, Sec. 91(1); HGB, Secs. 238 *et seq.*

[382] HGB, Sec. 239(1).

[383] HGB, Sec. 257; AO, Sec. 147(3).

[384] AO, Sec. 146(2a).

[385] HGB, Sec. 264(1).

[386] HGB, Sec. 316(1).

[387] AktG, Sec. 170.

[388] AktG, Sec. 172.

[389] AktG, Sec. 174.

[390] AktG, Sec. 59.

[391] AktG, Sec. 150.

[392] AktG, Sec. 262.

[393] AktG, Secs. 264 *et seq.*

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partners is unlimited (oHG)[394] or the liability of one or more partners is limited to the amount of their agreed liable capital (KG).[395] A silent participation arrangement, also sometimes referred to as a silent partnership, is not a real partnership. Rather it resembles a creditor-debtor relationship. For a more detailed description, see II.F.1.c.(5) and (6), above. In addition, EEIGs may be formed under German law and are largely governed by the provisions for general partnerships.[396]

2. Formation

A partnership is formed by express or implied agreement. Once formed, a commercial partnership must be registered with the Commercial Register. The application for registration must specify the name, surname and place of residence of each partner, the partnership's name and the seat of the partnership's business, and the partners authorized to represent the partnership legally.[397] The application for registration must be signed by all the partners.

Furthermore, as of August 1, 2021, the ultimate beneficial owner (UBO) of a partnership must be registered with the transparency register irrespective of whether the UBO has been registered with another commercial register (for example, via the filing of the partners of a KG with the register responsible for the KG.) UBOs who were already filed with another commercial registers before August 1, 2021, must have filed with the transparency register by December 31, 2022.

Although a partnership is not (yet) a legal entity (*juristische Person*), it may, under its firm name, acquire rights, including real property, incur liabilities, and sue and be sued.[398]

3. Dissolution

Unless the partnership agreement provides to the contrary, a commercial partnership is liquidated: on the expiration of the term for which it was formed, following a partners' resolution to that effect; on the commencement of bankruptcy proceedings with respect to the commercial partnership; as a result of a court decision; or, as applicable, if the claim to initiate bankruptcy proceedings was dismissed or if the commercial partnership was deleted from the Commercial Register under Section 394 of the Act on Proceedings in Family Matters and of Voluntary Jurisdiction.[399] The agreement may, however, provide for the continuation of a commercial partnership. Notice of termination may also be given by a creditor of one of the general partners.[400] Finally, a court of competent jurisdiction may order the liquidation of a partnership for cause.[401]

However, if a commercial partnership is entered into for an unlimited period, any partner is entitled to terminate his or her membership in the partnership by giving notice of termination six months prior to the end of a fiscal year.[402] In such event, the partnership will continue among the remaining partners.[403]

A partnership remains in existence while it is being wound up, but the words "in liquidation" must be added to the partnership's name during the winding up.[404] The name of the liquidator, who may be a partner, must be registered with the Commercial Register.

4. Partnership Law Reform

The German partnership law has been modernized by a new law[405] that has entered into force on January 1, 2024. Under the new law, all partnerships will have full legal capacity instead of only partial legal capacity, except for a GbR, whose partners are now entitled to opt for full legal capacity of the GbR or to continue with the partnership's partial legal capacity. A partnership with full legal capacity is treated similar to a corporation and, in particular, can own assets. This, of course, has a significant impact on the tax treatment of a partnership and its partners, in particular with respect to income tax, trade tax, real estate transfer tax, the tax treatment of mere asset managing partnerships, inheritance/gift tax, and partnership reorganizations. Therefore, the legislature enacted last minute amendments to the law published on December 29, 2023.[406] Furthermore, partnership agreements urgently need to be reviewed thoroughly and revised accordingly. Finally, additional registration and filing obligations have come into force, in particular but not exclusively, in the case of GbRs.

E. Branch of a Foreign Corporation

1. Registration

a. Commercial Register

A branch of a foreign corporation must be registered with the Commercial Register of the court in the jurisdiction in which the branch has its offices. The application for registration must be signed by all board members of the foreign corporation.[407] No registration, however, is required if the activities of the representatives of the foreign corporation do not go beyond the mere handling of information or other liaison-type functions.

b. Business Registration

A branch must notify the local municipality of the commencement of its business operations, but generally it does not need the approval of the local municipality.[408]

2. Liability

A branch is not a separate and self-contained legal entity. It is merely an extension of the foreign corporation of which it

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[394] HGB, Secs. 105 *et seq.*

[395] HGB, Secs. 161 *et seq.*

[396] European Economic Interest Grouping (EEIG) Implementation Act (*Europaeische wirtschaftliche Interessenvereinigung* — EWIV), Sec. 1 — *Ausfuehrungsgesetz* of April 14, 1988, BStBl. 1988 I, 514, as amended.

[397] HGB, Sec. 106.

[398] HGB, Sec. 124.

[399] HGB, Sec. 131.

[400] HGB, Sec. 135.

[401] HGB, Sec. 133.

[402] HGB, Sec. 132.

[403] HGB, Sec. 131(3).

[404] HGB, Sec. 153.

[405] MoPeG.

[406] Arts. 21, 23, 25, 27, 28, 29, 30 Secondary Credit Market Promotion Act (*Kreditzweitmarktförderungsgesetz*) of December 22, 2023, BGBl. 2023 I, No, 411.

[407] HGB, Sec. 13e–13g.

[408] GewO, Sec. 14.

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is a branch. Its activities are the activities of the foreign corporation itself and, therefore, expose the foreign corporation to all the liabilities incurred by the branch. Nevertheless, the operation of a German branch does not expose the foreign corporation to jurisdiction in German courts generally, but only with respect to such suits as relate to the activities of the branch in Germany.[409]

3. Books and Records

The law under which a foreign corporation was organized determines which books and records the corporation must maintain. A foreign corporation that is required to register its branch with the Commercial Register in Germany is, in addition, required to maintain a set of books for the activities of its branch in accordance with German accounting practice. These books must be maintained and stored in Germany unless the tax authorities grant an exemption from this requirement.[410] Even where the books and records are stored outside Germany, the foreign corporation is not precluded from claiming a net operating loss under German tax law with respect to its German branch operations.[411]

[409] Code of Civil Procedure (*Zivilprozessordnung* — ZPO), Sec. 21.

[410] HGB, Sec. 13d; AO, Secs. 146(2a) and 148.

[411] EStG, Sec. 50(1).

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IV. German Tax Law — An Overview

A. *Sources of Authority in Tax*

1. *Legislative*

a. *Organization of the Tax Law*

Each of the principal taxes (see IV.B., below) is governed by a specific tax act, for example, the Income Tax Act (*Einkommensteuergesetz* — EStG) or the Trade Tax Act (*Gewerbesteuergesetz* — GewStG). The main body of a specific tax act is devoted to setting out the material provisions (i.e., the taxpayer, the subject matter of the tax and the tax rate) accompanied by a few specific procedural provisions. Apart from these few specific procedural provisions, the procedural law is laid down in the General Tax Code (*Abgabenordnung* — AO). The provisions of the General Tax Code are further supplemented by a specific act dealing with tax court proceedings (*Finanzgerichtsordnung* — FGO).

The power to tax is divided between the Federal State (*Bund*), the 16 States (*Bundeslaender*) and the municipalities (*Gemeinden*). In principle, the legislative arms of these public bodies enjoy a large degree of discretion in their drafting of tax laws. However, in exercising their discretion, the legislators must observe taxpayers' rights derived from the fundamental rights laid down in the Constitution. A further source of tax law is international law, including bilateral tax treaties and multilateral treaties such as the treaties governing the European Union (EU).

b. *Other Legislative Documents That Can Be Used to Interpret the Law*

The tax acts are further supplemented by "ordinances" (*Rechtsverordnung*). Acts are passed by parliament, whereas ordinances are enacted by the executive. Ordinances exist regarding the majority of the principal taxes.

It is generally accepted that the purpose of the tax law must be fulfilled when interpreting its provisions. Determining this purpose requires a thorough analysis of the legislative materials. However, the purpose of a provision as stated by the legislator controls the interpretation of the provision only if the intentions of the legislator have been properly implemented. If the wording of a provision does not support its intended purpose, the courts tend to rely on a strict interpretation of the wording.

c. *Legislative Process*

The right to initiate bills rests with the Federal Government (*Bundesregierung*), the *Bundesrat* — the organ through which the *Laender* participate in the legislation and administration of the Federation — and the members of parliament (*Bundestag*) themselves.[412]

Following the first reading of a bill in the *Bundestag*, the bill is referred to a committee of the *Bundestag*. If a bill is primarily concerned with taxation, it is referred to the finance committee (*Finanzausschuss*). The committee may wish to invite experts and representatives of interest groups for a public hearing on the bill. The committee submits a written report to the plenary session of the *Bundestag*. The report starts with the committee's recommendation to the plenary session. If adoption of the bill is recommended, the committee would also state whether the bill should be adopted in its original version or in the version of the bill adopted by the committee. A second and third reading of the bill in the *Bundestag* follows.

A bill that is adopted by the *Bundestag* on its third reading is passed on to the *Bundesrat*. A bill affecting the finances of the *Laender* requires the consent of the *Bundesrat*. If the *Bundesrat* refuses to give its consent, the bill fails. The *Bundestag* cannot override this veto.

If the *Bundesrat* is not prepared to grant its consent, the *Bundesrat*, the *Bundestag* or the Federal Government may demand that the Mediation Committee (*Vermittlungsausschuss*) be convened. The Mediation Committee is a joint body composed of representatives of the *Bundestag* and the *Bundesrat*. If possible, the Mediation Committee submits a compromise proposal to the *Bundestag* and the *Bundesrat*. The bill as amended by the Mediation Committee is then voted on by the *Bundestag* and the *Bundesrat*. If adopted, the Act is signed by the Federal Government and the Federal President (*Bundespraesident*). Finally, the Act is promulgated in the Federal Law Gazette (*Bundesgesetzblatt*) and takes effect in accordance with the relevant provisions.

d. *Constitutional Challenges*

A taxpayer does not have the right to refer his or her case directly to the Constitutional Court (*Bundesverfassungsgericht*). Instead, the taxpayer must first file a claim with a lower tax court. Either the taxpayer or the tax office may file an appeal with the Federal Tax Court (*Bundesfinanzhof* — BFH) against the decision of the lower tax court, if either the lower tax court permits the appeal, or the taxpayer or the tax office successfully files a non-admission complaint. In practice, the vast majority of non-admission complaints are rejected as inadmissible or unfounded. A constitutional appeal (*Verfassungsbeschwerde*) to the Constitutional Court against a decision of a tax court is admissible only after all other legal remedies have been exhausted.[413] In practice, the vast majority of constitutional appeals are rejected as unfounded by the Constitutional Court.

In addition to the taxpayer, the court itself (i.e., a lower tax court or the BFH) may refer the question of whether a provision is in conformity with the Constitution to the Constitutional Court.[414] The referring court must demonstrate in full detail the reasons supporting its opinion that the provision is in violation of the Constitution.

If the Constitutional Court renders a decision holding a provision to be unconstitutional, the provision is null and void *ex tunc*.[415] If it believes that there is more than one way to eliminate the violation of the Constitution, the Constitutional Court renders a decision to the effect that the provision is not in line

[412] GG, Art. 76. Useful websites: *www.bundesregierung.de* and *www.bundestag.de*.

[413] GG, Art. 93(1) no. 4a; Act on the Constitutional Court (*Bundesverfassungsgerichtsgesetz* — BVerfGG), Sec. 90(2).

[414] GG, Art. 100 (1); BVerfGG, Secs. 80–82a.

[415] BVerfGG, Secs. 78, 82(1), 95(3).

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with the Constitution and leaves the legislator the opportunity to replace the provision with a provision that conforms with the Constitution within a certain period of time. If the legislator does not issue a new provision prior to the end of this period, the challenged provision will no longer be in force. The latter is the most likely result of a constitutional challenge of a tax law provision, as the Constitutional Court allows a wide margin of discretion to the legislator in relation to particular tax provisions.

2. Administrative

The Federal government has the authority to issue regulations (*Richtlinien*) that contain the government's interpretation of the provisions of a specific tax act. Regulations exist for many of the principal taxes, for example, income tax regulations, corporate income tax regulations, and trade tax regulations. In addition to regulations, the Federal Ministry of Finance and the State Ministries of Finance issue decrees (*Schreiben oder Erlasse*), which ordinarily deal with interpretative questions that are not addressed in the regulations. Regulations and decrees are further supplemented by administrative circulars (*Verfuegungen*) issued by the Upper Tax Authorities (*Oberfinanzdirektionen*), which are charged with overseeing the tax offices (*Finanzaemter*) situated in their districts. It should be noted that only members of the tax administration have to adhere to these pronouncements — they have no binding effect on either the courts or, formally, taxpayers. However, in practice taxpayers must either follow such a pronouncement or must explain in detail whether and for what reasons their viewpoint differs from the pronouncement simply to avoid being accused of engaging in tax evasion.

3. Courts

A taxpayer who believes that a tax assessment violates his or her rights may, within one month of the announcement date of the assessment, file an administrative appeal (*Einspruch*) against the assessment with the tax office that issued the assessment. The appeals division of the tax office renders a decision either confirming or correcting the tax assessment. If the taxpayer disagrees with the assessment as confirmed or corrected by the appeals division, the taxpayer may, within one month of the announcement date of the confirmation or correction of the assessment, refer the matter to the lower tax court (*Finanzgericht*) (there are currently 18 lower tax courts in Germany, each being in charge of a particular district). The lower tax court considers all the factual and legal aspects of the matter. If the lower tax court grants permission to appeal its decision or in case of a successful appeal against the denial of such permission, the case may, within one month of the announcement date of the lowers court's decision, be referred to the BFH based in Munich. The BFH renders its decision based on the facts of the case, as established by the lower tax court, i.e., the BFH does not itself ascertain the facts of the case. If a decision on the matter depends on the interpretation of European law, for example, a provision of an EU directive, the BFH must refer the legal question to the Court of Justice of the European Union (CJEU). In contrast, a lower tax court is not under a similar obligation but may itself seek guidance from the CJEU. Similarly, a court must seek guidance from the Constitutional Court if the court is of the opinion that a provision of a tax act violates the taxpayer's constitutional rights. Neither a lower tax court nor the BFH has the authority to rule that a provision of a tax act is unconstitutional.

In principle, decisions of the tax courts (including the BFH) have no precedential value. Decisions rendered by the BFH gain precedential value once published in the Federal Tax Gazette (*Bundessteuerblatt*), unless the tax administration issues a decree calling for the non-application of the decision beyond the case decided.

B. Principal Taxes

1. Individual Income Tax

Individual income tax is imposed on resident and nonresident individuals at progressive rates that range from 14% to 45% (plus an income tax surcharge; see 3., below).[416] Ordinary rates apply to the business income of individuals as well, but trade tax on business income is credited in a standardized form against the personal income tax liability of sole proprietors and individual partners in partnerships. This reduces the income tax burden of such individuals accordingly. In the case of resident taxpayers, the tax base is net income. Since 2009, a final flat tax of 25% (plus an income tax surcharge; see 3., below) has been imposed on nonbusiness income from capital investment such as gross dividends, gross interest and capital gains (see VIII.C.4. and 5., below). This flat tax is usually imposed by way of a final withholding tax. Despite the imposition of the flat tax, income tax collected by way of withholding at source is, in the case of a resident taxpayer, simply a prepayment on account of his or her income tax liability and is refundable if no income tax or less income tax than the amount of tax withheld is due (for example, in the case of tax withheld on salaries by employers and directors' fees). In the case of a nonresident individual, income tax is generally settled by way of final withholding on gross receipts; an assessment of income taxes on net income is made only occasionally. For further discussion, see VIII. and IX., below.

2. Corporate Income Tax

The corporate income tax rate is a flat 15% (plus income tax surcharge, see below). To avoid the corporate income tax having a cascading effect, 100% of the dividends received by a corporate taxpayer holding at least 10% of the distributing corporation's share capital at the beginning of the respective calendar year can now, as a rule, be excluded from the taxable income of the recipient. However, 5% of the dividends received are treated as nondeductible expenses, regardless of whether actual expenses are higher or lower, if this minimum participation rate applies; if not, the net dividend income is subject to standard corporate income tax rates of 15% (plus income tax surcharge; see 3., below). Thus, if the minimum participation rate applies, in effect, only 95% of dividends are excluded from taxable income. The same principle generally applies to capital gains realized by a corporation from the disposal of shares in another corporation (i.e., a 95% exemption). In the case of cap-

[416] Tax at the minimum rate of 14% is levied on income of 11,784 euros or more (since 2024); tax at the maximum rate of 45% is levied on income over 277,826 euros (since 2022). The amounts referred to are doubled for spouses electing for joint taxation (*Zusammenveranlagung*).

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ital gains, this principle applies regardless of the level of participation held by the recipient corporation in the distributing corporation. The tax burden of a corporation may be compared to the tax burden of an individual earning dividend income or capital gains from the disposal of shares in a corporation. As a rule, an individual who receives dividends or realizes capital gains on the sale of shares in a corporation need include in his or her taxable income only 60% of the gross dividends or the capital gains if this income is not subject to 25% final flat taxation as non-business income. For further discussion, see V. and VI., below.

3. Income Tax Surcharge

An income tax surcharge[417] (called the "solidarity surcharge") of 5.5% has been imposed on both the individual income tax and the corporate income tax, irrespective of whether the tax is imposed by way of assessment or withholding. The overall corporate income tax burden is therefore 15.825% (15% plus an additional 5.5% on 15%). While the proceeds from income tax and corporate income tax are split between the federation and the various states, the proceeds from the income tax surcharge belong to the federation only. However, since 2021, the income tax surcharge has not been imposed on individual net income up to a certain threshold amount. For 2025, the solidarity surcharge is not imposed on single individuals owing income taxes of 19,950 euros or more or couples owing income taxes of 39,900 euros or more. Corporations continue to pay the full income tax surcharge on corporate income tax. The income tax surcharge is also paid on the flat tax on interest and dividend income and capital gains.[418] For further discussion, see XVII., below.

Comment: There is an intense debate over whether the partial omission of the income tax surcharge is in accordance with constitutional law.

4. Net Worth Tax

The net worth tax lapsed as of December 31, 1996, after it had been declared unconstitutional by the Federal Constitutional Court and the Federal Parliament could not agree on a new Net Worth Tax Act that might have been constitutional. The (old) net worth tax was imposed on an annual basis on the value of the net assets of individual taxpayers, corporations and other entities.

Comment: Germany's political parties frequently discuss whether to reinstate the net worth tax. Against the background of significant public spending as a result of the war in the Ukraine and its impact on the German economy and German defense expenses and the intended decarbonization of the German economy, and the transport and building sectors, this discussion should be monitored closely. In particular, the reinstatement of the net worth tax would have a direct impact on the attractiveness of Germany as an inbound investment destination, given that Germany already has one of the world's highest tax burdens.

[417] Solidarity Surcharge Act (*Solidaritaetszuschlagsgesetz 1995* — SolzG 1995), as amended.

[418] SolzG, Sec. 3(3).

5. Trade Tax

Trade tax is imposed by federal law but assessed and collected by the municipalities from all businesses irrespective of their legal structure. It is the most important source of revenue for the municipalities. As it is based on trade income, trade tax represents an additional tax on the income of businesses, irrespective of their legal structure, that are operated as a permanent establishment (PE) in Germany. Depending on the municipality, subject to a few exceptions, the trade tax rates usually vary within a range of approximately 10% to 20% (in 2024) of taxable profit. The effective trade tax rates for corporations are slightly higher than those for sole proprietorships and partnerships, as the latter can discount a tax allowance. Furthermore, the trade tax burden on the latter is partially credited against the income tax debt of taxpayers subject to income tax. In contrast, a corporation must pay the trade tax in addition to the corporate income tax of 15.825% (including income tax surcharge), as the trade tax is a non-deductible expense for corporations. For further discussion, see X., below.

6. Value Added Tax

Value added tax (VAT) represented a first effort to harmonize taxation throughout the European Union and replaced the former sales and turnover taxes in the EU Member States. While taxable events have been harmonized, there are still significant variations in the scope and application of VAT among the Member States, and the tax rates have not yet been harmonized. The regular tax rate in Germany is 19% (16% between July 1 and December 31, 2020, as part of the COVID-19-pandemic measures). There is also a reduced rate of 7% (5% between July 1 and December 31, 2020, as part of the COVID-19-pandemic measures). For further discussion, see XI., below.

For further research on Germany's VAT system, see also the VAT Navigator.

7. Inheritance and Gift Tax

Under German succession law, title to and possession of the assets of a decedent pass automatically to the heir(s) without the interpolation of a personal representative. Inheritance tax is not imposed on an estate, but on the beneficial share of each heir or legatee. The jurisdictional basis for the imposition of the tax is not only the last residence of the decedent or the situs of the property, but also the place of residence of the heirs, legatees or other beneficiaries. The tax rates are graduated and depend on the degree of kinship between the decedent and the beneficiary. They vary within a range of 7% to 50%. The same rules apply, *mutatis mutandis*, to *inter vivos* gifts. For further discussion, see XIII., below.

8. Municipal Taxes

The most important local taxes, such as municipal trade tax (see 5., above) and real estate tax (*Grundsteuer*) are regulated by federal law. Other local taxes may be imposed if they are not preempted by similar federal taxes, but these are of minor importance (for example, tax on public entertainment events, dog tax, and hunting tax). Under state law, the municipalities

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may, however, be restricted as to the kinds of taxes they can impose.[419]

It should be noted that the real estate tax has been the subject of a tax reform[420] driven by a decision of the Constitutional Court holding the tax base to be unconstitutional. The reform was in place by January 1, 2025. The Real Estate Tax Reform Act regulates the new valuation bases for purposes of the real estate tax in the Valuation Act (the "federal model") and accompanying amendments to the Real Estate Tax Act and other laws. The new real estate tax values will be determined for the first time on January 1, 2022 (main determination date) and will form the basis for real estate tax as of January 1, 2025. In future, the main assessment period will be seven years, so that the next main assessment will be made on January 1, 2029. The Law allows the German states (*Laender*) to calculate the assessment basis for real estate tax located in their respective territories in a way that deviates from the federal model. Given that the real estate tax was included in the catalogue of Article 72(3) sent. 1 of the Constitution (*Grundgesetz* — GG). (the "Laender opening clause," which applies from 2025 at the earliest), it is to be expected that, in future, the 16 German states may apply different, individualized real estate tax laws, which will change the respective tax base and will likely increase it.

9. Church Tax

The Constitution authorizes the imposition of a special church tax on individuals who are members of recognized churches. In 2025, the rates of this tax vary between 8% and 9% of the individual income tax. Churches may have their own finance offices that assess and collect this tax. Employers are obliged to withhold church tax from the salaries of employees who are members of a recognized church. Similarly, financial institutions must withhold church tax from investment income.

10. Real Estate Transfer Tax

Real estate transfer tax is the only German transfer tax of importance. In 2022, the tax rates vary between 3.5% and 6.5% from state to state. The tax applies not only to the sale of real property, but also to certain transactions involving partnerships and corporations owning real property. It is triggered both on sales of assets and shares. For further discussion, see XII., below.

11. Energy Windfall Profits Tax

Based on the Council Regulation (EU) 2022/1854 of October 6, 2022, on an emergency intervention to address high energy prices,[421] the German legislature passed the EU Energy Crisis Contribution Act on December 16, 2022[422] in Article 40 of the Annual Tax Act. The windfall profits tax is a tax on top of the corporate income tax, levied on companies whose annual turnover in the fiscal year beginning after December 31, 2021, and the subsequent fiscal year consists of more than 75% of business activities in Germany involving extraction, mining, petroleum refining, and the manufacture of coke oven products. The rate of the tax is 33%. The base of the tax is the positive difference between the taxable profit of the respective fiscal year and the average taxable profit of the fiscal years beginning after December 31, 2017, and ending on or before December 31, 2021, plus 20%.

For purposes of assessment, an affected taxpayer must file a specific windfall profits tax return with the Federal Central Tax Office and do so within the time limits for filing the corporate income tax return. The windfall profits tax is due and payable within 10 days after the filing of the windfall profit tax return.

Comment: It is intensely disputed whether the Council Regulation (EU) 2022/1854 is in line with Article 122, paragraph 1 of the Treaty on the Functioning of the European Union (TFEU), as the windfall profits tax does not improve the energy supply situation of the EU Member States; instead, it harms the financial situation of the companies which are the tax debtors under the law. Moreover, this Council Regulation is arguably in conflict with Articles 20, 17 and 16 of the EU Fundamental Rights. This issue ought to be decided by the CJEU, which can be taken up as part of an appeals proceeding against the windfall profits tax before a German tax court, which would then need to refer the question to the CJEU. It should be noted that the EU lawmakers based this Council Regulation on Article 122 of the TFEU, which unlike tax-related regulations does not require unanimity for adoption but merely a majority vote. This "trick" is increasingly used by EU lawmakers to pass regulations and directives by majority votes although, according to the traditional understanding, a unanimous vote is required. Whether this "trick" is in line with fundamental EU law needs to be reviewed in each case by the CJEU.[423] The German Federal Constitutional Court found the windfall profit tax as transposed into German domestic law to be in line with the German constitution.[424]

12. Social Security Contributions

In 2025, the general health insurance rate is 14.6%, with an average additional contribution of 2.5% to be borne by employees. The long-term care insurance rate is 3.6%, increasing to 4.2% for childless employees over the age of 23. The pension insurance rate is 18.6%, and the unemployment insurance rate is 2.6%. The annual contribution assessment ceilings are 66,150 euros for health and long-term care insurance, and 96,600 euros for pension and unemployment insurance. The annual income threshold for compulsory statutory health insurance is 73,800 euros. In principle, employees and employers share such social security payments equally, with the exception of employees' additional contribution to health insurance and,

[419] For example, in Bavaria: *see* Municipal Tax Act (*Kommunalabgabengesetz* — KAG), Art. 3(3).

[420] Real Estate Tax Reform Act (*Grundsteuerreformgesetz*) of December 2, 2019, BGBl. 2019 I, 1794.

[421] Council Regulation (EU) 2022/1854 of October 6, 2022 on an emergency intervention to address high energy prices, published on October 7, 2022 in the Official Journal of the European Union, L 261/I/1.

[422] Act on the Introduction of an EU Energy Crisis Contribution Pursuant to Regulation (EU) 2022/1854 (EU Energy Crisis Contribution Act) published in Art. 40 of the Annual Tax Act 2022 BGBl. 2022 I, 2294.

[423] CJEU, Vermillion Energy Ireland, file no. C-533/24 (still pending). See also Local Tax Court Cologne, decision of December 20, 2024, file no. 2V 1597/24, which granted suspension of enforcement due to serious doubts about compatibility with EU law (appealed, BFH, file no. II B 5/25, still pending).

[424] Federal Constitutional Court, decision of November 24, 2024, file nos. 1 BvR 460/23 and 1.

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in the case of childless employees, the top-up to long-term insurance.

C. Tax Measures Currently Announced by the New Government

On June 4, 2025, the new government agreed on a number of tax measures designed to boost the German economy. These measures form a bill that still needs to be passed by the *Bundestag* and the second chamber, the *Bundesrat*. The bill includes the following measures:

(i) The introduction of 30% declining-balance depreciation for movable fixed assets, applicable to investments made between July 1, 2025 and December 31, 2027. 75% declining-balance depreciation for newly acquired electric vehicles in the year of acquisition, which will be valid for purchases made between July 1, 2025 and December 31, 2027, is also to be introduced.

(ii) A gradual reduction in the corporate income tax rate from 15% to 10% by 2032, with annual 1%-point reductions starting in 2028.

(iii) The raising of the maximum assessment base for the R&D tax allowance from 10 million euros to 12 million euros for expenses incurred after December 31, 2025.

Comment: These measures appear to be a little bit disappointing and should be only the very first step, as given a long lasting standstill, a serious tax reform is urgently required to improve the competitiveness of German companies. Further, the reduction of the CIT rate over the period from 2028 until 2032 will occur mainly after the next general elections, which raises the question of the reliability of this announcement.

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V. Taxation of Resident Corporations

A. *What Is a Resident Corporation?*

A corporation is a resident taxpayer if it has its statutory seat or its principal place of management in Germany. The statutory seat of a corporation is the place so designated in its charter. Where no such place is expressly designated in the charter, the seat is deemed to be located at the corporation's actual principal place of management. The principal place of management is the center from which the corporation's activities are directed. It is generally located at the main office where the final decisions on major issues that affect the corporation's business are made. Since a corporation organized under German law is required to specify in its charter a statutory seat in Germany, all German corporations are resident taxpayers.

An entity incorporated under the laws of a foreign jurisdiction may be a resident corporation if it transfers its principal place of management to Germany and, in addition, has a legal structure similar to that of a German corporation (see III.B. and C., above). The mere operation of a German branch by a foreign corporation does not make it a resident corporation for German tax purposes provided its actual head office remains outside Germany. Nevertheless, if a foreign corporation maintains its actual principal place of management in Germany, it will be recognized as a resident corporate taxpayer for purposes of corporate income tax.[425] For the status of such foreign corporations under German corporate law, see III.B.4., above.

B. *Corporate Income Tax*

1. *Taxation of Worldwide Income*

Resident corporations are subject to corporate income tax on their worldwide income in accordance with the rules of the Corporate Income Tax Act (*Koerperschaftssteuergesetz* — KStG). In German terminology, this is referred to as "unlimited tax liability." In principle, taxable income is gross income, less business expenses and other statutory allowances incurred by the taxpayer during the fiscal year, as determined by the accrual method of accounting for the taxable year.

Taxpayers for purposes of corporate income tax are *Aktiengesellschaften* (AGs), *Gesellschaften mit beschraenkter Haftung* (GmbHs), *Kommanditgesellschaften auf Aktien* (KGaAs), cooperatives, mutual insurance companies and comparable foreign entities. The tax may also apply to unincorporated associations and conglomerations of property, such as foundations, which, in certain respects, may resemble trusts under Anglo-American law. For the sake of simplicity, however, taxable entities are referred to in this Portfolio as "corporations."

A general or limited partnership in principle is not a taxable entity for corporate income tax purposes, unless its partners opt for the partnership to be taxed as a corporation (see VII.D., below). Instead, the share of the taxable profit of each partner is directly attributed to that partner and subjected either to income tax or to corporate income tax in the partner's hands, depending on whether the partner is, respectively, an individual or a corporation. See VII., below.

2. *Corporate Income Taxation*

The corporate income tax system is a classical system with one flat rate of 15% (plus income tax surcharge of 5.5%). Split rates for retained earnings and distributed profits were applicable between 1977 and 2000 but no longer apply. There is no integration of corporate income tax paid at the company level and individual or corporate income tax at the shareholder level, even though there is an exclusion for dividends received by a corporate shareholder[426] holding a minimum participation of at least 10% in the distributing corporation at the beginning of the calendar year[427] and either flat taxation at a rate of 25% (plus income tax surcharge of 5.5%) or a 40% exclusion for dividends received by an individual shareholder. The dividends received exclusion is not granted as part of the corporate income tax system but to mitigate the double taxation that would result if the system were applied without such adjustments and, in the case of corporate shareholders, to avoid corporate income tax having a cascading effect.

The discussion below illustrates how the system works in selected situations.

a. *Contributions to Capital*

Contributions to the capital of a German corporation may consist of:

(i) Stated equity capital subscribed and paid in on the organization of the corporation or subsequent increases in stated equity capital;

(ii) In the case of a GmbH, additional contributions to capital (*Nachschuesse*) that do not involve the issue of new shares by the corporation;

(iii) Other informal contributions to capital (including waivers of shareholders' loans) in the amount of their fair market value (see II.F.1.c.(2), above); or

(iv) Constructive (hidden) contributions to capital.

(1) *Increases in Stated Equity Capital*

Capital contributed as a subscription to shares issued in the context of the organization of a subsidiary corporation or a subsequent increase in its stated equity capital qualifies as equity capital. This means that, in the event of a subsequent liquidation or decrease in the nominal equity capital, the repayment of capital so contributed is subject to neither corporate income tax nor withholding tax, but the distribution of liquidation proceeds may result in a gain at the shareholder level if and to the extent the liquidation proceeds exceed the cost basis of the shares.

An exception to this rule applies to the repayment of stated equity capital where such capital had been created out of retained earnings. Such amounts must be recorded separately and, if the stated equity subsequently is reduced, such separate-

[425] BFH decision of June 23, 1992, BStBl. 1992 II, 972.

[426] Five percent of the dividends received is treated as non-deductible expenses.

[427] Corporate Income Tax Act (*Koerperschaftssteuergesetz* — KStG), Sec. 8b(4) sent. 1.

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ly recorded amounts are deemed to have been used first and are classified as a dividend that is taxable as such.[428]

(2) Other Contributions to Capital

Open or constructive contributions to capital (*nicht in das Nennkapital geleistete Einlagen*) that do not involve the issue of new shares by a corporation will be credited to the contribution account under Section 27 of the Corporate Income Tax Act. If such paid-in surplus is repaid to the shareholders, it is subject to neither corporate income tax nor withholding tax at the level of the corporation. However, distributable earnings are deemed distributed first (see V.B.2.a.(1), above).

b. Key Aspects of the Taxation of German Subsidiary Corporations

Significant aspects of the taxation of German subsidiaries include the treatment of constructive dividends, interest deduction limitations, the treatment of interim dividends, loss carryforwards and loss carrybacks. These are dealt with at (1) to (4), below.

(1) Constructive Dividends

Pursuant to case law developed by the Federal Tax Court (*Bundesfinanzhof* — BFH), a constructive dividend is any decrease (or prevented increase) in capital that:

(i) Is caused by the shareholder relationship, i.e., that would not have been granted to an unrelated person;

(ii) Affects the amount of the corporation's income; and

(iii) Is not based on a shareholders' resolution to declare a dividend adopted in accordance with the rules of company law. A corresponding monetary benefit in the hands of a shareholder or a person related to a shareholder is not required.[429]

The requirement of causality in (i) is not met if the decrease (or prevented increase) in income reflects arm's-length terms. Under prevailing case law, even the non-exercise by a corporation of an opportunity for profit to benefit a shareholder may be a constructive dividend. Four standard situations give rise to constructive dividends:

(i) A corporation acquires an asset from a shareholder at an excessive price;

(ii) A corporation uses services, capital or assets of a shareholder for which it pays excessive consideration (for example, excessive salaries are paid to officer-shareholders or excessive rental payments are made for assets owned by a shareholder but used by the corporation);

(iii) A corporation transfers assets to a shareholder for no consideration or for a consideration that is lower than the fair market value of the assets; or

(iv) A corporation grants to a shareholder for his or her use services, capital or assets for no consideration or for a consideration that is lower than an arm's-length price (for example, interest-free loans are granted or a company apartment is provided at below-market rent).[430]

In the case of controlling shareholders, a clear-cut, prior written agreement is required to avoid constructive dividend treatment. In the absence of such a written agreement, even otherwise adequate arrangements may be considered constructive dividends.[431] When a tax treaty is applicable, the absence of a written agreement is not sufficient grounds for assessing a constructive dividend.[432]

Normally, but not invariably, a constructive dividend increases both the taxable income of the corporation and the taxable income of the shareholder concerned. In certain instances, the taxable income of the corporation is increased without a corresponding receipt of additional income at the shareholder level. These different kinds of treatment may be illustrated as follows:

(i) Where an interest-free loan is made to a sister company, the taxable income of the lender company is increased by the amount of interest at an arm's-length rate. The BFH has held that such a constructive dividend also attracts withholding tax[433] and that the taxable income of the common controlling corporation is increased by the amount of the constructive dividend.

(ii) Where excessive salary is paid to an officer/shareholder, the excess part of the salary is disallowed as a business expense at the company level, thus increasing the taxable income of the company. The officer/shareholder must, in any event, include his or her total salary in taxable income. The excess portion is reclassified as a dividend and, because only 60% of the gross dividend is includible in taxable income at the shareholder level, this reclassification benefits the officer/shareholder. Because the officer's/shareholder's salary was subject to income tax at the ordinary rates, a refund claim should succeed.[434]

Conversely, there are instances in which the distribution of a constructive dividend does not affect the taxable income of the corporation but increases income at the shareholder level, for example, where a corporation dissolves a discretionary reserve and distributes it to its shareholders.

(2) Interest Deduction Limitation (Interest Barrier Rule)

The Enterprise Tax Reform Act for 2008 introduced a limitation on the deductibility of interest surplus as of 2008, as a consequence of which the former thin capitalization rules for shareholder loans were abolished. "Interest surplus" is defined as the excess of interest expense over interest income. "Interest" for these purposes also includes commitment fees, guarantee commissions, prepayment penalties, construction-period interest, accrued interest (discounting/uplift), interest compo-

[428] KStG, Sec. 28.

[429] BFH decisions of February 22, 1989, BStBl. 1989 II, 475 and October 11, 1989, BStBl. 1990 II, 89. Corporate Income Tax Regulations (*Koerperschaftsteuerrichtlinien* — KStR), Sec. H 8.6.

[430] For further examples, see KStR, Sec. H 8.5.

[431] KStR, Sec. H 8.5 (2). See BFH decision of March 2, 1988, BStBl. 1988 II, 590: the corporation has the burden of proving whether a prior oral agreement existed.

[432] BFH decision of October 11, 2012, BStBl. 2013 II, 1046; KStR H 8.5.III.

[433] BFH decision of October 26, 1987, BStBl. 1988 II, 348.

[434] KStG, Sec. 32a.

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nents in swaps and imputed interest on hidden profit distributions.

Interest surplus is deductible only to the extent of 30% of taxable earnings before interest, taxes and depreciation (tax EBITDA). Non-taxable income of a corporation, such as dividends, is not included for purposes of determining tax EBITDA. The nondeductible portion of excess interest as well as a tax EBITDA exceeding 30% of taxable earnings may be carried forward to subsequent fiscal years and may be deducted in those years subject to the same limitations.

There are three exceptions to the limitation:[435]

(i) Exemption limit of three million euros: interest expenses are fully deductible if the interest surplus of the corporation is less than three million euros. If the interest surplus is three million euros or more, the entire interest surplus will be subject to the deductibility limitation under the general rule described above.

(ii) No-affiliation clause: the limitation applies only if the corporation that is conducting business operations and seeking the deduction of interest is not related to any person defined in § 1 para. 2 of the AStG.[436] This includes entities with a direct or indirect ownership stake of at least 25%. Further, the corporation must not have a permanent establishment (PE) outside of the country of its place of actual management.

(iii) Adequate equity ratio: if the no-group clause does not apply, the general limitation rule can only be avoided if the ratio of equity to total assets of the corporation's business operation is not higher than the overall ratio of equity to total assets of the entire group to which the corporation belongs (the "escape clause"), unless the shortfall does not exceed 2%. The relevant ratio generally will be determined using international financial reporting standards (IFRS); in certain circumstances, U.S. generally accepted accounting principles (US GAAP) are also applicable. A group is deemed to exist subject to the same conditions as are specified under the no-group clause. Like the no-group clause, the escape clause applies only if there are no harmful shareholder loans. The conditions for a harmful shareholder loan granted by a person not belonging to the group are basically the same as under the no-group clause, except for the following two crucial differences:

- The escape clause will not apply if 10% or more of the interest expense is attributable to related-party debt, i.e., loans from shareholders with 25% or greater direct and/or indirect participations in the corporation concerned, regardless of the location of the related-party's seat or place of management. In other words, shareholder loans for these purposes are not limited to those granted to the German entity actually seeking the interest deduction. Thus, for example, the shareholder financing of a French subsidiary could lead to a denial of the escape clause for the German subsidiary seeking the deduction.
- The shareholder loan exception to the escape clause does not apply to shareholder loans that are consolidated in the balance sheet of the group.

This regime has an immense impact on the structuring of leveraged transactions. Non-deductible expenses can be carried forward. Their utilization in future years will be restricted in accordance with the same rules as apply in the context of the general loss carryforward (see V.B.8., below).

The excess non-deductible interest and the non-used tax EBITDA cannot be carried forward in the event of: (i) the discontinuation or transfer of the business operations of the corporation seeking the deduction; (ii) a partner leaving the partnership, where the entity seeking the deduction is a partnership; or (iii) regarding only to the nondeductible portion of excess interest, a "harmful" direct/indirect transfer of the shares held in the corporation seeking the deduction within five years under the rules on a harmful change of control of more than 50% of the capital or the voting rights of the corporation to another shareholder.[437] If in a given year, the net interest expenses are less than 30% of the tax-adjusted EBITDA, the amount of the unused tax EBITDA can be carried forward. Subsequently, the tax EBITDA carryforward can be used to offset net interest expenses otherwise not deductible because the net interest expense in a subsequent year exceeds 30% of the tax-adjusted EBITDA and no exception is available.

Comment (1): Many commentators view the interest barrier rule as violating Germany's constitution. The BFH strongly supported this view in its October 15, 2015 decision to refer the issue to the Federal Constitutional Court, which has not yet decided on the case.[438] Taxpayers affected by the application of the interest barrier rules should seriously consider lodging an appeal against the respective tax assessments.

Comment (2): In recent years, many countries, including the United States, have introduced very similar rules or are about to introduce such rules in line with their commitments arising from the Organisation for Economic Cooperation and Development (OECD)/G20 Base Erosion and Profit Shifting (BEPS) project and the EU Anti-Tax Avoidance Directive (ATAD).[439] If the Federal Constitutional Court regards the interest barrier rule as violating Germany's constitution, the German Government will find itself in a rather uncomfortable situation since it will have to design a new rule that is at the same time in line with the constitution and its international commitments.

(3) Interim Dividends

The distribution of interim dividends (i.e., dividends paid out of the profits of the current fiscal year or paid out of the profits of the prior fiscal year but distributed before the financials of the prior year have been ratified) by a company organized as a GmbH is permitted under both company law and tax law. An AG may distribute interim dividends only out of prof-

[435] See also decree of the Federal Ministry of Finance of March 24, 2025.

[436] EStG, Sec. 4h para. 2 b).

[437] EStG, as amended, Sec. 4h(4); KStG, Sec. 8c.

[438] BFH decision of October 14, 2015, BStBl. II, 2017, 1240; the case is still pending before the Federal Constitutional Court (*Bundesverfassungsgericht* — BVerfG) (file no. 2 BvL 1/16).

[439] Council Directive (EU) 2016/1164 of July 12, 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, Art. 4.

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its for the prior fiscal year (i.e., before the financials for that prior fiscal year are ratified).

(4) Net Operating Losses

A loss reduces a corporation's equity capital in the fiscal year in which it is incurred, but the corporate income tax is reduced in the year in which the loss may be deducted.

Under the provisions governing loss carrybacks, a loss incurred in one fiscal year may be carried back to the previous year. The tax loss amount carried back may not exceed one million euros. Tax losses can be carried back to the two previous years.[440]

A remaining net operating loss (NOL) may be deducted in future assessment periods up to an amount of one million euros per year. A loss in excess of the limit may be deducted for CIT purposes (but not trade tax purposes) to the extent of up to 70% for the years 2024 to 2027[441] and as of 2028 to the extent of up to 60% of net income (*Gesamtbetrag der Einkuenfte*) only.[442] This leads to a minimum tax base of 30% and 40%, respectively, of net income exceeding one million euros.

c. Liquidation

The liquidation procedure follows the rules of company law (see III.B.3. and C.3., above). The liquidation gain of a corporation is computed by deducting from the assets distributed to the shareholders at the end of the liquidation, the book value of the assets at the beginning of the liquidation. In making this comparison, liquidating distributions-in-kind of appreciated assets must be recognized at their fair market value if and to the extent the appreciation would be taxable if realized by the liquidating corporation.

In the hands of the shareholder, the tax status of the liquidation proceeds depends on whether the proceeds are classified as dividends, capital gains or a repayment of equity. If the shareholder is a resident corporation, see V.B.4.c., below, for dividends, and V.B.4.b.(6), below, for capital gains. If the shareholder is a nonresident corporation, see VI.B.2. and 3.c., below. If the shareholder is an individual, see VIII.C.4.c., below, for dividends, and VIII.C.5., below, for capital gains. The repayment of stated capital is not a taxable event.

d. Repayment of Informal or Constructive Contributions to Capital

An informal or constructive contribution to the capital of a resident corporation must be credited to the paid-in surplus account. It can be repaid free of withholding tax, but only if the corporation has distributed all of its retained earnings.[443]

3. Accounting

Accounting has been one of the major harmonization of law issues in the European Union since the late 1970s. This has led to the enactment of the Financial Statements Directive Act (*Bilanzrichtlinien Gesetz* — BiRiLiG) of December 19, 1985, effective as of January 1, 1986, which incorporated the rules of the 4th, 7th, and 8th EC Directives into German commercial and company law. Various changes apply for fiscal years commencing on or after January 1, 2010, based on the German Accounting Law Modernization Act (*Bilanzrechtsmodernisierungsgesetz* — BilMoG) of May 25, 2009,[444] and for business years beginning after December 31, 2015, on an Act of July 17, 2015, transposing an EU directive into domestic law (*Bilanzrichtlinie-Umsetzungsgesetz*).[445]

a. In General

Under Sections 238 *et seq.* of the Commercial Code (*Handelsgesetzbuch* — HGB), corporations such as AGs and GmbHs, as well as partnerships and sole proprietors, are required to maintain proper accounting records in accordance with the provisions of the HGB and, in addition, with generally recognized accounting principles as subsidiary law. Accordingly, all business transactions must be recorded individually and currently.[446] Records and vouchers must be kept on file in Germany or as of January 1, 2023 in another EU Member State, provided the taxpayer ensures that the data is fully accessible by the German tax authorities.[447] At the end of the financial year, financial statements must be prepared based on a corporation's books and physical inventories.[448] No particular system of accounting is prescribed, but certain basic requirements for all commercial enterprises are set forth in Sections 242 to 245 of the HGB, with special provisions for corporations (and general and limited partnerships, if no general partner is an individual) in Sections 264 *et seq.* and Sections 41 *et seq.* of the GmbH Code and Sections 150 to 160 of the Stock Corporation Act.

The requirements of commercial and company law must also be complied with for purposes of corporate income tax.[449] The balance sheet, which is prepared in accordance with these commercial and company law provisions (the "legal balance sheet") is the basis for measuring the amount of possible profit distribution to shareholders. The legal balance sheet must be adjusted in accordance with the requirements of tax law (the "tax balance sheet"). The tax balance sheet is the basis for the computation of a corporation's taxable income. The legal balance sheet must be filed electronically with the relevant commercial register of the corporation, while the corporation must file its tax balance sheet electronically with the responsible tax office.[450]

The legal balance sheet differs from the tax balance sheet as a result of their different targets. While the legal balance sheet is characterized by the prudence principle, the tax balance sheet is the basis for taxing profits. Thus, the legislator has relaxed the prudence principle to increase the taxable profit, for example, by prohibiting certain provisions for purposes of the tax balance sheet that are accepted for purposes of the legal balance sheet[451] and by reducing the amount of liabilities in

[440] KStG, Sec. 8(1); EStG, Secs. 10d (1).
[441] KStG, Sec. 8(1); EStG, Secs. 10d (2).
[442] KStG, Sec. 8(1); EStG, Sec. 10d(2).
[443] KStG, Sec. 27(1) sent. 3.

[444] German Accounting Law Modernization Act (*Bilanzrechtsmodernisierungsgesetz* — BilMoG), BGBl. 2009 I, 1102.
[445] Act transposing an EU directive into domestic law (*Bilanzrichtlinie-Umsetzungsgesetz* — BilRUG), BGBl. 2015 I, 1245.
[446] HGB, Sec. 238(1).
[447] AO, Sec. 146(2a).
[448] HGB, Secs. 242 *et seq.*
[449] AO, Sec. 140; KStG, Sec. 7(4).
[450] EStG, Sec. 5b.
[451] E.g., EStG, Secs. 5(4), 5(4a), 5(4b).

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the tax balance sheet by discounting them at an interest rate of 5.5%.[452] In addition, certain election rights only applicable for tax purposes can now be exercised without matching them in the commercial balance sheet. Special, current documentation is required under the tax code.[453] It should be further noted that it is possible to maintain electronic bookkeeping outside Germany if this is approved by the responsible German tax office. One of the prerequisites is that, during an audit, the tax office must have the right to access the electronic bookkeeping files.[454]

b. Accounting Period

A corporation's taxable income is computed based on its fiscal year, which may or may not coincide with the calendar year, but which may not extend beyond 12 months. A change from the calendar year to a fiscal year that does not coincide with the calendar year requires the consent of the local tax assessment office.[455] If the books are kept based on a fiscal year that does not coincide with the calendar year, the results of a taxable year that ends within a particular calendar year must be reported as the taxable income (or loss) of that calendar year.[456]

c. Accounting Methods

For all practical purposes, the accounting records must be maintained in accordance with the accrual method of accounting to ensure the proper periodic recognition of revenues and costs. Consequently, cost and revenue items that relate to a future financial year may be deferred. If certain revenues or specific cost items are prepaid for several years in advance, then only that part of the revenue or cost properly allocable to the financial year may be recognized.[457] Under the principle of imparity, anticipated unrealized gains need not be recognized, but unrealized losses are taken into account by way of extraordinary depreciation to the lower going concern value, which, however, is subject to a mandatory recouping to the original cost basis less regular amortization in the following fiscal year both in the legal and tax balance sheets, unless the corporation can establish that the going concern value still is lower.[458]

Note: If a corporation does not maintain proper accounting records and the tax authorities are unable to compute the taxable income of the corporation based on these records, the tax authorities may estimate the corporation's taxable income.[459]

d. Methods of Valuation

All assets and liabilities of a corporation must be valued as of the end of the fiscal year.[460] In principle, each individual asset or liability must be valued separately, except for groups of assets that are sufficiently similar to permit verification of an average price.[461] For purposes of this valuation, the term "assets" includes all tangible items of economic value appropriated to the use of the business in which the taxpayer has an economic property right. Intangible rights may be capitalized as fixed assets for tax purposes only if they have been acquired from a third party for consideration.[462] Thus, costs incurred in developing intangible industrial property rights, goodwill and similar intangible rights must be expensed currently and may not be capitalized in the tax balance sheet. Under Section 248(2) of the HGB, subject to certain exceptions, such as trademarks and customer lists, self-built intangibles may be capitalized in the legal balance sheet.

The methods of valuing particular kinds of assets and liabilities are discussed in (1) to (6), below.

(1) Depreciable Fixed Assets

Depreciable fixed assets are valued at acquisition cost or manufacturing cost, adjusted by proper depreciation allowances.[463] The terms "acquisition cost" and "manufacturing cost" include the entire outlay for the asset concerned.[464] Thus, the cost of an asset comprises the purchase price and incidental direct expenses (for example, freight, duty, insurance and real estate transfer tax, but not financial charges incurred in connection with the acquisition or manufacturing of the asset; see (3), below). If the going concern value (*Teilwert*) is permanently lower than the adjusted cost basis, depreciable fixed assets may be valued at the lower going concern value. The going concern value of an asset is defined as the sum that a purchaser of the entire business would allocate to the individual asset within the total purchase price, assuming the purchaser were to continue to operate the business.[465] The going concern value of a depreciable fixed asset is presumed to equal its adjusted cost basis. A valuation at the lower going concern value requires conclusive proof of such lower value.

Comment: Depreciable fixed assets that may be valued separately and whose costs do not exceed 800 euros may be expensed in the financial year in which they are acquired, provided the date of acquisition and acquisition cost are listed in a specific account or appear in the accounting books.[466]

(2) Other Assets

Other assets (non-depreciable fixed assets such as land, participations in other corporations, acquired goodwill and current assets) must be valued at the lower of cost or going concern value, provided, if they are valued at going concern value, it is anticipated that the going concern value will be permanently lower than cost (however, such assets may never be valued at more than their cost basis).

In the case of inventories, the going concern value will, as a rule, equal the market value. In determining cost, actual cost must be used if available. For tax purposes, the last-in-first-out (LIFO) method may be used for inventories of the same kind if this conforms with proper accounting principles, for example, that the physical movement of the goods should not obvi-

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[452] EStG, Sec. 6(3).
[453] EStG Sec. 5(1).
[454] AO, Sec. 146(2a).
[455] EStG, Sec. 4a(1) no. 2; KStG, Sec. 7(4).
[456] EStG, Sec. 4a(2) no. 2.
[457] EStG, Sec. 5(5); *see* HGB, Sec. 250.
[458] HGB, Sec. 253(5) sent. 1; EStG, Secs. 6(1) no. 1 sent. 4, 6(1) no. 2 sent. 3, 7(1) sent. 7.
[459] AO, Sec. 162(1).
[460] HGB, Secs. 240(1) and (2).
[461] HGB, Sec. 240(4).
[462] EStG, Sec. 5(2).
[463] EStG, Sec. 6(1) no. 1; HGB, Sec. 253(1).
[464] These terms are defined in HGB, Sec. 255(1)–(3).
[465] EStG, Sec. 6(1) no. 1.
[466] EStG, Sec. 6(2).

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ously be incompatible with the assumption on which the LIFO method is based.[467]

Raw materials, auxiliary materials, and supplies that are always needed in the business may be carried on the books at a fixed base stock value, the cost of replacements being expensed currently. This method is permitted only if the basic stock fluctuates only minimally with respect to its size, value and contents, and if a physical inventory is made at least once every three years to determine whether use of the base stock value is still justified.[468]

(3) Liabilities

Liabilities, such as loans, are valued at the gross amount repayable by the taxpayer to cover the legal balance. Non-interest bearing loans are valued for tax purposes in accordance with the fair market value principle (*Teilwertprinzip* under Sec. 6 para. 1 No. 2 of the German Income Tax Act, EStG). From a lender's perspective, loan is generally recognized at its nominal value unless the fair market value (*Teilwert*) is significantly lower. In the case of interest-free or low-interest loans, a lower fair market value may apply, potentially leading to a tax-deductible write-down. From a borrower's perspective, the liability is typically recognized at the repayment amount (nominal value), unless the loan has been granted by an affiliated person and the loan terms are not at arm's length (for example, in shareholder or group relationships). In this case, a deemed contribution or hidden distribution may arise. In the case of cross-border intra-group loans adjustments may be required under the transfer pricing rules (§ 1 of the AStG), if the loan terms deviate from the arm's length principle. Proper documentation is essential in such cases.

(4) Provisions

Although provisions are generally permitted for accounting purposes in the legal balance sheet, they are either fully or partially disallowed[469] or severely restricted[470] for tax balance sheet purposes. No provisions may be set up for tax purposes for acquisition or manufacturing costs that have to be capitalized in a future fiscal year.

(5) Contributions In-kind

Contributions in-kind to a corporation's capital are generally valued at their going concern value when contributed.

(6) Distributions In-kind

Assets distributed in-kind by a corporation must be valued at their going concern value when distributed. This can result in a taxable gain at the corporate level, if the book value of the assets distributed is below their going concern value.

e. Consolidated Returns

Consolidated legal financial statements must be drawn up for a German parent corporation and domestic subsidiaries that are under the parent corporation's control or in which the parent corporation holds the majority of voting rights, or where the parent has the right to appoint and dismiss the subsidiary's board of directors or supervisory board, or has a controlling influence over the subsidiary by virtue of a control agreement.[471] In addition, listed corporations must prepare their consolidated statements for fiscal years that begin after December 31, 2004 in accordance with international accounting standards (IAS) and IFRS, if not already obligated to do so by other legal provisions.[472] However, no consolidated returns may be filed for corporate income tax purposes. As to consolidation for tax purposes, see V.B.10., below.

4. Calculation of Gross Income

a. In General

All activities of a domestic corporation are considered to be business transactions and, therefore, all income of a domestic corporation is treated as business income even if the corporation does not actually engage in a business activity.[473]

b. Capital Gains

(1) General Rule

As a rule, all capital gains realized on the sale or exchange of assets of a corporation are included in the corporation's ordinary income and taxed at the normal tax rates. However, the Tax Reduction Act 2001 introduced new tax rules for the disposal of shares in another resident or nonresident corporation. These rules are discussed in V.B.4.b.(6), below.

(2) Exemption for Involuntary Realization

Capital gains realized involuntarily (for example, as a result of destruction by an act of God, larceny, theft, or compulsory sale covered by insurance or if compensation is paid) are not taxable if a replacement asset is acquired in the same financial year as that in which the gains are realized. The replacement asset must perform the same basic business functions as the original asset, although allowance may be made for technological progress. If the asset is not replaced in the year in which the gain is realized, the gain may be placed in a tax-free reserve if the taxpayer intends to acquire a replacement asset. However, the gain becomes taxable if a replacement asset is not ordered within one year from the end of the financial year in which the reserve was formed in the case of a movable asset, or four years from the end of that year in the case of an immovable asset. A gain is also recognized to the extent the replacement reserve exceeds the cost of the replacement asset.[474]

Note: Depreciation of a replacement asset is computed based on acquisition cost less the amount of the untaxed capital gain (i.e., the excess of the insurance proceeds or other compensation over the book value of the old asset).

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[467] EStG, Sec. 6(1) No. 2a; Income Tax Regulations (*Einkommensteuerrichtlinien* — EStR), Sec. 6.9; *see also* HGB, Sec. 256, for financial statement purposes.

[468] EStR, Sec. R 6.8; HGB, Sec. 256 sent. 2, 240(3).

[469] EStG, Secs. 5(4), 5(4a), 5(4b).

[470] EStG, Sec. 6(3a).

[471] HGB, Sec. 290(1), (2).

[472] HGB, Sec. 315e.

[473] KStG, Sec. 8(2).

[474] EStR, Sec. R 6.7.

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(3) Voluntary Conversions

Capital gains realized on the sale or exchange of land and/or buildings can be deferred by reducing the cost of replacement assets by the amount of the gains if the replacement assets are acquired in the fiscal year of disposal or the preceding year. Eligible replacement assets are real property, where the gain results from the disposal of real property, or buildings where the gain results from the disposal of real property or buildings. For these purposes, the expansion or remodeling of a building is treated as the acquisition or construction of a building.[475] A company that does not avail itself of this rollover option in the fiscal year of disposal or the preceding year may set up a reserve that can be used to reduce the basis of eligible replacement assets acquired within the four fiscal years following the disposal. In the case of newly constructed buildings, this period is extended to six years if construction commenced before the end of the fourth year. Assets must have been held by a corporation for six years before their disposal is eligible for rollover treatment. In addition, rollover relief used to be available only if the replacement asset was attributed to a German permanent establishment (PE). On April 16, 2015, the Court of Justice of the European Union (CJEU) held that this condition violates Article 49 EC Treaty.[476] In reaction to this decision, the Tax Amendment Act 2015[477] provides for a new deferral facility with respect to replacement assets situated in another EU/European Economic Area (EEA) Member State.[478] More specifically, the tax arising on the capital gain may be discharged in five equal annual installments at no interest charge. This new facility applies retroactively with respect to capital gains recognized prior to the entering into force of the Tax Amendment Act 2015, provided the tax assessment for the tax year during which the capital gains were recognized is not statute-barred.

(4) Reorganization Aspects

Under the Reorganization Tax Act, the transfer of a corporation's assets or of part of its assets forming a separable division (*Teilbetrieb*), or of a partnership interest, or of the entire interest in a wholly-owned subsidiary may be effected free of income tax, if the transfer is made in exchange for stock in the transferee corporation and complies with the provisions of Section 20 *et seq.* of the Reorganization Tax Act (*Umwandlungssteuergesetz* — UmwStG). For further discussion, see V.B.14.c.(2), below.

(5) Transfer of Assets Abroad

The transfer of an asset by a corporation to its foreign PE is regarded as a deemed disposal that, in principle, gives rise to a taxable gain in the amount by which the going concern value of the asset exceeds its adjusted tax basis. This applies not only where the foreign PE is in a country that has a tax treaty with Germany that uses the exemption method to avoid double taxation, but also in cases in which Germany grants a tax credit either under a treaty or unilaterally. However, if a fixed asset is transferred by a German resident corporation to a PE in another EU Member State, the gain may be taxed in equal parts over five years.[479]

(6) Capital Gains from Sales of Shares in Domestic or Foreign Corporations

Capital gains from the sale of shares in domestic or foreign corporations realized by a corporate taxpayer are, in principle, fully excludable from the taxable income of the corporation. This exclusion applies without any minimum shareholding or minimum holding period or activity requirement having to be met. However, the exclusion is limited by the fact that a non-deductible lump sum of 5% of the capital gains from the disposal of shares in another corporation is added back to taxable income. Under these rules, the 5% sum is deemed to be business expenses that are non-deductible and, therefore, taxable regardless of the actual amount of the costs.

For this purpose, Section 8b(2) of the Corporate Income Tax Act defines capital gains as the sale price minus sale costs, minus the book value of the shares sold at the time of the disposal. Sale costs include such items as notaries' fees, brokers' commissions and appraisal costs, if such costs are borne by the seller. They do not include financing charges borne by the seller. Capital gains triggered by reductions of capital stock and hidden contributions are also taxed under the Section 8b(2) rules. Reductions in profit in connection with tax-exempt shares, shareholder loans or collateral provided by a shareholder holding directly or indirectly more than 25% of the corporation's shares or a party affiliated to such a shareholder do not form part of the calculation of the capital gains, unless the corporation can prove that a third party would also have granted such loan under the same terms and conditions; this does not apply to currency losses linked to such shareholder loan, which occur after December 31, 2021; therefore, such currency losses will become tax deductible.[480]

Losses incurred by a corporate shareholder on the sale of shares in a corporation or a reduction of profits that results from a write-down to a lower going concern value or any measures described above are not deductible and a taxable gain will result to the extent of the unlawful deduction. Despite the tax exemption for capital gains, the actual financing and other costs incurred in the context of a participation in a corporation are fully deductible (except the 5% of capital gains deemed to be non-deductible business expenses).

There are two exceptions to the 95% tax exemption for capital gains on sales of shares in a corporation. These apply with respect to:

(i) Shares held as investment assets by a health or life insurance corporation;[481] and

(ii) Shares owned by a financial institution that are attributable to its trading book. The same applies to shares acquired after December 31, 2016, by a finance company if: (i) financial institutions own more than 50% of the finance

[475] EStG, Sec. 6b.

[476] CJEU decision of April 16, 2015 — C591/13 *EU Commission v. Germany*.

[477] Published on Tax Amendment Act 2015 (*Steuerergaenzungsgesetz 2015*) November 2, 2015, BGBl. I, 2015, 1834.

[478] EStG, Sec. 6b (2a).

[479] EStG, Secs. 4g (2), 36 (5); KStG, Sec. 12 (1).

[480] Corporate Income Tax Modernization Act (*Koerperschaftssteuermodernisierungsgesetz*, KöMoG), BGBl. 2021 I, 2050.

[481] KStG, Sec. 8b(8).

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company; and (ii) the finance company must record the shares acquired as current assets.[482]

Where these exceptions apply, capital losses (and the write-down of the investment cost to the lower going concern value) are tax deductible, while the capital gains are taxable.

c. Dividends

Subject to three important exceptions, dividends are 95% tax-exempt in the hands of corporate shareholders. This generally applies to all dividends irrespective of whether the distributing corporation is engaged in an active business and irrespective of its country of residence, if: (i) the shareholder holds a direct minimum participation of at least 10% of the distributing corporation's stock at the beginning of the respective calendar year; and (ii) at the level of the distributing corporation, the distributed dividends are neither tax-deductible nor exempt under a tax treaty shielding privilege.[483] The exemption is denied in two instances where dividends are received on shares that are excluded from the capital gains exemption, i.e., where the dividends are paid on shares held as investment assets by a health or life insurance corporation or on shares owned by a financial institution that are attributable to the institution's trading book. By way of exception, such dividends are nonetheless tax-exempt if an exemption is provided for under an applicable tax treaty or the EU Parent-Subsidiary Directive.[484]

Expenses (including financing expenses) incurred or accrued in the economic context of the acquisition or holding of the share interest giving rise to the dividends may, however, be deducted.

Comment: Because the taxable income of the resident recipient of a dividend is increased by 5% of the tax-exempt dividends received, the exemption amounts to 95% rather than 100% of the dividends received. As a consequence, in corporate structures with several tiers in Germany, this will result in a cascading corporate income tax effect that the legislators had thought to avoid by granting a 100% exemption for inter-company dividends in the first place. This cascading effect, however, can be avoided by using an *Organschaft* arrangement (a German form of consolidation), as the attribution of the income of the subsidiary to the parent company under such an arrangement is not deemed to be a dividend distribution under Section 8b(1) of the Corporate Income Tax Act.

d. Foreign Income

Resident corporations are taxed on their foreign-source income as well as their domestic-source income, except on particular items of foreign-source income for which an applicable tax treaty provides an exemption. For purposes of the corporate income tax, total income, including foreign-source income, is considered to be business income. By contrast, Germany's treaties make a distinction between:

(i) Income from foreign-situs real property;

(ii) Commercial or industrial income derived through a foreign PE;

(iii) Income from capital investment (whether debt or equity investment) if the debtor's residence, principal place of management or statutory seat is located abroad, or, under a few treaties, if the capital investment is secured by foreign-situs real property;

(iv) Royalties paid with respect to foreign intangible property rights; and

(v) Capital gains from the sale of foreign-situs real property or shares in a corporation that has its principal place of management or statutory seat in a foreign jurisdiction.

Commercial or industrial income qualifies as foreign-source income only if it is derived from the activities of a foreign PE; the place of contract, payment and title passage are irrelevant.[485]

Foreign-source income may be excluded from a resident corporation's gross income under the terms of a tax treaty. Germany's treaties mainly provide for an exclusion for business profits derived through a PE located in the treaty partner country and for dividends received with respect to shares in a foreign subsidiary corporation resident in the treaty partner country in which the payee corporation holds an interest of at least 10% or 25%. A credit for foreign taxes levied with respect to items of income that are not exempt is usually granted under either German domestic tax law or an applicable treaty.

Comment: As a result of the ongoing anti-BEPS negotiations and the negotiations on a new international tax systems,[486] the principle of excluding profits derived through a foreign PE may be challenged more and more frequently in the future. This might leave German resident corporations with full tax liability in Germany, including liability on their foreign income, with a credit for foreign taxes (assessed or paid) against German taxes levied on that foreign income.

Foreign-source income must be computed based on accounting methods in compliance with German law. Profits derived from a foreign PE or a foreign permanent representative are usually computed based on the "direct method," which presupposes that separate books and financial accounts are maintained.

Profits attributable to a PE must be determined by applying the Authorized OECD Approach (AOA) as implemented into German law in Section 1(5) of the Foreign Tax Act (*Aussensteuergesetz* — AStG). This means that, in principle, a PE is to be treated as a separate and independent enterprise whose profits are to be determined by applying the arm's length principle. Section 1(5) is also to be applied where an applicable tax treaty does not incorporate the AOA. However, if the tax-

[482] KStG, Sec. 8b(7). A different rule applies with respect to shares acquired on or before December 31, 2016.

[483] KStG, Sec. 8b(1), (4).

[484] KStG, Sec. 8b(9), tax treaties and the EU Parent-Subsidiary Directive require a minimum participation of 10% of the share capital.

[485] EStG, Sec. 34(d)(2)(a).

[486] See for further details the Organisation for Economic Cooperation and Development (OECD) Blueprints on Pillar 1 and Pillar 2 of October 14, 2020 ("OECD (2020), Tax Challenges Arising from Digitalization — Report on Pillar One Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/beba0634-en" and "OECD (2020), Tax Challenges Arising from Digitalization — Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/abb4c3d1-en"), and later amendments.

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payer provides evidence that the application of the AOA as such, would result in double taxation, the treaty prevails. In these instances, it should still be possible to compute the profit attributable to a PE by employing the "indirect method" (based on Article 7(4) of the 2008 OECD Model Convention). However, the future of the AOA needs to be monitored closely against the background of the ongoing negotiations on a new international tax system.[487]

Conversely, the "indirect" or "global method" starts with the worldwide income of the resident corporation and seeks to allocate income based on certain key indicators, such as sales, balance sheet total, and/or payroll. The indirect method is used largely as a test to determine whether the results of the direct method are within an acceptable range.

e. Other Exclusions from Income

(1) Contributions to Capital

Contributions made by shareholders to the capital of a domestic corporation are excluded from the corporation's taxable income. Such contributions need not be made in exchange for shares in the corporation, but may be made, for example, by way of cancellation of a shareholders' loan. However, the waiver by a shareholder of a shareholders' loan continues to be recognized as a (tax-free) contribution to capital up to the fair market value of the loan at the time of the waiver.[488] Where the face value of the loan exceeds its fair market value, this gives rise to taxable income at the level of the corporation, which makes a waiver less attractive. In appropriate cases, a mere subordination or a conditional waiver may be preferable (see II.F.1.c., above). Where a contribution is not made in exchange for shares, i.e., in the case of a disguised contribution, the contribution is included in the corporation's taxable income to the extent the contribution diminishes the income of the shareholder.[489]

(2) Premiums on Shares Issued

If shares are issued at a price above par, the premium less the expense of issuing the shares is taken to capital reserves (paid-in surplus account).

5. Business Expenses and Other Allowable Deductions

a. In General

In general, a corporation may deduct all expenses incurred by it in conducting its business operations, irrespective of whether they are ordinary or necessary. However, the tax authorities closely scrutinize expenses paid to related parties to see whether they reflect arm's-length standards and whether they are based on a prior written agreement between the parties. In addition, certain expenses are expressly allowed, and others are specifically disallowed.[490]

[487] See for further details the OECD Blueprints on Pillar 1 and Pillar 2 of October 14, 2020, and later amendments.

[488] BFH decision of June 9, 1997, BStBl. 1998 II, 307.

[489] KStG, Sec. 8(3).

[490] KStG, Secs. 9 and 10; EStG, Sec. 4(5)(5b)(6).

b. Incorporation Costs

Expenses incurred in connection with the organization or incorporation of a corporation may no longer be capitalized in the legal financial statements. For tax purposes, such expenses are not capitalized, but instead constitute business expenses that are deductible in the financial year in which they are incurred.

c. Travel and Entertainment

Seventy percent of expenses incurred for business entertainment purposes is deductible if the expenses are reasonable and their amount and business purpose can be established. A specific form must be used to establish the amount and the business purpose of entertainment expenses.[491]

Travel expenses (including meals and lodging) are deductible if they are incurred for *bona fide* business purposes and are reasonable in amount. Regulations list certain lump-sum meal and lodging allowances that may be used as a safe haven if the taxpayer does not elect to itemize actual expenses by presenting the relevant vouchers.[492]

d. Interest and Royalties

Interest on loans and other debts incurred for business purposes is generally deductible as a business expense, unless the loans or debts are directly and economically connected with tax-exempt income.[493] Interest on shareholders' loans will be reclassified as constructive dividends where interest rates exceed arm's-length rates. It should be noted that as a result of the ongoing BEPS-discussions at the OECD and the corresponding discussions at the EU level regarding the taxation of intra-group business transactions, the German domestic rules on transfer pricing documentation were tightened with effect from the assessment period 2022 onwards.[494]

The deduction of otherwise deductible interest expense may be deferred in accordance with the interest barrier rules (see V.B.2.b.(2), above). Debt issued with an original issue discount is shown on the books of the debtor at the issue price and increased to the face value over the term of the debt. Costs incidental to the loan must be capitalized and spread over the term of the loan.

Similar rules apply to license fees incurred by a corporation.

e. Rents

Current rental payments for business premises are deductible. Prepayments of rent are recognized as business expenses only in the financial years to which they relate. Other expenditures in connection with a lease (for example, payments to real estate agents and contributions to the building cost or leasehold improvements) must be capitalized and amortized over the term of the rental agreement.

[491] EStG, Sec. 4(5) No. 2.

[492] Wage Tax Regulations (*Lohnsteuerrichtlinien* — LStR), Secs. R 9.4 *et seq.*

[493] EStG, Sec. 3c(1).

[494] Deduction Tax Relief Modernization Act (*Abzugsteuerentlastungsmodernisierungsgesetz* — AbzStEntlModG), BGBl. 2021 I, 1259, Art. 5.

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f. Repairs and Maintenance

Expenditure incurred at more or less regular intervals to keep an asset in proper operating condition without changing its character is a deductible business expense. In contrast, the cost of major repairs must be capitalized and may be amortized over their useful life.

g. Insurance Premiums

Premiums for property insurance and liability insurance are deductible. No deduction is allowed for reserves for self-insurance.

h. Taxes

In general, taxes imposed on a particular subject are deductible, but taxes imposed on a corporation as a person are not. Hence, excise taxes, property taxes and transfer taxes (unless they constitute part of the acquisition cost of an asset) are deductible. Nondeductible taxes include, in particular, income taxes[495] and trade tax.[496] The amount of deductible taxes accrued but not yet paid may be shown in a tax reserve.

Note: Additions to tax and interest payable for late payment of a tax are deductible if the tax itself is deductible.

i. Amortization of Fixed Assets

(1) In General

A depreciation allowance is available to the beneficial owner of a fixed tangible or intangible asset if the useful life of the asset exceeds one year but is limited in time.

In contrast, the cost of land and equity participations in other corporations may not be amortized by way of regular depreciation allowances, but a substantial and permanent reduction in their value may be recognized by adjusting their cost basis to their lower going concern value. The deduction of regular depreciation allowances is mandatory and may not be shifted to reduce profits in a subsequent taxable year. However, depreciation allowances that have been inadvertently forgotten may be recognized in subsequent financial years.[497]

Note: In the case of the finance lease of a movable fixed asset, the lessee is considered to be the economic owner of the subject of the lease if the basic term of the lease amounts to less than 40% or more than 90% of the estimated useful life of the asset, or if the basic term of the lease is between 40% and 90% of the estimated useful life and the lessee has an option to renew the lease or to purchase the asset at a nominal cost. This also applies if the leased asset is specifically designed or equipped to fit the lessee's needs and cannot be expected to be usable by another person after the termination of the lease.[498] Similar rules apply to the leasing of immovables.[499]

(2) Basis and Methods of Depreciation for Movable Fixed Assets

The depreciation basis is the cost of acquisition or manufacture. Generally, immovable assets may be depreciated only by using the straight-line method. With respect to movable fixed assets, the straight-line and declining basis methods are permitted.[500] The declining balance method is permitted for movable fixed assets that are acquired or manufactured in 2020, 2021 or 2022. The rate may not exceed 25%.[501] The declining balance method has been further permitted for movable fixed assets that are acquired after March 31, 2024 and before January 1, 2025; however, the maximum rate is twice the straight-line rate, but not more than 20%.[502]

A change from the declining balance method to the straight-line method is permitted, but not a change from the straight-line method to the declining balance method. Salvage value may be ignored at the taxpayer's election unless the salvage value is expected to be substantial.[503]

Note: At any time during the life of a fixed asset, the going concern value may be substituted if it is permanently lower than the adjusted cost basis. The relevant election may be made independently of the method used in the commercial financial statements.[504]

Acquired goodwill may be amortized using the straight-line method, based on a useful life of 15 years.[505]

The rates of depreciation for any other asset depends on the ordinary useful life of the asset concerned.[506] The Federal Ministry of Finance publishes tables with recommended depreciation rates. As the local tax office may deviate from the tables in individual cases, the actual rates may be a matter of negotiation especially at the audit level. The following straight-line rates are generally accepted: machinery: 7%–33%; automobiles: 17%; trucks: 11%; and office furniture: 7.5%. The German Ministry of Finance has published a decree[507] according to which computer hardware and software acquired after December 31, 2020 or that has not been fully depreciated prior to January 1, 2021, can be depreciated within one year instead of three to seven years (computer hardware) and three years (computer software). This approach is intended to support the acquisition of new computer hardware and software to speed up digitalization in Germany, since deficiencies in this area were observed during the COVID 19 pandemic and will result in a discrepancy between a taxpayer's legal and tax balance sheets.

[495] KStG, Sec. 10(2).

[496] EStG, Sec. 4(5b).

[497] EStG, Sec. H 7.4.

[498] Federal Ministry of Finance (*Bundesfinanzministerium* — BMF), decree of April 19, 1971, BStBl. 1971 I, 264; as to the position regarding finance leases of movable fixed assets; BMF, decree of December 22, 1975, DB 1976, 172, as to the position regarding non-full-payout leases of movable fixed assets.

[499] BMF, decree of March 21, 1972, BStBl. 1972 I, 188 (finance lease); BMF, decree of June 9, 1987, BStBl. 1987 I, 440; as to the position regarding non-full-payout leases, BMF, decree of December 23, 1991, BStBl. 1992 I, 13, as to the position regarding non-full-payout leases of immovable fixed assets.

[500] EStG, Sec. 7(1) fourth sent.; Sec. 7(2).

[501] EStG, Sec. 7(2) as amended by the Fourth Act Implementing Tax Relief Measures to Address the Corona Crisis (Fourth Corona Tax Relief Act) of June 19, 2022, BGBl. 2022 I, 911, Art. 3(4).

[502] EStG, Sec. 7 para. 2 as amended by the Growth Opportunities Act (*Wachstumschancengesetz*) of March 27, 2024, BGBl. 2024 I, No. 108.

[503] BFH decisions of December 7, 1967, BStBl. 1968 II, 268 and July 22, 1971, BStBl. 1971 II, 800.

[504] BMF, Decree of September 2, 2016, BStBl. 2016 I, 995.

[505] EStG, Sec. 7(1).

[506] EStG, Sec. 7(l) sent. 2.

[507] BMF, decree of February 22, 2022, BStBl. 2022 I, 187, substituting the decree of February 26, 2021, BStBl. 2021 I, 298.

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(3) Basis and Methods of Depreciation for Buildings

The depreciation basis for a building is the cost of acquisition or manufacture of the building only, without the cost of the land. The rate of depreciation for buildings is fixed by statute. It amounts to either: 3% if the building is not used for residential purposes and the construction permit was applied for after March 31, 1985; to 2% if one of these conditions is not fulfilled and the building was completed after December 31, 1924; to 2.5% if the building was completed before that date; or to 3% if the building was completed after December 31, 2022.[508] Alternatively, the taxpayer may furnish evidence that the remaining useful life of a building is shorter than the period implied by these depreciation rates and claim higher depreciation allowances based on that remaining useful life.

Furthermore, accelerated depreciation is available for buildings if certain requirements are met. The Income Tax Act (as it applies to corporations) provides for specific progressive depreciation rates for buildings that depend on the date of the application for a building permit or the acquisition date. The rates vary between 10% and 1.25% and between 4% and 1.25%. The more it is desired to encourage investment in real estate, the higher the initial depreciation rate.[509]

Based on the Growth Opportunities Act (*Wachstumschancengesetz*) of March 27, 2024, the degressive depreciation or declining balance method applies to residential buildings in one of the EU or EEC Member States that are constructed or acquired between September 30, 2023 and October 1, 2029.[510] Special depreciation of 5% has been granted or the construction of new rental flats, where the relevant building permission is applied for before October 1, 2029. The depreciation is limited to manufacturing and acquisition costs of 5,200 euros per square meter at a maximum, while the depreciation base is limited to 4,000 euros per square meter.[511]

(4) Other Depreciation Rules

Expenditure on movable fixed assets costing 800 euros (net of value added tax (VAT)) or less may be written off in full during the year of acquisition.[512]

In addition to the regular depreciation allowances, small businesses may claim an allowance of 50% of the cost of movable fixed assets acquired or manufactured in the future (up to a maximum allowance of 200,000 euros for the year of the allowance and the three previous years). Moreover, further to the regular depreciation, another 40% of the manufacturing/acquisition costs can be deducted for tax purposes in the year of manufacture or acquisition and the subsequent four years if acquired or manufactured after December 31, 2024.[513] A business is a "small business" if its net business assets at the end of the fiscal year in which the allowance is claimed do not exceed 200,000 euros.[514] Also, depreciable assets must remain in a PE of the business for at least one year following their acquisition or manufacture. Further, for each year in which accelerated depreciation allowances are claimed, the assets must be used exclusively or almost exclusively in the business of the taxpayer.[515]

j. Obsolete Equipment

Depreciation for obsolescence attributable to technological or economic factors is allowed but may not be computed using the declining balance method.[516]

k. Charitable and Other Contributions

Charitable, religious or scientific contributions to qualified recipients, as well as contributions for the public benefit acknowledged as deserving special promotion, are deductible up to a maximum of 20% of income or 0.4% of the sum of sales and payroll per calendar year.[517] Contributions exceeding these percentage rates may be carried forward for deduction in subsequent years.[518]

l. Reserve Accounts

(1) Liability Reserves

A deduction is allowed for a reserve for debts existing on the balance sheet date, the amount of which is not definitely fixed at that date.[519] Such reserves are usually formed for liabilities resulting from warranties, damage claims, quantity discounts, commissions, profit participations, etc. Reserves for obligations that are due only if profits are realized in the future may not be set up until such profits are realized.[520]

Reserves for potential liabilities for infringements of patents, copyrights or similar intangible rights are deductible only once claims against the corporation concerned have been raised or if such claims are to be seriously anticipated.[521]

(2) Contingency Reserves

The appropriation of surplus for future contingencies or for use in future years (for example, legal reserves and self-insurance against possible losses on currency exchange) is not allowable for tax purposes.

(3) Reserves for Loss Contingencies

Reserves to provide for loss contingencies with respect to pending transactions are not allowable for tax purposes.[522]

(4) Reserves for Future Acquisitions or Production

Reserves for expenses to be capitalized as acquisition or production costs of an asset in future fiscal years are not allowable for tax purposes.

[508] EStG, Sec. 7(4), (5); Income Tax Implementing Ordinance (*Einkommensteuerdurchfuehrungs-verordnung*, as amended — EStDV), Sec. 9a *et seq.*
[509] EStG; Sec. 7(5).
[510] EStG, Sec. 7(5a, 5b).
[511] EStG, Sec. 7b.
[512] EStG, Sec. 6(2).
[513] EStG, Sec. 7g(5).
[514] EStG, Sec. 7g(6).
[515] EStG, Sec. 7g(6).
[516] EStG, Secs. 7 (1) sent. 5 and (2) sent. 4.
[517] KStG, Sec. 9 (1)(2).
[518] KStG, Sec. 9(1) no. 2, sentence 9.
[519] HGB, Sec. 249(l)(1); EStG, Sec. 5(l)(1).
[520] KStG, Sec. 5(2a).
[521] EStG, Sec. 5(3).
[522] EStG, Sec. 5(4a).

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m. Bad Debts

Doubtful or uncollectible accounts receivable may be written off either directly or via a reserve. However, the write-off of certain loans to related parties is not accepted for tax purposes.[523]

n. Casualty Losses

Losses as a result of casualty, an act of God or confiscation are deductible business expenses when incurred.

o. Salaries

Salaries and other compensation for the services of employees and former employees are deductible. However, compensation paid to a shareholder of a corporation for his or her services as an employee of the corporation is deductible only if it is reasonable (i.e., it passes the arm's-length test) and is based on an explicit prior written agreement. Any excessive part of such remuneration is reclassified as a constructive dividend in the hands of the shareholder (see V.B.2.b.(1), above.)

Note: Only 50% of remuneration and bonuses paid to members of the supervisory board of an AG or to members of a comparable board of a GmbH are deductible.[524]

p. Employer's Social Welfare Expenses

(1) Pension Reserves

An employer may either deduct pensions as they are paid or set up a pension reserve. In the latter case, the present discounted value of future pension costs in the tax balance sheet is computed based on an annual legal interest rate of 6%, which exceeds by far the interest rate to be used for the pension reserves in the legal balance sheet; this results in lower tax deductions for pension reserves in the tax balance sheet. The tax court of Cologne had doubts as to whether this is compatible with constitutional law and submitted this question in 2017 to the Constitutional Court, which for formal reasons declined the submission.[525] Further, the pension reserve must be actuarially computed, and the employer's obligation must be legally binding. Traditionally, such pensions guaranteed particular benefits but are now rarely granted. Pension reserves need not and usually are not funded, which means that the funds may be used by the company for general corporate purposes, even though the employer may purchase insurance to cover his or her exposure.[526]

(2) Pension Funds

Pension funds are organized as separate legal entities. As pension funds grant enforceable pension rights to employees and their dependents, pension funds are subject to insurance regulation. Employer contributions to a pension fund can be deducted up to the amounts fixed in the fund's budget or requested by the insurance supervisory authority, or to the extent needed to cover a deficit of the fund.[527]

(3) Relief Funds

Contributions to a tax-exempt relief fund that currently distributes benefits to present or former members of an organization or their families are deductible. In addition, contributions to build up the capital of a relief fund are deductible up to certain limits.[528] Relief funds are separate legal entities but, technically, do not grant enforceable pension or relief rights to employees.

(4) Jubilee Benefits

A reserve for the obligation to pay awards to employees (for example, for length of service) may be set up only if a written commitment was made by the employer after December 31, 1992, the employment lasted for at least 10 years, and the payment presupposes at least 15 years of service.[529]

q. Inter-Company Charges

Arm's-length inter-company charges are deductible as proper business expenses provided an explicit prior written agreement was concluded between the relevant corporation and its controlling shareholder. As to international inter-company charges, see XIV., below, for a discussion of the German transfer pricing system.

r. Business Gifts

Gifts to persons other than employees that cost more than 50 euros per annum per recipient may not be deducted.[530]

s. Non-deductible Expenses

Non-deductible expenses include expenses incurred in connection with non-taxable items of income (for example, contributions to capital and items of income exempted under the terms of a tax treaty), capital expenditure, one-half of the fees paid to members of a supervisory board, and open or constructive distributions of profits.

6. Capital Expenditure

Except for investments in small fixed-asset items costing 800 euros or less,[531] the cost of acquiring or manufacturing fixed assets must be capitalized. If they are depreciable in nature, such costs may be amortized via depreciation allowances. Expenses incurred on the self-development of fixed intangible assets must not be capitalized in the tax balance sheet,[532] but may be capitalized in the legal balance sheet if certain requirements are met.[533]

7. Deductibility of Foreign Losses

Losses resulting from the following may be deducted only from income of the same kind and from the same jurisdiction

[523] KStG, Sec. 8b (3), sent. 4ff; AStG, Sec. 1(1).
[524] KStG, Sec. 10(4).
[525] Tax Court Cologne, decision of October 12, 2017 (file no. 10 K 977/17); Federal Constitutional Court, decision of July 28, 2023, file No. 2 BvL 22/17.
[526] EStG, Sec. 6a; EStR, Sec. R 6a; Income Tax Note (*Einkommensteuer-Hinweise* — EStH), Sec. H 6a.
[527] EStG, Secs. 4c, 4e.
[528] EStG, Sec. 4d.
[529] EStG, Sec. 5(4).
[530] EStG, Sec. 4(5) no. 1.
[531] EStG, Sec. 6(2).
[532] EStG, Sec. 5(2).
[533] HGB, Sec. 248(2).

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but, subject to that restriction, may be carried forward indefinitely:[534]

(i) The activities of a foreign PE maintained outside the European Union/EEA;

(ii) Depreciation of the basis of a participation in a foreign (non-EU/EEA) corporation, or the sale or liquidation of, or a reduction in the equity capital of, a foreign (non-EU/EEA) corporation;

(iii) A silent participation or a participation right, if the debtor does not have its residence, registered seat or actual principal place of management in the European Union/EEA; and

(iv) The letting of real estate situated outside the European Union/EEA.

The foregoing limitations do not apply with regard to losses incurred by a foreign PE maintained outside the European Union/EEA if the taxpayer establishes that the PE is engaged exclusively or almost exclusively in the active conduct of a business as listed in Section 2a(2) of the Income Tax Act (*Einkommensteuergesetz* — EStG).

The above limitations originally also applied to EU/EEA-source losses. The non-deductibility of such EU/EEA losses was considered a violation of the EU Treaty by the CJEU to the extent the losses were final (in particular, if the business in the foreign country was shut down).[535] As a consequence, the scope of Section 2a of the Income Tax Act was narrowed with effect from December 24, 2008.[536]

Comment: Whether EU/EEA-source losses are deductible is the subject of intense debate and of a number of CJEU and German tax court decisions. While EU/EEA-source losses were held by the CJEU in a 2015 decision to be no longer deductible if the profits of the PE to which the losses are attributable would be exempt from German income tax under an applicable tax treaty,[537] a later CJEU decision[538] turned back to basic principles and stated that the non-deductibility of such EU/EEA-source losses violates the EU Treaty to the extent the losses are final. Thus, the BFH has again submitted this issue for consideration by the CJEU.[539] On September 22, 2022, the CJEU decided[540] that the final losses of a PE, whose profits/losses are tax exempt due to the exemption method provided by an applicable tax treaty (sic), cannot be deducted for tax purposes by the headquarters in its home jurisdiction, even if such losses cannot be used anymore in the foreign jurisdiction where the PE was located. Nevertheless, the CJEU confirmed that its decision in the case "Bevola and Trock" of June 12, 2018, still applies, if — as in this case — the final losses were not tax exempt because of an applicable tax treaty, but because of a unilateral decision of the home jurisdiction of the headquarters. The differentiation made by the CJEU depends on whether a tax treaty is applicable or not. Whether this is a convincing criterion for the tax deductibility of final foreign losses can be disputed with good reasons. However, it seems that the CJEU has made its final decision insofar for the time being. Nevertheless, the tax deductibility of foreign losses in scenarios different from the one in the case decided by the CJEU should be disputed again (e.g., the issues whether or not the non-deductibility of foreign losses is based both on a unilateral provision and a tax treaty provision or whether or not Germany can make use of its right of taxation because of a fallback provision in its treaty overriding domestic tax provisions). Further, it is disputed whether the non-deductibility of final foreign losses are in breach of the EU Charter of Fundamental Rights and/or the German Constitution (namely the principle of equality and taxation according to ability to pay).

8. Loss Carryforward and Carryback

a. In General

Net operating losses of up to a maximum of one million euros may be carried back under Section 8(1) of the Corporate Income Tax Act in conjunction with Section 10d of the Income Tax Act. The tax losses of 2022 and subsequent years can be carried back to the two previous years.[541]

Under the general rule, losses carried forward from prior years by a corporate taxpayer may be deducted in full up to an amount of one million euros. Any excess may be deducted only to the extent of 60% of profits through year 2023, but up to 70% for years 2024 until 2027, before this threshold drops to 60% again as from 2028.[542] This means that, even if sufficient losses carried forward are available to absorb the full amount of the profits of a corporation in the relevant year, 40% and 30% respectively of the profits (over the one million euro threshold) will attract corporate income tax in that taxable year ("minimum tax").

Comment: It should be noted that these more favorable loss carryforward rules do not apply for trade tax purposes.[543]

Thus, despite the fact that losses may be carried forward indefinitely, the actual use of such loss carryforwards will be deferred and, where its business is cyclical lines, a corporate taxpayer may not be able to use its carried forward losses in full. In such circumstances, it could be argued that the application of the rule violates the constitutional rights of the taxpayer. The Federal Constitutional Court has been asked by the BFH to rule on this question[544] but, as of the time of writing, the case was still pending.[545] At the very least, the deferral will lead to a loss of liquidity, which means that the timing of losses and profits has become more important than in the past, as taxpayers will aim to achieve an offset of profits with ex-

[534] EStG, Sec. 2a.

[535] CJEU, Decision of May 15, 2008, file no. C-414/06 — *Lidl Belgium GmbH & Co. KG*, BStBl. 2009 II, 692.

[536] EStG, Sec. 52(3).

[537] CJEU, Decision of December 17, 2015, Case C-388/14 — *Timac Agro Deutschland*, BStBl. 2016 II, 362, followed by the Federal Tax Court (BFH decision of February 22, 2017, file no. I R 2/15, BStBl. 2017 II, 709).

[538] CJEU, Decision of June 12, 2018, file no. C-650/16 — *Bevola and Trock*.

[539] BFH decision of November 6, 2019, file no. I R 32/18.

[540] CJEU, decision of September 22, 2022, file no. C-538/20, IStR 2022, 767.

[541] EStG, Sec. 10d(19), (2), KStG, Sec. 8(1).

[542] EStG, Sec. 10d as amended by the Growth Opportunities Act (*Wachstumschancengesetz*) of March 27, 2024, BGBl. 2024 I, No. 108.

[543] GewStG, Sec. 10a.

[544] BFH decision of February 26, 2014, file no. I R 59/12, BStBl. 2014 II, 1016.

[545] BVerfG, file no. 2 BvL 19/14.

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penses (and in a group of companies of profits with losses) in the same taxable year. In corporate groups, in particular, this can be achieved by establishing an *Organschaft* arrangement between profitable and loss-making corporations. Alternatively, a loss-making corporation may be merged with a profitable group corporation having due regard, however, to the fact that, in a merger, any loss carryforward of the absorbed corporation is forfeited.

b. Anti-Loss Trafficking Rules

Under the Anti-Loss Trafficking Rules, entitlement to a loss carryforward in the case of a direct or indirect transfer of shares is completely lost if more than 50% of the shares are transferred (a "harmful change in ownership").[546] The disallowance applies only in the case of a transfer of shares to one person, to related persons or to a group of persons acting in concert. Other transfers, for example, where more than 50% of the stock is traded among unrelated persons on the stock market, do not trigger the disallowance.

On August 29, 2017, the Lower Tax Court of Hamburg again referred to the Constitutional Court the question of whether Section 8c of the Corporate Income Tax Act violates the constitution with respect to share acquisitions of more than 50%.[547] As of the time of writing, the matter was still pending before the Constitutional Court.

The anti-loss trafficking rules provide some relief for the direct or indirect transfer of shares after December 31, 2009:[548]

(i) In the case of an intra-group acquisition, tax losses are not forfeited as a result of a share transfer if 100% of the shares in the transferor and the transferee are directly or indirectly held by the same entity.

(ii) Even in case of a harmful change in ownership, tax losses of a corporation still may be set off against its profits up to the amount of the corporation's built-in gains. Built-in gains are calculated as the difference between the equity on the corporation's tax balance sheet and the fair market value of its shares (which corresponds basically to their purchase price), to the extent that such built-in gains are subject to German tax.

(iii) Nor is the forfeiture of tax losses under the general rule triggered by a harmful change in ownership if shares in a corporation are acquired with the intention of rescuing the corporation through financial restructuring and if certain further requirements are met.[549] According to the EU Commission, this exemption for financial restructuring constituted State Aid in violation of EU law and, therefore, was suspended. However, the CJEU decided on June 28, 2018[550] that the exemption does not constitute State Aid and is, therefore, applicable with retroactive effect to January 1, 2008.

The "Act on the further development of the utilization of tax losses of corporations" of December 20, 2016,[551] introduced a new Section 8d into the Corporate Income Tax Act,[552] which provides for a further relaxation of the rules on harmful changes in control after December 31, 2015, on application. By way of an exception to the general rule contained in Section 8c of the Corporate Income Tax Act, a loss carryforward remains intact (irrespective of a harmful change in ownership), if the corporation concerned has operated the same business since its establishment (or at least during the three years preceding the harmful change in ownership) and continues this same business following the harmful change in ownership until the end of the year in which the harmful change in ownership occurs. Should the corporation in a subsequent business year terminate its business, start an additional business, acquire an interest in a trading partnership or assume the role of the controlling company in an *Organschaft*, the loss carryforward at the beginning of the year is forfeited.

c. Transfers of Net Operating Losses in Statutory Mergers

In the context of a statutory merger, it is not possible to transfer losses, including loss carryforwards (or interest carryforwards or tax EBITDA carryforwards), unless the absorbed corporation could have used its losses anyway.[553] It is, therefore, necessary instead to merge a profitable corporation into a loss-making corporation to safeguard a loss carryforward,[554] as long as this is not in conflict with the anti-loss trafficking rules (see V.B.8.b., above). However, even then, taxable profits earned by the absorbed corporation may neither be offset by losses of the absorbing corporation to the extent the taxable profits were earned during the period for which the merger is given retroactive effect (which can be a maximum of eight months).[555] Mergers between corporations that qualify as associated enterprises prior to the effective date of the merger are outside the scope of this limitation.[556] Further details are subject to the interpretation of the Federal Ministry of Finance.[557]

9. Tax Credits

a. Domestic Withholding Tax

Dividend payments are subject to a 25% withholding tax (plus 5.5% income tax surcharge). In principle, a corporation receiving a dividend is entitled to credit the tax withheld against its corporation tax liability.

For many years, this mechanism has been used by domestic banks, investment funds and other financial institutions in transactions known as "cum/cum trades." These transactions

[546] KStG, Sec. 8c(1).
[547] Lower Tax Court of Hamburg, decision of August 29, 2017, EFG 2017, 1906 — still pending (BVerfG, file no. 2 BvL 19/17).
[548] The Economic Growth Acceleration Act of December 22, 2009, BGBl. I, 2009, 3950.
[549] KStG, Sec. 8c(1a).
[550] CJEU decision on June 28, 2018, file no. C-219/16 P.
[551] Act on the Further Development of Tax Loss Offsetting for Corporations (*Gesetz zur Weiterentwicklung der steuerlichen Verlustverrechnung bei Koerperschaften*) of December 20, 2016, BGBl. I, S. 2998.
[552] BMF, decree of March 18, 2021, BStBl. 2021 I, 363, representing the tax authorities' restrictive point of view, in particular with respect to the "same business" criterion.
[553] UmwStG, Secs. 12(3), 4(2), 2(4).
[554] BFH, file no. I R 2/18 of November 17, 2020, BStBl. 2021 II, 580.
[555] UmwStG, Secs. 2(4).
[556] UmwStG, Sec. 2(4).
[557] Decree of the Federal Ministry of Finance of January 2, 2025 re the UmwStG, text no. 2.39 to 2.40a.

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entail stock trades over the dividend record date, under which the stock purchaser (for example, a domestic bank) acquires the stock including entitlement to the dividend payable on the stock shortly before the dividend record date (i.e., "cum dividend"), cashes in the net dividend, resells the stock, and credits the tax withheld against its corporation tax liability. The other party to these transactions is typically a nonresident investor, such as an investment fund, that is not entitled to a low (or even zero) dividend withholding tax rate under an applicable tax treaty and is not in a position to obtain a tax credit against its home country tax liability. A typical cum/cum trade is set up as a stock lending transaction under which a domestic bank borrows German stock from a nonresident party for a short period of time against a lending fee set at a level that divides the tax benefit between the two parties.

In recent years, these cum/cum trades have gained much publicity and have been heavily criticized as abusive. Following the rules in force in other countries, the rules governing entitlement to credit dividend withholding tax were severely tightened with effect from January 1, 2016.[558] Under new Section 36a of the Corporate Income Tax Act, the claimant must: (i) have owned the stock for at least 45 days during the period beginning 45 days before and ending 45 days after the dividend record date; (ii) bear, during the minimum holding period of 45 days, significant exposure (equal to at least 70%); and (iii) not be under an obligation to pay on the dividend received to another person.[559] The claimant has the burden of proof that it meets these requirements. Where the claimant has been the beneficial owner of the shares for at least one year on the dividend record date, the above requirements do not apply.[560] If a claimant does not meet the above requirements, the amount of the credit is reduced to 40% of the withheld tax. The non-creditable portion may be deducted as a business expense.[561] These rules apply irrespective of the legal form of the claimant, whether an individual, partnership, corporation or other corporate body. The German tax authorities published a decree on July 9, 2021, with further details and recommendations on how to deal with existing cum/cum-trades and the transfer of beneficial ownership.[562]

Furthermore, for many years, the German tax authorities took the view that, as with dividend payments, repayments of contributions by foreign corporations not resident in an EU/EEA Member State were subject to German domestic withholding tax. This interpretation conflicted with a decision of the Federal Tax Court, which took the view that it violated EU laws.[563] According to the court, which the German tax authorities did not agree with, repayments of contributions of a corporation resident in an EU/EEA Member State were subject to the stringent requirements of Section 27 (8), KStG, while repayments of corporations not resident in an EU/EEA Member State were privileged as not being bound to such legal requirements. However, the position of the German tax authorities has since changed for repayments of contributions made after December 31, 2022.[564] Henceforth, repayments of contributions by corporations not resident in an EU/EEA Member State are to be treated similarly to repayments by corporations that are resident in an EU/EEA Member State. These payments are no longer subject to German withholding tax, but only if the amounts have been stated separately and the repaying foreign corporation has applied for an exemption from German withholding tax. However, the amount to be repaid is to be calculated pursuant to German tax laws, i.e., the domestic provisions for the maintenance of a depository account shall apply, and not according to the foreign laws applicable to the repaying foreign corporation.

Comment: In practice, these provisions and their previous interpretation by the German tax authorities[565] are likely to hinder the application of the exemption from German withholding tax significantly, both for corporations resident in an EU/EEA Member State and now also foreign corporations not resident in an EU/EEA Member State.

b. Foreign Tax Credit

Resident corporations may claim a direct foreign tax credit for foreign withholding taxes with respect to dividends, interest or royalties received from abroad. Since the year 2001, no indirect foreign tax credit has been available with respect to dividends received from foreign subsidiary corporations. For further discussion, see XV.A., below.

c. Investment Tax Credit

There is no investment tax credit.

d. Other Credits

There is no general tax credit.

10. Group Consolidation

The Corporate Income Tax Act does not provide for consolidated returns or the consolidated assessment of groups of corporations. However, if certain requirements are met, an "*Organschaft*" offers a tax group relief that more or less provides an equivalent to consolidation for tax purposes.

The *Organschaft* concept is important for purposes of corporate income tax, trade tax and VAT. An *Organschaft* for corporate income tax and trade tax purposes presupposes the financial control of one or more controlled corporations (*Organgesellschaften*) by a domestic or foreign entity, including a corporation (*Organtraeger* or controlling entity), and the conclusion of a profit and loss pooling agreement (or profit and loss absorption agreement) for at least five years between the controlling entity and the controlled corporations.[566] The controlled entity can be a corporation like an AG, a GmbH, a *Societas Europaea* (SE) as well as a KGaA with its statutory seat and its actual principal place of management in Germany or an-

[558] Investment Tax Reform Act (*Gesetz zur Reform der Investmentbesteuerung* — InvStRefG) of July 19, 2016, BGBl. I, 1730.

[559] EStG, Sec. 36a(1), (2), (3).

[560] EStG, Sec. 36a (5).

[561] EStG, Sec. 36a (1).

[562] See BStBl. 2021 I, 995, which is not in line with the recent decision of the Federal Tax Court of September 29, 2021, file no. I R 40/17, DStR 2022, 482.

[563] Federal Tax Court decision of July 13, 2016, file No. VIII R 47/13, DStR 2016, 2395.

[564] Sec. 27 (8), Corporate Income Tax Act, as amended by the Annual Tax Act 2022, BGBl. 2022 I, 2294.

[565] Decrees of April 21, 2022, IStR 2022, 475, and of April 4, 2016, BGBl. 2016 I, 468.

[566] KStG, Sec. 14.

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other EU/EEA Member State.[567] The controlling entity needs to be subject to German income taxation and can be either an individual person, a corporation or a partnership, that operates a business. Further, the controlling entity needs to maintain a PE in Germany, to which the participation in the controlled corporation functionally belongs under both applicable domestic and treaty attribution rules (see also VI.B.1., below).[568] This might cause difficulties in case of, for example, a services PE or storage facilities that are classified differently under German domestic law and the applicable tax treaty.

For VAT purposes, an *Organschaft* requires that the corporations concerned meet the additional tests of economic and organizational integration but does not require a profit and loss pooling agreement.[569] Thus, if an *Organschaft* is to be applied to all three taxes, i.e., to corporate income tax, trade tax and VAT, the economic and organizational integration tests must be met. On the other hand, the tests for an *Organschaft* are now identical for corporate income tax and trade tax and, for this reason, an *Organschaft* for trade tax purposes alone is not possible.

An *Organschaft* arrangement is recognized for corporate income and trade tax purposes if the following requirements are met from at least the beginning of the fiscal year of the controlled corporation for which the *Organschaft* is to become effective:[570]

(i) The controlling entity must have held a majority of the voting stock of each controlled corporation that is to be included in the *Organschaft* without interruption since the beginning of the controlled corporation's fiscal year. If such a majority interest is held by the controlling entity, the controlled corporation is deemed to be integrated with the controlling entity from a financial perspective. The financial control test can be met by direct or indirect shareholdings or by a combination of both, provided each indirect participation represents a majority interest in each intermediary company.

(ii) The controlling entity must conclude with each controlled corporation that is to be included in the *Organschaft* arrangement an agreement under which each controlled corporation undertakes to transfer its total profits to the controlling entity and the latter commits itself to refund to the controlled corporation any losses incurred by it. Generally, such agreements are referred to as profit and loss absorption or pooling agreements. If the controlled entity is a stock corporation, the agreement must be in writing and must be registered. The agreement must be approved at shareholders' meetings of both the controlled corporation and the controlling entity and must be registered in the Commercial Register with respect to the controlled corporation. The shareholders' resolutions of the controlled and the controlling corporation must be notarized.

(iii) The agreement under which the controlling entity is to receive the profits of the controlled corporation in consideration for absorbing the eventual losses of the controlled corporation must be for a minimum term of five years. During this period, the parties to the agreement must fulfill all the obligations assumed under the agreement. In particular, the parties must ensure that the controlled corporation transfers its entire profit to the controlling entity and that the controlling entity assumes the entire loss of the controlled corporation. Profit and loss in this context mean the amounts stated as profit or loss in the financial statements of the controlled corporation. If the balance sheet of the controlled corporation is incorrect, the parties are deemed to have complied with the requirement that the entire profit be transferred if the financial statement has been duly resolved, the annual financial statements have been effectively determined and have received an unqualified audit opinion, and the incorrect item on the balance sheet is corrected in a subsequent financial statement.[571] The agreement must be executed and registered before the end of the fiscal year for which the *Organschaft* is applied. This means that, as of fiscal year 2003, an *Organschaft* arrangement can no longer be applied retroactively, except in very particular cases (i.e., when the permitted backdating of a statutory merger for tax purposes can be put to use). Early termination of the agreement will not result in retroactive non-recognition of the *Organschaft*, provided the termination is justified by a substantial cause; nevertheless, such a termination for cause should be made as of the close of a fiscal year or a newly-created short fiscal year of the controlled company so as not to jeopardize the *Organschaft* for the current year of termination.

(iv) During the term of the *Organschaft* arrangement, the controlled corporation may transfer amounts forming part of its net profits to surplus reserves only to the extent this is economically reasonable from a business perspective.[572]

(v) The taxable income of the controlled corporation, which is to be allocated to the controlling entity, is calculated using a modified method,[573] under which the controlled corporation's gross income is allocated to (and taxed in the hands of) the controlling entity. To achieve this, dividends, capital gains and losses, and other reductions of income covered by Section 8b(1) through (6) of the Corporate Income Tax Act, as well as certain transfer gains arising in the context of a reorganization are disregarded for purposes of computing the income of the controlled corporation that is attributable to the controlling entity. Instead, these rules apply for purposes of determining the taxable income of the controlling entity. This has significant consequences for the deductibility of expenses connected with such income and suggests that debt incurred in the context of the shareholding of the controlled corporation should be held by a corporate controlling entity. The income of a foreign PE of the controlled corporation that is exempt in Germany under the terms of an ap-

[567] KStG, Sec. 14(1).
[568] KStG, Sec. 14(1) sent. 1 no. 2.
[569] UStG, Sec. 2(2).
[570] KStG, Secs. 14, 17; Trade Tax Act (*Gewerbesteuergesetz* — GewStG), Sec. 2(2).
[571] KStG, Sec. 14(1) No. 3, as amended on February 20, 2013. The amended version is applicable also in past years within the limits of the statute of limitations.
[572] KStG, Sec. 14(1) no. 4.
[573] KStG, Sec. 15.

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plicable treaty is not part of the controlled corporation's income attributable to the controlling entity.

Comment (1): Losses of the controlling entity or the controlled corporation are to be disregarded to the extent they are taken into consideration in a foreign country for purposes of taxing the controlling entity, the controlled corporation or another person.[574] Further, the controlled corporation is held liable for the tax debts of the controlling corporation.[575]

Comment (2): Since the profits/losses to be transferred by the controlled entity to the controlling entity — due to the profit and loss transfer agreement — are based on the commercial balance sheet, they might differ from the tax balance sheet figures, which are the basis for calculating the controlling entity's taxable income. The controlling entity, therefore, needs to consider these differences when calculating its taxable profit.

The Corporate Income Modernization Act of June 25, 2021,[576] changed the tax treatment of such differences for the fiscal years starting after December 31, 2021. If the transferred profits, according to the controlled entity's commercial balance sheet, exceed the profits according to the tax balance sheets, the difference is treated as a (non-taxable) capital repayment of the controlled entity to the controlling entity, which reduces, in particular, the tax book value of the shares held by the controlling entity in the controlled entity.

On the other hand, if the transferred profits, according to the controlled entity's commercial balance sheet, fall below the profits according to the tax balance sheet, the difference is treated as a capital contribution, which increases, in particular, the tax book value of the shares held by the controlling entity in the controlled entity (non-taxable increase). For the fiscal years before January 1, 2021, the adjusted items in the tax balance sheets of the controlling entity need to be reversed, in particular, the book value of the shares held in the controlled entity. This may result in a taxable profit of the controlling entity, which can be allocated to the adjusted fiscal year and the following nine years.[577]

11. Tax Rate

Profits derived by a resident corporation are subject to a flat income tax rate of 15%.[578] The solidarity surcharge of 5.5% on the corporate tax rate, i.e., 0.825%, plus trade tax at the level of the municipality (which is non-deductible for corporate income tax purposes) must also be taken into account. Because of the trade tax burden, the overall average corporate tax burden in Germany is roughly 30% plus.

12. Assessment and Filing

a. Tax Returns

Corporate income tax returns must be filed annually on a date prescribed each year by the finance ministries of the states. The date is usually July 31 of the year following the tax year, except where professional advisers aid in the preparation of a return, in which case the return must generally be filed by the end of the following February (i.e., 14 months after the year-end). The deadline for filing the 2023 tax returns was extended to September 2, 2024, and — for returns prepared by a professional advisor — to June 2, 2025.[579] The deadline for filing the 2024 tax returns has not been extended and is once more the end of July of the subsequent year (i.e., July 31, 2025), except where the returns are prepared by a professional advisor, in which case the deadline by which the return must be filed is April 30, 2026.[580] Further extensions may be secured on a case-by-case basis on application. Where a tax return is filed late, an addition of 0.25% per month of the tax due (as reduced by the quarterly prepayments — see V.B.12.b., below) is charged, subject to a maximum of 25,000 euros.[581]

Note: The principal documents that must accompany a return include the financial statements and, if available, the report of the auditors, the annual report of the management, and copies of shareholders' resolutions concerning financial statements and distributions of profits.[582]

b. Tax Payments

The filing of a return need not be accompanied by payment of the taxes due. However, a resident corporation must make quarterly payments of estimated corporate income tax plus income tax surcharge on March 10, June 10, September 10 and December 10 of each year. Such payments are fixed by the local tax office based on the tax assessment for the previous financial year, unless substantial increases or reductions in taxable income are anticipated. A newly-organized corporation receives a form from the tax authorities that, among other things, requests information regarding anticipated profits to allow the tax office to fix the estimated tax payments. If the total tax liability assessed for the taxable year exceeds the prepayments, the difference is payable within one month after the receipt of the notice of assessment by the taxpayer. Overpayments may be refunded or credited against other tax liabilities.

c. Audits

Audits are initiated by the local tax offices, which are authorized to request information on matters of substance even before the due date for the submission of tax returns. Usually, this is done by way of a request for written information, but such a request may be made only if the information received from a taxpayer is insufficient or its correctness is in doubt. Furthermore, the taxpayer's affidavit may be required. Large businesses are audited at three-year intervals with respect to all previous fiscal years back to the last audit, but there is no fixed or periodical audit schedule. Although taxpayers have no right to require an audit, they may ask for an audit and such requests are normally granted, particularly where a corporation is merged or sold. As a rule, taxpayers are informed in advance

[574] KStG, Sec. 14(1) No. 5. The scope of this provision has been greatly expanded as compared to the original version. The revised version was enacted on February 20, 2013 and is applicable also in past years within the limits of the statute of limitations.

[575] AO, as amended, Sec. 73.

[576] BStBl. 2021 II, 889.

[577] Decree of September 29, 2022, BStBl. 2022 I, 1412.

[578] KStG, Sec. 23(1).

[579] Fourth Act Implementing Tax Relief Measures to Address the Corona Crisis (Corona Tax Relief Act IV), BGBl. 2022 I, 911, Art. 6.

[580] Fourth Act Implementing Tax Relief Measures to Address the Corona Crisis (Corona Tax Relief Act IV), BGBl. 2022 I, 911, Art. 6.

[581] AO, Sec. 152.

[582] EStDV, Sec. 60(3).

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of the date of an audit. At the close of an audit, the taxpayer receives a copy of the auditor's report, and disputes regarding matters of fact and their interpretation are often settled at a final meeting between the taxpayer, the auditor and the local tax office.

Note: Sections 204 to 207 of the General Tax Code (*Abgabenordnung* — AO) provide for the issuance of binding advance rulings, on the application of the taxpayer, with respect to matters that have been the subject of an audit in the past and covered in the auditor's report.

As regards cross-border cases, "joined audits," conducted together with foreign tax officers from other EU Member States, are permissible.[583] Joint audits[584] are coordinated bilateral or multilateral government tax audits on cross-border cases. Unlike in a mutual agreement procedure (MAP), the taxpayer is involved in a joint tax audit. However, a taxpayer cannot officially ask the German tax authorities to conduct a joint tax audit because such audits are an instrument for mutual assistance between/among the tax authorities of different countries. Thus, any costs of a joint tax audit are to be borne by the respective tax administrations.

On December 20, 2022, a law implementing the Council Directive (EU) 2021/514 of March 22, 2021, amending the Directive 2011/16/EU on administrative cooperation in the field of taxation and modernizing the law on tax procedure was published.[585] One of the aims of this law is to conduct government tax audits in a more timely and efficient manner. For this purpose, taxpayers will become subject to more rigid cooperation requirements including, for instance, new sanctions. The law also provides that tax auditors must alert taxpayers to the main areas of focus at the beginning of a tax audit and are expected to finalize separable parts of the tax audits with binding interim results at the request of the taxpayer. The new law is applicable for the first time to taxes and tax refunds arising after December 31, 2024 and tax audits announced after December 31, 2024.

Comment: This new law appears to be unbalanced, as it places a greater burden on the taxpayer and gives more powers to tax officers. The taxpayer can request a binding interim report from the tax officer. However, there is no legal obligation for the tax officer to prepare one, and there are no consequences for a tax officer who refuses to do so. Further, in practice, it seems rather unlikely that a taxpayer would require such an interim report, as this would, in principle, weaken his or her bargaining position at the end of the audit in the closing discussion with the government tax auditors.

d. Statute of Limitations

The statute of limitations for the assessment and collection of corporate income tax is four and five years, respectively, and tax cannot be assessed or collected after the applicable statute has run. The statute of limitations for assessments runs from the end of the calendar year in which the return is filed, but not later than the end of the third calendar year following the calendar year in which the tax liability arose.[586] The statute of limitations for collection runs from the end of the calendar year in which the corporate income tax was assessed.[587]

e. Interest

Interest is imposed at the rate of 0.5% per month for all calendar years including 2018 in the following instances:

(i) If an extension for payment has been granted;[588]

(ii) If a tax fraud is committed; in these circumstances, interest must be paid with respect to the amount of the deficiency;[589]

(iii) If collection is suspended pending objection proceedings or litigation; in the case of over-assessment, interest is paid if the refund claim is delayed due to litigation;[590] or

(iv) If the total tax liability assessed for the taxable year is different from the sum of the prepayments, interest is imposed or paid on the difference payable or refundable, unless the difference is settled within 15 months after the end of the calendar year for which the tax is payable.[591]

The rate of interest (6% p.a.) remained unchanged for decades. In view of the duration of very low levels of market interest rates, the Federal Constitutional Court[592] regarded this rate as excessive and in violation of the constitutional rights of taxpayers as of 2014, but it allowed the legislature to create a constitutional solution by July 31, 2022. Hence, the current interest rate remained applicable until December 31, 2018, even if it was in breach of the Constitution, in the view of the Court. Subsequently, under a new law enacted in 2022,[593] the rate of interest was reduced to 1.8% p.a. with effect from January 1, 2019, in the circumstance listed above under (iv). Henceforth, this interest rate is to be reviewed every two years beginning January 1, 2024. In the other circumstances listed above at (i), (ii) and (iii), the applicable interest remains unchanged at 6% p.a.

f. Additions to Tax

If a corporate income tax deficiency is not paid within one month of the receipt of the notice of assessment and no extension of payment has been granted, the deficiency is increased by 1% per month.[594]

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[583] EU Administrative Assistance Act (*EU Amtshilfegesetz* — EUAHiG) of June 26, 2013, BGBl. 2013 I, 1809, as amended.

[584] AO, Sec. 117, based on the EU Directive 2011/16/EU of February 15, 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC.

[585] Law on the implementation of Council Directive (EU) 2021/514 of March 22, 2021, amending Directive 2011/16/EU on administrative cooperation in the field of taxation and modernizing the law on tax procedures of December 20, 2022, BGBl. 2022 I, p. 2730.

[586] AO, Sec. 170.

[587] AO, Sec. 229(1).

[588] AO, Sec. 234.

[589] AO, Sec. 235.

[590] AO, Sec. 236.

[591] AO, Sec. 233a.

[592] Decision of the Constitutional Court of July 8, 2021, file no. 1 BvR 2422/17.

[593] Second Act Amending the Fiscal Code and the Introductory Act to the Fiscal Code (Zweites Gesetz zur Aenderung der Abgabenordnung und des Einfuehrungsgesetzes zur Abgabenordnung) of July 12, 2022, BGBl. 2022 I, 1142.

[594] AO, Sec. 240.

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g. Advance Rulings

Under Section 89(2) of the General Tax Code,[595] a taxpayer may request from the competent tax office a ruling in circumstances in which the taxpayer is able to show that it has a justified interest in receiving a ruling because of the substantial tax consequences that may follow from a particular transaction or investment. As a rule, the tax office should decide upon the request within six months. The granting of a ruling triggers a fee that is generally based on the amount of tax that would be at risk if the planned transaction were to be executed. The amount of tax at risk is capped at 30 million euros and the maximum fee for a binding ruling is 109,736 euros. However, no ruling can be expected with regard to a simple question of fact or where the ruling request concerns a structure designed to avoid taxes or transfer pricing issues.

Based on an applicable tax treaty, an advance pricing agreement (APA) may also be obtained regarding the adequacy of transfer prices. The fee to initiate an APA is 20,000 euros.[596] (See XIV.D., below.)

13. Incentives

Tax incentives used to be available for investments in particular assets or particular regions.

A tax-based research allowance, which has been available since January 1, 2020,[597] can be claimed by any eligible company regardless of its respective profit situation. The tax allowance becomes part of the well-developed project funding landscape and is intended to strengthen Germany as an investment location and stimulate the research activities of small and medium-sized enterprises, in particular. The funding relates to research and development (R&D) projects in the categories of basic research, industrial research and experimental development and is calculated based on the cost of research staff wages and the contract costs for commissioned projects. In addition, expenses of an entrepreneur that is conducting its own research also qualify. The subsidy takes the form of a research allowance and amounts to 25% of a maximum assessment base of 10 million euros, which can be increased by another 10 percentage points in the case of a small or medium-sized company. The eligible share of contract research costs has increased from 60% to 70%, while for individual entrepreneurs and partners in partnerships, the flat hourly rate for their own R&D work has been raised from 40 euros to 70 euros.[598] The research allowance is set off against the next tax assessment and paid out to the extent it exceeds the assessed tax. There is a legal entitlement to the research allowance, provided all requirements are met.

14. Reorganizations

a. In General

Two statutes in effect from January 1, 1995 significantly changed the corporate law and tax rules for reorganizations.[599] From a corporate law perspective, it is possible to effect not only mergers, but also corporate spin-offs and split-ups. The previous tax rules permitting tax-free mergers of resident corporations were adjusted and extended to cover, in particular, corporate spin-offs and split-ups. Further significant changes became applicable as of December 12, 2006, extending the geographical scope of tax-free reorganizations to cover additional foreign and cross-border transactions involving entities resident in the European Union/EEA.[600] Further changes became applicable in 2022 with respect to tax-free organizations involving entities resident outside the EU/EEA (except contributions in-kind-to corporations).[601] On January 2, 2025, a new decree was published by the Federal Ministry of Finance that reflects the tax authorities' interpretation of the law and updates the former, outdated decree.

b. Change in Legal Form

A mere change in the legal form of an entity (for example, from that of an AG to that of a GmbH or vice versa) has no income tax implications for either the entity or its shareholders, as such a change does not affect the entity's identity. Similarly, a corporation is not dissolved when it reorganizes into a partnership, but for tax purposes such a reorganization entails the disappearance of a corporate taxpayer and its substitution with a partnership, which is transparent and, therefore, not a taxpayer for income tax purposes.

c. Statutory Mergers and Consolidations

(1) General Rule

Generally, a gain is recognized but a loss is disregarded in the hands of the transferor corporation where substantially all of the assets and liabilities of a resident corporation are transferred to another resident corporation in a statutory merger. The amount of the gain is the excess of the fair market value over the book value of the assets transferred, including goodwill. On application, gain recognition can be avoided if the transferor corporation states its assets at their book values in the transferor's final balance sheet, if the transfer is effected exclusively for newly issued shares of stock in the transferee corporation, if the transferee corporation is subject to corporate income tax, and if Germany's right to impose its income tax on a capital gain of the transferee corporation disposing of the assumed assets is neither excluded nor limited.[602]

Note: Subject to a specific anti-abuse provision, a net operating loss of the final taxable period or a loss carryforward may be used to offset a reorganization gain. Any remaining net operating loss of a merging entity is forfeited.[603]

[595] Federalism Reform Accompanying Act (*Foederalismusreform-Begleitgesetz*) of September 5, 2006, BGBl. I 2006, 2098.

[596] AO, Sec. 178a; BMF, decree of October 5, 2006, BStBl. I, 2006, 594.

[597] Law on tax incentives for research and development of December 14, 2019 (*Forschungszulagengesetz* — FZulG), as amended.

[598] Growth Opportunities Act (*Wachstumschancengesetz*) of March 27, 2023, BGBl. 2024 I, No. 108, Art. 27.

[599] BGBl. 1994 I, 3210, 3267.

[600] BGBl, 2006 I, 2782.

[601] Repeal of UmwStG, Sec. 1(2) as of January 1, 2022.

[602] UmwStG, Sec. 11(2).

[603] UmwStG, Sec. 2(4).

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(2) Tax-Free Reorganizations

Under the provisions of the Reorganization Tax Act,[604] the following types of reorganizations may be effected tax-free using a roll-over method:

(i) A statutory merger;

(ii) A corporate division;

(iii) A change of legal form that does not affect the identity of an enterprise;

(iv) The transfer of a business, a separable part of a business or a partnership interest to a corporation in exchange for newly issued shares in that corporation;

(v) The contribution of a share interest in a corporation to a corporation for shares in that corporation if the latter corporation, immediately following the contribution, holds a majority of the voting rights in the contributed corporation; and

(vi) The contribution of a business or of a separable part of a business to a partnership in exchange for an interest in that partnership.

d. Cross-Border Reorganizations

As a result of a change in the law, the application of the Reorganization Tax Act to cross-border mergers, demergers and changes of legal form from a corporation to a partnership with a transfer date after December 31, 2021 across the border, is in principle no longer limited to EU/EEA resident corporations.[605]

In the case of cross-border contributions-in-kind to a corporation, the Reorganization Tax Act still requires a link to a transferee established and resident in the European Union/EEA. The further requirement that the transferor be established and resident in the European Union/EEA does not apply if Germany's taxing rights with respect to the new shares received by the transferee in exchange for the transferred assets are not limited.

The above requirements do not apply with respect to contributions-in-kind to a trading partnership, if Germany's taxing rights with respect to the transferred assets are not limited (and no further significant consideration is provided in exchange for the assets).[606]

In the case of a cross-border change of legal form from a partnership to a corporation, the requirement that the deemed transferee be established in an EU/EEA Member State still applies. The additional requirement that the partners of the partnership, as the deemed transferor, be established (where the partners are not individuals) and resident in an EU/EEA Member State does not apply, if Germany's taxing rights with respect to the new shares received in exchange for the deemed transferred assets are not limited.[607]

In the case of a share swap, the Reorganization Tax Act still requires only that the transferee be a corporation established and resident in an EU/EEA Member State.[608]

To the extent the Reorganization Tax Act applies, in principle, such reorganizations can be executed on a roll-over basis, if the additional requirements stated in the Reorganization Tax Act are met.

e. Liquidations

The liquidation of a corporation is treated as a taxable disposition and thus may give rise to a taxable gain in the hands of both the corporation itself and its shareholders. For further details, see V.B.2.c., above.

[604] UmwStG.

[605] UmwStG, Sec. 1(1); this derives from the deletion of UmwStG, Sec. 1(2) as of January 1, 2022.

[606] UmwStG, Sec. 1(3), (4), Sec. 24(2).

[607] UmwStG, Sec. 1(3), (4), Sec. 21(1).

[608] UmwStG, Sec. 1(3), (4).

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VI. Taxation of Nonresident Corporations

A. What Is a Nonresident Corporation?

A corporation that has neither its statutory seat nor its principal place of management in Germany is considered to be a nonresident corporation for purposes of corporate income taxation. Such a corporation is subject to tax only with respect to certain items of income derived from German sources.[609] However, a foreign corporation can qualify as a resident corporation if it transfers its principal place of management to Germany (see V.A., above).

B. Determination of Taxable Income

Unlike the profits derived by a resident corporation, which can only be business profits, the profits of a nonresident corporation are not automatically considered to be business profits.[610] Instead, it is necessary to determine whether the corporation concerned derives items of income from German sources that would be classified as belonging to another category of income, such as dividends, interest, rentals or royalties, or income from independent services, if they were derived by an individual, and if an individual could have performed the relevant services outside the scope of a business activity.[611] However, rental income and capital gains from the sale of German-situs real property derived by a foreign corporation are deemed to be business income, even if the foreign corporation does not have a permanent establishment (PE) in Germany.[612] The same applies regarding royalty income from the exploitation of intellectual property rights (for example, patents or trademarks) registered in Germany.[613]

1. Business Profits

Business profits are considered to be derived from German sources if they are derived through a German PE or through the activities of a permanent representative stationed in Germany. (For the treatment of remuneration paid to a nonresident corporation with respect to services rendered in Germany by professional sportsmen, entertainers or artists, see VIII.B., below.) Profits derived by a nonresident corporation from sales made or services rendered to a third country may be considered to be German-source income if they were generated through the activities of a German PE or permanent representative.

Under Section 1(5) of the Foreign Tax Act (*Aussensteuergesetz* — AStG), the net taxable income attributable to a PE or permanent representative is determined based on the assumption that the PE is a separate and independent enterprise whose profits are to be determined by applying the arm's length principle. In line with the Authorized OECD Approach (AOA), Section 1(5), in conjunction with the Ordinance for the Application of the Arm's Length Principle on Permanent Establishments, from October 13, 2014,[614] a taxpayer is required to identify "dealings" (assumed contractual relationships) between its PE and head office (and other PEs) and to determine the arm's length transfer price for these dealings. "Dealings" for these purposes are the purchase and sale of tangible goods, rental and lease agreements, service provisions, and licensing arrangements with respect to intangible assets. Finance transactions (for example the provision of loans and guaranties) are not dealings for these purposes (subject to an exception for the banking industry). Interest bearing liabilities are to be attributed to a PE to the extent the liabilities are directly related to the assets attributed to the PE. Furthermore, the amount of equity (endowment capital) attributable to a PE must be determined as a fraction of the equity of the enterprise; the fraction corresponds to the share of the PE in the assets and risks and opportunities in proportion to the assets, etc. of the rest of the enterprise. At a minimum, the amount of equity shown on the commercial financial statements drawn up for the domestic PE must be used.

A nonresident corporation may take advantage of an *Organschaft* arrangement if it has a German PE that assumes the function of the controlling company with regard to one or more controlled domestic subsidiary corporations (see V.B.10., above). In particular, the shares of stock in the subsidiary corporation(s) must form part of the assets of the PE in accordance with applicable domestic and tax treaty attribution principles.

The dissolution of a German branch or other PE of a nonresident corporation, or the transfer of its assets to another entity or individual, is a taxable event for corporate income tax purposes, the tax being computed based on the amount by which the fair market value of all the assets of the German PE exceeds their adjusted book value (see VI.D.3., below).[615] However, the transfer of a German PE by a European Union (EU)/European Economic Area (EEA) corporation to a corporation resident in another EU/EEA Member State in exchange for shares of stock in the transferee corporation may be effected tax-free under Section 20(1) of the Reorganization Tax Act.

2. Capital Gains on Sales of Shares

Subject to the same exceptions as apply to domestic corporations, the 95% exemption for capital gains from the sale of shares in a resident corporation is available to a nonresident corporate taxpayer that holds the shares through a German PE. There are no minimum holding percentage, holding period or activity requirements. If the shares in the German corporation are held directly by a foreign corporation (outside a German PE), the capital gain is completely exempt since the rule that 5% of the capital gain is to be deemed a non-deductible business expense applies only to shares attributable to a German PE.[616] Most of Germany's tax treaties provide for an exemption for such capital gains in any event, but about 30 of Germany's tax treaties provide for an exception to this exemption with regard to shares in a corporation (whether or not a German corporation) holding predominantly real property situated in Germany. A corresponding capital loss will be disregarded, whether or not a German PE is involved.

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[609] KStG, Sec. 2(1).

[610] KStG, Sec. 8(2).

[611] EStG, Sec. 49(2); BFH decision of December 14, 1974, BStBl. 1975 II, 464.

[612] EStG, Sec. 49(1) no. 2 lit. f.

[613] EStG, Sec. 49(1) no. 2 lit. f.

[614] BGBl. 2014 I, 1603.

[615] KStG, Sec. 12(1). The prevailing view requires the inclusion of goodwill in the determination of the fair market value of the assets of the branch.

[616] BFH, decision of May 31, 2017, BStBl. 2018 II, 144.

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Since January 1, 2019, a nonresident corporation has also been subject to German corporation tax with respect to capital gains derived from the disposal of shares in a foreign corporation if more than 50% of the value of the shares at any point in time during the 365 days preceding the disposal is based on real property situated in Germany; for purposes of the 50% threshold, the assets must be accounted for at their tax book value.[617] Such capital gains are taxable only to the extent the gains are attributable to appreciation occurring after December 31, 2018.[618] To the extent it is entitled to a full exemption for such capital gains in accordance with the May 31, 2017 decision of the Federal Tax Court (*Bundesfinanzhof* — BFH) because the shares are not attributable to a German PE, in practice, a nonresident corporate seller is not affected by this new rule.

3. Income from Capital Investment

a. In General

A nonresident corporation is, in principle, subject to tax on income from capital investment derived from German sources. Income from capital investment that is not attributable to a German PE or permanent representative is considered to be derived from German sources if the domicile, statutory seat or principal place of management of the debtor is in Germany. To that extent, the nonresident corporation needs to file tax returns with the responsible tax office in Germany, unless the debtor of the income paid is required to withhold the tax payable on behalf of the nonresident taxpayer.

b. Interest

Nonresident corporations are subject to tax, in particular, on interest paid:

(i) On a mortgage or other debt secured, directly or indirectly, by German situs-real property or by ships registered in Germany, irrespective of whether the debtor is a German resident;[619]

(ii) With respect to participation rights (*Genussrechte*) that is not covered by the term "dividend" (see c., below);[620] or

(iii) By a resident debtor with respect to a silent participation arrangement (*stille Gesellschaft*) or a participating loan (*partiarisches Darlehen*).[621]

With the exception of interest on mortgages described above under (i), which is not subject to withholding tax,[622] such items of interest income are subject to withholding tax at source at the rate of 25% plus an additional income tax surcharge of 5.5%[623] or a lower tax treaty rate, which settles the taxpayer's tax debt.

c. Dividends

The term "dividends" includes constructive dividends. It also includes payments with respect to participation rights that entitle the holder to share in the profits and the liquidation proceeds of the issuer. Dividends distributed by a resident corporation to a nonresident corporation attract dividend withholding tax at the regular rate of 25%[624] (plus 5.5% income tax surcharge), or at a lower tax treaty rate, or at a zero rate when the recipient is an EU Member State parent company. For withholding tax purposes, the 95% exemption for dividends received may not be applied.[625] Two fifths of the withholding tax is to be refunded at the request of the recipient nonresident corporation, if the conditions of the anti-treaty shopping rules are fulfilled.[626] The withholding tax is fully creditable or refundable if the foreign corporation holds the relevant shares through a German PE; if the shares are not held through a PE, the withholding tax may be a final tax.

Tax treaties typically provide for a withholding tax rate of 15% if the nonresident corporation owns less than 10% of the shares of the domestic distributing corporation and a withholding tax rate of 5% if the nonresident corporation owns at least 10% of the shares of the domestic corporation. Since January 1, 2017 and as a countermeasure against cum-cum (dividend stripping) transactions, relief is denied if the nonresident corporation has held the shares in a collective deposit[627] and has owned the shares for less than 45 days in the period beginning 45 days before the dividend date and ending 45 days after the dividend date if the withholding tax rate is lower than 25%.[628]

4. Rents and Royalties

Rents from the leasing of real property or a conglomeration of personal property (*Sachinbegriff*) are taxable in the hands of a nonresident corporation, if the property is in Germany or registered in a German public register, or used in a domestic PE, even if the rentals are not attributable to a PE or permanent representative in Germany.

If an intangible industrial property right, such as a patent, trademark, copyright or design pattern, is recorded in a German public register or is used in the German PE of a licensee or another party, the relevant royalties are taxed as rental income. The same treatment applies to income from the utilization of personal property in Germany, as well as to income from the utilization of technical, scientific or business know-how within Germany.[629]

Recently, the German tax authorities have taken the view[630] that income from a license registered in Germany using the licensed right granted by a foreign licensor to a foreign licensee is subject to German taxation, even where the right is used outside Germany (subject to the terms of an applicable tax treaty and the issuance of a corresponding exemption certificate from the Federal Central Tax Office). This results in a German tax liability for the foreign licensor. In the case of temporary use of

[617] EStG, Sec. 49(1) no. 2 lit. e cc.
[618] EStG, Sec. 52(45a).
[619] EStG, Sec. 49(1) no. 5 lit. c aa.
[620] EStG, Sec. 49(1) no. 5 lit. c bb.
[621] EStG, Sec. 49(1) no. 5 lit. a.
[622] EStG, Sec. 43.
[623] EStG, Sec. 43(1) No. 2, 3, 4, Sec. 43a(1) no. 2.
[624] EStG, Sec. 43a(1) no.1.
[625] EStG, Sec. 43(1) sent. 3.
[626] EStG, 44a(9), EStG, 50d(3); see XV.A.
[627] EStG, Sec. 43a(1) no. 1a.
[628] EStG, Sec. 50j.
[629] EStG, Sec. 49(1) no. 2 lit. f, no. 6, no. 9.
[630] BMF, decrees of November 6, 2020, file no. IV C 5 — S 2300/19/10016: 006, and February 11, 2021, file no. IV B 8 — S 2300/19/10016: 007, extended by decree of July 14, 2021 for license fees paid before July 1, 2022, and again extended to license fees paid before July 1, 2023 by decree of June 29, 2022.

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the licensed right, the foreign licensee is expected to withhold 15.825% (including income tax surcharge) and transfer it to the German tax authorities on behalf of the foreign licensor.[631] The foreign licensor is not obliged to file income tax returns with the German tax authorities in these circumstances. To the extent the foreign licensor is entitled to treaty benefits, the foreign licensee can refrain from withholding the 15.825% only if the foreign licensor provides the licensee with an exemption certificate from the Federal Central Tax Office. Otherwise, the foreign licensor will need to file for a withholding tax refund with the Federal Central Tax Office.

In response to these circumstances, the Ministry of Finance published a series of decrees designed to ease the consequences of this new interpretation of the old law ("register cases").[632] According to the decrees, in the case of royalty payments made for the temporary use of a licensed right, the withholding tax can be avoided if the following conditions are fulfilled:

(i) The debtor is not a tax resident in Germany at the time when the royalty payments are made;

(ii) The creditor of the royalty payments is a tax resident of a tax treaty country and entitled to benefits under the applicable treaty; and

(iii) The creditor, or the (authorized) debtor, of the royalty payments applies to the German Federal Central Tax Office for an exemption certificate analogous to that provided under Section 50c(2), first sentence of the Income Tax Act (*Einkommensteuergesetz* — EStG), disclosing all the licenses granted to the affiliated and unaffiliated parties of the licensor. This application is then subject to revision and approval by the tax authority.

This solution was intended to avoid the back-and-forth payment of past withholding taxes, but — as set out above — it requires full disclosure of the license agreement and further details of any intra-group licensing of the right concerned to other affiliated group companies. If the Federal Central Tax Office denies the exemption certificate, the debtor will need to file corresponding income tax returns for all royalty payments made before the Federal Central Tax Office within one month after the denial. The taxation of such payments is subject to the restrictions imposed under the applicable tax treaties. The tax base, in all these cases, is the gross amount of the royalty payments. Where this amount is uncertain, the German tax authority will estimate the German tax base. Where a right is licensed for an unlimited period of time (i.e., there is a sale of the licensed right), no withholding tax applies. Instead, the licensor must file income tax returns with the responsible German tax office, even if Germany has no taxation rights with respect to the sale proceeds under the applicable treaties.

Comment: It is doubtful whether this new interpretation of the law is in line with EU law, as it represents Germany's wish to tax business transactions of nonresidents entered into outside Germany in the absence of any applicable anti-abuse rule. Therefore, it seems likely that the interpretation will be challenged before the Court of Justice of the European Union (CJEU).

New legislation enacted as part of the Annual Tax Act 2022[633] is intended to further clarify and remedy the situation. As of January 1, 2023, non-resident tax liability no longer applies to royalty payments made between affiliated parties if an applicable tax treaty prevents Germany from taxing them. In turn, if the payments are made between affiliated parties and no tax treaty applies, then the rules described above continue to apply. Likewise, if the creditor of the royalty payments is unaffiliated and resident in a cooperative tax jurisdiction, then German taxation of the royalty payments is waived and retroactively so to all such cases that remain open. If the creditor of the royalty payments is resident in a non-cooperative tax jurisdiction,[634] then as of January 1, 2022, the non-resident tax liability is based on Section 10 (1), no. 5 of the Law on Defense against Tax Avoidance and Unfair Tax Competition[635] (see XV.E., below), irrespective of whether the creditor is affiliated or not to the debtor, while for royalty payments made before January 1, 2022, the rules described above continue to apply.

5. Real Estate Capital Gains

Capital gains from the sale of domestic real property derived by a nonresident corporation are irrefutably deemed to be business income taxable at ordinary rates, irrespective of whether the nonresident corporation has a PE in Germany.[636]

C. Tax Assessment and Rates

1. Assessment

Tax on business profits derived through a German PE or permanent representative is levied under German domestic tax law by way of assessment based on the corporation's tax returns. This also applies to tax on income and capital gains from real property. On the other hand, German tax obligations with respect to items of income to which a withholding tax applies (for example, dividends, certain interest payments and royalties) are satisfied by way of a final withholding tax if the tax is properly withheld and paid over to the tax office.[637] By way of an exception, EU/EEA resident corporations may opt for the assessment procedure with respect to royalties.[638]

[631] EStG, Sec. 50a(1) no. 3.

[632] BMF, decrees of February 11, 2021, BStBl. 2021 I, 301, for royalty payments made until September 30, 2021, if the application for the exemption certificate has been filed by December 31, 2021, before the German Federal Central Tax Office; extended by decree of July 14, 2021, BStBl. 2021 I, 1005, for royalty payments made before July 1, 2022, if the application for the exemption certificate has been filed by June 30, 2022, before the German Federal Central Tax Office; again, extended by decree of June 29, 2022, BStBl. 2022 I, 957, to royalty payments made before July 1, 2023, if the application for the exemption certificate has been filed by June 30, 2023, before the German Federal Central Tax Office.

[633] Annual Tax Act of December 16, 2022, BGBl. 2022 I, 2294, Art. 1 no. 18.

[634] As of February 14, 2023, these jurisdictions include American Samoa, Anguilla, British Virgin Islands, Costa Rica, Fidschi, Guam, Marshall Islands, Palau, Panama, Russia, Samoa, Trinidad and Tobago, Turks and Caicos Islands, U.S. Virgin Islands, and Vanuatu.

[635] Law on Defense against Tax Avoidance and Unfair Tax Competition of June 25, 2021, BGBl. 2021 I, 2056, as amended by the Annual Tax Act 2022, Art. 24 no. 1, BGBl 2022 I, 2294.

[636] EStG, Sec. 49(1) no. 2 lit. f.

[637] EStG, Sec. 50(2); KStG, Sec. 32(1).

[638] KStG, Sec. 32(4).

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2. *Tax Rates*

All categories of German-source income that are taxed on a net basis by way of assessment are subject to corporate income tax at the flat rate of 15%, plus 5.5% income tax surcharge (giving a total of 15.825%).

Other items of income that are not taxed on a net basis are generally taxed by way of withholding at the ordinary rate of 25% (15% in the case of royalties) of gross receipts, plus 5.5% solidarity surcharge (resulting in a total of 26.38% or 15.83%, respectively) or a lower tax treaty rate. Most of Germany's tax treaties provide for an exemption from or a reduction of such domestic withholding tax rates. To obtain such an exemption or rate reduction, the nonresident corporate taxpayer must apply in advance for an exemption certificate.[639] With regard to royalty payments to an affiliated corporation resident in another EU Member State or Switzerland, the withholding tax rate can be reduced to 0% on application, if certain requirements are met.[640] It should be noted that, as a result of various CJEU decisions and new domestic law in Germany,[641] the conditions for obtaining such tax refund and exemption certificates have been changed with immediate effect, unless the previously applicable law is more advantageous for the taxpayer.[642]

For the rates of source country taxation applying to investment income, services income and capital gains under Germany's domestic law and tax treaties and the context for the application of those rates, see the Withholding Tax Chart.

D. Subsidiary vs. Branch

The German corporate income tax system does not provide for different tax rates for resident and nonresident corporate taxpayers and does not distinguish between retained earnings and distributed profits. In all cases, the corporate income tax rate is 15%. The most important considerations relevant in deciding whether to conduct business operations in Germany through a German subsidiary corporation or a branch of a foreign corporation are summarized in 1. to 4., below.

Comment: A branch registered with the Commercial Court usually qualifies as a permanent establishment (PE), but a PE does not necessarily qualify as a branch. While 'branch' is a term of the Commercial Code, PE is a tax term. As a consequence of the Organisation for Economic Cooperation and Development (OECD) anti-Base Erosion and Profits Shifting (BEPS) action items and related negotiations at the OECD and EU levels, the definition of a PE will be expanded significantly with the result that more foreign corporations may become subject to German nonresident taxation than was the case in the past.

1. *Tax Rates*

Even though the corporate income tax rates proper are identical for a branch and a subsidiary, dividends distributed by a German subsidiary attract German withholding tax at the general rate of 25%[643] plus 5.5% income tax surcharge or, where a tax treaty applies, at the lower treaty rate. The treaty rate can be as low as 0%. However, the availability of these lower rates is subject to strictly enforced anti-treaty shopping provisions.[644] On the other hand, Germany does not impose a branch profits tax, which means that the overall tax burden on income derived by a German subsidiary is higher if the German subsidiary distributes that income, than that on the income of a branch, to the extent of the amount of the dividend withholding tax. Moreover, if a branch of a foreign corporation holds shares in a German corporation that distributes dividends, the withholding tax imposed on such dividends is refundable to the branch. This means that, if equity participations in German corporations are held by a German branch of a foreign corporation, dividend distributions can be made without a withholding tax burden having to be borne.

Note: As a result of a number of CJEU decisions, Section 50d(3) of the Income Tax Act is the subject of major changes,[645] which are dealt with in more detail in XV.A.1., below.

2. *Inter-Company Charges*

It is important to note that inter-company charges within groups of affiliated companies (management charges, royalties and interest charges for loans) are, as a rule, recognized as proper business expenses for resident corporations if they reflect arm's-length terms, while, in particular, the deduction of interest charges against the profits of a German branch is restricted to a significant extent. Interest charges paid with respect to loans may not be deducted by a branch unless it is proven that the head office borrowed the funds specifically for purposes of the branch. Furthermore, domestic branches of foreign corporations are subject to the interest barrier rule (see II.F.1.e., above, and V.B.2.b.(2), above) and further restrictions regarding the tax deductibility of interest expenses and partial write downs.

3. *Reorganization of a Branch*

If a branch is subsequently reorganized into a subsidiary corporation, the foreign head office will be deemed to have derived a profit to the extent the fair market value of the branch's assets (including goodwill) at the time of the reorganization exceeds their book value (see V.B.14.d., above). The German PE of foreign corporation may apply for rollover treatment if the transfer is effected for shares in the (domestic or foreign) transferee corporation under Section 20(1) of the Reorganization Tax Act and *inter alia*, Germany's tax rights with respect to the transferred assets are not limited.[646]

4. *Non-Tax Considerations*

Aside from the tax aspects discussed in VI.D.1. to 3., above, a number of non-tax considerations may make it easier to set up and maintain a subsidiary operation rather than a branch office. For instance, the branch of a foreign corporation may have to be entered in the Commercial Register (see III.E.1.a., above). A branch may encounter problems in securing telephone and telex listings in its name, as well as in open-

[639] EStG, Sec. 50d(2).
[640] EStG, Sec. 50g.
[641] AbzStEntlModG, BGBl., Art. 1.
[642] See XV.A.1.; EStG, Sec. 52(47b), as amended by AbzStEntlModG, Art. 1.
[643] EStG, Sec. 43a(1)(1).
[644] EStG, Sec. 50d(3).
[645] AbzStEntlModG.
[646] UmwStG, Sec. 20(2).

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ing bank accounts. Employees may prefer to be employed by a resident corporation, and suppliers and customers may prefer to deal with a German entity.

E. Tax Classification of Foreign Legal Entites

Foreign entities are classified as either corporations or partnerships (see VII., below) by comparing them to the basic form of a general partnership or corporation (*Gesellschaften mit beschraenkter Haftung* (GmbHs) *Aktiengesellschaften* (AGs)) under German law. Their foreign civil law or tax status is not taken into account for these purposes. Among the important factors to be considered are whether at least one holder of an interest in the entity concerned has unlimited liability or is required to be part of the entity's management (*Grundsatz der Selbstorganschaft*).

A Decree of March 19, 2004, of the German Federal Ministry published a list of the factors that are decisive for determining the classification of a U.S. limited liability company (LLC).[647] It summarizes the key criteria for qualification as an income tax opaque corporation or an income tax transparent partnership, as follows:

A single member LLC is to be treated as a U.S. branch of the member. In classifying other U.S. LLCs, the following factors are to be taken into account:

(i) Centralized management and representation;

(ii) Limited liability;

(iii) Free transferability of interests;

(iv) Profit attribution mechanism;

(v) Capital contribution rules;

(vi) Limited or unlimited life;

(vii) Profit distribution mechanism; and

(viii) Registration and formation provisions.

The 2004 Decree stipulates that a U.S. LLC is to be classified primarily by taking into account all of the above factors. It goes on to state that a U.S. LLC is to be classified as a corporation when at least three out of the first five factors listed above are present.

[647] BStBl. I, 2004, 411.

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VII. Taxation of Partnerships

A. Scope of Income Taxation

1. Income Allocation

For income tax purposes, the profits or losses of a partnership are attributed directly to its partners and taxed under the income tax rules in the case of individual partners and under the corporate income tax rules in the case of corporate partners. A partnership is, however, an accounting and reporting entity, certain elections have to be exercised uniformly by all partners, and a partnership must maintain proper accounting records and file information returns with the local tax office where it maintains its principal place of management. This tax office reviews the determination of profits (or losses) and their allocation among the partners and its findings are binding for the income tax assessment of the partners.[648]

Comment: Under certain very rigid and unfavorable preconditions, the partners can choose to accumulate the pre-tax profits in the partnership at a preferred income tax rate of approximately 29.8% only (including solidarity surcharge, but not church tax).[649] This results in kind of a partially deferred taxation, as the partners will be taxed later in case of withdrawal of the pre-taxed accumulated profits with additional 25.825% (including solidarity surcharge, but not church tax), which in total exceeds the maximum individual income tax rate of 47.475% in case of an immediate taxation of the partnership's profit at the partner's level. The Growth Opportunities Act[650] provides for some easements regarding the privileged pre-tax profits, but it worsens the tax treatment of the accumulated profits. Thus, the new rules result in a deferred taxation only, but do not result in a less complex system or in a reduced overall tax rate.

The Corporate Income Modernization Act of June 25, 2021 allows the partners of a partnership to opt for the partnership to be subject to income taxation on its profits instead of the partners' income being subject to taxation based on the partnership's profits. The following comments refer to the traditional transparent income tax regime applicable to a partnership and its partners, while the ability of a partnership to opt out of this income tax regime is explained in more detail in VII.D., below.

2. Qualification as a Partnership

Historically, Germany has not had check-the-box type rules like those in the U.S. Internal Revenue Code. All German entities in the form of a general partnership (*offene Handelsgesellschaft* — oHG), limited partnership (*Kommanditgesellschaft* — KG), civil law partnership (*Gesellschaft buergerlichen Rechts* — GbR) or atypical silent partnership (*atypische stille Gesellschaft*) are treated as transparent for income tax purposes. However, see discussion under VII.A.1., above.

B. Partnership Income

1. In General

The German income tax code distinguishes between seven different sources of income (agriculture and forestry; trade or business; independent personal services; services performed as an employee; income from the investment of capital; rental of immovable property and units of personal property, and royalties; and certain miscellaneous items, such as certain capital gains). Different rules apply depending on the type of income. For example, if immovable property is not considered a business asset, any capital gains from its disposal are tax-free provided the real property was held for more than 10 years. Only income from a trade or business is also subject to trade tax.

Note: For purposes of municipal trade tax, however, a partnership is a separate taxable entity and has to pay trade tax on its trade income. However, individual, but not corporate, partners can claim a credit for the trade tax attributable to their share in the profits of the partnership against their personal income tax.[651] This means that, at a municipal multiplier of about 400% (see X.A., below) on the full trade tax burden, the credit reduces the income tax by the full amount of the trade tax. Any excess trade tax burden must be paid in addition to the income tax burden. In 2021, the average municipal multiplier was 403%. In particular, bigger towns apply a municipal multiplier in excess of 400%.

In general, the income of a partnership of individuals must be similarly classified. Therefore, for example, a law firm in the form of a German partnership should not be subject to trade tax because the income received by it is not trade or business income. Two individuals who form a mere asset managing civil law partnership can receive joint rental income from their real property holdings via the partnership and are not subject to tax on any capital gain if they sell the real property or the interest in the partnership after a 10-year holding period. However, if even only a small fraction of the income of a partnership is classified as income from a trade or business, the entire income of the partnership will be so classified.[652]

All the income of a resident corporation is classified as income from a trade or business (and is, therefore, also subject to trade tax at the municipality level). However, in general, this does not taint the classification of the income of an individual if a corporation and an individual form a partnership. There is one exception: if only corporations have unlimited liability in the partnership and only the unlimited partner(s) and/or third persons (and not the limited partner) form the management, all the income of the partnership will always be classified as income from a trade or business, irrespective of the nature of the income.[653] It should be noted that the Federal Tax Court (*Bundesfinanzhof* — BFH) has held in several decisions that this domestic rule is not applicable when determining whether this is also income from a trade of business under a tax treaty containing a provision similar to Article 7 of the Organisation for Economic Cooperation and Development (OECD) Model Con-

[648] AO, Secs. 180 and 181.

[649] EStG, Sec. 34a.

[650] Growth Opportunities Act (*Wachstumschancengesetz*) of March 27, 2023, BGBl. 2024 I, No. 108, Art. 3.

[651] EStG, Sec. 35.

[652] EStG, Sec. 15(3) no. 1.

[653] EStG, Sec. 15(3) no. 2, *gewerbliche Praegung* esp. *GmbH & Co. KG.*

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vention.[654] After many years of debate, the Germany tax authorities have finally accepted the position of the BFH.[655]

The above rule also applies where only corporations form a partnership. While all the income of a resident corporation is always classified as income from a trade or business, only a partnership that either receives income from trade or business or is deemed to receive such income because only corporations have unlimited liability in the partnership and only the unlimited partner and/or third persons form the management, is subject to trade taxation on its own (with a matching exemption at the level of the partner for his or her own trade taxation). Thus, a partnership in the form of a GmbH & Co. KG with no trade or business income (for example, with only rental income) may avoid being subject to German trade taxation if, under the partnership contract, the limited partner in the form of a corporation is appointed as one of the managing directors.[656] Such structures are often used in inbound real property investments and can reduce the overall tax burden in Germany on a foreign corporation to the corporate income tax rate plus the income tax surcharge (i.e., to 15.875%) provided the foreign corporation has no permanent establishment (PE) in Germany.

2. *Transactions Between Partners and Partnerships*

A further peculiarity of German partnership taxation is that remuneration paid by a partnership (assuming it receives income from agriculture and forestry, a trade or business, or independent personal services) to a partner for services rendered (for example, management services), interest paid with respect to a partner's loan, or rentals for property let by a partner to the partnership, do not constitute deductible business expenses for the partnership but rather they increase the partner's distributive share in the partnership's profits (*Sonderbetriebseinnahmen*).[657] The rationale behind this rule is that it protects the trade tax base allocated to the partnership.

This relates not only to the income from such dealings, but also to the underlying assets. For example, if a partner rents real property to a partnership, the real property is allocated as a special business asset to the partnership (*Sonderbetriebsvermoegen I*) in a special additional balance sheet of the partner that is part of the partnership declaration filed with the revenue office. Depreciation on the value of such a building is, therefore, also a special business expense (*Sonderbetriebsausgabe*) that is deducted from the profit allocated to the partner via the partnership.

These rules have a negative impact on the German tax base in the case of inbound investments by foreign investors, unless the relevant tax treaty includes special rules (see, in particular, the Germany-Austria tax treaty).[658] For example, if the foreign partner grants a loan to the partnership, the interest at the first level is deductible in determining the income of the partnership. Under German domestic law, it is added back to the tax base at a second level and allocated to the foreign partner as special additional business income that forms part of the partnership's profit calculation. The BFH has held that Germany has no right to tax the nonresident partner on the interest income under the terms of a treaty with wording based on that of the OECD Model Convention because such income does not fall under Article 7 (Business income from a permanent establishment), but rather under Article 11 (Interest) of such a treaty.[659] In response to this decision, treaty overriding legislation was initially enacted in the *Jahressteuergesetz* 2009, followed by a revision in 2013 to allow for such taxation on a retroactive basis in all open cases.[660] To mitigate the double taxation that would otherwise arise, a nonresident taxpayer is entitled to credit the foreign tax against his or her German tax provided the nonresident taxpayer furnishes evidence that he or she has been taxed on the income in his or her country of residence and is not entitled to a credit for the German tax.[661]

Similar legislation exists to prevent negative classification conflicts under Germany's tax treaties in the case of outbound investments.[662] For example, where a German resident partner in a U.S. partnership engaged in a trade or business earns interest income from a loan granted to the U.S. partnership, the German tax administration treats the interest income as business profits for treaty purposes. This means that the interest income is to be exempted from German tax if the applicable treaty provides for an exemption for foreign business profits. If the PE country does not charge income tax on the interest earned because the PE country does not regard the interest as business profits, the interest income would escape taxation in both countries. Section 50d(9) of the Income Tax Act (*Einkommensteuergesetz* — EStG) provides that, in these circumstances, the interest income is not to be exempted irrespective of the existence of an applicable treaty.

Treating expenses incurred by a partner as deductible expenses (*Sonderbetriebsausgaben*) in calculating the partner's taxable share in the profits of the partnership results in deducting the same amount twice if the partner is resident in another country that allows a deduction for purposes of its tax. Since January 1, 2017, Germany has disallowed a deduction for *Sonderbetriebsausgaben* to the extent such expenses are also deductible in another country, unless the taxpayer provides evidence that the expenses are deducted from income that is subject to taxation in both Germany and the other country.[663]

3. *Partnership Losses*

Under Section 15a of the Income Tax Act, the losses of limited partners are not deductible to the extent the deduction results in a limited partner having a negative capital account. The nondeductible portion is carried forward and set off against future profits.

[654] BFH decisions of April 28, 2010, BStBl. II, 2014, 754; and of December 9, 2010, BStBl. II, 2011, 482.

[655] BMF, decree of September 26, 2014, BStBl. I, 2014, 1258 (annotation 2.2.1).

[656] EStR, Sec. 15.8(6).

[657] EStG, Sec. 15(1), (2).

[658] Convention Between the Federal Republic of Germany and the Republic of Austria for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital, signed on August 24, 2000, as amended by the Protocol of December 29, 2010 (the "Germany-Austria tax treaty").

[659] BFH decision of November 17, 2008, BStBl. II, 2009, 356.

[660] EStG, Sec. 50d(10).

[661] EStG, Sec. 50d(10).

[662] EStG, Sec. 50d(9).

[663] EStG, Sec. 4i.

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4. Partnership Law Reform

As discussed in III.D.4., above, the partnership law reform fundamentally changes the legal understanding of a partnership and, therefore, have an impact on the tax treatment of partnerships and partners. Pursuant to the Act to Modernize of the Law on Civil-Law Partnerships (MoPeG),[664] partnerships are granted full legal capacity instead of only partial legal capacity. As such, a partnership is now treated legal-wise similar to a corporation and, in particular, is allowed to own assets. This has a significant impact on the tax treatment of a partnership and its partners, who traditionally were taxed based on their respective shares of partnership profits, while as a flow-through entity the partnership itself was subject only to income calculation, not income taxation. Thus, a partnership was treated as an income tax transparent legal entity, unless the partnership opted in favor of being taxed like an income tax opaque corporation (see VII.D., below). The MoPeG reform entered into force on January 1, 2024. For keeping the income tax transparent status of the partnership unchanged, i.e., for keeping the partners subject to income taxation, the Secondary Credit Market Promotion Act (*Kreditzweitmarktförderungsgesetz*) of December 22, 2023,[665] provides for a new law, which confirms the tax understanding of an income tax transparent partnership even after the MoPeG entered into force.

C. Asset Transfers Between Partners and Partnerships

Section 24 of the Reorganization Tax Act deals with the contribution to a partnership by an existing or a new partner of a whole business, a separable part of a business (*Teilbetrieb*) or a partnership interest. In general, the contributing partner must recognize gain. However, on application, gain recognition may be deferred provided Germany's right to tax the contributed assets is neither excluded nor limited.

An asset transfer involving a single business asset rather than an entire business or a separable part of a business is governed by Section 6(5) of the Income Tax Act. Such a transfer must be effected on a rollover basis if either the transfer is for no consideration or the interest in the partnership is increased or reduced. Restrictions and claw-back provisions apply if the asset is sold during a three-year period after the filing of the tax declaration or if a corporation subsequently acquires an interest in the partnership.

D. "Check-the-Box" Option

The Corporate Income Modernization Act of June 25, 2021 introduced a kind of "check-the-box" option for a German or foreign trading partnership (whether a commercial partnership or a partnership company) and since March 28, 2024 for all registered general civil law partnerships.[666] The new law applies for fiscal years starting after December 31, 2021. The exercise of the option requires a unanimous partners' resolution unless the partnership agreement provides for a minimum 75% majority decision. The partnership must file the option at the latest one month prior to the beginning of the partnership's subsequent fiscal year with the responsible tax office. The option is irrevocable. Once it has exercised the option, the partnership is taxed like a corporation with respect to its income, while only the partners' withdrawals are taxed like dividend distributions. The new measures affect only the income tax regime, i.e., the legal form of the partnership remains unchanged.

The transition from the transparent income tax regime (which taxes the partners on the partnership's income irrespective of their withdrawals) to the new opaque income tax regime (which taxes the partnership on its profits) follows the rules of the Reorganization Tax Act for the transformation of a partnership into a corporation. Although the partnership is entitled to opt back into the transparent income tax regime under the rules for the transformation of a corporation into a partnership, the partnership must comply with a lock-in period of at least seven years before doing so if the deemed transformation will not take place at fair-market value under the applicable rules in the Reorganization Tax Act. Further, the opt-in might breach holding periods and trigger taxable gains. Thus, before opting-in, the tax history of the partnership needs to be checked thoroughly, as well as the possible consequences from a real estate transfer tax perspective.

The new tax regime results in significant changes for both a partnership and its partners. The partnership is taxed on its profits at the corporate income tax rate, which probably is lower than the individual partner's income tax rate. Thus, it may be more tax efficient for the partnership to accumulate profits after income tax given that the partners are no longer taxed on their individual portion of the partnership's profit, but only with respect to their withdrawals. Further, the partners' remuneration for services provided to the partnership, partners' loans or assets let to the partnership are no longer taxed as business income of the partnership, but as income from employment, interest income or rental income, respectively. The opt-in further results in an expiry of in particular the trading partnership's trade tax loss carry-forwards and with respect to the German interest barrier rule its interest carry-forwards and tax EBITDA carry-forward.

Assets legally owned by the partners, which were treated for income tax purposes as special business assets (*Sonderbetriebsvermoegen*) are at risk of being reclassified as privately-held assets, which would result in the partners being subject to income taxation on the difference between the fair market value of the assets and their book value.

Furthermore, such an opt-in will result in additional income taxes to be paid by the partners on the profits of the partnership accumulated under the special tax regime at a lower income tax rate.[667] In particular, if foreign partners hold an interest in a partnership that opts in, the tax consequences need to be carefully checked for potential classification conflicts.

A partnership is entitled to opt back into the partnership tax regime under the rules for the transformation of a corporation into a partnership. As previously stated, before doing so,

[664] Act to Modernize of the Law on Civil-Law Partnerships (MoPeG) of August 10, 2021, BGBl. 2021 I, 3436.

[665] AO, Secs. 14a, 39 as amended by the Secondary Credit Market Promotion Act (*Kreditzweitmarktförderungsgesetz*) of December 22, 2023, BGBl. 2023 I, No, 411, Art. 23.

[666] KStG, Sec. 1a as amended by the Growth Opportunities Act (*Wachstumschancengesetz*) of March 27, 2023, BGBl. 2024 I, No. 108.

[667] EStG, Sec. 34a.

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a lock-in period of at least seven years must be observed if the deemed transformation will not take place at fair-market value.

Furthermore, if only one partner is left, the deemed corporation will be deemed to be dissolved mandatorily.

After opting-in, the partnership is entitled to the benefits of tax treaties unless a domestic treaty-override provision applies, which in the case of an opted-in partnership with permanent establishments abroad in a tax treaty case could result in significant disadvantages to the partners, as the exemption method of the tax treaty does not apply at the partners' level, but only at the level of the opted-in partnership. Further qualification conflicts might arise in the foreign jurisdiction, unless the foreign jurisdiction follows the German opt-in methodology (unlikely). Further, a partnership qualifies as a controlling entity for purposes of consolidating the profits and losses of controlled subsidiaries (see V.B.10., above).

The Federal Ministry of Finance has issued a decree clarifying the tax authorities' views on the issues arising from the "check the box" regime.[668] Further developments should be closely monitored. Before opting-in, existing partnership agreements need to be checked to establish whether the arrangements will still be appropriate to the new tax situation after the option is exercised.

[668] BMF, decree of November 11, 2021, BStBl. 2021 I, 2212.

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VIII. Taxation of Resident Individuals

A. *In General*

Resident individuals are subject to unlimited tax liability (*unbeschraenkte Steuerpflicht*), which encompasses all items of income, whether derived from domestic or foreign sources.[669] In effect, unlimited tax liability encompasses the taxpayer's worldwide income, subject to certain exemptions provided for under German domestic tax law and under Germany's tax treaties.

B. *Tax Residence*

1. *Definition of Residence*

The "residence" for income tax purposes of an individual is established either by an actual residence or a customary place of abode. Citizenship is not relevant in determining German jurisdiction to tax an individual's income.[670] The term "residence" for this purpose is defined as the place where the individual occupies a residence under circumstances that indicate an intent to remain and not merely to use the residence temporarily. An individual may have more than one residence, and an individual who has residences within, as well as outside Germany, is considered to be a resident of Germany for German income tax purposes. No distinction is made between first and second residences. Intent is established only by external and recognizable facts, and not by declared or undeclared intention. Some of the more important factors in this respect are whether an individual moving to Germany brings his or her family with him or her, and whether the apartment or house that he or she owns or leases is furnished and equipped for his or her use. An individual ceases to be a resident if he or she leaves Germany in circumstances that indicate that he or she will not return. For practical purposes, it is helpful if the taxpayer can demonstrate that he or she has taken up residence elsewhere.[671]

Public officials and employees of German public authorities or bodies who are German citizens but who do not reside in Germany will be treated as German residents if they are taxed in their country of residence on income only from sources within that country.[672] The same applies to their dependents who do not derive income of their own or who derive only income that may be taxed exclusively in Germany.

"Customary place of abode" merely connotes physical presence for an extended period of time in circumstances that indicate the stay will not be temporary only. Once an individual's sojourn exceeds six months, the individual is irrefutably presumed to maintain a customary place of abode in Germany. The six-month period is not calculated on a calendar year basis, and once the sojourn exceeds six months, the customary place of abode is deemed to have existed since the beginning of the six-month period. This means, for example, that a stay from September 30, 2020 through April 3, 2021 would create an abode from September 30, 2020.[673]

Note: Tax treaty provisions regarding an individual's residence apply for purposes of the respective treaty only. If a tax treaty allows Germany to tax a certain item of income, the rules of German law determine whether an individual is considered to be a resident or a nonresident taxpayer.

An individual who moves to or from Germany in the course of a calendar year must file an income tax return as a resident taxpayer that includes income earned as a nonresident if and to the extent Germany is entitled to tax that income under its domestic tax law and, where applicable, under an applicable tax treaty.[674] This reflects an amendment enacted in 1996 to ensure that total taxable income is uniformly taxed at the progressive rate applicable to the total income of the year concerned.

2. *Elective Residency*

In certain instances, a nonresident individual may elect to be treated as a resident for German income tax purposes.

a. *Section 1(3) of the Income Tax Act*

A nonresident individual may apply for resident status with respect to his or her domestic-source income if at least 90% of his or her total income in the calendar year is taxable in Germany or if the income that is not subject to German income tax does not exceed 10,347 euros in the calendar year (2022).[675]

b. *Section 1a of the Income Tax Act*

Citizens of a European Union (EU) or European Economic Area (EEA) Member State (i.e., the European Union plus Iceland, Liechtenstein and Norway) who satisfy the criteria outlined in a., above can benefit from rules applicable to residents regarding certain allowances and may elect to be assessed jointly with their spouses.

C. *Determination of Gross Income*

1. *In General*

Income from all of the following sources is included in the gross income of resident individuals:[676]

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[669] The income taxation of individuals is governed by the provisions of the EStG. The EStG is supplemented by several regulatory ordinances (the EStDV, the *Lohnsteuerdurchfuehrungsverordnung* — LStDV and the EStR).

[670] Under the Foreign Tax Act (*Außensteuergesetz* — AstG), Secs. 2 *et seq.*, however, a German citizen who moves to a tax haven country is subject to a special regime with respect to certain income from German sources for the 10 calendar years following the move. A tax haven country generally is defined as a country in which the tax burden on a single taxpayer with a taxable income of 77,000 euros is more than one third lower than the German income tax on such income.

[671] According to NATO Status of Forces Agreement (*NATO-Truppenstatut*), Art. X(l)(1), military personnel and members of a civilian component of the NATO forces do not become residents solely because they are stationed in Germany but do qualify as residents if they stay in Germany for reasons other than being stationed in Germany. BFH decision of November 9, 2005, BStBl. 2006 II, 374.

[672] EStG, Sec. 1(2).

[673] Self-employed persons or wage-earners who work in Germany but reside in another country to which they return every day after work do not have a customary place of abode in Germany. BFH decision of August 10, 1983, BB 1984, 195; BStBl. 1984 II, 11; BFH decision of February 6, 1985, BStBl. 1985 II, 331; Federal Ministry of Finance, letter concerning the application of the General Tax Act (AEAO), Sec. 9 AO, annotation 2.

[674] EStG, Sec. 2(7).

[675] Tax Relief Act 2022 (SteuerentlastungsG 2022) of May 23, 2022, BGBl. 2022 I, 749.

[676] EStG, Sec. 2(1).

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(i) Agriculture and forestry;

(ii) A trade or business;

(iii) Independent personal services;

(iv) Services performed as an employee;

(v) The investment of capital;

(vi) The rental of immovable property and units of personal property, and royalties; and

(vii) Certain miscellaneous items (i.e., certain capital gains, annuities and other items of a recurring nature).

Receipts that do not fall within one of the categories listed above in (i) through (vii) are not taxable (for example, gifts, bequests and lottery gains).

Adjusted gross income from agriculture and forestry, business, or independent personal services is determined by deducting business expenses from gross receipts. Sole proprietors, and other taxpayers whose gross income from above categories (i) through (iii) or whose sales or net worth exceed certain amounts, are required to keep proper accounting records and to determine their net profits from these sources in accordance with proper accounting principles. In this respect, the accounting principles discussed at V.B.3., above, with respect to resident corporations apply. In certain circumstances, businesspersons and farmers may use a financial year that does not coincide with the calendar year. A businessperson may initially elect to use such a fiscal year if he or she is registered with the Commercial Register, but a later change from the calendar year to a different fiscal year must be cleared with the local tax office. No fiscal year may be longer than 12 months.[677]

Businesspersons with small businesses and professional self-employed individuals may determine their adjusted gross income for the calendar year on a cash basis, unless they maintain proper accounting records on a voluntary basis, in which case they must report their income on an accrual basis.[678] Taxpayers with a right to make the appropriate election may change the method of determining their gross income, subject to certain adjustments. This means, for example, that a cash basis taxpayer who switches to an accrual basis must capitalize accounts receivable for amounts owed to him or her but not yet paid at the date of the change-over.[679]

Adjusted gross income from employment, the investment of capital and rentals of property, and other income is determined on a cash basis per calendar year by reducing, with respect to each item of gross income, gross receipts by income-related expenses (*Werbungskosten*) that are incurred by the taxpayer to gain, protect or retain the source of such gross income. In lieu of itemizing "income-related expenses," a standard allowance may be claimed as if January 1, 2022 that varies in amount depending on the category of income, as follows: income from employment: 1,200 euros;[680] income from the investment of capital: 801 euros (married couples filing a joint return: 1,602 euros);[681] and income from annuities and other recurrent payments: 102 euros.[682]

2. *Business Income*

a. *Gross Income*

Business income includes:

(i) Profits from carrying on a business, including the commercial extraction of minerals and the creation of trading in crypto currency;[683]

(ii) The distributive share of a partner, including an atypical silent participant (see II.F.1.c.(6), above), in a partnership's profits;

(iii) Profits from the sale or closing down of an unincorporated business or a division of such a business;

(iv) Profits from the sale or exchange of a partner's interest in a partnership; and

(v) Profits from the sale of shares in a corporation by a taxpayer who owned, at any time in the five-year period before the sale, at least 1% of the corporation's stock.

Professional sportspersons, business consultants and models will be deemed to be engaged in a business activity unless they are classified as employees.

Business income also includes other types of income, such as interest, dividends, rentals, royalties and other income that are properly attributable to a business activity.

The transfer of the business of a sole proprietorship to a partnership is not considered to be a sale of the business if the transferor becomes a partner in the partnership and the book value of the assets and liabilities transferred is carried over to the partnership.[684] Likewise, the incorporation of an unincorporated business is not taxable if the transferor receives shares in the new entity in return and the book value of the assets and liabilities transferred remains unchanged.[685] While a gain from the sale of a sole proprietorship or a partner's interest is, in principle, taxable at ordinary rates, a reduced capital gains tax rate of 56% of the average ordinary tax rate of the taxpayer (which may not however, be less than 14%) is available for capital gains up to the amount of five million euros, provided the taxpayer is at least 55 years old or is permanently disabled under the rules of the social security system.[686]

Comment: This benefit is available only once in a lifetime. This means that a taxpayer who conducts more than one business may wish to merge the businesses prior to selling them to make use of the reduced tax rate for the full five million euros.

Profits from the sale of any shares in a corporation by a taxpayer who held the shares as a business asset are in principle taxed at the rate for ordinary income. However, as a rule, the taxpayer has to include in taxable income only 60% of the capital gain, which, in effect, means that the gain is taxed at 60% of the ordinary rate, unless the rollover provision of Sec-

[677] EStG, Sec. 4a and EStDV, Sec. 8b.

[678] EStG, Sec. 4(3).

[679] EStG, Sec. R 4.6.

[680] EStG, Sec. 9a(1)(a), as amended by the Tax Relief Act 2022 (SteuerentlastungsG 2022) of May 23, 2022, BGBl. 2022 I, 749.

[681] EStG, Sec. 20(4).

[682] EStG, Sec. 9a(3).

[683] BMF, decree of May 10, 2022, BStBl. 2022 I, 668.

[684] UmwStG, Sec. 24.

[685] UmwStG, Sec. 20.

[686] EStG, Sec. 34(3).

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tion 6b(10) of the Income Tax Act (*Einkommensteuergesetz* — EStG) applies.

The rollover provision permits taxpayers who are not subject to corporate income tax to rollover gains realized on the disposal of shares in corporations. The provision permits a rollover to the basis of replacement assets, which may be newly acquired shares in corporations, depreciable movable assets or buildings, but not real estate plots. The reinvestment must be made within two fiscal years following the year of disposal of the shares. In the case of a roll-over to buildings, this period is extended to four years following the year of disposal. The maximum amount of the reinvestment that can be rolled over in the fiscal year of sale and the following two years is 500,000 euros. The maximum amount that can be claimed depends on the kind of reinvestment. If the reinvestment is made in the form of buildings or depreciable movable assets, the maximum that can be claimed is 60% of the capital gain that would be taxable under the 60% exclusion system, but not more than 500,000 euros. If the reinvestment concerns newly acquired shares in corporations, the maximum amount that can be deferred is the full amount of the capital gain realized, but not more than 500,000 euros. If the reinvestment is not effected within the same fiscal year, a reserve can be set up and, as soon as the reinvestment is made, the reserve is dissolved, and the cost of the reinvestment decreased accordingly.

b. Business Expenses and Other Allowances

To the extent applicable, business expenses and other allowances of an individual's business are determined on the same basis as those of corporations.

3. Dependent or Independent Services

a. Employment Income

For income tax purposes, a taxpayer qualifies as an employee, and his or her remuneration for services rendered as income from employment, if the taxpayer is required to perform services for a principal, is integrated in the principal's business organization, and/or is subject to instructions given by the principal and does not bear typical entrepreneur's risks.[687] This is a topical issue not only in the income tax field but also in the field of social security dues as regards individuals who represent themselves as entrepreneurs but who will be classified as employees if they meet two of the following criteria:

(i) They do not employ the services of other employees (except for family members);

(ii) They regularly and essentially work for one party only;

(iii) They render services in the way that employees typically perform their work, i.e., they must abide by instructions issued by their principal regarding the time, duration, place and nature of their work; and

(iv) They do not hold themselves out as entrepreneurs in the marketplace.

[687] LStDV, Sec. 1.

(1) In General

Income from employment includes salaries, wages, bonuses, profit participations, and other remuneration or benefits for dependent services, whether paid in cash or in kind, including, in the case of foreign employees transferred to Germany, such benefits as housing allowances, foreign service allowances, educational allowances and income tax equalization allowances. If an employee participates in a stock option scheme, the difference between the quoted value and the strike price at the date on which the shares are booked out of the deposit of the employer also could constitute taxable income from employment.[688] The treatment is different if the employee pays fair market value for the shares, even if the offer concerned is addressed exclusively to employees, and this kind of business transaction establishes a special (tax) relationship between the employee and the employer. Where this is the case, the special relationship changes the tax treatment of the income that arises from it, which is no longer income from employment but income from capital investment. The latter is advantageous in the case of a gain on sale and disadvantageous in the case of a loss because of the special tax regime that applies to gains on sale, under which 40% of the gain/loss is exempt from income taxes.[689]

In addition, income from employment encompasses pensions and other benefits in consideration of past services received by a former employee or his or her surviving spouse or descendants, but an employee was able to claim an exclusion of 40% (subject to a limit of 3,900 euros per annum) with respect to such income until the end of 2004.[690] From 2005 until 2040, this exclusion is being gradually abolished as a result of a general change in the system for taxing retirement pensions.

Income from employment does not include the reimbursement of specific expenditure incurred on behalf of the employer (*Auslagenersatz*) or advances with respect to such expenditure.[691] Furthermore, the reimbursement of otherwise deductible business expenses (*Werbungskostenersatz*) referred to in Subsections (13), (16), (30), (31), and (32) of Section 3 of the Income Tax Act, especially service-connected moving expenses, travel allowances, severance payments paid by public funds, additional expenses incurred as a result of maintaining two households and the employer's share of mandatory social security contributions, are excluded from taxable income. Overtime payments can be excluded up to specified maximum amounts provided they relate to services rendered on Sundays or legal holidays, or during night shifts.[692] An employee entitled to use a company car for personal use must include in taxable income imputed income amounting to 1% of the gross list price of the car per month plus 0.03% of such list price per kilometer of distance between the employee's residence and the place where the work is performed.[693] With a view to promoting electric mobility, this imputed income is reduced in the case of electric

[688] BFH decision of June 20, 2001, BStBl. 2001 II, 689.

[689] EStG, Sec. 3 no. 40.

[690] EStG, Sec. 19(2).

[691] EStG, Sec. 3 no. 50.

[692] EStG, Sec. 3b.

[693] EStG, Sec. 8(2).

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vehicles or externally chargeable hybrid cars used as company cars.[694]

In determining his or her adjusted gross income from employment, an employee may deduct income-related expenses, such as commuting expenses, and the costs of employment-related clothes, tools, books and periodicals, provided the costs were borne by the employee; without any further proof of such income-related expenses, a lump-sum amount of 1,230 euros (2023) is deducted from the gross salary income.[695] An employee who commutes to his or her place of work using his or her own car or public transport, or even if he or she walks to work, may claim an allowance for the first 20 kilometers of 0.30 euros per kilometer of distance between his or her house and place of work for one trip a day for the first 20 kilometers; thus, the allowance compensates only for a one-way trip to the place of work, but not for the return journey. For each kilometer exceeding 20 kilometers, the employee may claim an allowance of 0.38 euros for the years 2022 to 2026. This is intended to mitigate the extra burden of climate taxes on gasoline. The total allowance claimed by an employee may not exceed 4,500 euros per annum, except where the employee uses his or her own car or a car made available to him or her by the employer.[696]

(2) Withholding (Source) Tax

Employment income is generally subject to withholding of income tax at source.[697] An employer is required to withhold and pay over "wage tax" (*Lohnsteuer*) to the tax authorities. An employer that fails to withhold in the correct manner may become liable for the tax.

Note: A foreign employer is responsible for withholding the wage tax of his or her employees performing services in Germany if the employer has a permanent establishment (PE) or a permanent representative in Germany.[698] Tax treaties do not affect this secondary tax liability of an employer, but withholding may be avoided if the remuneration of a nonresident employee is exempt from German tax under the terms of an applicable treaty and the employer or the employee obtains a certificate to that effect from the local tax office.[699]

Wage tax is calculated based on tables that take into account the blanket deductions for income-related expenses and special expenses. Certain actual expenses in excess of blanket amounts may be taken into account on application. Generally, an employee's individual income tax liability is finally settled by the wage tax, subject to a claim for refund after the close of the calendar year if the employee is able to claim additional allowances or if, for any other reason (for example, dual employment), the wage tax withheld exceeds the tax actually due. However, an assessment is mandatory in a number of instances enumerated in Section 46(2) of the Income Tax Act. Also, an employee may request an assessment for purposes of claiming losses from other sources, loss carryforwards or tax credits.

[694] EStG, 6(1) no. 4: Discounted rates granted to CO_2 efficient hybrid and full electric cars.

[695] EStG; 9a.

[696] EStG, Sec. 9(1), as amended by the Tax Relief Act 2022 (SteuerentlastungsG 2022) of May 23, 2022, BGBl. 2022 I, 749.

[697] EStG, Secs. 38 *et seq.*

[698] EStG, Sec. 38(1).

[699] EStG, Sec. 39(4); LStR, Sec. R 39b.10.

b. Independent Services

Income from independent services includes income from professional services (including scientific, artistic, musical, and literary activities exercised in an independent capacity) and other independent activities, for example, the activities of an executor of a decedent's estate or those of a member of a supervisory board of a corporation. Professional sports-persons are, however, deemed to be engaged in a business activity unless they qualify as employees.

In determining adjusted gross income from professional services, taxpayers may deduct their business expenses.

c. Relief Provisions

(1) Back Pay

An employee or an individual rendering independent personal services who receives in a single taxable year compensation for work performed over a period of several years during which he or she was a German resident may apply a computation that has the effect of spreading the income over five years.[700]

For purposes of computing the tax due, the income tax in the year of receipt after deduction of the back pay must first be determined. Then, the income tax on the other taxable income plus one-fifth of the back pay must be determined and subtracted from the tax as first computed. The resulting difference is then multiplied by five. There are no amended tax assessments for the other years.

(2) Termination Pay

The exemptions regarding the taxation of termination pay were abolished with effect from January 1, 2006.

4. Capital Investments

There is a general savings exemption of 1,000 euros per year for a taxpayer filing an individual return and of 2,000 euros for a couple filing a joint return.[701]

a. Interest

Interest received with respect to loans and debt securities is generally taxed as income from capital investment. As regards taxability, no distinction is made between private loans and bank deposits, savings accounts, and loans represented by securities. Taxable interest includes discounts on notes and bills of exchange and other payments, and benefits granted in addition to or in lieu of interest proper. It also includes remuneration for making available funds if the debtor is committed to repaying those funds or if a consideration for the use of the funds has been stipulated, even if the amount of the consideration depends on a condition precedent.[702]

As of 2009, gross interest income and capital gains, including redemption gains, with respect to debt instruments acquired by a taxpayer on or after January 1, 2009 are taxable at a flat tax rate of 25% plus a 5.5% income tax surcharge and

[700] EStG, Sec. 34.

[701] EStG, Sec. 20(9).

[702] EStG, Sec. 20(1) no. 7.

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church tax, if applicable, unless the interest income and/or the said capital gains form part of the individual's income from agriculture and forestry, business income, income from independent personal services or rental income. In the latter cases, the interest income and the said capital gains are subject to the individual's respective income tax rate and — fully creditable — withholding tax of 25% (plus 5.5% income tax surcharge). If the interest income and the said capital gains are subject to the flat tax rate, such income does not need to be reported by the taxpayer and is no longer included in the tax assessment of income and no longer subject to the progressive tax rates.

b. Withholding Tax

If interest is subject to withholding tax, it is imposed at the regular rate of 25% plus the 5.5% income tax surcharge. This rate equals the flat tax rate.

(1) Withholding Agents

The withholding agent is the person that pays or credits the interest payment. Usually, it is the domestic bank that owes the interest, except that the debtor has the duty of a withholding agent in the case of a securitized loan if the interest is not paid or credited by a domestic bank. This means that, in the case of simple loans (in particular, shareholders' loans), a domestic debtor is not required to withhold the tax unless it qualifies as a domestic bank.

(2) Exemption

Nonresident taxpayers are subject to German tax only on German-source income from the sources listed in Section 49(1) of the Income Tax Act. As a rule, nonresidents are not subject to German tax on interest income from German sources. One exception pertains to interest paid or credited by a debtor or a domestic bank on the physical delivery of interest coupons if the underlying bonds representing a part of the issue are not deposited with that debtor or bank.[703] There are two alternative procedures for securing an exemption from German tax in these circumstances:

(i) The withholding agent may pay the interest gross (i.e., without deducting the withholding tax), if the creditor gave a foreign address when he or she identified himself or herself for purposes of opening a deposit account. Similarly, if the account is in the name of a foreign bank, the withholding tax is not imposed.

(ii) If, for whatever reason, the withholding tax was deducted, the withholding agent can claim a refund from the local tax office.[704]

c. Dividends

(1) In General

A distribution in cash or in kind made by a resident or nonresident corporation with respect to its shares of stock is taxable as a dividend irrespective of whether the distribution was made out of current or accumulated profits, provided (in the case of a resident corporation) the dividend is deemed to be paid out of equity available for distribution, with the exception of a distribution that is deemed to have been made out of the paid-in surplus account. In other words, a payment made by a corporation with respect to its shares will only qualify as a return of capital and not a dividend if the distribution is made out of stated equity capital or the paid-in surplus account. These rules also apply to distributions made pursuant to a plan of liquidation or a reduction of the stated equity capital adopted in accordance with the provisions of company law. Only distributions of the latter category that exceed the basis of the underlying shares may give rise to a taxable capital gain in the form of a gain on the sale of a share interest governed by Section 17(1) of the Income Tax Act (see VIII.C.5.c., below) or a private capital gain (see VIII.C.5.b., below).

As of 2009, gross dividend income is taxable at a flat tax rate of 25% plus a 5.5% income tax surcharge and church tax, if applicable, unless the dividend income forms part of the individual's income from agriculture and forestry, business income, income from independent personal services or rental income. In the latter cases, only 60% of the dividend income is subject to the individual's respective income tax rate, while 100% of the dividend income is subject to — fully creditable — withholding tax of 25% (plus 5.5% income tax surcharge). If the dividend income is subject to the flat tax rate, such income does not need to be reported by the taxpayer and is no longer included in the tax assessment of income and no longer subject to the progressive tax rates.

Foreign dividend withholding tax imposed with respect to dividends from foreign corporations is also fully creditable up to a maximum amount of 25%.[705]

The withholding tax is also applied to distributions of retained earnings.

(2) Constructive Dividends

Constructive dividends from resident corporations are taxable in the hands of the recipient as income from capital investment and are subject to withholding tax. Constructive dividends distributed by nonresident corporations are also taxable. For the definition of a constructive dividend, see V.B.2.b.(1), above.

(3) Stock Dividends

No gain is recognized in the hands of a shareholder receiving stock dividends that have been declared pursuant to the provisions of a special statute.[706] The shareholder is required, however, to allocate the cost basis of the old shares to the old and new shares in proportion to the relative par values of the shares. Stock dividends are defined as the receipt of newly issued shares resulting from a conversion of paid-in surplus into stated capital.

A corporation wishing to issue stock dividends may do so only out of reserves that were shown as reserves in the financial statements for the preceding fiscal year, so that current income cannot be used to declare a stock dividend. If the corpo-

[703] EStG, Sec. 49(1)(5)(d).
[704] EStG, Sec. 44b(5).

[705] EStG, Sec. 32d(5).
[706] Law on Tax Measures in the Event of an Increase in Nominal Capital from Company Funds (*Gesetz ueber steuerrechtliche Massnahmen bei Erhoehung des Nennkapitals aus Gesellschaftsmitteln* — KapErhStG) of October 10, 1967, as amended.

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ration does not comply with these specific provisions for tax-free stock dividends, the shareholder is presumed to have received a (constructive) taxable dividend and simultaneously to have reinvested the amount of the dividend in the corporation.

The same rules apply to stock dividends distributed by foreign corporations to resident shareholders, provided the stock dividends are issued in a way that is substantially in accordance with the rules applicable to stock dividends distributed by German corporations.[707] Whether stock dividends issued by a foreign corporation qualify for tax deferral is usually published in tax rulings.

(4) Investment Funds

Since January 1, 2018,[708] investment funds — other than specialized investment funds — have essentially been taxed in a manner similar to corporations (opaque tax regime). In addition, investors are subject to a second level of taxation. Both domestic and foreign investment funds are subject to German corporate income tax at a rate of, currently, 15% plus 5.5% income tax surcharge on their domestic source income (in particular, dividends from German corporations, rental income and capital gains on the sale of domestic real estate). If the fund maintains a German PE, such income is also subject to trade tax. Capital gains from the disposal of shares in a German corporation are not subject to taxation at the level of an investment fund. Unlike a corporation, an investment fund is not entitled to the 95% tax exemption for dividends received.

Investors are taxed on: (i) distributions received from the investment fund; (ii) capital gains from the disposal of interests in the investment fund; and (iii) an advance lump-sum amount (*Vorabpauschale*) equal to 70% of the basic interest rate multiplied by the redemption price of the fund units at the beginning of each calendar year. The advance lump-sum amount is capped at the amount of the increase in value of the fund units during the calendar year.

To mitigate double taxation at the level of the investment fund and the level of the investors, a partial exemption regime applies at the level of the latter. The rate of exemption depends on the type of investor and the type of investment fund, i.e.:

(i) In the case of stock funds (i.e., funds investing at least 51% of their assets in stocks), the general exemption rate is set at 30% (60% for business investors subject to income tax and 80% for institutional investors subject to corporate income tax);

(ii) In the case of mixed funds (i.e., funds that invest at least 25% of their assets in stocks), half of the exemption rates for stock funds apply;

(iii) In the case of German real estate funds, the exemption rate is set at 60% and in the case of foreign real estate funds at 80%; and

(iv) For trade tax purposes, only 50% of the relevant exemption rate applies.

(5) Participation Certificates

Participation certificates (*Genussscheine*) issued by corporations to shareholders and other persons for various purposes (for example, as compensation for services rendered as incorporators or for the waiver of a shareholder's loan) are taxed as income from capital investment. Distributions with respect to a participation certificate qualify as dividends if the certificate represents an equity interest.[709] This is deemed to be the case if the holder is entitled to share in both the profits and the liquidation proceeds of the issuer. In all other cases, the remuneration paid will be treated as interest.

(6) Real Estate Investment Trusts

The real estate investment trust (REIT) was introduced in Germany with effect from January 1, 2007. German REITs are tax-exempt provided they meet various requirements, including distributing at least 90% of their annual distributable profits. Distributions are taxed as dividends but do not benefit from the 40% dividends-received exclusion.

5. Capital Gains

a. In General

Gains from the sale or other exchange of nonbusiness capital assets are includible in taxable income only if they are private capital gains, gains from the sale of shares in corporations under Section 17 of the Income Tax Act, or gains from securities and other capital assets.

Capital gains from the sale of shares in corporations under Section 17 of the Income Tax Act benefit from the "partial income regime", with the result that an individual taxpayer includes in gross income only 60% of such capital gains. Capital gains under Section 17 are, however, reclassified as dividend income to the extent they are paid out of capital available for distribution, except where the payment constitutes the repayment of stated equity capital or paid-in surplus. If a capital loss is realized, only 60% of the loss is allowable as a deduction.

Capital gains arising from the disposal or liquidation of a sole proprietorship, a separable part of a business (including a 100% share interest in a corporation) or an entire partnership interest are taxed at 56% of the average tax rate applicable to the individual taxpayer on up to a gain of 5 million euros if the taxpayer is at least 55 years of age or permanently disabled according to the rules of the social security system. The tax rate may not, however, be lower than 14% and the preferential treatment can be claimed by a taxpayer only once during his or her lifetime.[710]

b. Private Capital Gains

Private capital gains include gains from the sale of real property held for 10 years or less and of personal property (for example, an art collection or crypto currency)[711] held for 12 months or less or sold before acquisition (short sales).[712] Since January 1, 2009, capital gains on all securities (except a partic-

[707] KapErhStG, Sec. 7.

[708] InvStRefG, of July 19, 2016, BGBl. 2016 I, 1730, as amended.

[709] EStG, Sec. 20(1) no. 1.

[710] EStG, Sec. 34(3).

[711] BMF, decree of May 10, 2022, DStR 2022, 992.

[712] EStG, Sec. 23(1).

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ipation of at least 1% held as a private asset in a corporation's share capital, see c., below) bought and sold after December 31, 2008, have been taxable at a flat tax of 25% plus income tax surcharge of 5.5% and church tax, if applicable, the tax usually being withheld by the deposit bank, regardless of the duration of the holding period. The term also encompasses gains on futures transactions that are to be settled by payment of the difference, rather than physical delivery, such gains being subject to tax at the ordinary rates, unless the amount of the gains is less than 1,000 euros per annum, in which case the gains are tax-free.[713] Capital losses on private transactions may be set off against private capital gains from similar transactions in the same year, and excess losses may be carried back to the previous year or carried forward indefinitely. In determining the holding period, the holding period of a predecessor is added to the holding period of the successor, if the transfer from the predecessor was a transfer by reason of death, a gift or any other transfer for no consideration.

c. *Sales of Shares*

Gains from the sale or other disposal of shares in a domestic or foreign corporation held as a private asset qualify as business profits if the seller, at any time during the five years preceding the sale, directly or indirectly owned a participation of at least 1% in the share capital of the corporation.[714]

> *Example:* A owns a 0.5% share interest in X GmbH directly and a 50% interest in Y GmbH, which, in turn, holds 1% of the shares in X GmbH. A meets the tests for the application of Section 17 of the Income Tax Act as his total direct and indirect shareholding in X GmbH amounts to 1%. Therefore, a capital gain arising to A from the sale of his direct 0.5% share interest would be taxable under Section 17.

Such a capital gain qualifies for the 40% exclusion under Section 3 No. 40(c) of the Income Tax Act. This means that 60% are subject to the individual's progressive tax rate.

Gains must also be recognized where shares are contributed to another corporation.

D. *Calculation of Taxable Income*

1. *In General*

Having determined adjusted gross income from all the relevant categories of gross income listed at VIII.C., above, a taxpayer must aggregate the income from the various categories to compute his or her total adjusted gross income. Consequently, losses incurred with respect to one or more categories of gross income may be used to reduce other items of gross income derived during the same calendar year (subject to certain exceptions and limitations).

The carryback of losses to the previous taxable year is generally limited to one million euros in the case of an individual taxpayer and to two million euros in the case of a married couple filing a joint return. Tax losses can be carried back to the two previous years.[715] Excess losses may be carried forward, subject to limitations. As a consequence of the minimum tax imposed under Section 10d(2) of the EStG, the amount of losses carried forward that may be used in the current year is limited to one million euros in the case of an individual taxpayer and two million euros in the case of a married couple filing a joint return. Excess losses carried forward can be used only to the extent of up to 70% of profits for the years 2024 to 2027, before the limit drops to 60% again for years after 2027.[716] These more favorable loss carryforward rules do not apply for trade tax purposes.[717]

Losses from investments in "tax deferral models" cannot be used to offset positive income from another category and can only be carried forward to offset positive income from the same source. A "tax deferral model" is deemed to exist where tax advantages will be gained from a ready-made model arrangement that purports to offer investors the opportunity to set off losses against other income. A tax advantage for this purpose exists if, in the starting phase of the arrangement, the proportion of forecast losses expressed as a percentage of invested capital exceeds 10%.

Total adjusted gross income may be further reduced by "special expenses," loss carryforwards and expenses attributable to extraordinary hardships, to arrive at taxable net income.

2. *Special Expenses*

Special expenses (*Sonderausgaben*) are expenses not connected with any specific category of gross income. Instead, such expenses are allowable as a matter of social policy and relate to personal or family costs. Special expenses must be itemized if they exceed the standard allowances provided for under Section 10c of the Income Tax Act.

The deductible special expenses include:[718]

(i) Insurance premiums, up to certain maximum amounts;

(ii) School fees, up to certain maximum amounts;

(iii) Expenses incurred for professional training, up to certain maximum amounts;

(iv) Church tax paid; and

(v) Contributions for charitable, religious or scientific purposes.[719] These are deductible up to a maximum of 20% of total adjusted gross income or 0.4% of total sales and payroll. Where such contributions are made to a foundation, an additional amount of up to 1 million euros per 10-year period (two million euros for spouses filing joint returns) is deductible.[720] In the case of a contribution-in-kind, it is the fair market value of the contribution that is taken into account. If the asset contributed has been withdrawn from the taxpayer's business assets immediately before the contribution, the deductible amount may not exceed the amount recognized as withdrawn. Also, contributions to a

[713] EStG, Sec. 23(3).
[714] EStG, Sec. 17(1).
[715] EStG, Sec. 10d (1).
[716] EStG, Sec. 10d(2).
[717] GewStG, Sec. 10a.
[718] EStG, Sec. 10.
[719] EStG, Sec. 10b.
[720] EStG, Sec. 10b(1a).

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political party of up to 1,650 euros per year (3,300 euros for spouses filing joint returns) may be deducted.[721]

3. Hardship Allowance

A taxpayer who incurs personal expenses that are unusually burdensome and that he or she cannot avoid may claim a special hardship allowance (*aussergewoehnliche Belastungen*). To qualify, the expenses must exceed a certain percentage of the taxpayer's total adjusted gross income. For example, such relief may be granted for extraordinary medical bills. These hardship allowances are limited to the unreasonable burdens according to the individual's personal background reflecting the individual's income situation and number of children.[722]

4. Family Allowances

a. Child Support

A dual system combining direct subsidy payments with child allowances addresses the costs of child support.

(1) Child Benefit

As an alternative to the child allowance discussed in VIII.D.4.a.(2), below, the Federal Government will pay a child benefit. For 2024, the amount of the allowance was 250 euros per month, per child for all families. For 2025, this has been increased to 255 euros per child and for 2026 will be increased to 259 euros per child.[723]

(2) Child Allowance

As an alternative to the child subsidy described in VIII.D.4.a.(1), above, a child allowance of 6,612 euros (2024), each per child and per year is available to parents filing a joint return. This has been increased to 6,672 euros for 2025 and will be increased to 6,828 euros for 2026. Parents filing separate returns can claim an allowance of 3,306 per child per year for 2024. This has been increased to 3,336 euros for 2025 and will be increased to 3,414 euros for 2026.[724] As part of the income tax assessment, the tax authorities examine whether the child subsidy payments were sufficient to provide the same effect as the child allowance and apply the more advantageous measure. Further, an allowance for care and education or training needs is granted in the amount of 1,464 euros or 2,928 euros per child, depending on whether the parents file their tax returns separately or jointly.

b. Old Age Exemption

A taxpayer or a taxpayer's spouse who turns 65 before the beginning of the taxable year may claim an exemption, for that taxable year and subsequent taxable years, for a portion (12.8% in 2024) of income from wages and total adjusted gross income (excluding income from dependent services and the pensions and related benefits referred to in Section 24a(2) of the Income Tax Act) up to a specified maximum amount per year (608 euros in 2024).[725] The exemption is calculated before the deduction of special expenses and expenses attributable to extraordinary hardship. The exemption is doubled for a husband and wife filing a joint return. As a result of major changes to the system of old age income taxation, the old age exemption is being gradually phased-out and will be abolished by 2058.

E. Tax Rates

1. Standard Tax Rates

The income tax rates range from 14% on the taxable income of an individual in excess of the standard exemption of 11,784 euros in 2024 (12,096 euros in 2025 and 12,348 euros in 2026) to a maximum of 45% (plus income tax surcharge of 5.5% and church tax, if applicable) on taxable income over 277,826 euros (unchanged since 2022).[726] The threshold amounts are doubled for spouses filing a joint tax return.

Note (1): Special withholding rules apply to employment income and estimated tax payments to ensure that individuals whose income is below the minimum threshold are not taxed.

Note (2): Since January 1, 2021, the income tax surcharge has applied to individuals subject to income tax only if their income tax exceeds a certain minimum amount (18,130 euros or 36,260 euros for taxpayers filing joint returns for 2024 and 19,950 euros and 39,900 euros, respectively, for 2025); similar thresholds apply to wage taxes withheld on behalf of individuals (except flat-rate wage taxes). The income tax surcharge, however, still applies to income tax exceeding these threshold amounts, withholding taxes and corporate income taxes.[727] The limited number of cases in which the income tax surcharge is still imposed are discussed in XVII., below.

2. Preferential Tax Rates

a. Capital Gains

An individual taxpayer realizing capital gains on the disposal of a business, an interest in a partnership operating a business, an independent services operation or an interest in a partnership operating an independent services business may be entitled to a preferred tax rate on the capital gains up to an amount of five million euros. The preferred tax rate equals 56% of the taxpayer's average income tax rate and may be claimed only once in a taxpayer's lifetime. The seller must have attained the age of 55 years in the year of disposal or be permanently incapable of carrying on an occupation.[728]

b. Retained Profits

An individual taxpayer earning income from a business or from independent services may elect to apply a flat tax rate, set at 28.25%, on some or all of his or her retained profits.[729] If the retained profits are subsequently withdrawn from the business, an additional tax charge of 25% of the amount withdrawn aris-

[721] EStG, Sec. 10b(2).
[722] EStG, Sec. 33.
[723] EStG, Sec. 66.
[724] EStG, Sec. 32(6).
[725] EStG, Sec. 24a.
[726] EStG, Sec. 32a, as amended by the Tax Relief Act 2022 of May 23, 2022, BGBl. 2022 I, 749.
[727] Law on the repayment of the solidarity surcharge 1995 (*Gesetz zur Rueckfuehrung des Solidaritaetszuschlags 1995)* of December 10, 2019, BGBl. 2019 II, 2115.
[728] EStG, Sec. 34(3).
[729] EStG, Sec. 34a.

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es. Accordingly, the lower rate of 28.25% is granted only temporarily.

Comment: Because of its very tight preconditions and high level of complexity, this special tax regime for retained earnings has not become very popular and has been subject to reform considerations since its inception. Furthermore, difficulties could arise if the partnership with respect to whose retained earnings an individuals is claiming the application of the flat rate opted to be subject to the corporate income tax regime, which would result in the partnership being deemed to transform into a corporation under the Transformation Tax Act. The Growth Opportunities Act provides for some easement regarding the privileged pre-tax profits, but it worsens the tax treatment of accumulated profits. Thus, the new rules result in a deferred taxation only, but do not result in a less complex system or in a reduced overall tax rate.[730]

F. Assessment and Filing

Income tax is usually levied by way of assessment, but income from employment and certain income from capital investment is taxed by way of withholding at source. Tax withheld at source is creditable against an individual's total assessed tax liability.[731] Married partners who are both German residents may elect to be assessed jointly, in which case an income splitting system applies (even when one partner has no income) under which the income tax payable is twice the amount that would be payable on half of the joint income.[732] Losses of one partner may be set off against gains of the other partner.

As in the case of resident corporations, in principle, tax returns must be filed no later than July 31 of the year following the taxable calendar year, unless they are prepared by a tax adviser or extensions are granted. The tax is payable within one month of the receipt by the taxpayer of a notice of assessment. The time limit for filing 2023 tax returns was extended to September 2, 2024 and to June 2, 2025 for returns prepared by a professional advisor.[733] Further extensions may be granted on application. Where a tax return is filed late, an addition of 0.25% per month of the tax due is charged (as reduced by the quarterly prepayments), subject to a maximum of 25,000 euros.[734]

A taxpayer must make quarterly payments of estimated tax on March 10, June 10, September 10 and December 10 of each year.[735] These payments are fixed by the local tax office based on the preceding tax assessment, unless substantial increases or reductions in taxable net income are anticipated. A taxpayer who commences business operations or an activity involving the provision of independent personal services must notify the local tax office within one month of the date of commencement. On receipt of this notification, the tax office will request information regarding the anticipated profits to enable it to fix the estimated tax payments.

Like those of corporations, the tax returns of sole entrepreneurs and sole independent service providers are subject to audit by the tax authorities. Other individual taxpayers are audited only in exceptional circumstances.

Individuals and corporations are subject to the same set of provisions concerning the statute of limitations and the collection of taxes (see V.B.12.d., above).

G. International Secondment

The tax status of an employee working abroad depends on whether the employee retains German resident status. (For the tax status of nonresident employees, see IX.C.1., below.)

An employee who is assigned to a job abroad on a temporary basis and retains his or her apartment or home in Germany remains a resident for German tax purposes even if his or her stay abroad lasts for more than two years.[736] As a resident, such an employee remains subject to German income taxation with respect to his or her salary earned abroad, unless an applicable tax treaty provides for an exemption. Most of Germany's treaties provide an exemption for remuneration for services rendered in the treaty partner country. In principle, the taxation right remains with Germany only if the stay exceeds 183 days during a 12-month period, and if the remuneration is borne by the German employer in Germany and not by a PE of the German employer in the treaty partner country. This exemption from German income tax is subject to a German domestic law treaty-override according to which the exemption requires the taxpayer to provide evidence to the effect that either the treaty partner country does not exercise its taxation right (resulting in an exemption in both countries) or that the taxpayer has paid foreign tax on the salary.[737]

If there is no applicable tax treaty, remuneration for services rendered abroad for a German distributor, manufacturer or contractor can be received free of German income tax if the assignment is for at least three months (the assignment does not have to be at the same site or in the same country) and certain other requirements are met.[738]

[730] EStG, Sec. 34a as amended by the Growth Opportunities Act (*Wachstumschancengesetz*) of March 27, 2023, BGBl. 2024 I, No. 108, Art. 3.

[731] EStG, Sec. 36(2).

[732] EStG, Sec. 32a(5).

[733] Fourth Act Implementing Tax Relief Measures to Address the Corona Crisis (Corona Tax Relief Act IV), BGBl. 2022 I, 911, Art. 6.

[734] AO, Sec. 152.

[735] EStG, Sec. 37.

[736] BFH decision of May 17, 1995, file no. I R 8/94, BStBl. 1996 II, 2.

[737] EStG, Sec. 50d(8).

[738] EStG, Sec. 34c(5); BMF, decree of October 31, 1983, BStBl. 1983 I, 470.

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IX. Taxation of Nonresident Individuals

A. In General

Nonresident individuals are subject to limited tax liability (*beschraenkte Steuerpflicht*), which covers only certain items of income derived from German sources. These are enumerated in Section 49 of the Income Tax Act (*Einkommensteuergesetz* — EStG) and are, *inter alia*, as follows:

(i) Profits from agriculture and forestry carried on in Germany.

(ii) Commercial or industrial profits derived:

- Through a permanent establishment (PE) situated in Germany or a permanent representative located in Germany.
- Through the operation of sea vessels and aircraft used in domestic and cross-border traffic.
- From gains from a sale or exchange of shares, if a shareholder holds or, at any time during the five years prior to the sale, has held a qualifying interest (now reduced to at least 1%) in the shares of a resident corporation (see VIII.C.5.c., above) or in a nonresident corporation to the extent that more than 50% of the share value is based at any point during the 365 days preceding the disposal on domestic immovable property. While Germany is usually prevented from taxing the gains from the sale of shares held in a resident corporation where a tax treaty applies, most of Germany's modern treaties provide allow Germany to tax a foreign shareholder of a corporation that holds sufficient immovable property in Germany.
- From the performance or exploitation of services as an artist, athlete or entertainer in Germany, or from similar services performed or exploited in Germany irrespective of the person to whom the income accrues, to the extent the income is not classified as income from dependent or independent personal services.
- From renting or disposing of domestic immovable property that is either situated in Germany or registered in a public domestic register or exploited in a domestic PE or other establishment.
- From renting or disposing of rights that are registered in a public domestic register or exploited in a domestic PE or other establishment.
- From other activities referred to in Section 49(1) no. 2 of the Income Tax Act.

(iii) Income from independent personal services performed or exploited or carried out through a fixed establishment in Germany.

(iv) Compensation from employment if the relevant services are performed or exploited in Germany, and compensation paid out of German public funds (including the funds of the *Bundeseisenbahnvermoegen* and *Deutsche Bundesbank*) with regard to a current or former employment.

(v) Compensation from acting as managing director of a corporation that has its place of management in Germany.

(vi) Severance payments for the termination of an employment to the extent compensation received for the previously rendered services was subject to German income tax.

(vii) Compensation from employment performed on board an aircraft engaged in international traffic operated by an enterprise that has its place of management in Germany.

(viii) Dividends paid by resident corporations.

(ix) Interest on convertible bonds, income bonds or participation certificates if the debtor has his or her domicile, statutory seat or principal place of management in Germany; interest paid with respect to claims secured by German real property; and interest on certain coupons presented to a bank in Germany, if the underlying bond certificates are not deposited with the bank.

(x) Rental income from domestic real property or certain equipment, or intangible property situated in Germany or registered in a German public register or used in a PE or other facility in Germany.

(xi) Capital gains from the sale of German real property held as a private investment asset unless the property was held for a period of more than 10 years.

(xii) Pension income from specific German sources and income from the performances of entertainers in Germany.

B. Business Income

Under German domestic tax law, the business income of a nonresident individual includes profits from the operation of a German PE and profits derived through the activities of a German permanent representative. Under the terms of Germany's tax treaties, a nonresident individual has to have a PE in Germany for business profits to be subject to German tax. The definition of a PE under Germany's tax treaties is narrower than that applied under German domestic tax law, although there are differences from treaty to treaty, since not all Germany's treaties conform to the Organisation for Economic Cooperation and Development (OECD) Model Convention, which, in addition, is itself revised from time to time (the current version is from November 21, 2017).

Example (1):

(i) Under German law, a purchasing outlet, the maintenance of a stock of merchandise or a liaison office will normally constitute a PE. Such activities are specifically excluded from the definition of a PE under Article 5(4) of the OECD Model Convention of 2017, provided the activities are of a preparatory or auxiliary character and the enterprise does not maintain at the same place or at another place a PE with both establishments being part of a cohesive business operation.

(ii) Under German law, a building site constitutes a PE if it lasts for more than six months. Article 5(3) of

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the OECD Model Convention requires a duration of more than 12 months.

(iii) Under German law, an agent who consistently solicits orders on behalf of a foreign principal, without having the authority to bind the principal, already constitutes a permanent representative and exposes his or her principal to German income taxation. Under most of Germany's tax treaties,[739] the agent must have the authority to conclude contracts in the name of its principal to constitute a PE.

If a PE or permanent representative is found to exist in Germany under both the applicable tax treaty and the domestic standard, all income properly allocable to the PE or permanent representative may be taxed in Germany. As German tax law does not recognize source rules such as the passage-of-title test or the place of conclusion of the contract test, all profits derived through the activities of a German PE, even if they relate, for example, to sales in third countries, are allocable to the PE.

Example (2): The German branch of a U.S. bank must include in its taxable income interest received with respect to a loan it has extended to a U.S. borrower, provided the loan receivable is to be attributed to the German branch under Section 1(5) of the Foreign Tax Act (*Aussensteuergesetz* — AstG) (which incorporates the Authorized OECD Approach (AOA)).[740]

Nonresident professional athletes, artists, entertainers and individuals putting on personal performances who do not qualify as employees are deemed to be engaged in business activities under German domestic law.[741] Income from the performances of such individuals staged or exploited in Germany can be taxed in Germany irrespective of whether the income is paid (or payable) to the taxable individual himself or to another party (such as a company that employs the services of the individual and contracts with the promoter to make the individual's services available for the event), and irrespective of whether the individual (or other party) maintains a PE or permanent representative in Germany. The party that owes the remuneration to the nonresident must collect the tax by way of withholding at the rate of 15% of the gross remuneration plus 5.5% income tax surcharge where the income amounts to 250 euros or more per performance.[742]

C. Personal Services Income

1. Employment Income

Income of a nonresident individual from services rendered to a private employer is considered to be income from German sources if the services are performed or exploited in Germany.[743] If the employer is the German government or a German government agency, such income is in any case considered to be derived from German sources.[744] Services rendered abroad are considered to be exploited in Germany only if the result of the services rendered abroad is contributed to the employer by the employee in Germany. Thus, for example, the services of the local ground staff of a German airline in the Bahamas were not taxable because they were not exploited by the airline in Germany.[745]

Generally, Germany's tax treaties permit the imposition of German taxes with respect to income from employment only if the nonresident employee actually renders services within Germany.[746] Also most of Germany's treaties provide for the exemption of such compensation from German income tax if the employee's stay in Germany does not exceed 183 days during the calendar year and the compensation is paid by a foreign employer and not charged to a German PE maintained by the foreign employer. A nonresident individual or his or her employer must claim an exemption under a treaty by filing an application with the competent local tax office.[747]

If an applicable tax treaty permits it to be taxed in Germany or if there is no applicable treaty, income from employment derived by a nonresident individual is taxed by withholding at source. In the case of artists, professional athletes, writers and journalists, remuneration paid with respect to dependent services that is not tax-free under the terms of a tax treaty is distinguished from business income from such services (see B., above), and is subject to wage tax at the regular progressive rates; the employee's income tax liability is deemed to have been settled when the withheld wage tax is paid.[748] The term "dependent services" refers to the services of artists, professional athletes, writers or journalists who, generally, or in a particular instance, work under an employment contract and, therefore, receive income from employment in contrast to income from an independent personal or business activity. In the case of other employees, the withholding is also computed based on wage-tax tables as in the case of resident individuals, except that the standard exemption is (partially) denied. A nonresident, 90% of whose income derives from German sources or less than 10,348 euros (in 2022) of whose income derives from non-German sources, can elect to be taxed as a German resident.[749]

It should be noted that an employee working from home for his or her foreign employer could trigger a PE for the employer in Germany. In particular, this is a severe risk if the employee regularly works remotely from home. Germany has agreed with Austria, Belgium, France, Luxembourg, the Netherlands, Poland and Switzerland that employees who are

[739] See Germany-U.S. tax treaty, Art. 5(5).

[740] Germany-United States tax treaty, Art. 11(3).

[741] EStG, Sec. 49(1) no. 2 lit. d.

[742] EStG, Sec. 50a; expenses are not deductible. A nonresident who is a citizen of, and resident in, a European Union (EU)/European Economic Area (EEA) Member State may elect to claim a deduction for expenses, in which case the withholding tax rate is 30% rather than 15%.

[743] EStG, Sec. 49(1) no. 4 lit. a.

[744] EStG, Sec. 49(1) no. 4 lit. b.

[745] BFH decisions of November 12, 1986, BStBl. 1987 II, 377, 379 (file no. I R 69/83), 381 (file no. I R 320/83) and 383 (file no. I R 190/85).

[746] Under the provisions of EStG, Sec. 49(1) no. 4 lit c, the services of a managing director, *prokurist* or officer of a corporation that maintains its principal place of management in Germany are always deemed to be performed in Germany.

[747] EStG, Sec. 39(4) no. 5; Sec. 52(36).

[748] EStG, Sec. 50(2).

[749] EStG, Sec. 1(3) as amended by Tax Relief Act 2022 of May 23, 2022, BGBl. 2022 I, 749.

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cross-border commuters and work remotely from home because of the COVID19-pandemic will not trigger a PE for their employer. These exceptions require the employer to provide detailed documentation and are limited in time. After the COVID 19-pandemic, it should be closely monitored whether these exceptions will be prolonged as the trend that in particular white-collar employees tend to work remotely from home seems to continue.

2. Independent Services

Income of a nonresident individual from independent personal services is derived from German sources if the services are rendered or exploited in Germany or if a fixed facility or PE is maintained in Germany. Again, most of Germany's tax treaties limit German taxation to the taxation of income from services attributable to a fixed facility or PE within Germany.[750]

If there is no applicable tax treaty or the applicable treaty upholds German jurisdiction to tax, income from independent personal services is generally taxed by way of assessment. However, in the case of directors' fees and other compensation for supervisory services rendered to a resident corporation, withholding tax is imposed at the rate of 30% of the gross remuneration.[751] For income from literary, artistic and journalistic services, the withholding rate is 15%.[752]

D. Investment Income

1. Interest

Most interest paid to nonresident parties by German debtors does not attract German tax, even in the absence of an applicable tax treaty. This means, for example, that interest on loans made by a tax haven affiliate may be paid gross without deduction of German withholding tax.

However, interest paid *inter alia* with respect to convertible bonds and income bonds and participating loans (*partiarisches Darlehen*), and payments made with respect to participation rights that are not covered by the term "dividends" (see 2., below) are subject to German income tax.[753] Tax is collected by means of withholding at the rate of 26.375% (including the 5.5% income tax surcharge). Many of Germany's tax treaties do not provide for a reduced tax rate on these items. Interest income accruing to a nonresident individual is subject to income tax at regular rates by way of assessment if paid on a loan secured directly or indirectly by German real property unless an exemption is provided for under an applicable treaty.

Withholding tax also applies to interest received by nonresident parties where interest coupons are physically presented to a domestic bank for collection (see further at VIII.C.4.b., above).

2. Dividends

While the standard withholding tax rate for dividends paid by a domestic corporation to a nonresident individual is 25% (plus 5.5% income tax surcharge),[754] most of Germany's tax treaties reduce the withholding tax rate for such dividends to 15% (including income tax surcharge of 5.5%).

Even though nonresident individual taxpayers can exclude 40% of gross dividends from their taxable income, the basis for computing the withholding tax remains 100% of the gross dividend, i.e., it includes the tax exempt 40%.[755] It is the responsibility of a foreign shareholder to file an application for a refund of that part of the withholding tax that exceeds the rate permissible under the applicable tax treaty. By contrast, the rate reductions under the European Union (EU) Parent-Subsidiary Directive can be obtained in advance by applying for an exemption certificate.[756] It should be noted that, due to various Court of Justice of the European Union (CJEU) decisions, the preconditions for obtaining such tax refunds and exemption certificates have been tightened (see further at XV.A.1., below).

Rate reductions for inter-corporate dividends may also be obtained in advance by German subsidiaries of parent companies in non-EU Member States if the applicable tax treaty provides for a reduction of the withholding tax; this applies, in particular, under the Germany-United States tax treaty.[757]

The term "dividend" includes a distribution made by a resident corporation in cash or in kind, as well as a constructive dividend, unless the resident corporation makes the distribution in the context of a formal reduction of its stated equity capital or a liquidation distribution, or if it is deemed to have made the distribution out of its surplus account.

For purposes of most of Germany's tax treaties, the term "dividends" also includes, or is deemed to include investment income that is treated as dividend income under the domestic law of the country of residence of the "distributing" corporation. Among other payments, this includes:

(i) Payments with respect to participation rights entitling the holder to a share in the profits and the liquidation proceeds of the issuer;

(ii) Payments to a nonresident participant in a typical silent participation arrangement; and

(iii) Payments with respect to convertible or income bonds.

E. Rents and Royalties

Rents received by a nonresident individual from the leasing of domestic real property or the leasing of certain tangible personal property located in Germany are taxable at the ordinary rates by way of assessment.[758] Some of Germany's tax treaties contain a provision identical or similar to Article 21(1) of the OECD Model Convention, which provides for an exemption with respect to rental income from personal property derived by a resident of the treaty partner country. Germany's tax treaties contain a provision identical or similar to Article 21(1) of the OECD Model Convention, which provides for an exemption with respect to rental income from personal property derived by a resident of the treaty partner country.

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[750] For example, Germany-U.S. tax treaty, Art. 7(1).
[751] EStG, Sec. 50a(2).
[752] EStG. Sec. 50a(2).
[753] EStG, Sec. 49(1) no. 5 lit. a.
[754] EStG, Secs. 43(1) no. 1 and 43a(1) no. 1.
[755] EStG, Sec. 43(1), third sentence.
[756] EStG, Sec. 43b, 50d(2).
[757] EStG, Sec. 50d(2).
[758] EStG, Sec. 49(1) no. 2 lit. f, no. 6 or no. 9.

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Rental income from the letting of movable goods and royalties paid by domestic licensees to nonresident individuals with respect to intangible personal property rights is subject to withholding tax at the rate of 15%,[759] but most of Germany's tax treaties provide for an exemption from such withholding tax. Rate reductions under an applicable treaty can be obtained in advance by applying for an exemption certificate.[760] With regard to royalty payments made to an affiliated corporation resident in another EU Member State or Switzerland, the withholding tax rate can be reduced to 0% on application, if certain requirements are met.[761] It should be noted that, as a result of various CJEU decisions, the preconditions for such tax refunds and exemption certificates have been tightened (see further at XV.A.1., below). For royalty payments made in connection with a non-resident withholding tax liability arising from the use of licensing rights outside Germany, where the license right has been recorded in a German public register but does not involve a German licensor or licensee, see the discussion in V.B.4., above.

F. Capital Gains

1. Sales of Shares in Domestic Corporations

A nonresident individual who sells shares in a domestic corporation representing an interest of at least 1% must include only 60% of the capital gain from the sale in their taxable income.[762] However, where a tax treaty provides for the complete exemption of the capital gain (this is normally the case under a treaty that contains a provision corresponding to Article 13 of the OECD Model Convention), the full amount is exempt from German income taxation.

Comment: Germany has about 30 tax treaties that entitle it to tax the capital gains of a nonresident on the disposal of shares in domestic corporations (and sometimes foreign corporations) whose assets are predominantly composed of real property situated in Germany.

2. Private Capital Gains

Private capital gains include gains from the sale of real property in Germany by a nonresident individual that was held for 10 years or less and is not allocable to a German PE of the nonresident individual.[763] The capital gain is the amount by which the adjusted cost basis, plus selling expenses, is exceeded by the sales price. Germany's tax treaties do not eliminate or reduce the taxation of such capital gains arising to residents of a treaty country.

As of January 1, 2009, capital gains on disposals of all securities bought and sold after December 31, 2008 (other than a participation interest of at least 1% of a corporation's share capital held as a private asset) are taxed at a flat rate of 25% (plus income tax surcharge of 5.5%), the tax usually being withheld by the depository bank, regardless of the duration of the holding period. However, Germany's sovereign right to taxation is subject to the limitations of tax treaties, where applicable.

G. Assessment

The tax on dividends, interest and royalties is imposed by way of withholding,[764] and no deductions from gross receipts are allowable.[765] With respect to other categories of German-source income, only those expenses that are economically connected with the specific item of income concerned are allowable as business expenses or as income-related expenses. A loss carryforward is available only to the extent the losses in question are connected economically with German-source income,[766] and only with respect to income that is not subject to withholding tax. In the case of employment income, however, there is only a limited deduction for special expenses (for social security); there is no deduction for expenses resulting in extraordinary hardship.[767] The applicable tax rate is determined using the normal rate schedule, subject to a (partial) denial of the standard exemption.[768] As a rule, joint tax returns cannot be filed if one partner is a nonresident.[769]

H. German Expats in Low Tax Jurisdictions

1. In General

Section 2 of the Foreign Tax Act introduced "extended limited tax liability" for German citizens who are subject to "low-level taxation" because they emigrate to a tax haven country or do not take up residence in any country and who retain substantial economic ties with Germany. This extended limited tax liability applies to German citizens who were residents of Germany for German income tax purposes for at least five years during the 10-year period preceding the termination of their German residence.

For purposes of Section 2 of the Foreign Tax Act, a taxpayer will be deemed to be subject to low-level taxation if he or she does not take up residence elsewhere or if he or she moves to a country that is considered to be a tax haven. A country is deemed to be a tax haven if either:

(i) The country imposes its income taxes at rates that, in the case of a single individual whose taxable income is 77,000 euros or more, result in an income tax liability that is more than one-third less than the German income tax liability would be with respect to that taxable income; or

(ii) The taxpayer may qualify for preferential tax treatment in the foreign country because:

- Persons moving to the country are exempt from its income tax;
- The taxpayer may be eligible to receive tax privileges (such as taxation based on consumption rather than actual income, the possibility of obtaining a favorable tax agreement or a tax waiver); or

[759] EStG, Sec. 50a(1).
[760] EStG, Sec. 50d(2).
[761] EStG, Sec. 50g.
[762] EStG, Sec. 3 no. 40 lit. c.
[763] EStG, Sec. 49(1) no. 8.
[764] EStG, Secs. 50(2) and 50a(1).
[765] EStG, Sec. 50a(2).
[766] EStG, Sec. 50(1).
[767] EStG, Sec. 50(1).
[768] EStG, Sec. 50(1).
[769] EStG, Sec. 26.

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• Items of income from German sources are given preferential tax status (for example, exemption or remittance basis taxation).

In either instance, a taxpayer may rebut the presumption that he or she is subject to low-level income taxation abroad by providing evidence that he or she owes income taxes equal to at least two-thirds of the amount that would have been payable had the taxpayer been resident in Germany.

2. Retention of Substantial Ties

A taxpayer will be deemed to have retained substantial economic ties with Germany if:

(i) At the beginning of the taxable year, the taxpayer was a sole proprietor or a co-entrepreneur in a German business, was a limited partner in a German partnership whose distributive share in the partnership's profits exceeded 25%, or owned a share interest of at least 1% in a domestic corporation within the meaning of Section 17 of the Income Tax Act;

(ii) The taxpayer's income that would not qualify as foreign-source income if he or she were a German resident exceeds the lower of 30% of his or her total income or 62,000 euros within the taxable year; or

(iii) The taxpayer's net assets that would not qualify as foreign assets if he or she were a German resident exceeded, at the beginning of the taxable year, the lower of 30% of his or her total assets or 154,000 euros.

In determining whether these conditions are fulfilled, the share of the income or net assets of an interposed controlled foreign corporation (CFC) the corresponds to the taxpayer's shareholding in the CFC must be included.[770]

Extended limited tax liability does not, however, apply for taxable years during which the amount of all the items of income subject to limited tax liability does not exceed a total of 16,500 euros.

It should be noted that the above threshold amounts have not been increased since 1972.

3. Scope of Liability

If the conditions described in 1. and 2., above, are satisfied, a taxpayer will be subject to extended limited tax liability for a period of 10 years from the close of the year in which German residence was terminated with respect to all items of income that, in the case of a resident taxpayer, would not be considered foreign-source income under Section 34c(1) of the Income Tax Act.

In addition to income normally subject to limited German income tax liability, income from capital investment, such as interest paid with respect to loans, savings accounts, bonds, charges and mortgages on real property, is subject to extended limited income tax liability if the debtor is a German resident, irrespective of whether the capital invested is secured by a charge on domestic real or personal property.

Such income is taxed at the normal progressive tax rate applicable to the taxpayer's total worldwide income. The tax payable, however, may not exceed the tax that would have been payable by the taxpayer if he or she had remained a German resident subject to unlimited tax liability and must at least equal the amount of tax payable as a result of normal limited tax liability.[771]

[770] AStG, Sec. 5.

4. Deemed Disposals of Shares in Domestic Corporations

Previously, individuals who had been residents of Germany for 10 years or more and who terminated their residence before January 1, 2022, while holding shares in a domestic or foreign corporation as privately held assets (Section 17 of the EStG, i.e., if they held at the time of the move abroad, or had held within the five years before the move, shares representing 1% or more of a corporation's stock), were deemed to have realized a capital gain in the amount by which the fair market value exceeded the cost basis of the shares.[772] This rule applied irrespective of whether an individual possessed German citizenship at the time.

In 2019, this regime was held by the CJEU to be in breach of EU law.[773] Later, it was changed by the ATAD Implementation Act of June 25, 2021,[774] with respect to terminations of Germany residency occurring after December 31, 2021, by individuals who had been subject to German income taxation in seven of the last 12 years before losing residency status.

Individuals who terminated their German residency before January 1, 2022, and who enjoyed a tax deferral according to the law applicable until June 30, 2021, are subject to a grandfathering rule.

Under the current regime, the tax deferral is subject to major changes that go beyond those required by the EU ATAD Directive, namely:

(i) The tax deferral results in a tax debt that is immediately due and payable also by a citizen of an EU/EEA Member State, unless the tax debtor applies for payment in seven equal installments (interest free); such deferral usually needs to be collateralized by the tax debtor, but is not subject to an interest charge, which both the CJEU and German Federal Fiscal Court stated that EU law requires not only mere tax payment by installments regarding the shares' hidden reserves from the point of time when the German tax residency status is terminated until the actual realization of the hidden reserves of the shares, but an interest free and fully deferred taxation of the shares' hidden reserves instead.[775] These decisions refer to cases governed by the regime formerly applicable until December 31, 2021, but the reasons apply in the same way to the period beginning on January 1, 2022.

(ii) The deferred tax on the gain on the deemed disposal of a share interest will be waived if the shareholder returns

[771] AStG, Sec. 2(6).

[772] AStG, Sec. 6(1).

[773] CJEU decision of February 26, 2019 (Rs. Wächtler), file no. C-581/17.

[774] ATAD Implementation Act of June 25, 2021 (*ATAD Umsetzungsgesetz* or ATAD-UmsG), BGBl. 2021 I, 2035.

[775] CJEU decision of February 26, 2019 (*Wächtler*), ref no: C-581/17; BFH decision of January 11, 2024, ref. no. I R 35/20 (*Wächtler*), both addressed this issue for the regime formerly applicable until December 31, 2021.

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to Germany and becomes a resident taxpayer again within seven years; this period can be extended for another five years on application and applies to moves to another EU/EEA Member State as well as to a non-EU/EEA country, instead of being limited to moves to a non-EU/EEA country, as was the case under the prior regime.

(iii) The step-up in the acquisition cost of the share interest requires the actual payment of the tax on the gain; a tax deferral leaves the acquisition cost unchanged.

(iv) The catalogue of harmful events that cancel the tax deferral has been significantly extended.

(v) Subsequent write-downs of the share interest will no longer be accepted.

5. Deemed Disposals of Shares Held in Funds

Since January 1, 2025, investment units in public funds held as private assets are subject to a new exit taxation regime[776] if: (i) the unlimited tax liability of the unit holder is terminated; or (ii) the investment units are transferred for no consideration to a person not subject to German unlimited tax liability; or (iii) Germany's right to tax future capital gains from the investment units is forfeited or restricted; and (iv) the total of all taxable gains (under §19(1), §22, and §56 of the InvStG) is positive; and (v) either the investor has held at least 1% of the fund units (directly or indirectly) within the last five years, or the acquisition costs of the investor's fund units are at least 500,000 euros at the time of the deemed disposal.[777]

I. Taxation of Foreign Expatriates

Foreign expatriates who qualify as nonresidents or residents for German tax purposes do not enjoy any special tax status. Such individuals are taxed as nonresidents or residents, subject to any tax treaty benefits that may be available to them. Further, foreign citizens become subject to German inheritance and gift tax if they are tax resident in Germany.

German residents who leave Germany by terminating their tax residence in Germany may remain subject to German income tax liability, at least to the extent of (some) of their income from German sources, as discussed in IX.H., above. German residents who have terminated their tax residence in Germany remain subject to German inheritance and gift tax, at least to the extent of some of their assets in Germany. Further, a decedent or beneficiary (or a donor or a donee) who is a German citizen who emigrated within the five-year period preceding the taxable event is deemed to be a resident and the entire estate or the beneficial share of the beneficiary concerned is taxable[778] (see XIII., below.)

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[776] InvStG, Secs. 19(3), as amended by the Annual Tax Act 2024 of December 2, 2024, BStBl. 2024 II, p. 1484.

[777] InvStG, Sec. 49(5) modifies these rules slightly for investment units of special purpose funds.

[778] Under the 1998 Protocol to the 1980 Germany-United States estate, inheritance and gift tax treaty, the five-year period was extended to 10 years.

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X. Trade Tax

A. *Scope of Provision*

Trade tax (*Gewerbesteuer*) is regulated by federal law, but it is collected by the municipalities.[779] Federal law fixes the basic rate of tax, but the effective rate is established by the municipality concerned applying a multiplier that may be changed annually by the municipality.

For 2024, the multipliers range from about 200% (legal minimum)[780] to 900%, while most of the municipalities use multipliers in a range between 250% and 650%. If a business has permanent establishments (PEs) in more than one municipality, an allocation between them (based on payroll) is required.[781]

Trade tax is based on trade profits[782] and is imposed on all business enterprises, regardless of their legal form (for example, on legal entities such as corporations, on partnerships and on sole proprietorships), that have PEs in Germany.[783] Thus, the residence or nationality of the taxpayer is not significant for purposes of the tax.

Subject to certain adjustments discussed in X.B., below, the term "trade profit" is defined in the same manner as "business income" for income tax purposes. Trade tax is not imposed on income from independent personal services, agriculture, the investment and management of capital by the investor, the rental of real property, or the licensing of intangibles, unless such activities have a commercial character. With respect to domestic and foreign corporations, however, total income is irrefutably deemed to constitute trade profits for trade tax purposes.[784] A partnership is subject to trade tax if it either operates a trade or is deemed to be a trading partnership, or if it owns an interest in a trading or deemed trading partnership. In contrast to the situation under income tax law, a partnership itself (rather than its partners) is subject to trade tax on its trade tax income.[785]

Trade tax is not deductible in computing income tax payable by a business,[786] but reduces the income tax burden of individuals up to a municipal multiplier of 400% (2022).[787]

The basic federal rate of trade tax on trade profits is 3.5%.[788] Individuals, partnerships, and other unincorporated businesses may claim an exemption for the first 24,500 euros of trade income; corporations may claim an exemption for the first 5,000 euros of trade income. If a municipal multiplier with respect to trade tax on trade profits of, say, 400% is applied, the resulting tax rate is 13.5% (if the basic exemptions are disregarded).

[779] GewStG, supplemented by regulatory ordinance (*Gewerbesteuer-Durchfuehrungsverordnung* — GewStDV), and the Trade Tax Regulations (*Gewerbesteuer-Richtlinien* — GewStR).
[780] GewStG, Sec. 16(4).
[781] GewStG, Secs. 28–34.
[782] GewStG, Sec. 7.
[783] GewStG, Sec. 2(1).
[784] GewStG, Sec. 2(1)–(3).
[785] GewStG, Sec. 5(1).
[786] EStG, Sec. 4(5b).
[787] EStG, Sec. 35.
[788] GewStG, Sec. 11(2).

A controlled corporation under the *Organschaft* concept (see V.B.10., above) is considered to be merely a PE of the controlling entity for purposes of trade tax if the controlling entity is a resident taxpayer.[789] The *Organschaft* concept does not extend trade tax to a controlling entity that is a nonresident taxpayer unless the participation held in the controlled corporation is held by the nonresident controlling entity in its PE in Germany that is recognized as a German PE under applicable domestic law and an applicable tax treaty. The requirements for an *Organschaft* for trade tax purposes are in line with the requirements for an *Organschaft* for corporate income tax purposes. This means that the test of financial integration, as well as the execution and registration of a profit and loss transfer agreement, are now sufficient to conclude an *Organschaft* arrangement for corporate income tax and trade tax purposes. If a profit and loss transfer agreement is concluded for corporate income tax purposes, it will also apply for trade tax purposes. An isolated *Organschaft* for trade tax purposes is therefore not possible.

Trade tax is ordinarily covered by Germany's tax treaties.[790] Generally, there are no specific rules concerning trade tax. Instead, the treaty provisions with respect to business income are also applied with respect to the trade tax on trade profits.[791]

B. *Trade Tax on Trade Profits*

1. *In General*

The basis for computing trade profits is taxable income for purposes of personal income tax or corporate income tax, subject to certain adjustments.[792] These adjustments are designed to ensure that the character of trade tax (i.e., as a tax on the object of the business and not a personal tax on the entrepreneur) is preserved. Thus, certain deductions allowable for income tax purposes must be disallowed, in full or in part, in determining the trade tax basis. On the other hand, certain items of income are deducted in calculating trade tax income.

2. *Additions to Taxable Income*

The tax base (taxable income) for purposes of income tax or corporate income tax is adjusted for trade tax purposes by adding back the following items to the extent these items have been deducted as expenses:

(i) The sum of:

- 25% of interest payments, including payments to a silent partner, and annuities;
- 12.5% of rent and lease payments with respect to immovable fixed assets such as real property;
- 5% of rent and lease payments with respect to movable fixed assets; and

[789] GewStG, Sec. 2(2).
[790] See, e.g., Germany-U.S. tax treaty, Art. 2(1)(b)(cc).
[791] See, e.g., Germany-U.S. tax treaty, Art. 23(3)(a).
[792] GewStG, Sec. 7.

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- 6.25% of royalty payments, if certain requirements are met, to the extent the sum of such payments exceeds 200,000 euros;[793]

(ii) Profit distributions and compensation for services paid to the general partners of a partnership limited by shares (*Kommanditgesellschaft auf Aktien* — KGaA);[794]

(iii) The tax-exempt part of dividends covered by Section 3 no. 40 of the Income Tax Act (*Einkommensteuergesetz* — EStG) or Section 8b(1) of the Corporate Income Tax Act (*Koerperschaftssteuergesetz* — KStG), unless they meet the requirements listed in (v) and (vi) under 3., below;[795]

(iv) Charitable contributions made by corporations;[796]

(v) Losses from an investment in a domestic or foreign partnership or other unincorporated association;[797]

(vi) Reductions of profits incurred:

- By way of depreciation of an interest in a corporation to the lower fair market value; or
- By disposal or withdrawal of such an interest, or by liquidation of, or reduction of the stated capital of, the corporation, to the extent the depreciation to the lower fair market value or the reduction of profit is based on dividend distributions made by the corporation that are not taxable for trade tax purposes or is based on profit remittances under an *Organschaft* arrangement;[798] and

(vii) Foreign taxes that can be deducted as business expenses under Section 34c of the Income Tax Act.[799]

3. Deductions from Taxable Income

Deductions from taxable income as computed for income tax purposes are permitted *inter alia* for the following items:

(i) 1.2% of the assessed value of real property in Germany (whether occupied, rented or otherwise used); alternatively, taxpayers that exclusively manage their own real property (and fulfill several other conditions) may apply for an exclusion of the part of their trade income as relates to such activity;[800] this will change as of January 1, 2025, as the deduction will be linked to actually assessed land tax instead;

(ii) Profits from an investment in a domestic or foreign partnership or other unincorporated association;[801]

(iii) Profits attributable to a foreign PE;[802]

(iv) Charitable contributions made by corporations (basically within the same limits as apply for income tax purposes);[803]

(v) Dividends from a domestic (taxable) corporation, if the taxpayer held a share interest in the corporation of at least 15% from the beginning of the taxable year;[804] and

(vi) Dividends from a foreign corporation, if the taxpayer held a share interest in the corporation of at least 15% at the beginning of the taxable year and the profit share was recognized in the determination of profits.[805]

4. Net Operating Loss Deduction

No loss carryback to the previous taxable year is available for purposes of trade tax. Losses carried forward can be used without restriction only up to a trade profit of one million euros in each taxable year. Thus, the loss carryback for trade tax purposes differs from the loss carryback for (corporate) income tax purposes.[806] Excess losses carried forward can be used only to the extent of 60% of the profits exceeding one million euros, which means that the minimum tax also applies to trade tax.[807]

A net operating loss (NOL) is determined in the same way as for income tax or corporate income tax purposes, subject to the adjustments required by the Trade Tax Act (*Gewerbesteuergesetz* — GewStG). As a result of these adjustments, the amount of trade tax loss tends to be significantly lower than the amount of income/corporate income tax loss.

Trade tax losses carried forward by a corporation that becomes a member of an *Organschaft* may not be applied against the income of the corporation or of other members of the *Organschaft* as long as the *Organschaft* is in effect.[808]

C. Assessment and Filing

Trade tax returns must be filed together with the individual income or corporate income tax returns.[809] The local tax offices that are responsible for assessing the income tax and corporate income tax review the returns and determine the federal trade tax base.

The tax office then notifies both the taxpayer and the municipal tax office of the tax base. Subsequently, the municipal tax office multiplies the tax base by the applicable multiplier and mails the notice of assessment to the taxpayer. Any excess of assessed trade tax over current prepayments is payable within one month of receipt of the assessment notice by the taxpayer. Payments of estimated tax are fixed by the municipal tax office based on the previous assessment and are payable in quarterly installments on February 15, May 15, August 15 and November 15 of each calendar year.[810]

[793] GewStG, Sec. 8 no. 1.
[794] GewStG, Sec. 8 no. 4.
[795] GewStG, Sec. 8 no. 5.
[796] GewStG, Sec. 8 no. 9.
[797] GewStG, Sec. 8 no. 8.
[798] GewStG, Sec. 8 no. 10.
[799] GewStG, Sec. 8 no. 12.
[800] GewStG, Sec. 9 no. 1, likely to be changed in the course of the real estate tax reform with effect from January 1, 2025.
[801] GewStG, Sec. 9 no. 2.
[802] GewStG, Sec. 9 no. 3.
[803] GewStG, Sec. 9 no. 5.
[804] GewStG, Sec. 9 no. 2a; this also applies to dual-resident corporations (BFH decision of June 28, 2022, file-no. I R 43/18, BStBl. 2024 II, p. 650).
[805] GewStG, Sec. 9 nos. 7, 8.
[806] See V.B.2.b.(4) and VIII.D.
[807] GewStG, Sec. 10a.
[808] GewStG, Sec. 2(2); KStG, Sec. 15(1).
[809] GewStG, Sec. 14a.
[810] GewStG, Sec. 19.

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XI. Value Added Tax

A. Scope of Taxation

Value added tax (VAT) (*Mehrwertsteuer*), which represents the first major fruit of efforts to harmonize indirect taxation within the European Union (EU) Member States, is imposed in Germany at a fixed standard rate of 19% and a reduced rate of 7% for certain transactions on the value added at each stage of the manufacturing and sales lifecycle. Moreover, since January 1, 2023, a 0% rate applies to the supply and installation of solar modules and other components for operators of small photovoltaic systems up to 30 kilowatt peak.[811] Entrepreneurs must show separately on outgoing invoices the net sales price and the applicable VAT charged.[812] On their VAT return, entrepreneurs may deduct from the total VAT shown on their outgoing invoices, the total VAT shown on their incoming invoices for goods purchased by them and services rendered to them (deduction or credit of input VAT).[813] In this way, the tax burden is ultimately shifted to the consumer.

> *Example:* Manufacturer (M) sells machinery to wholesaler (W) for 100 euros, who in turn, resells it to distributor (D) for 150 euros:
>
> (i) M charges W 100 euros plus 19% VAT, i.e., 119 euros, which W pays to M. M reports and pays VAT of 19 euros to the tax office; and
>
> (ii) W charges D 150 euros plus 19% VAT, i.e., 178.5 euros, which D pays to W. W credits against his VAT liability of 28.5 euros the 19 euros VAT charged to him by M (i.e., the input VAT) and reports and pays the remaining VAT of 9.5 euros to the tax office.

The result can, however, be affected either if particular transactions carried out by the entrepreneur are exempt from VAT (whether or not they carry a right to deduct input taxes) or if the deduction of input VAT is denied in full or in part for particular transactions.[814]

In principle, no distinction is made between foreign and domestic entrepreneurs, and neither the citizenship, residence or principal place of management of the entrepreneur nor the place of billing or payment affect German jurisdiction to impose VAT, provided the entrepreneur carries out the taxable events within Germany.[815]

For further research on Germany's VAT system, see also the VAT Navigator.

Note: German VAT law is essentially based on European VAT law as originally passed in the form of the 6th EC Directive on VAT of May 17, 1977. The 6th EC Directive was replaced by Council Directive 2006/112/EC of November 28, 2006, on the common system of value added tax, which is regularly amended. Since the German statutory provisions are supposed to comply with the provisions of the Council Directive, Germany's tax courts regularly refer interpretative issues for clarification to the Court of Justice of the European Union (CJEU).

B. Entrepreneurs

Subject to certain exceptions (for example, in the case of the importation of new vehicles or if the reverse charge system applies), the taxpayer for VAT purposes is the entrepreneur. An "entrepreneur" includes any person or entity that takes part in business transactions in its own name. Consequently, all commercial entities, such as *Aktiengesellschaften* (AGs), *Gesellschaften mit beschraenkter Haftung* (GmbHs), general partnerships, limited partnerships and other unincorporated business associations, as well as sole proprietorships and self-employed professionals and landlords, may qualify as entrepreneurs for VAT purposes.[816] The term "entrepreneur" is understood much more broadly in VAT law than in income tax law or trade tax law.

In this context, it should be noted that the *Organschaft* concept (see V.B.10., above) is also relevant for VAT purposes, although the prerequisites for an *Organschaft* for VAT law purposes differs from those for an *Organschaft* for income and trade tax purposes. A controlled corporation that is integrated with a controlling enterprise not only from a financial, but also from an economic and organizational perspective, is considered to be part of the controlling enterprise and, consequently, does not qualify as a taxpayer for VAT purposes.[817] Instead, taxable transactions entered into by the controlled corporation with third parties are attributed to the controlling enterprise for VAT purposes. Transactions between the controlling enterprise and the controlled corporation are not taxable. The *Organschaft* concept for VAT law applies only in relation to a corporation as a controlled entity, which is more restrictive than what is possible under the applicable EU law.[818] The controlling enterprise is not required to be a corporation, but only needs to qualify as an entrepreneur.[819] An *Organschaft* for VAT purposes does not require a profit and loss transfer agreement in contrast to an *Organschaft* for income tax and trade tax purposes. The VAT debtor for an *Organschaft* is the controlling entity as the sole entrepreneur.

With respect to EU law, the CJEU also confirmed this position recently, if the controlling entity can execute its will in the controlled entity (i.e., no majority of votes necessarily required). Upon new submission by the German Federal Tax Court (*Bundesfinanzhof* — BFH), the CJEU has confirmed this in its decision of July 11, 2024 (file no. C-184/23) that neither supplies nor services for a fee between the controlling and controlled entity are VATable.[820] Under EU law, it is also pos-

[811] UStG, Sec. 12, as amended by Annual Tax Act 2022 of December 16, 2022, BGBl. 2022 I, 2294.

[812] UStG, Sec. 14.

[813] UStG, Sec. 15.

[814] UStG, Sec. 15(2).

[815] UStG, Sec. 2.

[816] UStG, Sec. 2.

[817] UStG, Sec. 2(2) no. 2, the interpretation of which might turn out to be in conflict with a still pending CJEU decision, file no. C-141/20 (which should be closely monitored), which might hold that the VAT debtor is no longer the controlling entity, but the group consisting of the controlling and the controlled entity.

[818] UStG, Sec. 2(2) no. 2; Council Directive 2006/112/EC of November 28, 2006 on the common system of value added tax, as amended, L 347/1, Art. 11.

[819] Decree on the application of the Value Added Tax (*Umsatzsteuer-Anwendungserlass* — UStAE), Sec. 2.8(2).

[820] CJEU in its decisions of December 1, 2022, file no. C-141/20 and C-269/20; subject to further clarification by a new submission decision of Fed-

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sible for a correspondingly integrated partnership to be a controlled entity, which conflicts with German domestic VAT law. In a recent decision, the Federal Tax Court (*Bundesfinanzhof* — BFH) agreed with the CJEU on this issue.[821]

C. Taxable Events

1. Goods Delivered in Germany

The delivery of tangible goods for a consideration is considered to take place at the time and place at which the power to dispose of the goods in a person's own name is transferred from the entrepreneur to the purchaser or to a third party designated by the purchaser.[822] If the goods are shipped to the purchaser or, at the purchaser's direction, to a third party, the delivery is deemed to take place at the time and place at which the goods are handed to the forwarding agent, the postal service, the railroad, a shipping agent or another intermediary.[823]

As the terms of sale are under the control of the parties to the sale, the time and place of delivery may be fixed by agreement between them. For instance, a foreign manufacturer not residing in an EU Member State that ships goods to a German importer via a forwarding agent does not make a taxable delivery within Germany unless it assumes the burden of the VAT due on importation into Germany or, more accurately, into the European Union.[824] In the latter case, the foreign manufacturer is deemed to deliver the goods within Germany to its customer; it charges normal VAT to its customer, and takes the importation VAT paid as a credit against its VAT liability.

The following transactions are deemed to constitute the delivery of goods for consideration:

(i) The withdrawal of goods by an entrepreneur from its enterprise within Germany for purposes outside the scope of the enterprise;[825]

(ii) The delivery of goods by an entrepreneur to its personnel for their personal use within Germany for no consideration, except in the case of gifts worth no more than about 60 euros;[826] and

(iii) Any other delivery of goods, except for minor gifts or specimens for purposes of the enterprise.[827]

However, such deeming rules apply only to goods with respect to which the entrepreneur was fully or partly entitled to deduct input VAT.[828]

The transfer of an entire business or a separable part of a business in a merger/acquisition transaction does not constitute a taxable delivery of goods (irrespective of whether consideration is paid).[829]

An entrepreneur that acts in its own name but for the account of another party in delivering tangible goods (commissionaire agreements) performs a taxable delivery or receives a taxable delivery, as the case may be.[830]

2. Services Rendered in Germany

Services rendered for a consideration that do not qualify as deliveries of tangible goods are considered to be "other performances of services."[831] Other performances of services may also consist of refraining from an action or from taking advantage of a chance or opportunity.[832] For example, in the case of royalties paid with respect to the use of a patent, the holder of the patent is deemed to refrain from using the patent itself and to permit the licensee to use it.

Such another performance of services is taxable if the performance, i.e., the action or the abstention from acting, as the case may be, occurs in Germany. Sections 3a, 3b, 3e of the VAT Law contain extensive rules regarding where an action or refraining from an action is deemed to occur.

Furthermore, the following services performed for no consideration are deemed to constitute services rendered for consideration:

(i) The use of an item attributable to an enterprise with respect to which the deduction of input VAT was available, in full or in part, to the entrepreneur for purposes outside of the enterprise or for the personal use of its personnel, with the exception of minor gifts;[833] and

(ii) The performance of other services for no consideration by an entrepreneur for purposes outside the enterprise or for the personal use of its personnel, with the exception of minor gifts.[834]

An entrepreneur that performs services in its own name but for the account of another party or receives such services performs a taxable service or receives a taxable service, as the case may be.[835]

a. General Rule — Place Where the Entrepreneur Rendering the Service Conducts Business

Where none of the more specific rules described in b. to f., below apply, services are taxable if performed by an entrepreneur that conducts its business in Germany or performs the

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eral Tax Court of January 26, 2023, file no. V R 20/22; BStBl. 2023 II, 530, to CJEU, file no. C-184/23.

[821] Negative and traditional: Federal Tax Court, decision of December 2, 2015, file no. V R 25/13, BStBl. 2017 II, 547 (if the partners' resolution requires a unanimous vote of all partners and not all shares are held by the controlling entity); positive and new: Federal Tax Court, decision of January 19, 2016, file no. XI R 38/12, BStBl. 2017 II, 567 (agreed by the Federal Ministry of Finance in UStAE, Secs. 2.2(5). 2.8(2)). The CJEU rejected this negative, traditional view again in its decision of April 15, 2021, file no. C-868/19. The Federal Tax Court follows the CJEU point of view in its recent decision of March 16, 2023, file no. V R 14/21, BFH/NV 2023, 790 for a trading partnership with a capital structure involving a majority holding partner. *Comment:* Further consequences for the German VAT treatment of a partnership as a controlled entity should be monitored closely, in particular against the backdrop of the MoPeG reform, which, *inter alia,* will give a partnership full rights and obligations like a corporation, allowing a partnership to be characterized as an entity with full legal capacity.

[822] UStG, Secs. 1(1) no. 1, 3(1).

[823] UStG, Sec. 3(6).

[824] UStG, Sec. 3(8).

[825] UStG, Sec. 3(1b) no.1.

[826] UStAE, Sec. 1.8(3); UStG, Sec. 3 (1b) no. 2.

[827] UStAE, Sec. 3.3(11); UStG, Sec. 3(1b) no. 3.

[828] UStG, Sec. 3(1b) sent. 2.

[829] UStG, Sec. 1(1a).

[830] UStG, Sec. 3(3).

[831] UStG, Sec. 1(1) no. 1.

[832] UStG, Sec. 3(9).

[833] UStG, Sec. 3(9a) no. 1.

[834] UStG, Sec. 3(9a) no. 2.

[835] UStG, Sec. 3(11).

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services through a German permanent establishment (PE).[836] In what follows, only the most important specific rules are explained in more detail. Further rules could apply to the specific case at hand. Thus, VAT issues need to be checked carefully and thoroughly in advance to avoid harmful consequences.

b. Place Where the Entrepreneur Receiving the Service Conducts Business

Subject to the specific rules described in c. to g., below, services are taxable if rendered to an entrepreneur that conducts its business in Germany or the services are rendered to a German PE of an entrepreneur.[837]

c. Situs of Real Property

Services rendered in connection with real property are deemed to be rendered where the real property is situated. Such services include the rental of immovable property, the preparation and implementation of construction work and the development of real property, and services rendered in connection with the acquisition, sale or encumbrance of real property, such as the services of notaries, lawyers and tax consultants (but not financing services).[838]

d. Place of Transportation

Transportation services are taxable where the transportation is effected. Section 3b(1) of the VAT Law sets forth the basic rule that, in the case of international transportation, only the German portion is taxable. However, special rules apply if the place of shipping and the place of destination are located in different EU Member States (the intra-EU transportation of goods). In principle, intra-EU transportation services are taxable in the Member State of departure, unless the recipient of the service obtains and uses the VAT identification number issued by the tax authorities of each EU Member State[839] to entrepreneurs involved in intra-EU transactions. If the recipient uses such a VAT identification number, the transportation services are taxable in the Member State in which the identification number was issued. The entire intra-EU transportation of goods is taxable in Germany if the place of departure is in Germany and the recipient is not identified for VAT, or if the place of departure is in a Member State and the recipient uses a VAT identification number issued in Germany.[840] The same rules apply to services ancillary to transportation services, such as loading or storage activities.[841]

e. Place Where an Activity Is Carried Out

The following activities are taxable where they are exclusively or predominantly carried out:[842]

(i) Artistic, scientific, educational, sporting or entertainment services, including services rendered by the respective promoters. As of January 1, 2025 a different rule applies in the case of streaming or other virtual services supplied to a non-entrepreneur, which are taxable where the recipient is located.

(ii) Repairs of tangible personal property and appraisals relating to such property.

(iii) The services of intermediaries except where the location of the recipient of the services is decisive (see XI.C.2.f., below). However, as in the case of the intra-EU transportation of goods and services ancillary to such transportation, if the recipient of an EU-resident intermediary's services is identified for VAT and uses a VAT number issued by another EU Member State, the place of taxation is not the place where the intermediary renders the services but that other Member State.[843]

f. Location of Recipient of Services

Where the recipient is not an entrepreneur and has its residence or principal place of management outside the European Union, *inter alia* the following services are deemed to be rendered at the location of the recipient:[844]

(i) The granting, transfer or licensing of patents, copyrights, trademarks and other similar intangible rights;

(ii) Advertising and publicity services;

(iii) Legal, technical or economic advisory services;

(iv) Data processing services;

(v) The supply of information, including industrial processes and know-how;

(vi) Other performances of services referred to in Section 4(8)(a) to (g) and (10) of the VAT Law, the management of loans and of securities posted for loans, and services rendered in the context of the use of gold, silver and platinum, excluding coins and medals made from such metals;

(vii) The hiring out of personnel;

(viii) The waiver of any right referred to in (i), above;

(ix) The total or partial waiver of a right to exercise a business or a professional activity;

(x) The rental of movable tangible property, excluding means of transportation; and

(xi) The granting of access to natural gas and electrical power lines, as well as the transmission or distribution of gas and electricity over these lines and other directly connected services.

Telecommunications services, broadcasting and television services, and services rendered electronically to a non-entrepreneur are rendered at the location of the recipient.[845] If services are rendered electronically by an entrepreneur resident outside the European Union, the entrepreneur may declare these services wherever rendered within the European Union only to the authorities of a single EU Member State (mini one-stop-shop or MOSS procedure).[846]

[836] UStG, Sec. 3a(1).
[837] UStG, Sec. 3a(2).
[838] UStAE, Sec. 3a.(7)–(10); UStG, Sec. 3a(3) no. 1.
[839] In Germany the relevant authority is the *Bundeszentralamt fuer Steuern*.
[840] UStG, Sec. 3b(3).
[841] UStG, Sec. 3b(2).
[842] UStG, Sec. 3a(3) no. 3.
[843] UStG, Sec. 3a(3) no. 4.
[844] UStG, Sec. 3a(4).
[845] UStG, Sec. 3a (5).
[846] UStG, Sec. 18 (4c, d).

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g. Use or Exploitation of Services in Germany

The services listed in (i) through (x) in XI.C.2.f., above, supplied by an entrepreneur from a place outside the European Union to a German resident legal entity formed under public law, telecommunication services and broadcasting and television services, and the renting of means of transportation are deemed to be services rendered in Germany if the services are used or exploited in Germany.[847]

3. Importation of Goods from Non-EU Member States

The purpose of taxing the importation of goods is to equalize the VAT burden on goods, irrespective of whether they are manufactured in Germany or abroad. Import VAT is paid by the importer in addition to whatever customs duties may be payable. However, import VAT is levied only on the importation of goods from third countries, i.e., from countries that are not members of the EU.[848]

Note: All importers are liable for import VAT, including private individuals.

Import VAT is levied on the transaction value applicable for customs duties purposes. For customs purposes the value of a "previous transaction" may be applied; however, this requires a disclosure of the contract terms regarding the previous transaction to the customs authorities. This makes it necessary for a foreign seller to disclose all conditions of its purchase to its customer to enable it to reduce the customs burden. By doing so, the seller discloses not only its own calculations, but also its supplier and other usually confidential information. To avoid this, a foreign manufacturer may assume the role of the importer for customs purposes, which automatically makes the manufacturer liable to pay the import VAT. In this case, the sale will qualify as a taxable delivery of goods within Germany,[849] and the foreign manufacturer will be entitled to credit against its own VAT liability the import VAT paid by it or advanced by the forwarding agent on the importation of the goods. The invoice supplied by the importer to the purchaser will show the agreed price plus the normal VAT at the rate of 19% or 7%, as the case may be.

4. Intra-EU Delivery of Goods

The single most important aim of the European Union is to permit the free movement of goods between EU Member States. The principal features of the regime for the intra-EU delivery of goods are discussed below.

a. Acquisitions Between Taxable Persons

Intra-EU transactions in goods for consideration between taxable persons (i.e., entrepreneurs) are subject to taxation in the country of destination (the "destination principle"). The taxable event is not the supply of the goods, but the intra-EU acquisition of the goods.[850] This means that the taxpayer is the purchaser, not the seller.[851] Thus, an intra-EU transaction is subject to German VAT only if the purchaser is an entrepreneur and the country of destination is Germany.[852] If the purchaser does not qualify as an entrepreneur, the "country of origin principle" prevails, so that the taxpayer is the supplier of the goods and the transaction is subject to VAT in the country in which the supply of the goods starts,[853] unless the special rules outlined in b. and c., below apply.

The destination principle also applies if goods are moved only between two EU Member States for no consideration, i.e., if there is no sales transaction or if the goods are dispatched or transported to another Member State by an entrepreneur for purposes of its own business. Such a transfer of goods is deemed to be a taxable acquisition of goods for consideration for German VAT purposes if Germany is the State to which the goods are transferred. However, numerous transfers of goods are not regarded as taxable events, including:

(i) Transactions that already give rise to taxation in the country of destination, such as the intra-EU acquisition of goods and contract work; and

(ii) The transfer of goods for temporary use.

b. Acquisitions of New Vehicles

Rules similar to those described in a., above, make the acquisition of new vehicles, including cars, motorcycles, ships, and aircraft of a certain size and power subject to VAT in Germany, if Germany is the country of destination.[854] This will usually be the case if the purchaser applies for registration with a German licensing office. However, it should be noted that, in contrast to the position under the rules outlined in a., above, the acquisition of new vehicles is taxable, irrespective of the tax status of the acquirer. This means that even non-entrepreneurs, such as private individuals and tax-exempt persons, are deemed to be taxpayers when they buy new vehicles.

c. Sales to Private Individuals

Sales to private individuals (non-entrepreneurs) comprise all deliveries of goods, except new vehicles, where the transportation of the goods is arranged by, or on behalf of, the seller to a person not identified for VAT, and occur mainly in the mail order business. Under the destination principle, such sales, if they are intra-EU sales, are taxable in Germany if the goods are delivered to Germany, provided total sales made by the seller to Germany exceed a certain minimum threshold or are subject to excise taxes as defined in Section 1a(5) of the VAT Law (for example, the tobacco and liquor taxes).[855] These rules were changed as of July 1, 2021 by new rules under the EU Digital Package (see XI.K., below).[856]

D. Exemptions

For VAT purposes, a distinction is made between transactions that are not taxable, for example, because the services are performed outside Germany, and transactions that, although taxable, are subject to specific exemptions. Sections 4 *et seq.* of

[847] UStG, Sec. 3a(6).
[848] UStG, Sec. 1(1) no. 4.
[849] UStG, Sec. 3(8).
[850] UStG, Secs. 1(1) no. 5, 1a, 3d.
[851] UStG, Sec. 13a(1) no. 2.
[852] UStG, Sec. 1a.
[853] UStG, Secs. 1(1) no. 1, 3(6).
[854] UStG, Sec. 1b.
[855] UStG, Sec. 3c.
[856] See XI.K.

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the VAT Law contain a substantial number of exemptions; the most important of which are for the following:

(i) The exportation of goods to non-EU Member States (in this case, the exporting party can claim a credit or refund of the VAT previously paid with respect to the exported goods);[857]

(ii) The granting of loans, the assumption of liabilities, the provision of guarantees and similar securities, the deposit or management of securities, and similar banking transactions;[858]

(iii) The transfer of bonds and shares in *Aktiengesellschaften* (AGs), *Gesellschaften mit beschränkter Haftung* (GmbHs) and partnerships;[859]

(iv) Transactions covered by real estate transfer tax;[860] and

(v) The intra-EU supply of goods to a person that uses a VAT identification number.[861]

The exemption for the exportation of goods is granted because, in principle, VAT applies only to goods consumed within Germany. The exemptions listed above in (iv) and (v) are granted to avoid double taxation, as such transactions are subject to real estate transfer tax or VAT on intra-EU acquisitions, respectively.

E. Input VAT

Generally, an entrepreneur can deduct from its total VAT payable all input VAT, as follows:

(i) Input VAT that is shown separately on incoming bills charged to the entrepreneur's enterprise for goods or services delivered or provided by other entrepreneurs for purposes of the enterprise. A proper invoice is necessary for input VAT to be recovered.[862] Section 14(4) of the VAT Law requires that all the information listed in the section be contained in the invoice itself. This includes, in particular, the tax registration number or the VAT-ID Number of the entrepreneur performing the services, the date of the invoice and a billing number, as well as information on the tax rate applied and details regarding the goods supplied or the services rendered. If the payment was effected prior to the date of the invoice, the invoice must also contain the date on which the consideration was received if that date is already known and does not coincide with the date of the invoice. Furthermore, any reduction of the consideration agreed on in advance but not taken into account in the amount billed must be indicated in a note on the invoice. This applies, in particular, to sales bonuses that depend on future events.[863]

(ii) Import VAT paid on items imported into Germany for the enterprise.[864]

(iii) VAT on the intra-EU acquisition of items for the enterprise.[865]

(iv) VAT on supplies that fall within Section 13b(1) and (2) of the VAT Law, i.e., supplies that are subject to the "reverse charge" mechanism.[866]

(v) VAT on supplies covered by Section 13a(1) no. 6 of the VAT Law, i.e., supplies related to special regulations for warehouses.[867]

No input VAT can be deducted if, *inter alia*, the goods or services that attracted the input VAT:

(i) Are used to carry out tax-exempt transactions (except certain export-related exempt transactions);[868]

(ii) Are used to carry out transactions abroad that would be exempt if carried out within Germany;[869]

(iii) Represent expenses that are disallowed as business expenses for income tax purposes;[870] or

(iv) Relate to real property of an enterprise and are used for purposes outside the scope of the enterprise or for the private use of the personnel of the entrepreneur.[871]

F. Method of Assessment

Within 10 days of the end of each calendar month (or each calendar quarter if the VAT payable for the previous year did not exceed 9,000 euros (threshold amount applicable as of January 1, 2025)), an entrepreneur must file electronically a preliminary return covering the calendar month (quarter) and pay the VAT due. At this time, the entrepreneur may deduct input taxes charged to it as well as VAT payable on the intra-EU acquisition of goods.[872] At the end of the calendar year, the entrepreneur is required to file an annual VAT return,[873] together with the corporate income tax return (where applicable) and other returns. If the monthly prepayments made do not equal the total VAT liability for the year as computed by the entrepreneur in its annual return, any deficiency is payable within one month of the filing of the return. Any deficiency is also payable within one month of the receipt by the entrepreneur of a deficiency notice.[874] Any excess of prepayments over the final VAT liability is refunded.

In addition to the monthly and annual returns, each month (for intra-EU supplies depending on the supply volume) or each third month (for intra-EU supplies with a volume of 50,000 euros per calendar quarter or less for the current calendar quarter and the preceding four calendar quarters and for intra-EU services provided to another entrepreneur) an entrepreneur must file an information return with the *Bundeszentralamt fuer Steuern* with its VAT identification number as is-

[857] UStG, Sec. 4 no. 1 lit. a, Sec. 6.
[858] UStG, Sec. 4 no. 8.
[859] UStG, Sec. 4 no. 8 lit. f.
[860] UStG, Sec. 4 no. 9 lit. a.
[861] UStG, Sec. 4 no. 1 lit. b, Sec. 6a.
[862] UStG, Secs. 15(1) no. 1, 14, 14a.
[863] UStG, Sec. 14(4) no. 7.
[864] UStG, Sec. 15(1) no. 2.
[865] UStG, Sec. 15(1) no. 3.
[866] UStG, Sec. 15(1) no. 4.
[867] UStG, Sec. 15(1) no. 5.
[868] UStG, Sec. 15(2) no. 1.
[869] UStG, Sec. 15(2) no. 2.
[870] UStG, Sec. 15(1a).
[871] UStG, Sec. 15(1b).
[872] UStG, Sec. 18(1), (2), (2a), as amended by the Fourth Bureaucracy Relief Act, BGBl. 2024 I, no. 323, Art. 5.
[873] UStG, Sec. 18(3).
[874] UStG, Sec. 18(4).

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sued by that body.[875] The requirement to submit such quarterly returns was introduced to prevent potential tax evasion. The return must list, *inter alia*, the VAT identification numbers of customers outside Germany, the total value of goods supplied and transferred, and corrections of errors made in prior returns.[876]

With respect to services rendered electronically by a resident entrepreneur, where the services are regarded as being rendered in another EU Member State and are subject to VAT in that other State, the entrepreneur may elect to declare and pay the foreign VAT to the Federal Tax Office (*Bundeszentralamt fuer Steuern*) instead of registering for VAT in the other State (MOSS); it is the responsibility of the Federal Tax Office to distribute the VAT amounts to the respective other States.[877]

G. Registration Threshold

Businesses whose total taxable deliveries or performance of services in Germany, including VAT, did not exceed 25,000 euros (from January 1, 2025 onwards) in the preceding calendar year and are not expected to exceed 100,000 euros in the current calendar year are exempt from VAT with respect to the taxable events listed in XI.C.1., above.[878] However, such entrepreneurs may waive this exemption.[879] Entrepreneurs that do not waive the exemption may not charge VAT on their invoices and are not entitled to credit input VAT. Since January 1, 2025, a foreign entrepreneur resident in an EU Member State can also avail itself of this possibility if its taxable deliveries or services performed in all EU Member States did not exceed 100,000 euros in the preceding calendar year and are not expected to exceed 100,000 euros in the current calendar year; further, the foreign entrepreneur must register for a Small Entrepreneur VAT Number with the tax authorities of its home jurisdiction.[880]

H. Reverse Charge Mechanism

Under Section 13b(1), (5) of the VAT Law, the taxpayer for VAT purposes is the recipient of the services with respect to the taxable performance of services by nonresident entrepreneurs (reverse charge system), except where:

(i) The recipient is not an entrepreneur; or

(ii) The taxable transaction involves the transportation of persons.

The reverse charge system is further applicable with respect to *inter alia*:

(i) The supply of construction work by a nonresident entrepreneur;

(ii) Supplies that are within the scope of real estate transfer tax;

(iii) The cleaning of properties;

(iv) The supply of mobile phones and tablets;

(v) The supply of gas and electricity;

(vi) The supply of certain raw materials such as gold or silver;

(vii) The supply of certain scrap metals; and

(viii) Since January 1, 2021, telecommunication services provided by nonresident entrepreneurs where the main activity of the service recipient is also the provision of telecommunication services, and the recipient's own consumption of the telecommunication services received is of only secondary importance.[881]

Where the recipient is the taxpayer for VAT purposes, the recipient must pay VAT at the time the invoice is submitted to it (or, at the latest, at the end of the month in which the services were furnished). The invoice need not state any VAT but must indicate that the VAT taxpayer is the recipient. The recipient may claim a credit or refund of the VAT so paid as input VAT.[882]

I. Refunds

Nonresident entrepreneurs (irrespective of whether they reside within or outside the European Union) may apply for a refund of German VAT charged to them (i.e., input VAT) that they would be able to credit if they were German entrepreneurs, if certain requirements are fulfilled. For example, a nonresident entrepreneurs may apply for such refund provided they either have not carried out taxable transactions within Germany or have rendered only transactions for which the recipient is the legal debtor of German VAT (reverse charge). A nonresident entrepreneur is entitled to a VAT refund either under Articles 167 *et seq.* of Council Directive 2006/112/EC of November 28, 2006 on the common system of value added tax as amended[883] or under the general domestic rules as set out in Section 18 paragraphs 1 to 4 of the German VAT Act.[884] With a view to simplifying and speeding up the refund of VAT to nonresident entrepreneurs, the EU procedure under Articles 167 *et seq.* of the Council Directive has been introduced for nonresident entrepreneurs resident in another EU Member State and for those resident in a non-EU country.[885] A nonresident entrepreneur resident outside the European Union is entitled to a refund of German VAT only if the entrepreneur's home country either does not impose VAT or grants a refund of its VAT to German resident entrepreneurs. An application for refund must be filed within six months (nine months in the case of entrepreneurs resident in the European Union) of the close of the calendar year to which it relates. Together with the application, a nonresident entrepreneur must submit the original bills and importation documents, as well as confirmation from the tax authorities of its home country showing that it has obtained a VAT registration number as an entrepreneur in that country.[886]

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[875] UStG, Sec. 18a(1), (2).
[876] UStG, Sec. 18a.
[877] UStG, Sec. 18h.
[878] UStG, Sec. 19(1), as amended by the Annual Tax Act 2024.
[879] UStG, Sec. 19(2).
[880] UStG, Sec. 19(4).
[881] UStG, Secs. 13b(2) no. 12 and 13b(5) sent. 6.
[882] UStG, Sec. 15(1) no. 4.
[883] Directive on the VAT system (*Mehrwertsteuersystemrichtlinie* — MwStSystRL), Official Journal of the European Union L 347/1.
[884] Federal Tax Court, decision of April 28, 1988, file no. V R 95783, BStBl. 1988 II, 748.
[885] UStG, Sec. 18(9).
[886] Value Added Tax Implementing Regulation (*Umsatzsteuer-Durchführungsverordnung* — UStDV), Secs. 59–61.

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J. *Fiscal Agent*

Like all other EU Member States, Germany uses the fiscal agency system.[887] By appointing a fiscal agent, a nonresident entrepreneur avoids having to register for VAT purposes on its own account. The fiscal agent undertakes to fulfill the nonresident entrepreneur's filing obligations in Germany if specific requirements are met. In particular, the nonresident entrepreneur must engage exclusively in tax-exempt transactions and must not be entitled to claim a VAT credit. This applies in particular to imports that are tax-exempt because the subsequent intra-EU supply is exempted.[888] Thus, an entrepreneur that only imports goods into Germany and subsequently resells them into another EU Member State does not have to register for VAT in Germany but may fulfil its filing obligations with the German tax administration by using a fiscal agent.[889]

K. *EU VAT E-Commerce Rules*

The EU E-Commerce VAT Package[890] created new rules regarding e-commerce and distance services. On September 30, 2020, the Commission published explanatory notes on the new VAT rules for e-commerce, which began to apply as from July 1, 2021.[891] The new rules contain comprehensive explanations and clarifications, including practical examples of how these measures should be applied by a supplier or an electronic interface (for example, a marketplace or a platform) involved in e-commerce transactions. These explanations are now available in all official EU languages as well as in Chinese and Japanese. The explanatory notes will be complemented by an update of the one-stop VAT guide. The guide for EU Member States with respect to trade involving the import and export of low-value consignments has also been published.[892]

Note: In view of the practical difficulties triggered by the COVID-19 pandemic, the application of the new VAT rules for e-commerce were postponed for six months from January 1 to July 1, 2021.

The EU Commission aims to simplify VAT obligations for traders providing cross-border supplies of goods and services to final customers (mainly online) and to ensure that VAT on such transactions is correctly paid to the EU Member State in which the service is performed, in line with the principle of taxation in the country of destination. The EU Commission proposed legislative changes in this area in two stages. The first set of measures entered into force in 2015 and concerned telecommunications, broadcasting and services supplied electronically to final customers. The second set of measures was adopted by the Council in December 2017 and extended simplifications to distance sales and any type of cross-border services provided to a final customer in the European Union. The latter measures, also referred to as the "E-commerce VAT package", apply from July 1, 2021.

Since 2015, a simplified system for declaring and paying VAT has been available with respect to telecommunications, broadcasting, and services supplied electronically to end-customers in the European Union. Detailed information on how the MOSS works can be found on the MOSS portal. The E-Commerce VAT Package was one of the priorities of the Digital Single Market Strategy for Europe.

On December 5, 2017, the Council adopted the E-commerce VAT package, introducing a One-Stop Shop (OSS) procedure for services other than telecommunications, radio and television broadcasting services, and services supplied electronically to end-customers, i.e., intra-EU distance sales, certain domestic supplies of goods supported by electronic interfaces, and distance sales of goods imported from non-EU Member States with a material value not exceeding 150 euros.

From July 1, 2021, the OSS procedure also applies to entrepreneurs resident in an EU Member State that either render electronic services or supply goods above a certain *de minimis* threshold B2C to non-entrepreneurial customers in another EU Member State. Under this regime, the electronic services rendered and goods supplied to non-entrepreneurial customers in Germany are subject to VAT in Germany, unlike under the formerly applicable VAT regime. In particular, as of July 1, 2021:

(i) There is no longer a supply threshold at the level established under the previous regime; there is only a uniform *de minimis* threshold of 10,000 euros for all EU Member States,[893] which, together with the already established *de minimis* threshold for services supplied to non-entrepreneurs,[894] applies to other services provided electronically and other listed services. The *de minimis* limit does not apply per country, but to the total of all transactions covered by the rules.

(ii) The OSS procedure applies to B2C intra-EU distance selling, B2C intra-EU sales supported by an electronic interface, and B2C services rendered by an entrepreneur in one EU Member State to a non-entrepreneurial end-customer in another EU Member State,[895] whereas under the previous mail order scheme, the supplying entrepreneur

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[887] UStG, Sec. 22a.

[888] Further details of the system can be found in UStG, Secs. 22a through 22e.

[889] BMF, decree of May 11, 1999, BStBl. 1999 I, 515.

[890] Council Directive (EU) 2017/2455 of December 5, 2017 amending Directive 2006/112/EEC and Directive 2009/132/EEC as regards certain value added tax obligations for supplies of services and distance sales of goods, *EU Digital Package,* L 348/7; Council Regulation (EU) 2017/2454 of December 5, 2017, amending Regulation (EU) No. 904/2010 on administrative cooperation and combating fraud in the field of value added tax, L 348/1; Council Implementing Regulation (EU) 2017/2459 of December 5, 2017 amending Implementing Regulation (EU) No. 282/2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax, L 348/32; Council Directive (EU) 2019/1995 of November 21, 2019, amending Directive 2006/112/EC as regards provisions relating to distance sales of goods and certain domestic supplies of goods, L 310/1; Council Implementing Regulation (EU) 2019/2026 of November 21, 2019 amending Implementing Regulation (EU) No. 282/2011 as regards supplies of goods or services facilitated by electronic interfaces and the special schemes for taxable persons supplying services to non-taxable persons, making distance sales of goods and certain domestic supplies of goods, L 313/14; Commission implementing Regulation (EU) 2020/94 of January 22, 2020 amending implementing Regulation for the quota year 2020, L 18/1, re details of the One Stop Shop procedure, Council Decision (EU) 2020/1109 of July 20, 2020 amending Directive (EU) 2017/2455 and (EU) 2019/1995 as regards the dates of transposition and application in response to the COVID-19 pandemic, L 244/3.

[891] *See* at: https://ec.europa.eu/taxation_customs/business/vat/modernising-vat-cross-border-ecommerce_de.

[892] *See* at: https://ec.europa.eu/taxation_customs/news/new-guidance-document-import-and-export-low-value-consignments_en.

[893] UStG, sec. 3c(4).

[894] UStG, sec. 3a(5).

[895] UStG, Sec. 18j.

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also had to register and be taxed directly in the respective EU Member State of destination. This means that the supplying entrepreneur can handle the taxation obligations arising from these intra-EU distance sales via a national electronic portal without having to register in each of the destination countries.

(iii) If the supply of the goods by an entrepreneur resident in a non-EU Member State to a non-entrepreneurial end-customer starts and ends in the European Union, the entrepreneur that maintains an electronic interface that supports this supply is treated as if it had received and supplied the goods itself;[896] this interferes with the actual supply chain and creates two deemed supplies: the deemed supply to the entrepreneur that maintains an electronic interface is VAT exempt;[897] and the deemed supply from the entrepreneur that maintains an electronic interface to the non-entrepreneurial end-customer is subject to VAT. The entrepreneur that maintains an electronic interface can use the OSS procedure[898] instead of following the standard VAT procedure.

(iv) The rule contained in Section 3c of the UStG, previously known as "mail order delivery," is now known as "intra-EU distance selling." The place of supply continues to be where the goods are located at the end of the transport or dispatch in the case of a B2C supply to a non-entrepreneurial end-customer across the border between two EU Member States, unless the supplier is resident and has its PEs in only one EU Member State and the threshold amount of 10,000 euros for intra-EU distance sales and those described in the paragraph above has not been exceeded in the previous and current year.[899] The supplier can waive the application of this threshold amount, which is binding for two calendar years. If the supplier uses an electronic interface, this new VAT law interferes with the actual supply chain and creates two deemed supplies; the deemed supply to the entrepreneur that maintains the electronic interface is VAT exempt, while the deemed supply from the entrepreneur to the non-entrepreneurial end-customer is subject to VAT. The entrepreneur maintaining the electronic interface may use the OSS procedure[900] as may the supplier.[901]

(v) A new Import One-Stop Shop (IOSS)[902] applies to distance sales of goods imported from a non-EU country in consignments with a material value of up to 150 euros if an electronic interface is used. A distance sale is the sale of an item imported from a non-EU country into an EU Member State other than that in which the transport or dispatch of the item to the acquirer ends.[903] Again, this new VAT law interferes with the actual supply chain and creates two deemed supplies. The deemed supply to the entrepreneur that maintains the electronic interface is, exceptionally, not subject to import VAT,[904] if the VAT for the deemed supply from the entrepreneur operating the electronic interface to the non-entrepreneurial end-customer or an entrepreneur that has only VAT-exempt turnover and neither exceeds relevant acquisition thresholds nor waives its application, is filed with the VAT authorities in accordance with the IOSS procedure (which requires a customs declaration). Further, this deemed supply is not subject to VAT as the transport starts in a non-EU country.[905] The deemed supply from that entrepreneur to the non-entrepreneurial end-customer or an entrepreneur, who is performing only VAT exempt activities and neither exceeds relevant acquisition thresholds nor waives its application, is subject to VAT, which is owed by the entrepreneur operating the electronic interface.

Further, from July 1, 2021, the OSS procedure applies also to services rendered electronically B2C by entrepreneurs resident in a non-EU country to recipients in an EU Member State, if the fees for the electronically rendered services exceed the *de minimis* threshold of 10,000 euros per annum.[906]

The special VAT OSS[907] and IOSS procedures,[908] which apply from July 1, 2021, simplify the filing of VAT returns with respect to, in particular but not limited to, the B2C distance selling business. Unlike previously, when using the import scheme, the seller invoices, collects and declares VAT at the time of sale to EU non-entrepreneurial end-customers and pays VAT under the OSS procedure to the EU Member State of identification. These goods are exempt from VAT at the time of import, which ensures a speedy customs clearance. The introduction of the import regime goes hand in hand with the abolition of the prior VAT exemption for goods in small consignments with a value of up to 22 euros. This is also in line with the obligation to apply the system of the country of destination for VAT purposes.[909] If the import scheme is not used, a second simplification is available for such imports: the import VAT is collected by the customs declarant (for example, the post office, the courier or the customs agent) from the end-customer and paid to the customs authority on a monthly basis.

Comment: Businesses can expect to benefit from the reduction in VAT compliance costs for cross-border transactions. This will facilitate more extensive cross-border trade and EU businesses will no longer have to compete with businesses from outside the European Union that do not charge VAT. The EU Commission expects that the EU Member States will receive an additional seven billion euros in VAT revenue per year.[910]

L. *Obligatory Electronic Invoices as of January 1, 2025*

Since January 1, 2025, electronic machine-readable invoices have been obligatory in the B-2-B business in Ger-

[896] UStG, Sec. 3(3a) sent. 1, (6b).
[897] UStG, Sec. 4(4c).
[898] UStG, Sec. 18j.
[899] UStG, Sec. 3c(1).
[900] UStG, Sec. 3a(5).
[901] UStG, Sec. 18j.
[902] UStG, Sec. 18k.
[903] UStG, Sec. 3(3a) sent. 2.
[904] UStG, Sec. 5(1) no. 7.
[905] UStG, Sec. 3(7) sent. 2 no. 1.
[906] UStG, Secs. 3a(5), 18i and Sec. 27(33).
[907] UStG, Sec. 18j for the supply of goods and Sec. 18i for services rendered.
[908] UStG, Sec. 18k.
[909] UStG, Sec. 3c.
[910] See https://ec.europa.eu/taxation_customs/business/vat/modernising-vat-cross-border-ecommerce_en.

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many.[911] While each entrepreneur has had to be capable of receiving electronic invoices since that date, sending electronic invoices will become obligatory by beginning of the year 2027 for businesses with an annual turnover of more than 800,000 euros and by the beginning of the year 2028 for all other businesses, except where the invoice concerned is for less than 250 euros and invoices for non-VATable deliveries or services. Further, small entrepreneurs as defined in Section 19 of the UStG are exempt from sending electronic invoices but must be capable of receiving them. Electronic invoices are to be stored electronically for eight years.

[911] UStG, Sec. 14, as amended by the Growth Opportunities Act of March 27, 2024, BGBl. 2024 I Nr. 108.; see further, decree of the Federal Ministry of Finance of October 15, 2024, BStBl. 2024 I, p. 1320, with further details.

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XII. Real Estate Transfer Tax

A. In General

Real estate transfer tax (*Grunderwerbsteuer*) (or RETT)[912] is the only German transfer tax of any importance. RETT is imposed on the transfer of title to real property located in Germany for consideration. Neither transfers by reason of death nor *inter vivos* gifts attract the tax.[913]

B. Tax Rates

Since 1998, the RETT rate in all German states was 3.5% of the consideration for the transfer.[914] The 3.5% rate is still applicable in Bavaria. All other German states have increased the applicable rate over the years.

As of January 1, 2025, the applicable rates are as follows:

States	Rates
Brandenburg, North Rhine-Westphalia, Saarland, and Schleswig-Holstein	6.5%
Berlin, Hesse, and Mecklenburg-Western Pomerania	6%
Hamburg and Saxonia	5.5%
Baden-Wuerttemberg, Bremen, Lower Saxony, Rhineland-Palatinate, Saxony-Anhalt and Thuringia	5%
Bavaria	3.5%

C. Scope and Application

The most important taxable transactions are: the sale or conveyance of real property;[915] the contribution of real property to the capital of a corporation;[916] the in-kind split-up of real property among co-owners;[917] the direct or indirect sale or transfer within 10 years (five years prior to July 1, 2021) of at least 90% (95% prior to July 1, 2021) of the interests in a partnership that owns real property;[918] and the sale or transfer of at least 90% (95% prior to July 1, 2021) of the shares in a corporation holding German-situs real property, directly or via wholly-owned subsidiaries, by one person or by a group of affiliated companies, or the consolidation of at least 90% (95% prior to July 1, 2021) of all the shares in such a corporation in the hands of one holder, or by companies combined in an *Organschaft* arrangement for value added tax (VAT) purposes.[919]

However, if at least 90% (95% prior to July 1, 2021) of all the shares in a company that owns German-situs real estate were already held by members of a group, the subsequent transfer of such shares to one member of the group does not constitute a new taxable event for purposes of RETT. Similarly, if at least 90% (95% prior to July 1, 2021) of all the shares in a real estate holding company have been held since its formation, in part directly and in part indirectly, by one person, the subsequent transfer of the shares so far held indirectly to such a person does not constitute a taxable event.

Certain mergers, spin-offs and hive-downs are exempt from RETT subject to certain conditions.[920] In particular, the RETT exemption requires that only controlling and controlled entities are involved. The necessary level of control is met if at least 95% of the shares in the controlled entity are directly or indirectly held by the controlling entity during the period of five years before and after the reorganization.

In the past, certain planning techniques had evolved, i.e., RETT blocker structures enabling a single purchaser to acquire indirectly 99.6% of all shares/interests in a property-owning corporation/partnership. Legislative counter-measures aimed at making these transactions subject to real estate transfer tax came into effect on June 6, 2013. Under Section 1(3a) of the GrEStG, as amended, there was a taxable transfer if a person held, directly or indirectly, an economic participation of at least 95% in a corporation/partnership owning property. This holding percentage was reduced once again to 90% with effect from July 1, 2021.

Where the taxable event is the direct or indirect sale or transfer of at least 90% of the interests in a partnership, the direct or indirect acquisition or the consolidation of at least 90% of the shares of a corporation owning real property, or the transfer of real property in a corporate reorganization, the tax is based on the synthetic value of the underlying real property as determined in the German Valuation Law (*Bewertungsgesetz* — BewG).[921] The synthetic value is calculated using a standardized valuation method.[922]

To make share deals even less attractive, since July 1, 2021,[923] not only has the prior 95% limit been lowered to 90%, but also the prior holding period of five years has been doubled to 10 years and new holding periods of 10 and 15 years have been implemented for specific types of share deals. Furthermore, as of July 1, 2021, a direct or indirect transfer of the shares held in a corporation that owns real property is a taxable transaction subject to RETT if at least 90% of the shares are transferred either directly or indirectly to new shareholders within a monitoring period of 10 years.[924] In this case, RETT is imposed on the corporation. However, the tax will not apply if the real property-owning corporation is a stock corporation holding directly real property located in Germany and is listed either on a stock exchange within the meaning of Section 2 of the German Securities Trading Act (*Wertpapierhandelsgesetz* or WpHG) — an "organized stock market" — that is locat-

[912] Real estate transfer tax is regulated by the Real Estate Transfer Tax Act (*Grunderwerbsteuergesetz* — GrEStG), as amended by the Act Amending the Real Estate Transfer Tax Act of May 12, 2021, BGBl. 2021 I, 986.

[913] GrEStG, Sec. 3(2).

[914] GrEStG, Sec. 11.

[915] GrEStG, Secs. 1(1) no. 1 and 1(1) no. 2.

[916] GrEStG, Sec. 1(1).

[917] GrEStG, Sec. 1(1).

[918] GrEStG, Secs. 1(2a), 1(3a).

[919] GrEStG, Secs. 1(3), 1(3a).

[920] GrEStG, Sec. 6a, which applies to mergers, spin-offs and hive-downs governed by German law or the laws of EU/EEA Member States.

[921] Valuation Act (*Bewertungsgesetz* — BewG), Sec. 138(2) or (3); GrEStG, Sec. 8(2).

[922] BewG, as amended, Secs. 157 *et seq.*

[923] Act Amending the Real Estate Transfer Tax Act of May 12, 2021, BGBl. 2021 I, 986.

[924] GrEStG, Sec. 1(2b).

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ed in a European Union (EU)/European Economic Area (EEA) Member State or on a non-EU/non-EEA stock exchange that is — according to the EU Commission — the equivalent to such an EU/EEA organized market.[925] The Swiss stock exchange, for example, is deemed not to be equivalent, i.e., companies listed on the Swiss stock exchange cannot rely on the exemption. Further, the exemption applies only to transfers of shares that are listed for trading on such a stock exchange and are actually traded on that exchange.

Rather complex grandfathering rules apply to prevent partnerships and corporations 90% of the interests/shares in which had already been transferred prior to July 1, 2021 (without triggering RETT) from using the new law to transfer, either directly or indirectly, the remaining interests/shares in excess of the former 95% threshold without triggering real estate transfer tax at all.[926]

All these complex rules for share deals can easily trigger RETT a number of times where shares are transferred. This is because the real property held by the company whose shares are the subject of the transfer could be allocated, both directly and indirectly, to a number of different entities. This unsatisfying situation has been eased by a new law applying to all share transfers made after December 5, 2024 that introduced new rules for attributing the real property to one entity only.[927] In principle, real property is deemed to form part of the assets of a company (partnership or corporation) if the company most recently acquired the property through a transaction directly as: (i) a legal owner; or (ii) as a person authorized to exploit the real property, unless the transaction has been reversed. This attribution ends when the property is subsequently transferred directly to another legal owner or when the conditions for attribution cease to exist. Indirect acquisitions by way of share deals taking place after December 5, 2024 that, in principle, give rise to a RETT charge will be ignored if there has been a previous direct acquisition by a new legal owner or a person authorized to exploit the real property — even where that acquisition occurred before December 5, 2024. This represents a significant easing of the former position under which multiple attributions of the real property were possible with the consequence that multiple RETT charges could accrue as a result of a share deal. Instead, there can now only be one of two attributions: to the legal owner of the property or the person authorized to exploit the property. This is a departure from established Federal Tax Court case law,[928] which was accepted by the tax administration because it was published in the Federal Tax Gazette.

Since December 21, 2022, the basis for the RETT exemption in the case of a property transfer between a partner and a partnership is denied, if the partnership opts to be taxed like a corporation, according to the German check-the-box rules after December 31, 2021.[929] Further, if the property transfer happened within 10 years before or after the opt-in date, the basis for the RETT exemption in the case of a such property transfer between a partner and a partnership is likewise denied (even with retrospective effect).[930] Further, since December 21, 2022, the opt-in of a partnership within the 10-year period after the acquisition of real estate from another partnership results in a corresponding reduction of its interest in the transferring partnership. This triggers again a retrospective denial of such RETT exemption.[931]

As a result of the reform of the partnership law,[932] the basic idea for the RETT exemption in the case of a property transfers between a partner and a partnership has been given up (even with retrospective effect). This basic idea was premised on the principle that partnerships have only partial legal capacity. Pursuant to the Act to Modernize of the Law on Civil-Law Partnerships (MoPeG),[933] partnerships have now been granted full legal capacity. As such, a partnership is now treated legal-wise similar to a corporation and, in particular, is allowed to own assets. This means that a property transfer between a partner and a partnership must be treated similarly to a transfer between a shareholder and a corporation.

Comment: According to this understanding, the precondition for the RETT tax exemptions for transfers between partners and partnerships are at significant risks to be denied because of the different legal understanding of partnerships since January 1, 2024. Therefore, the Secondary Credit Market Promotion Act[934] states clearly, and in contrast to the partnership law reform, that for RETT purposes, the traditional understanding of a partnership with only partial legal capacity still applies — at least until end of 2026 (sic).[935] This means that a fundamental RETT reform can be expected by the end of 2026.

In the case of an asset purchase/acquisition of real property, RETT is imposed on the parties to the transaction (i.e., the seller and the buyer), which owe the tax jointly and severally,[936] even though most sales agreements shift the burden to one party, generally the buyer. However, such a contractual stipulation does not affect the position of the parties *vis-à-vis* the tax authorities, although the tax authorities will, as a rule, first try to collect the tax from the party that assumed the obligation to pay the tax. In the case of an indirect acquisition by way of a share sale/transfer, the RETT is, in principle, imposed on the acquirer,[937] except in the case of the direct or indirect sale or transfer of at least 90% of the interests in a partnership that owns real property. In that case, RETT is imposed on the partnership and the corporation, respectively.[938]

[925] GrEStG, Sec. 1(2c).

[926] GrEStG, Sec. 23(18)–(24).

[927] GrEStG, Sec. 1(4a), which may need to be combined with GrEStG, Secs 16(4a).

[928] See BFH decision of December 14, 2022, file no. II R 40/20, BStBl. 2023 II, p. 1012.

[929] See VII.D.

[930] GrEStG, Sec. 6 (3) (fourth sentence).

[931] GrEStG, Sec. 6 (3) (fifth sentence), as amended by the Annual Tax Act 2022 of December 16, 2022, BGBl. 2022 I, 2294.

[932] MoPeG of August 10, 2021, BGBl. 2021 I, 3436, applicable from January 1, 2024.

[933] Act to Modernize of the Law on Civil-Law Partnerships (MoPeG) of August 10, 2021, BGBl. 2021 I, 3436.

[934] Secondary Credit Market Promotion Act (*Kreditzweitmarktförderungsgesetz*) of December 22, 2023, BGBl. 2023 I, No. 411, Arts. 29, 30.

[935] GrEStG 24, as amended by Arts. 29, 30 of the Secondary Credit Market Promotion Act (*Kreditzweitmarktförderungsgesetz*) of December 22, 2023, BGBl. 2023 I, No, 411.

[936] GrEStG, Sec. 13 nos. 1, 2.

[937] GrEStG, Sec. 13 nos. 3, 4, 5.

[938] GrEStG, Sec. 13 nos. 6, 7.

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XIII. Inheritance and Gift Tax

A. *In General*

Inheritance and gift tax (*Erbschaft-und Schenkungsteuer*) applies to transfers of property by reason of death or by way of *inter vivos* gift.[939] This also includes disproportionate capital contributions made by a shareholder or partner to the reserve of a corporation or a partnership, if and to the extent that the co-shareholders or co-partners indirectly or directly benefit from the contribution. This is a significant risk if the capital contribution is not made in exchange for new shares in the corporation or an increase in the interest held in the partnership.

German inheritance tax is imposed not on the estate of the decedent but on the beneficial share of each beneficiary. Consequently, the jurisdiction to tax and the extent of the tax liability depends not only on the decedent's or donor's last country of residence, but also on the number and residence of the beneficiaries, and their degree of kinship to the decedent, as well as on the value of their beneficial shares.

In principle, a distinction must be made among five different situations:[940]

(i) If the decedent was a resident of Germany at the time of his or her death, his or her entire estate, wherever situated and regardless of the country of residence of the beneficiaries, is subject to inheritance taxation; the same applies, *mutatis mutandis*, where the donor is a resident at the time a gift is consummated.

(ii) If one or more of the beneficiaries are resident in Germany at the time the tax liability arises, their beneficial share of the estate is taxable wherever the underlying property is situated, even if the decedent's last country of residence was not Germany; the same rules apply, *mutatis mutandis*, where a donee is a resident of Germany.

(iii) If either the decedent or a beneficiary (or the donor or a donee) is a German citizen who emigrated within the five-year period preceding the taxable event, the decedent or beneficiary (or the donor or donee) is deemed to be a resident and the entire estate, or the beneficial share of the beneficiary concerned is taxable. Under the 1998 Protocol to the 1980 Germany-U.S. estate, inheritance and gift tax treaty,[941] the five-year period is extended to 10 years.

(iv) If the decedent (or donor) was a German citizen who was subject to extended limited income tax liability (see IX.H., above) at the time of the taxable event, his or her estate will be subject to extended limited inheritance or gift tax liability to the extent the income from this estate (or gift) is subject to the extended limited income tax liability, unless the taxpayer proves that the estate has been subject to a foreign tax that is comparable to German inheritance or gift tax and represents at least 30% of the German applicable tax debt.[942]

(v) In all other cases, inheritance taxation is limited to certain domestic assets such as, in particular, German-situs property and domestic business assets (whether held directly by the decedent or donor or indirectly by a partnership in a permanent establishment (PE) or a permanent agent in Germany) and shareholdings of at least 10% of a domestic corporation, as well as receivables secured by land charges on domestic real property.

Business assets are basically privileged as compared to private assets. Further, real property used to be privileged as a result of its rather low valuation for inheritance/gift tax purposes compared to its fair market value. For years, this was the subject of intense dispute against the background of German constitutional law. A decision of the Federal Constitutional Court of November 7, 2006[943] held inheritance and gift tax to be unconstitutional to the extent business assets and real property are not valued at fair market value for purposes of the tax. As a consequence, the tax had to be reformed by the end of 2008. The new law has applied since 2009, but as a result of another decision of the Federal Constitutional Court of December 17, 2014,[944] the rules regarding business assets had to be revised once again by June 30, 2016.

The decision of the Constitutional Court of December 17, 2014 was in response to a matter referred to the Constitutional Court by the Federal Tax Court (*Bundesfinanzhof* — BFH),[945] which regards the provisions of the law granting exemptions for business assets as overly generous and, therefore, unconstitutional. The Constitutional Court held Section 13a and 13b Inheritance Tax Act (*Erbschaftsteuergesetz* — ErbStG), which provided certain tax exemptions for the transfer of business assets, to be unconstitutional. These provisions remained applicable through June 30, 2016. In the opinion of the Constitutional Court, the 2009 exemptions are in principle acceptable insofar as transfers of small and medium-size businesses are concerned, but in other cases are justifiable only if a need for tax relief is demonstrated.[946]

Note: Revised provisions for the transfer of more valuable businesses were enacted on November 9, 2016 and are applied retroactively from July 1, 2016.[947] These provisions are very complex and again subject to dispute regarding their compatibility with the Constitution.

The Germany-U.S. estate, inheritance and gift tax treaty is discussed at XVI.C.5.c., below.

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[939] Inheritance Tax Act (*Erbschaftsteuergesetz* — ErbStG), as amended and supplemented by a regulatory ordinance (*Erbschaftsteuer-Durchfuehrungsverordnung* — ErbStDV).

[940] ErbStG, Sec. 2.

[941] Convention Between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation with Respect to Taxes on Estates, Inheritances and Gifts, signed on December 3, 1980, as amended by the Protocol to the treaty, which was signed on December 14, 1998, and entered into force on December 14, 2000, BGBl, 2001 II, 65.

[942] AStG, Sec. 4.

[943] BStBl. 2007 II, 192, file no. 1 BvL 10/02.

[944] Federal Constitutional Court — 1 BvL 21/12.

[945] Federal Tax Court, file no. II R 9/11 of September 27, 2012, BStBl. 2012 II, 899.

[946] Federal Constitutional Court, file no. 1 BvL 21/12, BStBl. 2015 II, 50.

[947] *Gesetz zur Anpassung des Erbschaft- und Schenkungsteuergesetzes an die Rechtsprechung des Bundesverfassungsgerichts*, dated November 4, 2016, BGBl. 2016 I, 2644.

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B. Estates and Gifts of Residents

An estate of a decedent or a gift of a donor who was or is resident in Germany is subject to inheritance or gift tax in its entirety, irrespective of the decedent's or donor's country of citizenship, the country of residence of the beneficiaries, and the location of the assets belonging to the estate. In determining the net taxable estate, all debts of the decedent, as well as "general expenses," such as funeral expenses and legacies, may be deducted.[948] A surviving spouse or surviving partner of a registered same sex marriage (*Lebenspartnerschaft*) may claim a personal exemption of 500,000 euros (unchanged since 2010)[949] plus an additional allowance of 256,000 euros (unchanged since 2002) reduced by the capitalized value of tax-exempt pension rights (which have been increased since 2002) to which the surviving spouse or partner is entitled.[950] Children may claim an exemption of 400,000 euros each, plus an additional exemption of 10,300 euros to 52,000 euros (unchanged since 2002) depending on the age of the child and reduced by tax-exempt pension rights.

If the estate includes business assets or participations of more than 25% in the shares of a corporation resident in Germany, a European Union (EU) Member State, Norway, Iceland or Liechtenstein, significant benefits may be obtained, if certain tight and very complex requirements are met. If the value of the privileged business assets does not exceed 26 million euros over a 10-year monitoring period, the recipient is entitled to an 85% exemption or full exemption if the following conditions are fulfilled: (i) the sum of the wages paid to employees during the five or seven years following the taxable event amounts to 400% or 700%[951] or more of the average annual sum of the wages paid during the five years prior to the taxable event; (ii) no sale or similar event occurs during the five or seven years following the taxable event; and (iii) the value of the business assets exceeds the net value of the administrative assets[952] (for example, real property not used for the business, shareholdings of 25% or less, receivables and net cash/net cash equivalents); the net value of the administrative assets is reduced by 10% of the fair market value of the business assets after deduction of the net value of the administrative assets that have been apportioned for more than two years to the business ("harmless administrative assets").

Additional tax privileges are available with respect to family-owned businesses, subject to the fulfillment of certain rigorous conditions.[953] The taxable value of the transfer of a family business is reduced by up to 30% provided the articles of association or the partnership agreement stipulate rather strict limitations as regards withdrawals or distributions from the business and valuation discounts on the sale of the interest to co-owners beginning (at least) during the two years prior to the transfer and 20 years following the transfer. This allowance is granted in addition to the relief outlined above.

If a partnership opts to be taxed like a corporation,[954] the partnership nevertheless remains qualified as a partnership for German gift and inheritance tax purposes.[955] However, some deviations should be noted according to a decree of the German tax authorities.[956] Firstly, although the opted-in partnership remains qualified as a partnership for gift and inheritance tax purposes, special business assets legally owned by the partner but used by the partnership (*Sonderbetriebsvermoegen*)[957] are not subject to the valuation privileges provided to partnerships for gift and inheritance tax purposes. Secondly, if for the valuation of the opted-in partnership its taxable profits is used, the taxable profit is to be calculated pursuant to the corporate income tax rules. Thirdly, the sum of the wages paid (a precondition for the gift/inheritance tax privilege) is to be allocated proportionally to the partner's interest. Finally, the required holding period of five years or seven years, respectively (a precondition for the gift and inheritance tax privilege) refers to the respective partner's interest in the partnership, while the partnerships' election to be treated as a corporation, itself, does not trigger a violation of this precondition. Neither the reform of the partnership law,[958] according to which a registered partnership since January 1, 2024 has been granted full instead of formerly only partial legal capacity, changed this. Pursuant to the Secondary Credit Market Promotion Act,[959] for a registered partnership the traditional understanding of a partnership with only partial legal capacity still applies, but in contrast to RETT (see XII., above), without any explicit time limitation.

If the value of the privileged business assets exceeds 26 million euros within a 10-year monitoring period, the tax privileges will be cancelled with retroactive effect. In this case, the only chance to reduce the inheritance or gift tax burden is to opt for reduced tax rates. The relief is reduced by one percentage point for every 750,000 euros above the 26 million euros amount. This option is limited to business assets with a value of 90 million euros.[960] Alternatively, the heir or legatee, or the donee is relieved of the residual tax liability on the business assets as part of the "exemption needs test," if he or she uses half of their available other assets not subject to the business assets exemption to pay the tax. Thus, an acquirer without valuable other assets could make use of the relief easily, while acquirers with valuable other assets need to check how to fund the inheritance/income tax burden.

It should be noted that none of the above privileges apply if the *gross* value of the administrative assets exceeds 90% of the *net* value of the business.[961] This is particularly harmful to retail businesses with high cash amounts and a high level of receivables.

[948] ErbStG, Sec. 10(5).
[949] ErbStG, Sec. 16(1) no. 1.
[950] ErbStG, Sec. 17(1).
[951] For businesses with fewer than 16 employees reduced rates apply under ErbStG, Sec. 13a(2).
[952] ErbStG, Sec. 13b(4), nos. 1 to 5.
[953] ErbStG, Sec. 13a(9).
[954] KStG, Sec. 1a KStG.
[955] BewG, Sec. 97(1), sent. 1, No. 5.
[956] Identical decree of the supreme tax authorities of the German states of Länder of October 10, 2022, DStR 2022, 2690.
[957] See VII.A.2., above.
[958] MoPeG of August 10, 2021, BGBl. 2021 I, 3436, applicable from January 1, 2024.
[959] ErbStG, Sec. 2a, as amended by the Secondary Credit Market Promotion Act (*Kreditzweitmarktförderungsgesetz*) of December 22, 2023, BGBl. 2023 I, No. 411, Art. 28.
[960] ErbStG, Sec. 13c.
[961] ErbStG, Sec. 13b(2) sent. 2.

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In addition, such business assets transferred to individual taxpayers in Classes II and III (see XIII.D., below) are, in effect, taxed at the lower rates applicable to assets transferred to taxpayers in Class I.[962] This relief is available for inheritances or gifts of privileged business assets.

Comment: These rules are very complex and rigid, in particular, the long five- and seven-year monitoring periods regarding the maintenance of the average annual sum of wages paid. Furthermore, these rules have proven insufficiently flexible to accommodate the economic downturn triggered by the COVID-19 pandemic lockdowns. Under the law, each violation of these thresholds results in the retroactive assessment of inheritance or gift tax, as the preconditions for the tax privilege granted cease to be fulfilled and the tax reductions decrease accordingly. Against this background, on December 30, 2021,the Supreme Tax Authorities of the German States issued a decree[963] under which, subject to very rigorous conditions, the responsible tax office can waive its claim for inheritance or gift tax, if the threshold regarding the maintenance of the average annual sum of wages paid was violated (only) because of the COVID-19 lockdowns between March 1, 2020 and June 30, 2022.

Foreign estate or inheritance or gift taxes assessed with respect to items of property situated abroad are creditable against German inheritance or gift tax, unless the foreign tax liability arose five years or more before the German tax liability.[964] If the decedent or the donor was or is a German resident, foreign-situs assets are those assets listed in Section 121 of the Valuation Law that are located abroad, as well as rights to use such assets. If the decedent or donor was not a German resident, foreign-situs assets are all assets except the domestic assets listed in Section 121 of the Valuation Law.[965]

Shares in a corporation are covered by Section 121 of the Valuation Law, provided the decedent or donor (either alone or together with associated parties within the meaning of Section 1, paragraph 2 of the Foreign Tax Act) owned (directly or indirectly) an interest in the corporation of at least 10%.

Under Article 11(2)(b) of the Germany-U.S. estate, inheritance, and gift tax treaty of December 14, 2000,[966] the United States grant a credit against U.S. estate tax for German taxes levied, if the estate of a U.S. citizen who died while in Germany included U.S. portfolio securities. Germany grants a similar credit in the opposite situation under Article 11(3)(a) of the treaty.

Two provisions tax both the transfer of assets by a decedent (or in the case of an *inter vivos* trust, the grantor) to a trust as well as the transfer of assets by the trust to the beneficiaries on the dissolution of the trust, or the distribution of income or other assets to live beneficiaries during the term of the trust.[967] However, actual taxation presupposes that the jurisdictional criteria outlined in III.A., above, are satisfied. In the case of a transfer to a trust, this means that the decedent or grantor must be a German resident, as the trust (or rather the trustee) would rarely qualify as a German resident. On the dissolution of the trust, payments to the beneficiaries will attract inheritance tax only if and to the extent one or more of the beneficiaries are German residents at the time (or were German residents at any time in the five preceding years). It also means that payments to nonresident live beneficiaries would not be taxable.

Comment (1): As a consequence of the rules described above, some tax planning should be possible, even though it should be noted that, for income tax purposes, the income of a trust (resident outside the European Union/European Economic Area (EEA)) will be currently attributed and taxed in the hands of the grantor if and for so long as the grantor is a German resident and, thereafter, in the hands of German resident beneficiaries.[968] (For further discussion, see XVI.C., below.)

Comment (2): Granting disproportionate profit participations to partners in partnerships and shareholders in corporations could become subject to gift tax. In the case of a departing partner or shareholder, the transfer of the company interest in either a partnership or a corporation below its fair market value, or the redemption of shares of the departing shareholder of a GmbH for less than its fair market value, may also be subject to gift tax.[969]

C. *Estates and Gifts of Nonresidents*

If neither the decedent nor the donor nor the beneficiary is resident in Germany or — as a German citizen — was tax resident in Germany within the last five years prior to the taxable event, and if neither the decedent nor the donor is subject to extended limited income tax liability (see IX.H., above) at the time of the taxable event, German inheritance tax or gift tax will be imposed only with respect to such assets as are located in Germany under Section 121 of the Valuation Law.

German-situs assets within the meaning of Section 121 of the Valuation Law include: German permanent establishments (PEs); agricultural assets; real property; shares in domestic corporations in which the decedent, either alone or together with related persons, owned directly or indirectly a participation of at least 10%; certain intangible rights registered in Germany; assets rented or leased to a German business; receivables collateralized with German real property; profit-participating loans and silent partnership interests if the debtor is resident in Germany; and rights of use (for example, usufruct) pertaining to any of the assets mentioned above. These situs rules apply equally to inheritances and gifts. For partnerships that opt to be taxed as a corporation,[970] see the discussion at XIII.B., above.

To the extent jurisdiction to tax is based on the residence of beneficiaries, the net taxable estate is determined in the same way as the net taxable estate of a resident. If, however, neither the decedent nor the beneficiaries reside in Germany, only debts that are economically connected with domestic property may be deducted.

[962] ErbStG, Sec. 19a.
[963] BStBl 2022 I, 156.
[964] ErbStG, Sec. 21.
[965] ErbStG, Sec. 21(2).
[966] BGBl. 2001 II, 65.
[967] ErbStG, Sec. 3(2) no. 1, Sec. 7(1) nos. 8, 9.
[968] AStG, Sec. 15; BFH decisions of November 5, 1992, BStBl. 1993 II, 388 and February 2, 1994, BStBl. 1994 II, 727.
[969] ErbStG, Sec. 7(6), (7).
[970] KStG, Sec. 1a KStG.

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D. Tax Rates

Inheritance or gift tax is imposed on the following classes of taxpayers at the rates indicated:[971]

(i) Class I: the transferor's spouse, partners in registered same sex marriages, children and stepchildren and their descendants, and the transferor's parents and grandparents in the case of transfers by reason of death (7% to 30%);

(ii) Class II: the transferor's parents and their parents, unless they are covered by Class I, sisters and brothers as well as sisters or brothers' children, stepparents, sons-in-law and daughters-in-law, parents-in-law and divorced spouses and divorced partners in same sex marriages (15% to 43%); and

(iii) Class III: all other transferees (30% to 50%).

The top rates apply where the value of the beneficiary's share exceeds 26 million euros (in Class III 13 million euros).

E. Procedures

A beneficiary must notify the tax office within three months after receiving notice of the relevant death. In the case of taxable gifts, both the donor and donee are required to notify the tax office. Notice is not required if the will of the decedent is granted probate by a German court or notary, or the gift contract was authenticated by a German court or notary.[972] The tax office forwards the appropriate forms, which must be filed within one month of receipt, although extensions of time are readily granted.[973]

F. Tax Treaty Aspects

Currently, Germany has separate inheritance tax treaties with France,[974] Greece (only movable assets),[975] Switzerland[976] and the United States. In addition, the comprehensive double taxation agreements with Denmark[977] and Sweden[978] include provisions that address taxes on inheritances and *inter vivos* gifts. (The Germany-U.S. estate, inheritance and gift tax treaty is discussed at XVI.C.5.c., below.) The Germany-Denmark tax treaty, the Germany-France inheritance and gift tax treaty, the Germany-Sweden tax treaty, and the Germany-U.S. estate, inheritance and gift tax treaty also apply to *inter vivos* gifts. If and to the extent a tax treaty is applicable, a thorough analysis of its impact on applicable domestic rules is required regarding the details and the interaction with the applicable domestic rules.

Unlike German inheritance tax law, these treaties generally accord importance to the residence of the decedent *and* the situs of certain assets only. The residence or nationality of the heir or other beneficiaries is immaterial (except under the Germany-Sweden tax treaty). The citizenship of the decedent or donor is also immaterial, except with respect to the tie-breaker rules, and under the Germany-Greece succession treaty (regarding the decedent), and the Germany-United States estate, inheritance and gift tax treaty.

Comment: If a partnership chooses to be taxed as a corporation, the consequences of this for the German partnership and its partners are to be checked thoroughly against the background of the applicable tax treaty.

The Germany-U.S. estate, inheritance and gift tax treaty applies to estates of deceased persons who are domiciled in one or both Contracting States and to donors who are so domiciled at the time of the making of a gift. For U.S. tax purposes, a person is domiciled in the United States if he or she is a resident or citizen of the United States; for German tax purposes, a person is domiciled in Germany if he or she has his or her domicile or habitual abode in Germany or is otherwise subject to unlimited German estate and gift tax liability.

Article 8 of the Germany-U.S. estate, inheritance and gift tax treaty includes a rule that an interest of a partnership, its real estate and its business assets held in a permanent establishment can be taxed proportionately to the partner's interest by the tax authorities of the jurisdiction where these specific assets are located. Obviously, this assumes the tax transparency of a partnership. However, if a partnership has opted for income taxation as a corporation, for tax purposes the partnership becomes income tax opaque, while it still remains transparent for gift/inheritance tax purposes (see above XIII.B., above).

Comment: It is not clear what this means for Article 8 of the Germany-U.S. estate, inheritance and gift tax treaty. Any open issues should be clarified with the responsible German and U.S. tax authorities prior to taking any measures.

If and to the extent a transfer of assets is exempt from German inheritance or gift tax under an applicable inheritance/gift tax treaty, Germany retains its right to impose inheritance/gift tax on resident beneficiaries or resident decedents or donors. The applicable tax rate is determined based on the total enrichment of the resident beneficiaries in order to preserve the progressive rate structure.[979] However, except for the Germany-Switzerland succession duties treaty, all inheritance/gift tax treaties provide for the credit method rather than the exemption method.

[971] ErbStG, Sec. 15, Sec. 19.

[972] ErbStG, Sec. 30.

[973] ErbStG, Sec. 31.

[974] Convention Between the French Republic and the Federal Republic of Germany for the Avoidance of Double Taxation with Respect to Taxes on Inheritances and Gifts, signed on October 12, 2006.

[975] Convention between Greece and Germany Concerning Succession Rights on Movable Property, signed on November 18 and December 1, 1910.

[976] Convention between the Swiss Federation and the Federal Republic of Germany for the Avoidance of Double Taxation with Respect to Succession Duties, signed on November 30, 1978.

[977] Agreement Between the Federal Republic of Germany and the Kingdom of Denmark for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital, as Well as Taxes on Estates, Inheritances, and Gifts, and for Assistance with Taxation Issues, signed on November 22, 1995.

[978] Convention Between the Kingdom of Sweden and the Federal Republic of Germany for the Avoidance of Double Taxation with Respect to Taxes on Income and Capital as Well as on Estates and Gifts and Concerning the Offering of Mutual Fiscal Cooperation with Respect to Such Taxes, signed on July 14, 1992.

[979] ErbStG, Sec. 19(2).

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Another material difference between Germany's inheritance tax treaties and German domestic inheritance tax law concerns the deduction of debts. In particular, if neither the decedent nor the beneficiary was or is a German resident, under domestic law, only debts economically connected with the taxable assets are allowable deductions. This is also the rule under Article 10(1) of the Germany-United States estate, inheritance and gift tax treaty. However, under the Germany-Switzerland succession duties treaty, such part of the remaining "general debts" will be allowed as a deduction in Germany as corresponds to the part of the estate that Germany is authorized to tax.[980]

[980] Germany-Switzerland succession duties treaty, Art. 9.

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XIV. Transfer Pricing

A. *Adjustment of Intercompany Prices*

1. *In General*

Section 1 of the Foreign Tax Act (*Aussensteuergesetz* — AStG) provides that, notwithstanding other statutory provisions, a taxpayer's income may be adjusted upwards to reflect arm's-length compensation if it is determined that, in the context of international business transactions, the taxpayer's income was reduced as a result of business dealings at a price below proper arm's-length compensation.

Comment: With the enactment of the new controlled foreign corporation (CFC) rules (see XV.B., below), both these rules and Section 1 of the Foreign Tax Act can now apply to the same circumstances — at least partially. As such, over-taxation is likely to result in these situations and should be avoided by reliance on a 2002 decision of the Federal Tax Court. A taxpayer in this situation should apply to the German tax authorities for a waiver of CFC taxation because of the unfair taxation it would produce, given that the taxpayer's income would have increased already pursuant to Section 1 of the Foreign Tax Act.[981]

Other provisions that remain applicable notwithstanding Section 1 of the Foreign Tax Act are the rules regarding constructive dividends[982] and constructive contributions to capital;[983] these rules, however, apply only to corporate structures.

For further discussion of the German transfer pricing system, see also Chapter 55 of 6950 T.M., *Transfer Pricing: Rules and Practice in Selected Countries (E–G).*

2. *Scope of the Provision*

Section 1(1) of the Foreign Tax Act, which addresses only international business transactions, permits the reallocation of income among two or more related entities, of which only one needs to be subject to German income taxation (taxpayer). A taxpayer may be an individual or a corporation or any other entity subject to German income taxation. Since 2013, a partnership is also deemed to be a taxpayer for this purpose. An entity (a corporation, an individual, a partnership, a foundation, etc.) is deemed to be related to a taxpayer if the entity is capable of agreeing on a transfer of profits with the other party; it is not required that the entity be a domestic entity or subject to income tax in Germany or that it have legal capacity. Entities are related to each other, if one entity controls the other entity either by a direct or indirect participation of at least 25%, or by other means.

The provision permits the reallocation of income only to the extent the income of a taxpayer is reduced to less than what a non-controlled taxpayer would have realized in an arm's-length transaction. It does not apply in cases in which the controlled transaction results in an increase rather than a reduction of income.[984] Business transactions include all transactions based on contractual obligations that do not constitute corporate or partnership agreements and that, for the taxpayer or an affiliate of the taxpayer, represent part of a business activity, an agricultural activity, an independent service or a rental activity.[985]

By contrast, the rules on constructive dividends and constructive contributions to capital apply at the domestic level as well and involve not only the income of the corporation proper, but also (in the case of constructive dividends) withholding tax aspects.

In certain instances, the scope of Section 1 of the Foreign Tax Act is broader than the scope of the rules on constructive dividends and constructive contributions. For example, where a parent corporation grants an interest-free loan to a domestic corporate subsidiary, the rules on constructive contributions do not allow for an adjustment of the taxable income of the parent corporation. In contrast, Section 1 allows for such an adjustment if the loan is granted to a foreign corporate subsidiary. In this context, the European Court of Justice held on May 31, 2018, that Section 1 is in principle compatible with the non-discrimination provisions of the European Union (EU) Treaty, subject to the requirement that the taxpayer must have the right to demonstrate that the non-arm's length terms are justifiable by sound economic reasons. If a taxpayer is able to present sound economic reasons, the tax authorities must refrain from making an adjustment.[986] Arguably, an adjustment is precluded if the foreign corporate subsidiary is in financial distress.

Under Section 1(5) of the Foreign Tax Act, these rules apply analogously to intracompany transactions between a head office and a permanent establishment (PE). In conformity with the Authorized OECD Approach (AOA), the PE will be treated for purposes of applying the arm's length principle as a separate and independent enterprise. To this end, a two-step approach is to be followed. In the first step, functions, risks, assets and equity capital must be allocated to the PE and, in the second step, the nature of the dealings between the head office and the PE, and the intracompany price must be identified. Further detailed guidance is contained in the Ordinance on the Application of the Arm's Length Principle to Permanent Establishments pursuant to Section 1(5) of the Foreign Tax Act of October 13, 2014.[987] The tax administration has also set out its interpretation of Section 1(5) in its Administrative Principles for the Attribution of Profits to Permanent Establishments of December 22, 2016.[988] Where an applicable tax treaty does not allow for the application of the AOA, the treaty will prevail over Section 1(5) provided the taxpayer provides evidence that the other treaty country is exercising its taxing rights in accordance with the treaty and that the application of the AOA would, therefore, result in double taxation.[989] The Court of Justice of the Euro-

[981] See Federal Tax Court (BFH), decision of March 19, 2002, file no. I R 4/01, BStBl. 2002 II, 644, whose suggested solution has been agreed to by the Federal Ministry of Finance in its decree of December 12, 2024 (Administrative Principles Transfer Pricing, *Verwaltungsgrundsaetze Verrechnungspreise* — VWG VP, chapter no. I, B. 1.8.).

[982] KStG, Sec. 8(3); KStR, Sec. 31.

[983] KStR, Sec. 36(a).

[984] AStG, Sec. 1(1).

[985] AStG, Sec. 1(4).

[986] CJEU decision of May 31, 2018 — C 382/16, *Hornbach-Baumarkt AG*, ECLI EU C 2018,366.

[987] BGBl. 2014 I, 1603.

[988] BStBl. 2017 I, 182.

[989] AStG, Sec. 1(5).

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pean Union (CJEU) stated in its decision of October 8, 2020[990] that, in the case of deemed business transactions across the border between a head office and a PE in different EU Member States, these rules are in principle compatible with the non-discrimination provisions of the EU Treaty, subject to the requirement that the taxpayer must have the right to demonstrate that the non-arm's length terms can be justified by sound economic reasons.

3. Determination of Arm's-Length Price

The determination of the proper arm's-length compensation serves a twofold purpose. First, it is necessary to determine the arm's-length compensation to establish whether the terms and conditions that were actually agreed on deviate from an arm's-length standard. If this is established, the arm's-length compensation is then the basis for determining the extent of the reallocation.

Originally, neither Section 1 of the Foreign Tax Act, nor the provisions on constructive dividends nor the provisions on constructive contributions to capital listed any specific criteria or tests that had or ought to be used for purposes of determining the arm's-length consideration. The tests and criteria developed in German case law and administrative practice in both the domestic and the international tax fields, therefore, had to be applied. However, since 2008, Section 1(1) sentence 3[991] has provided that it is to be presumed, in applying the arm's-length principle, that the third parties unrelated to each other (i.e., the third parties whose transactions are referred to determine whether the taxpayer's transactions are at arm's length) know all material circumstances of the business relationship and act in accordance with the principles of reasonable and conscientious business managers.

Based on Section 1 of the Foreign Tax Act, the German tax authorities can adjust a German corporation's taxable income in Germany unilaterally irrespective of the existence of an applicable tax treaty ("treaty override") if the terms and conditions of either an outbound or an inbound shareholder loan do not meet the arm's-length test and this reduces the corporation's income taxable in Germany as compared to what it would be in the case of an arm's-length loan.[992] In particular, as discussed in XIV.A.3.a., below, intra-group loans as well as intra-group licensing arrangements have been the subject of intense disputes between taxpayers, tax courts and tax authorities for many years.

Comment: The Decree of Federal Ministry of Finance of December 12, 2024 (Transfer Pricing, *Verwaltungsgrundsaetze Verrechnungspreise* — VWG VP 2024)[993] interprets this law against the background of the respective current version of the OECD Transfer Pricing Guidelines, which are neither mentioned nor referred to in the law, but form the basis of the understanding of the German tax administration. Whether German courts think that this is in line with German laws should be monitored closely.

a. Intra-Group Loans

Regarding outbound intra-group loans, the first senate of the Federal Tax Court (*Bundesfinanzhof* — BFH) changed its jurisprudence in June 2019. The responsible senate of the BFH has stated in various decisions[994] that an *uncollateralized* intra-group loan from a German parent to a foreign subsidiary does not meet the arm's-length test; in particular, the assumed *de facto* group recourse, which was accepted under the former jurisprudence, has been abandoned. Based on these court decisions, tax officers already have taken the position that, in the case of an inbound shareholder loan, the interest expenses are non-deductible if the loan is not collateralized. However, the Federal Constitutional Court held on March 4, 2021[995] that this decision of the BFH violates the constitutional rights of the taxpayer to the extent the BFH ignored its obligation to consult the CJEU on the matter.

Following the decision of the Federal Constitutional Court, the BFH decided on May 18, 2021[996] and on June 9, 2021[997] that, for purposes of determining arm's length loan interest rates, it is necessary to check whether the comparative values can be determined with the help of the price comparison method before applying the cost-plus method. This also applies to unsecured intercompany loans, irrespective of whether the loans were granted by the parent company or by another group company acting as the financing company. The assessment of the affiliated borrower's creditworthiness is not based on the average creditworthiness of the entire group, but only on the creditworthiness of the group company taking out the loan (a "stand alone" rating). Recourse to another group company, including the parent company, that is not reinforced by legally binding purchase commitments of other group companies is only to be taken into account if a third-party lender would consequently assign a credit rating to the borrower that exceeds the "stand alone" credit rating of the borrowing company.

With effect from January 1, 2024, new rules were introduced under the Growth Opportunities Act (*Wachstumschancengesetz*)[998] for the arm's-length test as it applies to inbound cross-border intra-group financing arrangements. Under these rules,[999] which are contrary to the recent jurisprudence of the BFH and the OECD Transfer Pricing Guidelines, a taxpayer is denied — probably entirely — a tax deduction for interest expenses (thus raising the likelihood of double taxation), if the taxpayer cannot prove either that:

(i) The entire interest expenses for the entire lifetime of the intra-group loan plus the redemption payment could have

[990] File no. C-558/19 "*Impresa Pizzarotti.*"

[991] Further details are provided under AStG, Sec. 1(3) sent. 1 *et seq.*

[992] AStG, as amended, Sec. 1(1).

[993] BMF, decree of December 12, 2024 (Administrative Principles Transfer Pricing, *Verwaltungsgrundsaetze Verrechnungspreise* — VWG VP, chapters II, III).

[994] BFH, decision of February 27, 2019, file no. I R 73/16, BStBl. 2019 II, 394; decision of February 27, 2019, file no. I R 51/17, BStBl. 2020 II, 440; decision of June 19, 2019, file no. I R 32/17, BFHE 266, 142; decision of February 19, 2020, file no. I R 19/17, DStRE 2021, 129.

[995] Decision of the Constitutional Court of March 4, 2021 (file no. 2 BvR 1161/19).

[996] BFH, decisions of May 18, 2021, file no. I R 4/17, DStR 2021, 2506 (unsecured inbound loan intra-group) and file no I R 62/17, DStR 2021, 2522 (domestic unsecured downstream loan intra-group).

[997] BFH, decision of June 9, 2021, file no. I R 32/17, DStR 2021, 2624 (unsecured outbound loan intra-group).

[998] Growth Opportunities Act (*Wachstumschancengesetz*) of March 27, 2023, BGBl. 2024 I, No. 108, Art. 10.

[999] Sec. 1(3d) AStG.

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been paid right from the start, and that the intra-group loan was commercially necessary and used only for purposes within the scope of the borrower's business; or

(ii) The taxpayer's interest expenses exceed the interest expenses calculated based on the group rating (which conflicts with the BFH's stand-alone approach).

Further, Section 1 paragraph 3e of the Foreign Tax Act (AStG) provides for a new rule that, in principle, considers intra-group financing activities to be low-risk activities, the remuneration for which is to be calculated exclusively on a cost-plus basis, unless the taxpayer can prove that this is not appropriate by way of supporting transfer pricing documentation.[1000] It is to be expected that the BFH will cling to its new position and will disagree with the tax authorities' primary classification of intra-group financing activities as mere low-risk activities.

This new law rejects the stand-alone approach offered alternatively by the OECD Transfer Pricing Guidelines and required by the BFH as well as the principle preference of both the BFH and the OECD for the comparison-price method. The VWG VP 2024[1001] interprets this new law in more detail. Further, the VWG VP 2024, in principle (some exceptions exist), still makes full reference to the respective version of the OECD Transfer Pricing Guidelines.[1002]

Comment 1: The German Government is interfering significantly with the free choice of taxpayers as to how to finance their inbound activities in Germany, placing taxpayers at increased risk of double taxation. It is doubtful whether this differentiation between inbound and outbound financing activities is in line with EU law. The new rules apply for the first time for the year 2024[1003] — even with respect to intra-group loan agreements concluded before this date. Taxpayers should, therefore, immediately look into adapting their intra-group loans and their transfer pricing documentation to the new tax environment.

Comment 2: The OECD Transfer Pricing Guidelines will form the basis for the arm's-length test, but are not included in the current law. Instead, VWG VP 2024, which replaced a number of old decrees, refers to the OECD Transfer Pricing Guidelines in their respective updated version.[1004] This is binding for all tax officers. The new decree, rather than the repealed decrees, will also apply to all open proceedings, such as tax audits, appeals and tax court proceedings, even if the case arose before January 1, 2022. Whether this implementation of the OECD Transfer Pricing Guidelines by a decree is justified by the current law and whether the full implementation of the respective updated OECD Transfer Pricing Guidelines into German tax practice by a mere decree will be backed by the Federal Tax Court seems doubtful — all the more so because of its retrospective implementation.

Further, and as a result of the OECD/G20 Base Erosion and Profit Shifting (BEPS) project,[1005] the German Government has adapted the currently applicable law to the G20/OECD project.[1006] The current law provides for minor changes in details, for example, the elimination of the priority of the standard methods (i.e., price comparison method, resale method, and cost-plus method), to better reflect the wording of the OECD Transfer Pricing Guidelines, and, in particular an explicit reference to the facts and circumstances that form the basis of the respective intra-group business transaction at the time of the agreement.

In contrast to the former law, however, the current law provides that, for purposes of determining the arm's-length transfer price, reference should be made exclusively to the actual situation as of the date when the intra-group business transaction was agreed on instead of as of the date of execution of the business transaction.[1007] Further, the applicable adequate pricing range has been narrowed to between 25% and 75% of the values found. Finally, specific rules for the remuneration in the case of an intra-group transfer and/or the use of intangibles are to be based on the DEMPE (Development, Enhancement, Maintenance, Protection and Exploitation) criteria.[1008]

Comment: Government tax audits conducted by specialized auditors are focusing more intensely on transfer pricing issues than in the past. The high — and growing — number of pending mutual agreement procedures (MAPs) (1,422 of which 636 deal with transfer pricing issues) confirms this view and the challenge it represents, even if the average time required for closing a MAP should decrease.[1009] The ongoing negotiations surrounding and implementation of Pillars One and Two, as further steps in the G20/OECD BEPS project, will change the legal situation even further to the extent no mandatory binding arbitration proceeding exists or such a proceeding is not reliable in practice.

b. *Intra-Group Licensing*

With effect from January 1, 2018, and subject to a treaty overriding legal provision,[1010] license fees are not or are only partially deductible, if: (i) the foreign creditor is affiliated to the debtor; (ii) the foreign creditor is subject to a preferential tax regime in the creditor's home jurisdiction at a tax rate of less than 15%; and (iii) the CFC rules do not apply. Furthermore, a PE can be either a creditor or a debtor. This license barrier rule applies to all licensing structures between affiliated parties that do not correspond to the "OECD nexus approach."[1011] Given that all license structures that do not follow the OECD nexus approach are governed by this license barrier rule, the application of the rule should be closely monitored.

[1000] Sec. 1(3e) AStG.

[1001] Decree of Federal Ministry of Finance of December 12, 2024 (Transfer Pricing, *Verwaltungsgrundsaetze Verrechnungspreise* — VWG VP).

[1002] Decree of Federal Ministry of Finance of December 12, 2024 (Transfer Pricing, *Verwaltungsgrundsaetze Verrechnungspreise* — VWG VP), chapter II.

[1003] AStG, Sec. 21 para. 1a.

[1004] See Decree of Federal Ministry of Finance of December 12, 2024 (Transfer Pricing, *Verwaltungsgrundsaetze Verrechnungspreise* — VWG VP), chapter II, chapter III, J.3.

[1005] Aligning Transfer Pricing Outcomes with Value Creation, Actions 8–10 — 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project of October 5, 2015.

[1006] AStG, Sec. 1(3a).

[1007] AStG, Sec. 1(3).

[1008] AStG, Sec. 1(3c).

[1009] Available at: http://www.oecd.org/tax/dispute/2019-map-statistics-germany.pdf.

[1010] KStG, Sec. 8(1); EStG, Sec. 4j.

[1011] BEPS Action 5 (OECD, Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5: 2015 Final Report).

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c. Hybrid Financing Structures

With respect to "hybrid financing structures," the ATAD Implementation Act of June 25, 2021[1012] transposed the EU ATAD II[1013] into German domestic law. Under this Act, interest expenses will no longer be deductible if they result in income not being subject to no tax or being subject to tax lower than the German tax that would apply to the income as a result of a qualification conflict (deduction/non-inclusion) or if they are deductible twice (double deduction); these rules apply to affiliated persons, to a corporation and its PE, and to structured tax arrangements.

Comment: As the legal and tax environment is changing rapidly, the above decrees are going to be adapted step by step. These decrees are binding on the tax officers with respect to pending cases. It should be noted that the Administrative Principles do not have the force of law. They are merely internal instructions to local tax officers that are necessary to ensure the uniform application of federal tax law in this area by state officials. They do not bind the courts.

B. Documentation and Reporting Requirements

1. In General

The transfer pricing documentation standards have been raised on various occasions since 2001 — either by the introduction of new more rigorous legal rules and/or by the adoption of more rigorous practices by the competent authorities. In 2001, the BFH held in a transfer pricing decision[1014] that German tax law did not require a taxpayer to keep specific transfer pricing documentation. A taxpayer was required only to prepare books, records and business papers, and to respond to questions. In the aftermath of this decision, it was quite clear that the German tax authorities would seek to limit the impact of certain aspects of the decision by introducing legislative changes.

2. Basic Documentation

For business years beginning after December 31, 2002, taxpayers are required to document the contents and character of their cross-border business relationships with affiliated entities. In this respect, the documentation must indicate, in particular, the economic and legal basis that may be relevant in determining adequate transfer prices between the parties. Extraordinary transactions must be documented no later than six months following the end of the relevant business year.

3. Master File and Local File

For business years beginning after December 31, 2016, a company belonging to a multinational group must prepare a master file — in addition to a local file — if the company's turnover in the preceding year exceeded 100 million euros. The master file must contain a transaction matrix, an overview of the global business activities of the group and a description of the transfer pricing system. Documentation of a regular transaction must be produced on the completion of the transaction and, as of the year 2025, must in no event be submitted later than 30 days after a request from the tax authorities, while the documentation for irregular transactions now must be produced promptly (the deadline of 60 days no longer) applies.[1015] Details are contained in an ordinance of July 12, 2017.[1016]

Further details in accordance with the interpretation of the tax authority are summarized in the VWG VP 2024.[1017] VWG VP 2024 differs from the former decree VWG VP 2023, which it replaced and which continues to apply for the assessment period 2023.

4. Non-compliance

Failure by a taxpayer to comply with the documentation requirements results in the imposition of severe sanctions, namely, the assessment of income based on an estimate made by the tax authorities, penalties of 5% to 10% of the adjusted income (in no case may the penalties be less than 5,000 euros), and penalties of up to one million euros in the case of late preparation of documentation (in no case may the penalties be less than 100 euros per day of delay).[1018]

5. Country-by-Country Report

For business years beginning after December 31, 2015, a German resident parent company of a multinational group with a consolidated turnover of 750 million euros or more must prepare an annual country-by-country (CbC) report pursuant to Section 138a of the General Tax Code (*Abgabenordnung* — AO). In year 2024, the taxpayer shall submit its CbC report no later than 60 days in general and no later than 30 days for extraordinary business transactions upon request of the tax office. This submission deadline will be shortened to 30 days in general for taxes arising after December 31, 2024, or for taxes arising before January 1, 2025, in case of a tax audit, if the tax audit order will have been issued before January 1, 2025. Further, the taxpayer is legally obligated to provide the tax office within 30 days in all cases with the transfer pricing documentation and to amend them upon the tax office's request.[1019] Thus, the taxpayer is required to draft and update the transfer pricing documentation on an ongoing basis to be prepared to present them to the tax office, whenever required. The tax office makes the CbC report available to the tax authorities of those countries that have ratified the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports.[1020]

[1012] EStG, Sec. 4k, as amended by the ATAD Implementation Act (*ATAD Umsetzungsgesetz* — ATAD-UmsG), BGBl. 2021 I, 2035.

[1013] Council Directive (EU) 2016/1164 of July 12, 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, L 193/1; Council Directive (EU) 2017/952 of May 29, 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries, L 144/1.

[1014] BFH decision of October 17, 2001, BStBl. 2004 II, 171.

[1015] AO, Sec. 90(3).

[1016] *Gewinnabgrenzungsaufzeichnungsverordnung*, BGBl. 2017 I, 2367.

[1017] Decree of the Federal ministry of Finance, of December 12, 2024 (Transfer Pricing 2024 (*Verwaltungsgrundsaetze Verrechnungspreise* — VWG VP 2024)), BStBl. 2024 I, 207, which replaces VWG VP 2023 of June 6, 2023, BStBl. 2023 I, 1093 after the assessment period 2023.

[1018] AO, Sec. 162(4).

[1019] AO, Sec. 162(3) as amended by the DAC 7 Implementation Act of December 20, 2022, BGBl. 2022 I, 2730.

[1020] Ratified by Germany under Act of October 19, 2016, BGBl. 2016 I, 1178.

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Comment: Originally, the CbC report was to be disclosed only to the tax authorities. However, as a result of intense discussions among the EU Member States as to whether the CbC report should also be disclosed to the public, the EU Presidency from January to June 2021 assumed by Portugal achieved the consent of 17 out of 27 EU Member States in favor of such a disclosure obligation, as requested by a number of non-governmental organizations. To justify the lack of a unanimous vote, which is required in tax matters, the argument has been made that this is a commercial law issue, which requires only a majority vote of the EU Member States. Directive 2021/2101[1021] was published in the EU Law Gazette on December 1, 2021. The Directive sets out the requirements for filing a Public CbC report, which is to be published in the EU Law Gazette and on the company website. The filing obligation applies to a group of companies with a consolidated group turnover of more than 750 million euros in two consecutive years where one of the members of the group has its registered seat or a branch in an EU Member State. The Directive applies for fiscal years beginning after June 21, 2024 and is to be transposed into domestic law at the latest by June 22, 2023. Whether the disclosure obligation will be challenged before the CJEU and the consequences of such a challenge will need to be closely monitored.

The disclosure obligation is also addressed to groups of companies controlled by a foreign parent company, if a German group company has been instructed by the foreign parent company to prepare the CbC report or if the German tax authorities have not received a CbC report filed by the foreign parent company with the tax authorities of its home jurisdiction.[1022] The 2021 Directive was transposed into German domestic law on June 21, 2023.[1023] The new law requires that the obligated companies give detailed information regarding the type of business activity, the number of employees, the income, the profit/loss before income tax, the income tax payable for the reporting period and the income tax paid in the period and the amount of retained earnings for (i) each EU/EEA Member State, (ii) each non-cooperative jurisdictions according to the EU Blacklist of non-cooperative jurisdictions,[1024] and (iii) for all other jurisdictions jointly. Such information is to be published in the Company Register and on the corporate website of the ultimate parent company. Non-compliance with the rules is punishable by a fine of up to 250,000 euros. Further, in the Federal Law Gazette of May 10, 2023,[1025] the German-U.S. agreement on the automatic exchange of CbC report was announced as of March 24, 2023, which replaces the practice of spontaneous exchange of CbC reports that had been in place up to this time.

[1021] Directive (EU) 2021/2101 of the European Parliament and of the Council of 24 November 2021 amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches.

[1022] AO, Sec. 138a.

[1023] Act implementing Directive (EU) 2021/2101 regarding the disclosure of income tax information by certain companies and branches and amending the Consumer Dispute Resolution Act and the Compulsory Insurance Act of June 19, 2023, amending the German Commercial Code (*HGB*) accordingly, BGBl. 2023 I, No. 154.

[1024] See https://taxation-customs.ec.europa.eu/common-eu-list-third-country-jurisdictions-tax-purposes_en, which is updated twice a year.

[1025] BGBl. 2023 II, No. 71.

C. Business Restructurings

A function is a business activity that consists of a combination of similar operational tasks that are performed by certain units or departments of a company. If such function is transferred across the border to another affiliated foreign company or a foreign PE, the taxpayer will taxed not only with the hidden reserves of the transferred assets, but on the entire potential profits of the transferred functions. Thus, the main challenge is to define the function. While the German tax authorities tend to extend the scope of a "function", the tax courts are less aggressive.[1026]

The transfer of functions is governed by new Section 1(3b) of the Foreign Tax Act.[1027] Further details are provided by an ordinance that applies to all transfers of functions commencing after December 31, 2021, while the old ordinance continues to apply to the transfer of functions commencing before January 1, 2022.[1028] The definitions in the new ordinance seem to be much wider than the definition in Section 1(3b) of the Foreign Tax Act, which raises the question of whether this ordinance's definitions are covered by the Foreign Tax Act. The interpretation of both the bill and the ordinance is to be found in VWG VP 2024,[1029] which provides guidance that applies to all cross-border transfers of functions occurring after December 31, 2021, while VWG VP 2023 continues to apply to all such transactions that occurred before January 1, 2022. The law still states that if no data is available on the terms of transactions between unrelated parties that are, to at least some extent, comparable with the transaction between the related parties, a hypothetical arm's-length comparison must be made. The taxpayer must, therefore, identify the supplier's minimum price and the recipient's maximum price as the relevant "range of agreement" determined by the respective profit expectations (the profit potentials). This range must be determined based on the transfer of the function as a whole (the "transfer package"). A still applicable exemption from the requirement to determine transfer prices for all relevant single assets will be accepted if the taxpayer shows proof that no material intangibles or advantages were transferred with the function. According to the new Section 1(3b), this will be the case if the transferee of the function provides this function exclusively to the transferor against a remuneration calculated using the cost-plus method.[1030] The former law provided for two further exemptions from the valuation of a transfer package — where: either the sum of the applied transfer prices measured by the evaluation of the transfer package as a whole complied with the arm's-length principle; or at least one exactly described intangible asset formed part of the transfer of the function. These additional exemptions are not provided for in Section 1(3b) of the Foreign Tax Act.

[1026] BFH, decision of August 8, 2023, file no. I R 54/19, is still relevant for transfers of functions prior to January 1, 2022, which defines the function less strict than the tax administration and states that the transfer of function taxation takes second place to other income correction rules.

[1027] AStG, Sec. 1(3b).

[1028] *Funktionsverlagerungsverordnung* of October 18, 2022, effective October 26, 2022, BGBl. 2022 I, 1803, which replaced the ordinance of August 12, 2008.

[1029] *Verwaltungsgrundsaetze-Verrechngspreise* of December 12, 2024 (VWG VP 2024) under no. 3.87 ff.

[1030] AStG, Sec. 1(3b) sent. 3.

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D. *Advance Pricing Agreements*

The German tax administration does not grant rulings on pricing matters (see V.B.12.g., above). However, taxpayers may request an advanced pricing agreement (APA) and, together with the tax authorities involved, can agree in advance on the applicable methodology for determining the pricing of the taxpayer's future international transactions. In Germany, APA applications must be filed with the Federal Central Tax Office. The fee to initiate an APA is 20,000 euros.[1031]

APAs were originally based on the respective rules in the applicable tax treaty that correspond to Article 25 (1) to (3) of the OECD Model Convention.[1032] While taxpayers may initiate APA proceedings by filing a request, taxpayers are not part of the actual APA proceedings.

Comment: APAs have proven to be less efficient and more time consuming than expected. In practice, APA proceedings usually last far longer than the intended binding maximum period of three years and are, therefore, often not too helpful. Since June 8, 2021, German APA proceedings have been based exclusively on Section 89a of the General Tax Code,[1033] which is also applicable to other issues regarding the tax treatment of not yet realized cross-border tax situations. According to this law, the Federal Central Tax Office decides — at the taxpayer's request — to start such proceedings where there is a risk of double taxation. APAs might become more attractive in combination with joint tax audits, if they could be used to make the results of a joint tax audit legally binding for the future as well.

[1031] AO, Sec. 178a; BMF, decree of October 5, 2006, BStBl. I, 2006, 594.
[1032] BMF, decree of October 5, 2006, BStBl. 2006 I, 594.
[1033] AbzStEntlModG, Art. 7.

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XV. Special Provisions Relating to Multinational Operations

A. *Treaty Shopping*

1. Section 50d(3) — The Anti-Treaty Shopping Provision

Unless special rules in a tax treaty (for example, the limitation on benefits clause in Article 28 of the Germany-United States tax treaty (see XVI.C.5.a., below)) prevail, a special limitation on treaty benefits provision under domestic law prevents a foreign corporation from claiming the benefits of a treaty to reduce domestic withholding tax. These rules apply, if and to the extent that the corporation's shareholders cannot themselves claim the treaty benefits with respect to such income.[1034]

It should be noted that, under its domestic law, Germany imposes a withholding tax on dividends (25% plus income tax surcharge of 5.5% on the withholding tax, giving a total of 26.375%) on all dividend recipients. It also imposes a withholding tax of 15% (plus income tax surcharge of 5.5%, giving a total of 15.875%) on royalties and the income of artists, entertainers or professional athletes performing in Germany, where the recipient is not subject to unlimited income taxation.[1035]

The provision applies also with respect to withholding tax imposed on dividends, interest or royalties paid by a German corporation to a foreign parent company that could apply for a zero rate under an EU Directive.[1036] The debtor is obliged to deduct and pay the withholding tax to the responsible tax office, even if a tax treaty or an EU Directive does not grant Germany the taxing right with respect to the income or grants Germany the right to tax only at a lower tax rate, unless the creditor presents an exemption certificate in advance. The relevant competent authority to apply to for an exemption certificate is the *Bundeszentralamt fuer Steuern*.[1037] Alternatively, the creditor may claim a refund of the withholding tax from the *Bundeszentralamt fuer Steuern*.

Section 50d(3) of the Income Tax Act defines the conditions for obtaining an exemption notice or recovering excess withholding taxes paid. This provision has been changed a number of times. The following comments focus on the currently applicable provision only.

Various CJEU decisions[1038] have further developed the abuse prohibition under EU law, which also has an impact on both the German general anti-avoidance rules (GAAR) and the German special anti-avoidance rules (SAAR) such as the treaty shopping rules. If a transaction is deemed to have been entered into mainly for tax avoidance purposes, pursuant to the GAAR the tax authorities are permitted to tax the parties involved based on the economic substance of the transaction rather than its form. This rule obliges taxpayers to demonstrate that their transactions have meaningful economic justification beyond merely reducing tax liabilities. While the GAAR[1039] is designed to counteract tax avoidance by disregarding transactions that lack substantial non-tax reasons and primarily aim to achieve a tax advantage inconsistent with the purpose of the law, the SAAR address specific constellations which the legislator has identified as problematic. The SAAR typically takes precedence over the GAAR. This case law and Article 6 of the EU's ATAD[1040] have resulted in another revised version of Section 50d(3) of the Income Tax Act.[1041] The new currently applicable version of Section 50d(3) has significantly changed the requirements, as well as the process, for obtaining an exemption notice or a withholding tax refund. The new Section 50d(3) states that a corporation, an associations of persons or an estate (*Vermoegensmasse*) is not entitled to tax treaty or EU Directive benefits insofar as:

> (i) Persons have an interest in the entity or are beneficiaries by virtue of the entity's articles of incorporation, the foundation business or any other constitution that would not entitle them to the same benefits (for example, the same provision of the same tax treaty) if they had earned the income directly as owners of the entity (step 1); and
>
> (ii) The source of income has no substantial connection with an economic activity of the entity; neither the earning of the income, the transfer of the income to participating or beneficiary persons, nor an activity to the extent it is carried out with a business operation not appropriately set up for the business purpose will be considered an economic activity (step 2).

This rule does not apply if the corporation, the association of persons or the estate proves that none of the main purposes of its involvement is to obtain a tax advantage, or if there is substantial and regular trading in its main class of shares on a recognized stock exchange (step 3). The GAAR provision in Section 42 of the General Tax Code remains unaffected.

The new law applies with effect from June 2, 2021 and also applies to ongoing proceedings, unless the old version of Section 50d(3) of the Income Tax Act applicable at the time when the income was received grants exemption from or a refund of the withholding tax.

Comment: The new provision substantially changes the applicable law to the disadvantage of the taxpayer. First, the subjects of this provision have been expanded from foreign corporations to corporations, associations of persons and estates. Second, the facts that bring a taxpayer within the scope of the provision, i.e., the denial of a refund and/or exemption, have been greatly expanded to the disadvantage of the taxpayer (steps 1 and 2). Third, although the exculpatory evidence (step 3) criteria have been relaxed, the exculpatory evidence is no longer considered by reference to factors typical of the situation concerned, but on a case-by-case basis. Fourth, the new case-by-case consideration will probably give rise to conditional and temporary exemption notices only, if any, which will place the responsibility for ensuring that the conditions are fulfilled on the debtor entity. This means that the debtor entity will

[1034] EStG, Sec. 50d(3).

[1035] EStG, Sec. 50a.

[1036] EStG, Sec. 43b, Sec. 50g.

[1037] EStG, Sec. 50d(2).

[1038] CJEU decisions of February 26, 2019 (file nos. C 115/16, C 116/16, C 117/16, C 118/16, C 119/16, C 299/16).

[1039] Sec. 42 of the General Fiscal Code or *Abgabenordnung* (AO).

[1040] Council Directive (EU) 2016/1164 of July 12, 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, L 193/1.

[1041] EStG, Sec. 50d(3) as amended by AbzStEntlModG, Art. 1.

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have to check the conditions in the exemption notice itself at its own risk and will, therefore, basically have to withhold the tax on behalf of the creditor. Fifth, the new provision will increase the number of refund proceedings because exemption notices will be granted probably only on a conditional and temporary basis. Sixth, existing (unconditional and indefinite) exemption notices granted under prior law will have to be explicitly revoked by the Federal Central Tax Office.

Whether the new Section 50d(3) of the Income Tax Act is now in line with EU law and in particular with the Parent-Subsidiary Directive[1042] is still unclear. Further developments will need to be closely monitored.

Applications for either exemption certificates or withholding tax refunds must be filed electronically.[1043] A taxpayer may apply for an exemption certificate or a tax refund using officially prescribed forms only to avoid undue hardship.

Ultimately, new Section 50d(3) of the EStG will make it much harder for nonresident taxpayers to obtain benefits under tax treaties and EU Directives in Germany. With regard to the taxation of dividend income, nonresident taxpayers may at least apply for a refund of 40% of the withholding taxes paid.[1044]

Where withholding tax on dividends is retained without cause, the taxpayer will receive interest of 0.5% per month on the amount of the refund,[1045] to the extent the retention of the withholding tax is deemed to be in breach of EU law. Such a breach of EU law is also assumed where a refund of withholding tax is subject to an excessively long processing time. The interest period starts; (i) three months after the completion of filing by the taxpayer, if no exemption certificate has been previously granted; or (ii) immediately on payment of the income subject to withholding tax, if the exemption certificate has previously been revoked by the Federal Central Tax Office in breach of EU law. The calculation of the interest amount is to be accurate to the day.

2. *Section 50j — Refusal of Relief from Capital Gains Tax in Certain Cases*

In an effort to combat "cum/cum" structures, which aim to avoid or reduce German dividend withholding tax by having nonresident shareholders sell their shares shortly before the dividend date with a view to reacquiring the shares shortly after the dividend date, Section 50j of the Income Tax Act, in effect as of January 1, 2017, imposes further limitations on treaty-based relief from German dividend withholding tax. Section 50j applies only where a nonresident taxpayer claims a reduction of withholding tax to less than 15% and the taxpayer's participation in the capital of the dividend paying corporation is less than 10%. Section 50j does not apply if the taxpayer has been the beneficial owner of the shares for an uninterrupted period of one year on receipt of the dividend. Section 50j denies relief from withholding tax on dividends if the recipient either does not comply with a minimum holding period requirement (broadly speaking, a period of 45 days within a monitoring period of 45 days before and after the due date for the payment of the dividends), does not bear a minimum risk with respect to changes in the value of the shares or is under an obligation to compensate a third party for receiving the dividends.

3. *ATAD III Proposal — Prevention of Misue of Shell Entities*

On December 22, 2021, the EU Commission presented a draft Directive for a new Anti-Tax Avoidance Directive (ATAD III or the "Unshell proposal")[1046] designed to combat tax avoidance and evasion in the European Union through the abusive use of letterbox companies in the European Union. Under the proposed draft Directive, a new tax declaration and reporting obligation was to be imposed on "letterbox companies," which were to be identified based on specified criteria. In addition, letterbox companies that did not meet certain substantive requirements were to lose tax benefits, for example, under a double taxation agreement. The provisions of the draft Directive were to be transposed into national law by June 30, 2023 and applied from 2024.

This should be welcome news for advisors and taxpayers: the cogency of the arguments advanced by the proposal's numerous critics has ultimately halted the further progress of the proposal, which would have duplicated and overlapped with existing EU measures (particularly DAC6), and would have created an excessive additional compliance burden for taxpayers and tax administrations alike. The targets of the Unshell Directive proposal will now be addressed through the application of existing anti-abuse measures and targeted DAC amendments. Even if the EU commission is not legally bound by the ECOFIN decision, it is unlikely that the EU commission will make another attempt to introduce an Unshell Directive in the current political climate. Further amendments to the anti-abuse measures and the DACs should be monitored closely.

B. Controlled Foreign Corporations

1. *In General*

Sections 7 to 13 of the Foreign Tax Act contain detailed rules on which items of income derived by controlled foreign corporations (CFCs) are included in the taxable income of their German shareholders. In principle, "passive income" from low-tax jurisdictions, calculated in accordance with German profit determination rules, forms part of the German shareholders' taxable income (the "add-on amount"), irrespective of whether the shareholders are corporations or individuals. "Active income" of a CFC is not subject to German taxation at the level of the shareholders. The German CFC rules characterize dividends actually realized by a CFC as "active" at the level of the CFC. Actual profit distributions of the CFC to its German shareholders are tax-exempt at the shareholder level.

As a result of the G20/OECD BEPS project, minimum standards have been agreed on for CFC rules. The European

[1042] Council Directive 2011/96/EU of November 30, 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (EU Parent-Subsidiary-Directive), L 345/8.

[1043] EStG, Sec. 50c(5) as amended by AbzStEntlModG, Art. 1.

[1044] EStG, Sec. 44a(9).

[1045] See BFH decision of February 25, 2025, file no. VIII R 32/21, which is referring to various decisions of the CJEU.

[1046] Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/E (ATAD III Directive) of December 22, 2021, see https://ec.europa.eu/taxation_customs/system/files/2021-12/COM_2021_565_1_EN_ACT_part1_v7.pdf.

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Union has transformed these minimum standards into Articles 7 and 8 of the Council Directive (EU) 2016/1164 of July 12, 2016[1047] laying down rules against tax avoidance practices that directly affect the functioning of the internal market (ATAD I). ATAD I had to be transposed into German domestic law by December 31, 2019. This finally took place in Germany on June 25, 2021. The new ATAD Implementation Act of June 25, 2021 applies with effect from January 1, 2022.

2. *Definition of a CFC*

Before January 1, 2022, Section 7(1) of the Foreign Tax Act defined a CFC as a foreign corporation, more than 50% of whose shares or the total voting power of all of whose shares was owned or considered to be owned, directly or indirectly, on the last day of the corporation's fiscal year, by a German-resident taxpayer ("domestic shareholder") alone or together with persons that were subject to extended limited tax liability under Section 2 of the Foreign Tax Act. If the foreign corporation neither had a stated capital nor granted voting rights, participation in the corporation's assets were decisive.

Before January 1, 2022, a "domestic shareholder" was a domestic corporation or resident individual that held an interest in a CFC. There was no minimum holding requirement. This meant that even those resident shareholders that owned only a few shares in a foreign corporation could be covered by the attribution provisions of the Foreign Tax Act, if resident shareholders in the aggregate held more than 50% of the corporation's shares, irrespective of whether they were aware of this fact, and irrespective of whether they could, in fact, control the foreign corporation. Even if a resident shareholder only held a 50% interest in a foreign corporation, the foreign corporation was held to qualify as a CFC if, under its charter, it acted exclusively as the commercial agent or commission agent for the account of the shareholder and was bound by contract to abide by instructions issued by the shareholder.[1048]

With effect from January 1, 2022, instead of focusing on the element of national control, the current definition of a "domestic shareholder" takes a shareholder-based approach. Under this definition, only one resident shareholder (plus any affiliated persons) needs to control a foreign corporation, rather than various unaffiliated resident shareholders. The same principle applies to a nonresident shareholder in the case of shares of a foreign corporation being held directly or indirectly through a PE in Germany. The control test is met where at the end of the financial year of the foreign corporation in which it generated the passive income, the resident shareholder either (i) has a direct and/or indirect holding of more than 50% of either the shares or the voting rights of the foreign corporation, or (ii) is entitled to more than 50% of the profits or liquidation proceeds of the foreign corporation.

3. *Income of a CFC*

Section 8(1) of the Foreign Tax Act contains an exhaustive list of items of income that are considered to be active or "good" income; all other items of income are "tainted" or "passive income" and may be attributed to domestic shareholders if the foreign entity deriving them qualifies as a CFC.

The following are listed as "good" or active items of income:

(i) Income from agriculture and forestry (unchanged from the pre-January 1, 2022 rules).

(ii) Income from manufacturing activities, including the manufacture, processing, transformation or assembly of tangible personal property, the production of energy, and the exploration and extraction of natural resources (unchanged).

(iii) Before January 1, 2022, income from the operation of a bank or insurance business that maintains office facilities for purposes of transacting its business, unless its business is predominantly conducted with controlling domestic taxpayers or affiliated persons. With effect from January 1, 2022, such income is only active when it is derived from *substantial* bank or insurance business operations, unless *more than one third* of the business is conducted with the controlling taxpayer or the affiliated persons.

(iv) Sales income: where the goods are delivered by a controlling domestic taxpayer or an affiliated person of such a taxpayer, or where the goods are delivered to a controlling domestic taxpayer or an affiliated person, sales income will be considered to be tainted, unless the taxpayer can establish that the foreign corporation maintains office facilities equipped to transact such sales activities (i.e., equipped for the preparation of, the execution of, and follow-up with respect to, such sales) without the assistance of a controlling domestic taxpayer or an affiliated person, and that it engages in trading activities with the public at large (unchanged).

(v) Services income, unless the services are performed by the CFC with the assistance of either a resident controlling shareholder or a person considered to be affiliated with such a taxpayer, or, if the services are rendered to a resident taxpayer that is considered to be a controlling shareholder or to an affiliated person, unless the taxpayer can establish that the CFC maintains office facilities required fully equipped for the performance of the services concerned and engages in the active conduct of its business with third parties; in addition, the activities forming part of its services must be carried on without the assistance of the controlling taxpayer or an affiliated person (unchanged).

(vi) Rental and royalty income, subject to very stringent limitations contained in Section 8(1) no. 6 of the Foreign Tax Act (unchanged).

Note: Rentals from foreign-situs real estate are not tainted if the rental income would be exempt from German income tax under a tax treaty with the jurisdiction in which the real estate is situated.[1049]

(vii) Before January 1, 2022, income from the borrowing and lending of money, if the taxpayer established that the funds were borrowed exclusively on foreign capital mar-

[1047] L 193/1 (ATAD I).

[1048] BFH decision of October 23, 1985, BStBl. 1986 II, 195.

[1049] AStG, Secs. 8(1) no. 6 lit. b.

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kets and were lent on a permanent basis to either PEs situated in Germany or to businesses or PEs located outside Germany that derived their earnings exclusively or almost exclusively from the activities listed above under (i) through (vi). As of January 1, 2022, this provision was deleted without being replaced; as a result, interest income is now always passive income, unless it is attributable to another active business activity listed in the catalogue in Section 8 of the Foreign Tax Act.

(viii) Before January 1, 2022, in general, dividend income realized by a CFC. With effect from January 1, 2022, dividend income is now in principle only active income, unless either the dividend distribution is tax-deductible or the CFC's dividend income derives from a shareholding of less than 10% at the beginning of the calendar year or derives from a shareholding that is to be allocated to the trading portfolio of a credit institution, securities institution or financial services institution or is to be classified as a current asset held by a financial enterprise in which credit institutions, securities institutions or financial services institutions directly or indirectly hold an interest of more than 50 percent.[1050]

(ix) Before January 1, 2022, in general, capital gains derived from a disposal of shares in a lower-tier corporation, from the liquidation of such a corporation or from a reduction of its capital, if the taxpayer could prove that the capital gain was not attributable to "harmful" assets serving defined activities. With effect from January 1, 2022, such capital gains are always active income, unless the shares are to be allocated to the trading portfolio of a credit institution, securities institution or and financial services institution and the shares are to be classified as current assets held by a financial enterprise in which credit institutions, securities institutions or financial services institutions directly or indirectly hold an interest of more than 50 percent.[1051]

(x) Before January 1, 2022, income derived on the conversion of a legal entity outside Germany at book value according to the — assumed fictitiously applicable — requirements of the German Reorganization Act. With effect from January 1, 2022, such income is classified as active only if, in addition, the conversion of the CFC is possible at book value under the actually applicable foreign conversion law.

If a CFC derives a mixture of active and tainted income, the tainted income will still not be attributable to German shareholder(s) if no more than 10% of the gross receipts of the CFC results from a tainted activity and the tainted income of the CFC does not amount to more than 80,000 euros per annum. Also, a resident shareholder whose attributable tainted income from all CFCs does not exceed 80,000 euros per annum may claim an exemption (unchanged).[1052]

[1050] AStG, Sec. 8 no. 7.
[1051] AStG, Sec. 8 no. 7.
[1052] AStG, Sec. 9.

4. *Counterevidence Rules*

Before January 1, 2022, a company resident in an EU/EEA Member State was not deemed to be a CFC whose income is to be attributed to its German shareholders if: (i) the domestic shareholders prove that the CFC is engaged in an *actual* economic activity in that State, which passes the at arm's-length test; and (ii) information is provided to the German tax authorities under either the EU Mutual Assistance Directive or a comparable bilateral or multilateral agreement that is necessary for imposing taxation in Germany.[1053] According to the BFH,[1054] a non-EU/non-EEA resident company might not qualify as a CFC because of the EU right of free movement of capital. The German tax administration has published a decree[1055] under which the criteria referred to above should prohibit the characterization of a non-EU/non-EEA resident company as a CFC. With effect from January 1, 2022, instead of actual economic activity, substantive activity on the part of the EU/EEA resident CFC is required, which passes the at arm's-length test. Additionally such activity may not be carried on mainly by third parties, but must be carried on by the CFC's sufficiently qualified personnel working independently and on their own responsibility.[1056] For investment management companies, the counterevidence rule applies also to non-EU/non-EEA resident companies.[1057] This new rule limits the ability of the taxpayer to escape tainted income characterization and goes beyond the requirements of CJEU case law[1058] and the ATAD Directive.[1059]

5. *Low Taxation*

The tainted income of a CFC will still be attributed to its German controlling shareholders if it is subject to income tax at an actual rate of now less than 15%.

Comment: This former minimum tax rate of 25% was subject of intense political debate for years, at both the domestic and the international level since the Germany CIT rate was reduced to 15%. The decision to fix the minimum rate at 25% seemed in particular somewhat peculiar, particularly against the background of the German government's support of the international minimum tax rate of 15% under Pillar Two. The transformation of the Pillar Two Directive into German domestic law of December 21, 2023,[1060] has implemented a minimum tax rate of 15% (instead of 25%) also for CFC purposes for fiscal years ending after December 31, 2023.

It should be noted that tax refunds and credits accruing to a shareholder of a foreign company are also taken into account in determining whether the company is subject to low-level taxa-

[1053] AStG, Sec. 8(2) former version.
[1054] BFH, decision of May 22, 2019, file no. I R 11/19, and decision of December 18, 2019, file no. I R 59/17.
[1055] BMF, decree of December 22, 2023, BStBl. 2023 I, special no. 1.
[1056] AStG, Sec. 8(2) new version.
[1057] AStG; Sec. 13(4) (1).
[1058] CJEU decision, Cadbury Schweppes of September 12, 2006, file no. C-196/04.
[1059] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market of July 12, 2016, Art. 7(2).
[1060] Act on the Implementation of Council Directive (EU) 2022/2523 of the Council to Ensure a Global Minimum Level of Taxation and Other Accompanying Measures (Mindestbesteuerungsrichtlinie-Umsetzungsgesetz) of December 21, 2023, BGBl. 2023, No. 397.

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tion.[1061] It may be difficult to determine whether items of tainted income are subject to low-level foreign income taxation, particularly where the company involved derives both active and tainted items of income. Where the normal foreign corporate income tax rate is less than 25%/15%, the actual tax burden may, nevertheless, reach or exceed 25%/15%; in this case, the rate may be determined by a comparison of the tainted income computed in accordance with the rules of German tax law and the taxes payable in the foreign country. In the opposite circumstance, the actual tax burden may be less than 25%/15% even where the regular corporate income tax rate exceeds 25%/15%, for example, because of the operation of a foreign tax credit[1062] or tax exemption available in the country concerned. The fact that the attribution of the tainted income to its German controlling shareholders counteracts tax exemptions granted in the foreign jurisdiction is not recognized as a hardship that might justify a reduction of the German tax.[1063]

6. Computation of Attributable Tainted Income

Before January 1, 2022, under Section 10(1) of the Foreign Tax Act, a CFC's attributable tainted income was deemed to have been received by one or more resident controlling shareholders immediately after the close of the financial year of the CFC.

With effect from January 1, 2022, the attributable tainted income is instead deemed to have been received by the controlling shareholder *in* the financial year of the CFC. Thus, the attributed income must be reported in the German controlling taxpayer's corporate or individual income tax return and trade tax return[1064] as deemed dividend income in the assessment period in which the CFC's financial year ends. It is possible to set off losses only against future income at the level of the German shareholders under the limiting standard rules for tax loss carryforwards.

The net income forming the basis of the attributable tainted income must be computed in accordance with the provisions of German tax law. In principle, such net income must be determined on an accrual basis.

In determining the attributable tainted income, only expenditure economically connected with the attributable items of tainted income may be deducted as business expenses. Income taxes, but no longer net worth taxes, levied on a CFC may be credited against the German (corporate) income tax but are no longer deductible from the attributable tainted net income.[1065]

7. Passive Income with a Capital Investment Character

The phrase "tainted income with a capital investment character" is defined as comprising all items of income that result from the holding and management of, and from transactions to maintain or enhance the value of the means of payment of, accounts received, securities, participations (except dividends and, in principle, capital gains under Section 8(1) nos. 7 and 8 of the Foreign Tax Act) and other similar assets.[1066]

Tainted income with a capital investment character derived by a CFC is attributed — even to a non-controlling taxpayer — if: (i) more than 10% of the CFC's gross income is income with a capital investment character; (ii) the German Investment Tax Act does not apply to the tainted income with a capital investment character;[1067] (iii) the company is subject to low-level taxation; and (iv) the attributable tainted income with a capital investment character exceeds 80,000 euros. The attribution of such income to the taxpayer does not require the shareholder to control the foreign company; instead such income is attributed on a *pro rata* basis to the taxpayer holding a share interest in the CFC.[1068] If the shareholding is less than 1% and the CFC earns exclusively or almost exclusively income with a capital investment character, the tainted income is also allocated to the taxpayer, unless the shares in the CFC are regularly traded on a recognized stock exchange.

8. Tainted Income of Lower-Tier Subsidiaries

Before January 1, 2022, to prevent the insulation of tainted income in two- or more-tier foreign corporate structures, Section 14 of the Foreign Tax Act provided that, subject to a few exceptions, the tainted income of a lower-tier CFC was attributed to the next higher-tier CFC. If a CFC had two or more subsidiaries that derived tainted income or losses, losses of one subsidiary could be used to offset the tainted income of another subsidiary.[1069]

With effect from January 1, 2022, the tainted income in two- or more-tier foreign corporate structures is to be allocated to the taxpayer directly. Thus, losses can no longer be set off against profits within two- or more-tier structures.

9. The Investment Tax Act

The German Investment Tax Act 2018, which governs the taxation of investment vehicles, takes precedence over the provisions of the Foreign Tax Act if both sets of provisions are potentially applicable to a case.[1070]

C. Foreign Family Foundations

Section 1(1) no. 4 of the Inheritance Tax Act provides that the assets of a family foundation are subject to inheritance/gift tax each 30 years.

Further, Section 15 of the Foreign Tax Act provides that the positive income of a family foundation that has its principal place of management and its statutory seat outside Germany is to be attributed to the founder and subject to unlimited German tax liability if the founder is a German resident. If this is not the case, such income is to be attributed to German resident persons who are beneficially entitled to the income or liquidation proceeds of the foundation; the attribution is made in propor-

[1061] AStG, Sec. 8(5).
[1062] BMF, decree of December 22, 2023, nos. 8.5.2. *et seq.*
[1063] BFH decision of April 20, 1988, DB 1988, 2612.
[1064] AStG, Sec. 10(1), (2) sent. 4.
[1065] AStG, Secs. 10(1), 12(1) current version in contrast to AStG, Secs. 10(1), 12(1) former version.
[1066] AStG, Sec. 13.
[1067] AStG, Sec. 13(5).
[1068] AStG, Sec. 13(1), while the former AStG, Sec. 7(6) provided for a minimum shareholding of at least 1%.
[1069] BFH decisions of April 20, 1988, file no. I R 41/82, BStBl. 1988 II, 868 and of September 28, 1988, file no. I R 91/87, BStBl. 1989 II, 13.
[1070] AStG, Sec. 7(7) former version, AStG, Sec. 7(5) current version.

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tion to the share of such persons in the income or liquidation proceeds.

For purposes of Section 15 of the Foreign Tax Act, a "family foundation" is defined as a foundation in which the founder, his or her descendants or their descendants are entitled to more than 50% of the income or liquidation proceeds. Conglomerations of property and incorporated or unincorporated associations are treated like foundations. In its decisions of November 5, 1992[1071] and February 2, 1994,[1072] the BFH held that an irrevocable common law trust will generally be classified as the equivalent of a foreign family foundation if the grantor, the beneficiaries and/or the remaindermen who are members of the grantor's family are entitled to more than 50% of the income and/or assets of the trust. On this basis, all the income and assets of a trust will be attributed to the grantor if he or she is a German resident, irrespective of whether he or she is a beneficiary. If the grantor is no longer a German resident, the income and assets of a trust are attributable to and taxable in the hands of the resident beneficiaries.

Comment: It is doubtful whether the above provision is constitutional and/or enforceable to the extent the attribution of income and assets to resident beneficiaries is concerned.

The income of a family foundation that has its seat and place of management in an EU/EEA Member State is not to be attributed to the founder and beneficiaries provided: (i) the assets of the foundation are legally and effectively not controlled by either the founder or the beneficiaries; and (ii) the country in which the foundation is resident exchanges tax-relevant information with Germany under an EU Directive or a bilateral agreement.[1073] Income earned by a CFC that is owned by a family foundation is attributed under the CFC rules[1074] to the family foundation.[1075]

D. Administrative and Mutual Assistance in Tax Matters

1. Exchange of Information

Under German tax law, a taxpayer's affairs must be treated as strictly confidential unless a disclosure is specifically authorized by statute.[1076] Authorization for the international exchange of information is contained in Sections 117, 117a, 117b, and 117c of the General Tax Code in the instances described in a. to f., below.

a. Requests for Information

Germany's tax treaties contain two types of exchange of information clauses: a restricted clause permitting the exchange of information only to the extent that this is necessary to give effect to the provisions of the particular treaty; and a "broad" or "major" information clause, covering the exchange of information for giving effect to the domestic laws of the Contracting States with respect to all taxes covered by the treaty. Article 26(1) of the Germany-U.S. tax treaty is an example of the broad type of information clause. Depending on the terms of the treaty concerned, the information may be supplied on request only, automatically or even spontaneously. It has been held that, under a treaty, information may be supplied by the German tax administration spontaneously, i.e., without prior request,[1077] but this may be in doubt where the treaty itself requires a request for information.

In addition, Germany has entered into several Tax Information Exchange Agreements (TIEAs) with tax havens, such as Jersey.[1078] The scope of these agreements is limited to the setting out of the framework for exchanging tax-relevant information.

b. Spontaneous Exchanges of Information

Under Section 117(3) of the General Tax Code, the German authorities may supply information to foreign tax authorities on request if the following prerequisites are met:

(i) Reciprocity is guaranteed;

(ii) The other country guarantees that the information supplied may be used only for tax purposes or for tax fraud proceedings and that it may be made available only to persons, authorities and courts charged with tax matters or tax fraud proceedings;

(iii) The other country must be prepared to enter into competent authority proceedings with a view to eliminating double taxation by an appropriate allocation of tax bases; and

(iv) The implementation of the request must not affect German sovereignty, security or public order, and no damage other than that warranted by the purpose of the assistance must be caused to the domestic party if the information involves a business secret.

c. EU Directives on Information Exchange

Germany has implemented Council Directive 2011/16/EU of February 15, 2011, on administrative cooperation in the field of taxation (DAC 1), as well as the later amendments thereto by Council Directive 2014/107/EU on automatic exchange of financial accounts (DAC 2), Council Directive 2015/2376 on automatic exchange of advance cross-border rulings and pricing agreements (DAC 3), Council Directive 2016/811/EU on automatic exchange of Country-by-Country reports (DAC 4), Council Directive 2016/2258/EU on access to Anti-Money-Laundering information by tax authorities (DAC 5), Council Directive 2018/822/EU on automatic exchange of information in relation to reportable cross-border arrangements (DAC 6), and Council Directive 2021/514/EU on reporting obligations for operators of digital platforms (DAC 7).

Pursuant to the exchange of information under the EC Directive on Mutual Assistance of February 15, 2011, as implemented in German law,[1079] the German tax authorities acting through the Federal Central Tax Office (*Bundeszentralamt fuer*

[1071] BStBl. 1993 II, 388.
[1072] BStBl. 1994 II, 727.
[1073] AStG, Sec. 15(6).
[1074] AStG, Secs 7–14.
[1075] AStG, Sec. 15(9).
[1076] AO, Sec. 30.

[1077] BMF, decree of May 25, 2012, BStBl. 2012 I, 599 at 6.1.
[1078] Agreement Between the Government of the Federal Republic of Germany and the Government of Jersey for the Exchange of Information Relating to Tax Matters, signed on July 4, 2008.
[1079] *EU-Amtshilfe-Gesetz* of June 26, 2013, BStBl. 2013 I, 1809, as amended.

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Steuern) or the Federal Ministry of Finance may supply information to EU Member States on request, in certain automatic exchanges, and spontaneously, insofar as the information relates to any kind of tax other than value added tax (VAT), customs duties and certain excise taxes.

There may be a spontaneous exchange of information (i.e., without a prior request from the other EU Member State), if the German authorities have reason to believe that tax fraud has been committed in the other state, or if a taxpayer claims a tax benefit in Germany that should lead to taxation or to increased taxation in the other state, as well as in other instances enumerated in Section 8 of the *EU-Amtshilfe-Gesetz.*

Section 7(1) of the *EU-Amtshilfe-Gesetz* imposes an obligation on the German authorities to provide for the automatic exchange of information pertaining to a person resident in another EU Member State with regard to income from employment, director's fees, life insurance products and the ownership of immovable property.

Section 7(3)–(7) of the *EU-Amtshilfe-Gesetz* transposes the amendment of the EC Directive on Mutual Assistance of December 8, 2015 on the automatic exchange of information on tax rulings into German law.[1080] The information concerned is to be exchanged automatically between EU Member States at regular intervals based on predetermined parameters. Tax rulings include rulings on cross-border transactions with at least one of the other parties involved being resident in another Member State. Also covered are APAs. Subject to a few exceptions, all tax rulings issued, reached, amended or renewed since January 1, 2014 must be exchanged.

Sections 117a and 117b of the General Tax Code are based on the EU Council Framework Decision 2006/960/JI of December 18, 2006 concerning the exchange of personal data between law enforcement authorities of the EU Member States. At the request of a law enforcement authority, a tax office is to exchange information for the purpose of preventing an offense.

d. U.S. FATCA Information Exchange

On May 31, 2013, Germany and the United States signed an Agreement to Improve International Tax Compliance and with respect to the United States Information and Reporting Provisions commonly known as the Foreign Account Tax Compliance Act (the "FATCA Agreement"). This agreement entered into force on October 10, 2013.[1081] It closely corresponds to the U.S. Model 1A Intergovernmental Agreement (IGA). The FATCA Agreement provides for an automatic exchange of information between the two countries to improve international tax compliance by imposing reporting obligations on financial institutions. Specifically, German financial institutions are to exchange information on financial accounts held by a U.S. person or held by a non-U.S. entity controlled by a U.S. person. German financial institutions complying with these reporting obligations are protected against a 30% U.S. withholding tax.

The FATCA Agreement is supplemented by domestic provisions implementing the reporting obligations of German financial institutions. Under Section 117c of the General Tax Code, the information must be provided electronically to the Federal Tax Office (*Bundeszentralamt fuer Steuern*) in accordance with the provisions of the FATCA-USA-Implementation Ordinance.[1082] The Federal Tax Office transfers the information to the U.S. authorities. Taxpayers have no right to be informed or heard in advance of any exchange of information.[1083] The provisions of the May 31, 2013 Agreement are further supplemented by the German-U.S. FATCA implementation ordinance,[1084] detailed regulations published in a November 3, 2015, decree of the Federal Ministry of Finance,[1085] and a competent authority arrangement between the U.S. and German competent authorities prescribing rules and procedures necessary for implementing certain provisions of the Agreement.[1086]

e. Multilateral Competent Authority Agreement on Automatic Exchange of Information

The Organisation for Economic Cooperation and Development (OECD) together with the G20 countries has developed the Common Reporting Standard to tackle tax avoidance and evasion and improve tax compliance. Germany and 50 other countries agreed to implement the Common Reporting Standard in the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information of October 29, 2014. The Agreement was implemented in German law by the Law on the Automatic Exchange of Financial Account Information of December 21, 2015.[1087] As under the FATCA Agreement, financial institutions will have to transfer the relevant financial account information to the Federal Central Tax Office, which will automatically transfer this information to the competent tax authorities of the other signatory states.[1088] The first automatic exchange was to be carried out by July 31, 2017, stating financial account information for the year 2016. Also, as under the FATCA Agreement, taxpayers have no right to be informed or heard in advance of any exchange of information.[1089]

f. Bilateral and Multilateral Joint Audits

The view of the German tax administration is that coordinated bilateral and multilateral tax audits[1090] may be conduct-

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[1080] *Gesetz zur Umsetzung der Aenderungen der EU-Amtshilferichtlinie und von weiteren Maßnahmen gegen Gewinnkuerzungen und — verlagerungen* of December 20, 2016; BGBl. 2016 I, 3000.

[1081] BGBl. 2013 II, 1363.

[1082] FATCA-USA-*Umsetzungsverordnung* of July 23, 2014, BGBl. 2014 I, 1222, as amended.

[1083] AO, Sec. 117c(2).

[1084] FATCA-USA-*Umsetzungsverordnung* of July 23, 2014, BGBl. 2014 I, 1222, as amended.

[1085] BMF, decree of February 1, 2017, *Anwendungsfragen im Zusammenhang mit einem gemeinsamen Meldestandard sowie dem FATCA-Abkommen*, BStBl. 2017 I, 305.

[1086] BMF, decree of December 16, 2015; *Automatischer Informationsaustausch mit den Vereinigten Staaten von Amerika; Abschluss einer nach Artikel 3 Absatz 6 des zwischen der Bundesrepublik Deutschland und den Vereinigten Staaten von Amerika abgeschlossenen FATCA-Abkommens* of May 31, 2013, *getroffenen Abmachung*, BStBl. 2015 I, 1047.

[1087] Law on the Automatic Exchange of Financial Account Information (*Finanzkonten-Informationsaustauschgesetz* — FKAustG), BGBl. 2015 I, 2531, as amended.

[1088] The German Federal Central Tax Office regularly publishes a CRS country exchange list (see https://www.bzst.de/SharedDocs/Downloads/DE/CRS/crs_teilnehmende_staaten_2024_vorlaeufig.html?nn=67750).

[1089] FKAustG, Sec. 5(8).

[1090] Based on: EU Administrative Assistance Act of June 26, 2012, Secs. 10–13; bilateral tax treaty provision similar to OECD-Master Agreement, Art.

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ed within the framework of international administrative assistance, in addition to the exchange of information on request, and the spontaneous and automatic exchange of information. These include simultaneous tax examinations and joint audits, both with other EU Member States in accordance with the EC Directive on Mutual Assistance and with third countries in accordance with a tax treaty and the Administrative Assistance Convention.[1091]

Comment: In practice, joint audits are playing an increasing role. It has been reported that more than 100 joint audits have been completed. Taxpayers may ask for a joint audit to be initiated but the tax authorities are not obliged to honor such requests. Neither are the results of such joint audits with respect to the allocation of profits binding on the participating tax authorities.[1092] Nonetheless, the German tax administration is quite committed to this instrument and has dedicated significant resources to conducting joint audits. The administration is confident that potential double taxation conflicts are resolved much faster in a joint audit than in the traditional mutual agreement procedure (MAP). Joint audits run by the tax authorities of different EU Member States are further governed by a Council Directive of March 22, 2021 (DAC 7).[1093]

g. *Mandatory Disclosure of Reportable Cross-Border Arrangements (DAC 6)*

Council Directive (EU) 2018/822 amending Directive 2011/16/EU as regards the mandatory automatic exchange of information in the field of taxation on reportable cross-border arrangements of May 25, 2018[1094] (DAC 6) obliges the EU Member States to establish rules under which certain cross-border tax arrangements must be notified to the tax authorities of the Member States and then automatically exchanged between the Member States.

With the consent of the Bundesrat, the Bundestag passed the Act on the Introduction of an Obligation to Notify Cross-Border Tax Arrangements[1095] on December 21, 2019. This transposed DAC 6 into German law. The law entered into force on January 1, 2020 as Sections 138d–138k of the General Tax Code.

DAC 6, and thus also the Act, concerns cross-border tax arrangements for which the first step of implementation took place after June 24, 2018. Notifications on cross-border tax arrangements are to be submitted as of July 1, 2020. These notifications are subsequently to be entered into an EU central directory to enable the automatic intergovernmental exchange of information.

Under Sections 138d to 138k of the General Tax Code, users and their advisors ("intermediaries") are now obliged to notify the Federal Central Tax Office electronically and the corresponding authorities in other EU Member States regarding the cross-border tax arrangements used. For tax arrangements entered into between June 24, 2018 and June 30, 2020 ("old arrangements"), the time limit for this notification terminated on August 31, 2020. For cross-border tax arrangements entered into after June 30, 2020 ("new arrangements"), the deadline for this notification is 30 days after the end of the day on which either the tax arrangement is made available for implementation or the user of the tax arrangement is ready to implement it or at least one user of the tax arrangement has taken the first step of implementing the tax arrangement — whichever occurs first. Where there is a user and an intermediary, the intermediary is obliged to file this notification for the user. If the intermediary is subject to a professional duty of confidentiality (for example, a lawyer, a tax advisor or an auditor), the intermediary must ask the client/user for release from the duty of confidentiality. If the client approves, the intermediary needs to file a full notification also for the user; if the client rejects the request, the intermediary needs to file a partial notification, which, however, may still allow the user to be identified, while the user is obliged to file the rest of the required information that is still missing.

Comment: It should be noted that the above rule undermines client confidentiality under German law, which was not the case under Directive (EU) 2018/822.

Failure to comply with this duty to notify is subject to a fine of up to 25,000 euros under Section 379(2) of the General Tax Code if the act cannot already be qualified as a frivolous tax reduction, or even as tax evasion and punished more severely.

Cross-border tax arrangements are tax arrangements that: (i) are subject to tax except VAT, harmonized excise duties or customs duties; (ii) concern either more than one Member State or at least one Member State and one or more third countries; and (iii) meet certain hallmarks. Some of the hallmarks additionally require that a "main benefit test" is met, i.e., a tax benefit is the main goal of the cross-border tax arrangement ("conditional hallmarks"), while some of the hallmarks are not subject to this additional main-benefit test ("unconditional hallmarks"). Conditional hallmarks for which the main benefit test is additionally required are: (i) the agreement of a confidentiality clause; (ii) the agreement of performance-related remuneration; (iii) standardized documentation or structure; (iv) arrangements with loss-making companies; (v) conversions to non-taxable or lower-taxable income: (vi) circular asset transfers; and (vii) certain cross-border payments between related parties. In the case of an unconditional hallmark, there is a reporting obligation whenever such an indicator is met. This group includes: (i) certain deductible cross-border payments between affiliated companies; (ii) the exploitation of classification conflicts; (iii) the undermining of the reporting obligation regarding financial accounts; (iv) arrangements with no clearly identifiable ultimate beneficial owners ("non-transparent chains"); and (v) certain transfer pricing arrangements. Details on the hallmarks can be found in Annex IV to the Directive (EU) 2018/822.

26; Administrative Assistance Convention of January 25, 1988, Arts. 8, 9; bilateral Tax Information Exchange Agreement (TIEA) similar to OECD TIEA, Art. 6.

[1091] See Federal Ministry of Finance, Guidance note on coordinated external tax audits with tax administrations of other states and jurisdictions of January 6, 2017, BStBl. 2017 I, 89.

[1092] Tax Court Düsseldorf, decision of May 28, 2020, file no. 9 K 1904, 18 G, IStR 2020, 718.

[1093] Council Directive (EU) 2021/514 of March 22, 2021, amending Directive 2011/16/EU on administrative cooperation in the field of taxation, L 104/1, Art. 1, Section IIa., as transposed into German law by Law of December 20, 2022 implementing Council Directive (EU) 2021/514 of March 22, 2021, amending Directive 2011/16/EU on administrative cooperation in the field of taxation and modernizing the law on tax procedure, BGBl. 2022 I, 2730.

[1094] Official Journal of the European Union L 139/1 of June 5, 2018.

[1095] BGBl. 2019 I, 2875.

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If a reportable cross-border tax arrangement exists, information on the intermediary (and, if applicable, on other intermediaries), the user and, if applicable, on affiliated companies and other directly affected persons, as well as information on the design of the arrangement, must be reported electronically to the German Federal Central Tax Office. Both the intermediary and the user are to be clearly identified by reporting name, address, residence and tax identification number. An accurate picture of the design is to be created by reporting the hallmarks fulfilled, the domestic and foreign regulations that form the basis of the tax arrangement, its economic value and a description. Also, in particular, the date of the (expected) implementation of the arrangement and the Member States likely affected by the arrangement are to be disclosed. In this respect, the Implementation Act adheres to the Directive.

If an intermediary files a notification, the notifying intermediary receives an arrangement ID number for the notified arrangement and a disclosure ID number for the received notification from the Federal Central Tax Office. The intermediary is to pass on these ID numbers to the user and, if applicable, to other intermediaries. The ID numbers exempt other intermediaries and the user from their individual reporting obligations. Further, the user must indicate both ID numbers in the tax return of the year in which the tax advantage of the cross-border tax structuring is to take effect for the first time.

Comment: The short deadline of 30 days poses major challenges (and risks) for users and intermediaries alike. First, because the definition of tax arrangements is vague it may be unclear whether a reportable tax arrangement exists at all; second, the interpretation in particular of the hallmarks differs in the various EU Member States; and third, collecting, checking and transmitting the required information in a 30-day period is very challenging.

In government tax audits, tax officers must focus on facts that require a DAC 6 notification. If such a notification has not been filed, the tax officers are to hand the case over to the penal and fine department of the responsible tax office.

To simplify the DAC 6 notification procedure, a “white list” of non-reportable tax arrangements was published as part of a draft decree of the Federal Ministry of Finance on July 14, 2020. The white list names a (very small) number of non-reportable tax arrangements, such using tax allowances or exercising a tax option, which in practice does not really help. Although notifications based on the draft decree started to be given on July 1, 2020, the Federal Ministry of Finance did not publish the final and binding version of the draft decree until March 29, 2021, on which date it also entered into force.[1096]

The CJEU stressed in a recent decision of December 8, 2022 regarding a Belgian case[1097] that the client-attorney privilege, which is based on Article 7 of the EU Charter of Fundamental Rights, protects the lawyer’s client against disclosures of the lawyer as the intermediary according to DAC 6, unless such disclosure was approved by the client in advance. If not, the legal obligation to disclose even the fact that the lawyer was instructed by the client is protected as confidential information, which — according to the CJEU — hinders the lawyer from disclosing anything regarding the mandate (if the client does not approve of this in advance) and makes a corresponding legal obligation null and void. Thus, the transposition of DAC 6 into German domestic law does not seem to be in line with these standards confirmed by the CJEU. This view has been confirmed by Article 8ab (5) of the DAC 8 Directive,[1098] according to which each EU Member State may take the necessary measures to give intermediaries the right to a waiver from filing information on a reportable cross-border arrangement where the reporting obligation would breach the legal professional privilege under the national law of that Member State. In such circumstances, each Member State shall take the necessary measures to require any intermediaries that have been granted a waiver to notify, without delay, their client, if that client is an intermediary or, where there is no such intermediary, that client is the relevant taxpayer, of that client’s reporting obligations.

Comment (1): It will be important to watch closely how this CJEU decision on DAC 6 and its conversion into Article 8ab of DAC 8 is going to affect the current aggressive approach of the Federal Central Tax Office towards German lawyers and how the German legislature will respond. In particular, it will be important to monitor how the duty of confidentiality, which German tax advisors (like German lawyers) are also bound by, will change DAC 6 practice in Germany, even though the CJEU denied this protection, which is provided for in the EU Fundamental Charter, to tax advisors because of the lack of a common understanding of the profession of a tax advisor in the European Union.[1099]

Comment (2): Note that the German Government nevertheless intends to extend the filing obligation of intermediaries’ to purely domestic tax arrangements even after the first attempt by the bill for the Growth Opportunities Act failed. Further developments should be monitored closely.

h. *Reporting Obligations of Digital Platform Operators (DAC 7)*

Under Council Directive 2021/514[1100] of February 19, 2021 (DAC 7), the Directive 2011/16/EU on administrative cooperation has been amended, in particular with respect to:

(i) Expanding the scope of the automatic exchange of information to operators of digital platforms: operators of digital platforms will be required to report the income generated by users via the platform, including income from real property rentals, personal services, the sale of goods, the renting of all types of means of transport, and investments and loans related to crowdfunding.

(ii) Expanding the scope of the automatic exchange of information to royalty income: royalties are added to the types of income subject to the automatic exchange of information.

[1096] BMF, decree of March 29, 2021, BStBl. 2021 I, 582.

[1097] CJEU, decision of December 8, 2022, file no. C-694/20.

[1098] Council Directive (EU) 2023/2226 of 17 October 2023 amending Directive 2011/16/EU on administrative cooperation in the field of taxation (DAC 8 Directive), Document 32023L2226.

[1099] CJEU, decision of July 29, 2024, file no. C-323/22.

[1100] Council Directive (EU) 2021/514 of March 22, 2021, amending Directive 2011/16/EU on administrative cooperation in the field of taxation, L 104/1, Art. 1, Section IIa.

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(iii) Strengthening administrative cooperation: the proposed Directive for the first time provides a clear legal framework for the conduct of joint audits between two or more EU Member States.[1101] Such an audit is to be carried out in accordance with the procedural modalities applicable in the EU Member State in which the audit takes place. Evidence is to be mutually recognized by the competent authorities of the participating EU Member States. The language regime is to be agreed on by the participating EU Member States. The conclusions of a joint audit are to be presented in an audit report that has the same legal force as national instruments. The conclusions and the audit report must be received by the taxpayer subject to the audit within 60 days of the issuance of the audit report. In addition, rules on the presence of officials of one EU Member State during an investigation in another EU Member State or on a simultaneous audit are introduced into the Directive.

On December 20, 2022, these rules were transposed into German domestic law by the Law implementing Council Directive (EU) 2021/514 of March 22, 2021, amending Directive 2011/16/EU on administrative cooperation in the field of taxation and modernizing the law on tax procedure.[1102] As implemented, the new law applies to all providers of digital platforms provided the platform operator is:

(i) Registered in an EU Member State;

(ii) Maintains its place of management in an EU Member State;

(iii) Maintains a permanent establishment in an EU Member State; or

(iv) Maintains business operations in an EU Member State.

As from 2023, these providers of digital platforms are subject to a legal obligation to report electronically with the German Federal Central Tax Office by January 31 of the subsequent calendar year. The report must include information about themselves, their digital platform and those individuals or legal persons offering a so-called "relevant activity" on their digital platforms.

"Relevant activities" are all the services, sales, temporary use of real estate or any means of transport rendered through the digital platform. The notifying providers of digital platforms are obliged to report those individuals or legal persons offering a "relevant" activity on their digital platform prior to their first filing. Any intentional or negligent omission is subject to fines and further sanctions. The information gathered by the German Federal Central Tax Office will then be subject to exchange of information with the tax authorities in the other EU Member States.

[1101] DAC 7, Art. 12a.

[1102] Law of December 20, 2022 implementing Council Directive (EU) 2021/514 of March 22, 2021, amending Directive 2011/16/EU on administrative cooperation in the field of taxation and modernizing the law on tax procedure, BGBl. 2022 I, 2730.

i. Reporting Obligations of Crypto-Asset Service Providers (DAC 8)

The Council agreed on October 17, 2023, on a new Council Directive amending Council Directive 2011/16/EU on administrative cooperation in the field of taxation (DAC 8) that will expand the automatic information exchange between the tax administrations of EU Member States, in particular with respect to service providers for crypto-assets, such as cryptocurrencies, electronic money, and dividend income from shares not held in a bank deposit account. The DAC 8 Directive mainly takes effect on January 1, 2026.[1103] The Directive, aims at enhancing tax transparency especially in the context of crypto-assets and focuses on broadening the reporting requirements for transactions involving crypto-assets, including those handled by both regulated and non-regulated crypto-asset service providers. Key features of DAC 8 include:

(i) Scope of reporting: DAC 8 expands the scope of reporting to encompass not just traditional financial instruments but also e-money and central bank digital currencies under the Common Reporting Standard (CRS). Crypto-assets used for payment or investment are reportable unless equivalent information is exchanged with non-EU jurisdictions that have effective agreements with the European Union.

(ii) Automatic exchange of information: crypto-asset service providers are required to collect and report detailed information on transactions and user identities to their local tax authorities. This information will then be shared among the EU Member States.

(iii) Implementation timeline: the Directive was published in the Official Journal on October 24, 2023 and entered into force on November 13, 2023. Member States have until December 31, 2025 to incorporate the new rules into their national laws, with most provisions taking effect from January 1, 2026.

(iv) Compliance and penalties: the Directive also outlines the penalties for non-compliance with the new reporting standards, emphasizing the need for crypto-asset service providers to adhere to these requirements to avoid legal and financial consequences.

As noted, DAC 8 must be transposed into the domestic law of EU Member States by the end of 2025. It has not yet been transposed into German domestic law, although a draft bill was published as long ago as November 4, 2024.

j. EU-wide Centralized Filing Mechanism for the Top-up Tax Information Return — DAC 9

To bolster the Pillar Two Directive, the draft of DAC 9 would introduce an EU-wide centralized filing mechanism for the "Top-up Tax Information Return" (TTIR) requiring the TTIR to be filed with only one EU tax authority. The filed information would then be automatically exchanged among all relevant EU tax administrations. On April 14, 2025, the Coun-

[1103] Council Directive (EU) 2023/2226 of 17 October 2023 amending Directive 2011/16/EU on administrative cooperation in the field of taxation (DAC 8 Directive), Document 32023L2226.

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cil of the European Union formally adopted DAC 9 as an amendment to Directive 2011/16/EU (DAC). This followed a political agreement reached on March 11, 2025, five months after the European Commission's initial proposal but before the very strong rejection of the Pillar Two project by the new US government.

k. International Compliance Assurance System

As a further consequence of the G20/OECD BEPS project, in January 2018, the International Compliance Assurance Programme (ICAP) pilot project was launched as a voluntary risk assessment and assurance program designed to facilitate open, co-operative multilateral engagements between multinational enterprise (MNE) groups and tax authorities in jurisdictions in which such groups have activities. ICAP 1.0 started at the beginning in January 2018 with an initial participation of eight tax administrations (those of Australia, Canada, Italy, Japan, the Netherlands, Spain, the United Kingdom and the United States). Based on the initial experience and feedback from these tax administrations and MNEs, the ICAP process has since been updated. On March 28, 2019, the OECD announced a second, revised ICAP pilot (ICAP 2.0). The number of states participating in ICAP 2.0 (which commenced in March 2019) increased to 19.[1104] Although Germany did not participate in the first ICAP pilot because of constitutional concerns, it has agreed to participate in ICAP 2.0. Austria, Belgium, Colombia, Denmark, Finland, France, Ireland, Luxembourg, Norway, Poland, Russia and Singapore are now also among the participants.

ICAP will offer taxpayers with cross-border activities that are required to file country-by-country (CbC) reports a tool that will allow the national tax authorities involved to carry out an advance check of low-risk topics. By coordinating conversations between an MNE group and multiple tax administrations, ICAP will support the effective use of transfer pricing documentation, including the MNE group's CbC report. ICAP will provide a faster, clearer and more efficient route to improved multilateral tax certainty. In addition, ICAP will reduce the resource burden on both MNE groups and tax authorities, which could mean fewer disputes requiring resolution through MAPs. Where an area is identified as needing further attention, work conducted in ICAP is expected to improve the efficiency of compliance action taken outside the program, if needed. Participation is not mandatory but is available on a voluntary basis to taxpayers that meet the relevant requirements. Based on a taxpayers' CbC report and additional information, an open discussion about tax risks may be initiated among the taxpayer and the participating tax authorities. In particular, risks in the areas of transfer pricing/PEs and other specific risks arising, for example, from the CbC report are analyzed (the "covered risks"). The aim of this exchange is to classify the audited risk areas into "low-risk" and "not low-risk" (the "development of risk profiles"). To the extent the taxpayer and the tax authorities involved agree in the course of the risk audit on a "low-risk" status for the areas under review, the taxpayer receives an "outcome letter" that assures the taxpayer of the "low-risk" status of the identified risk areas and the fact that they will not be audited for a specified period of time.

Comment: Thus far, German law has not provided an explicit legal basis for ICAP. However, section 89b of the German Fiscal Code (AO) refers to an "international risk assessment procedure," which may be interpreted as a link to ICAP. First experiences in practice have revealed difficulties resulting from the different approaches taken and evaluations made by the various jurisdictions involved, and the high additional compliance costs attributable to cooperative, as opposed to enforced, tax compliance. Specifically, this is attributable to the extensive preparatory work involved as compared to what is involved in merely responding to information requests. It would be advantageous to taxpayers for government tax audits to omit the risk areas listed in the "outcome letter" and to be based on an agreed global narrative after ICAP has been successfully closed. However, the overwhelming output generated by the G20/OECD BEPS project, of which ICAP is a part, overstresses the capacity of both taxpayers and tax authorities to adapt both technically and as regards content and increases the tax risks for taxpayers and their officers due to a significant increase in the number of more or less vague reporting obligations. Furthermore, the G20/OECD measures create a split tax system that differentiates between MNEs and small and medium-sized enterprises (SMEs) and, contrary to its intent, ICAP has not reduced the number of MAPs since it began in 2018.[1105]

2. Mutual Assistance in Collection

Germany has implemented the EU Council Directive 2010/24/EU of March 16, 2010, concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures under the *EU-Beitreibungsgesetz* of December 7, 2011.[1106] The purpose of the Directive is to make assistance in the recovery of tax claims more efficient and effective, and to facilitate the provision of such assistance in practice. This is to be accomplished by adopting a uniform instrument to be used for enforcement measures in the EU Member State to which the request for assistance is made, by introducing an obligation for EU Member States to communicate requests and documents in a digital form and via an electronic network, and by creating a central liaison office in each EU Member State that is responsible for granting assistance in the recovery of tax claims of other EU Member States.

The mutual assistance between non-EU Member States and EU Member States for the recovery of tax claims agreed to in tax treaties is usually subject to further restrictions. Under Article 26(4) of the Germany-United States tax treaty, for example, assistance is to be granted only in cases involving the improper availing of treaty benefits.[1107]

[1104] See https://www.oecd.org/tax/forum-on-tax-administration/international-compliance-assurance-programme.html, on June 10, 2021.

[1105] According to OECD data, the mutual agreement procedures have increased by approximately 13% since 2018. See https://www.ey.com/en_gl/tax-alerts/oecd-releases-2019-mutual-agreement-procedure-statistics-and-2019-mutual-agreement-procedure-awards#:~:text=The%20starting%20inventory%20of%20both,2019%2C%20from%201%2C231%20to%20934.

[1106] Act concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures (*Gesetz ueber das EU-Beitreibungsgesetz* — EUBeitrG), BGBl. 2011 I, 2592.

[1107] BMF, decree of January 23, 2014, BStBl. 2014 I, 188 at. 5.2.9.

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3. Mutual Agreement Procedure

Under Germany's tax treaties, the MAP can be used in three ways: a taxpayer may object to its tax administration that it is subject to double taxation in violation of a treaty; the competent authorities of the Contracting States may consult with a view to eliminating, generally, difficulties in the implementation and interpretation of a treaty; and the competent authorities may consult to eliminate double taxation in instances not covered by a treaty. In this context, the German tax administration is generally willing to proceed with the competent authority procedure whenever there is economic double taxation (for example, in the context of intercompany charges) and does not restrict the procedure to cases of juridical double taxation (i.e., where the same taxpayer is subject to double taxation with respect to the same item of income).[1108] The taxpayer may simultaneously attempt to prevail in the German tax courts, but a final court decision is not a prerequisite for the institution of competent authority proceedings. A competent authority agreement in favor of the taxpayer is implemented in Germany irrespective of whether the statute of limitations has expired.[1109]

Germany also employs MAPs for purposes of entering into bilateral or multilateral APAs concerning the profit allocation between related parties and between a head office and a PE.[1110] An APA is entered into with the foreign competent authority and then converted into a unilateral advance ruling addressed by the German tax authority to the taxpayer.[1111]

Where the competent authorities are not in a position to avoid double taxation, some German tax treaties, including the Germany-U.S. tax treaty, provide for an arbitration procedure.[1112] A taxpayer may also resort to the EU Arbitration Convention of July 23, 1990, for eliminating double taxation resulting from transfer pricing adjustments and from adjustments to the amount of profit attributable to a PE.[1113]

A new approval process in advance of a MAP (*Vorabverstaendigungsverfahren*) has been introduced with effect from June 9, 2021.[1114] Upon application of the taxpayer, this process is intended to help avoid any double taxation issues where a tax treaty applies prior to a MAP being initiated, provided the facts that are the subject of the process are not yet in place. The result of the approval process will be a joint understanding by the contracting treaty states involved regarding the tax treatment of the future facts submitted. The understanding will be binding for no more than five years but may be extended on application. The approval process will usually be subject to a fee of 30,000 euros (15,000 euros for an extension) to be paid by the applicant taxpayer at the beginning of the process and requires the applicant to agree to the result of the approval process and waive its right to object to a tax assessment notice to the extent the assessment notice is based on the results of the approval process. If all these conditions are fulfilled, the results of the approval process will be binding on the local German tax authority, unless the other treaty state is found not to have acted in accordance with the joint approval or the applicable law was changed after the approval is issued.

E. Prevention of Tax Avoidance and Unfair Tax Competition

The Law on Defense against Tax Avoidance and Unfair Tax Competition[1115] intends to encourage "tax havens," i.e., non-cooperative tax jurisdictions, to implement and comply with international standards in the tax area. The new law will affect only business relationships with and in countries and territories on the EU list of non-cooperative countries and territories for tax purposes as transformed into German domestic laws by an Ordinance (the "Blacklist"). There are currently 11 jurisdictions on this Blacklist: American Samoa, Anguilla, Fiji, Guam, Palau, Panama, Russia, Samoa, Trinidad and Tobago, the U.S. Virgin Islands and Vanuatu.

If a taxpayer maintains business relationships or shareholdings in or with reference to a non-cooperative tax jurisdiction, this will result in the non-deductibility of income-related expenses, the application of tighter CFC rules (i.e., to the entire active and passive income of the CFC, without application of the counterevidence rule),[1116] extended withholding tax regimes for residents of the countries/territories on the EU blacklist, and a denial of tax exemptions for dividend income and gains from share sales. Additionally, increased cooperation and documentation will be required from affected taxpayers. This new law, which applies generally from January 1, 2022, is more rigid than required by the Code of Conduct Group (Business Taxation) Report to the Council as approved by the EU Council on December 5, 2019.[1117] The new law provides for all defense measures provided for by the Code of Conduct Group (Business Taxation) Report and adds an additional defense measure (the suspension of taxation barriers provided for by tax treaties) that does not form part of the Report.

F. Hybrid Mismatches

The G20/Organisation for Economic Cooperation and Development (OECD) Base Erosion and Profit Shifting (BEPS) project found that double non-taxation, in particular as a result of hybrid mismatches, is one of the major loopholes in international tax law.[1118] Action item 2 of the BEPS action plan ("hybrid mismatch arrangements") and the European Union (EU) Anti-Tax Avoidance Directive II (ATAD II)[1119] combat tax arrangements in which tax (structuring) advantages are generated from an asymmetry, resulting in a tax deduction in one state and an exemption in another. Thus, one-time taxation is to

[1108] Circular letter of the Federal Ministry of Finance of July 13, 2006, BStBl. 2006 I, 461, as amended on April 5, 2017, BStBl. 2017 I, 707.
[1109] AO, Sec. 175a.
[1110] AO, Sec. 178a.
[1111] AO, Sec. 89(2).
[1112] Germany-United States tax treaty, Art. 25(5) and (6).
[1113] EU Arbitration Convention of July 23, 1990, as amended.
[1114] AO, Sec. 89a.

[1115] Law on Defense against Tax Avoidance and Unfair Tax Competition of June 25, 2021 (*Gesetz zur Abwehr von Steuervermeidung und unfairem Steuerwettbewerb und zur Aenderung weiterer Gesetze* or *Steueroasenabwehrgesetz* — StAbwG), BGBl. 2021 I, 2056 and its interpretation by the decree of the Federal Ministry of Finance of June 14, 2024, BStBl. 2024 I, p. 1086.
[1116] For the general rules, see XV.B., above.
[1117] Code of Conduct Group (Business Taxation) Report to the Council of November 25, 2019 — 14114/19, 45 ff, as approved by the EU Council on December 5, 2019 — 14530/19, note 10.
[1118] Action Item 2.
[1119] Council Directive (EU) 2017/952 of May 29, 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries.

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be achieved by developing linkage rules that align the tax treatment of such transactions in the affected states.

Even before ATAD II came into force, German domestic law had already begun to implement measures to combat tax asymmetry — not just with respect to intra-group cross-border structures:

(i) With effect from January 1, 2017, Germany disallows a deduction for expenses incurred by a partner (*Sonderbetriebsausgaben*) in calculating the partner's taxable share in the profits of a partnership to the extent the expenses are also deductible in another country, unless the taxpayer provides evidence that the expenses are deducted from income that is subject to taxation in Germany and in the other country.[1120] This is to prevent expenses from being deducted twice, once in the partner's country of residence and once in the country that calculates the partnership's profit and the foreign partner's share of that profit.

(ii) With effect from January 1, 2017, license fees are not or are only partially deductible, if: (i) the foreign licensor is affiliated to the licensee; (ii) the foreign licensor is subject to a preferential tax regime in its home jurisdiction at a tax rate of less than 25%; and (iii) the controlled foreign corporation (CFC) rules do not apply. A permanent establishment (PE) can also be a licensor or a licensee. This license barrier rule applies to all licensing structures between affiliated parties that do not align with the "OECD nexus approach."[1121]

(iii) Dividends are 95% tax-exempt in the hands of corporate shareholders (holding 10% of the shares at the beginning of the calendar year) provided that, at the level of the distributing corporation, the distributed dividends are generally neither tax deductible nor exempt under a tax treaty shielding privilege.[1122]

(iv) In case of a cross-border tax group, negative income of a controlling entity or the controlled corporation may not be taken into account for domestic taxation purpose to the extent it is taken into account in a foreign country within the scope of the taxation of the controlling entity, the controlled corporation or another person.[1123]

(v) In certain circumstances, domestic law may overrule an exemption with respect to income from employment or trading income from partnerships, dividend income or other income that is exempt from German taxation under an applicable tax treaty.[1124]

While these rules are in line with ATAD II, there are additional requirements resulting from ATAD II.

ATAD II is designed to counteract additional hybrid mismatches that result in a double deduction or a deduction without inclusion. First and foremost, ATAD II prohibits deductions in these cases and, second, provides for a switch-over from the exemption to the credit method. The additional identified hybrid mismatches between affiliated entities include:

(i) Hybrid entity mismatches;[1125]

(ii) Hybrid financial instrument mismatches;[1126]

(iii) Hybrid PEs;[1127]

(iv) Tax residence mismatches;[1128]

(v) Imported mismatches;[1129] and

(vi) Reverse hybrid mismatches.[1130]

ATAD II was to be implemented into domestic law by the end of the year 2019 except with respect to reverse hybrid mismatches (to be implemented by the end of 2021).

In addition to the rules counteracting hybrid mismatches described above, the ATAD Implementation Act of June 25, 2021[1131] covers further hybrid mismatches as provided for by Articles 9 and 9b of ATAD II.

The new ATAD Implementation Act provides for a new Section 4k of the Income Tax Act (*Einkommensteuergesetz* — EStG), which deals with both double deduction and deduction/no inclusion situations and denies either the deductibility of the expense or the exemption of the income from German taxation (treaty override). This new rule will apply to interest, royalties and service fees as well as depreciation with respect to transactions between related entities (see XIV.A.1., above) or deemed transactions between a head office and its foreign PEs or in the case of "structured tax arrangements" that offer a tax advantage and do not require any actual or deemed business transactions between related entities or a head office and its foreign branch respectively. While ATAD II addresses only entities subject to corporate income tax in one or more EU Member States, in addition to tax-transparent partnerships (only Article 9a of ATAD II — reverse hybrid mismatches — applies in this context), draft Section 4k of the Income Tax Act generally also addresses individuals, partnerships and other entities in EU Member States and non-EU Member States if they are related "entities." The new law significantly extends the scope of ATAD II and is applicable to expenses incurred after December 31, 2019, i.e., with retroactive effect.[1132]

G. BEPS 2.0: Pillar One and Pillar Two

1. In General

Based on the G20/OECD BEPS project, on October 14, 2020, the OECD for the first time published its thoughts regarding tax issues relating to the "digital economy" (Action Item 1 of the BEPS project). These thoughts are summarized in the blueprints for a possible redistribution of international taxation rights (Pillar One)[1133] and a possible global minimum

[1120] EStG, Sec. 4i.
[1121] EStG, Sec. 4j.
[1122] KStG, Sec. 8b(1) sent. 2 et al.
[1123] KStG, Sec. 14(1) no. 5.
[1124] EStG, Sec. 50d(8)–(11).

[1125] ATAD II, Art. 9.
[1126] ATAD II, Art. 9.
[1127] ATAD II, Art. 9.
[1128] ATAD II, Art. 9b.
[1129] ATAD II, Art. 9.
[1130] ATAD II, Art. 9a.
[1131] ATAD Implementation Act of June 25, 2021.
[1132] On December 5, 2024, the Federal Ministry of Finance published a decree summarizing the tax administration's interpretation of the law.
[1133] See https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-one-blueprint-beba0634-en.htm.

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taxation regime (Pillar Two)[1134] after a series of concept papers and consultation drafts. These rules were intended to apply to large MNE groups. While the rules on possible group-wide minimum taxation under Pillar Two should, in principle, apply equally to all industries, the rules on the reallocation of international taxation rights to market/user jurisdictions provided for under Pillar One should apply only to in-scope companies providing automated digital services ("Automated Digital Services Businesses") and consumer-facing businesses ("Consumer-Facing Businesses").

Comment (1): Given that most "traditional industries" have already begun to digitalize (a process accelerated by the COVID 19 pandemic), it is clear that most industries will become subject to Pillar One. The principles of Pillar One and Pillar Two deviate significantly from the currently applicable international taxation systems and their complexity will require a massive additional bureaucratic effort at the level of both taxpayers and tax authorities.

Comment (2): The political support for Pillar One and Pillar Two is puzzling since, even according to the OECD's original calculations, the global corporate income tax revenue will increase by only USD 50 to 80 billion per annum, without taking into account the US Global Intangible Low-Taxed Income (GILTI) regime,[1135] i.e., an estimated surplus of 4% of global corporate income tax revenues. The main part of this surplus is said to be expected from Pillar Two. Furthermore, even the OECD calculates the costs of implementing Pillars One and Two at an amount that would have a negative effect on global gross domestic product (GDP).

The potential effects of Pillars One and Two on German corporate income tax revenue are the subject of intense debate. According to a study prepared for the German government and published by the Ifo Institute for Economic Research in Munich in June 2020,[1136] Pillars One and Two will generate a small corporate income tax surplus of approximately 600 euros million per annum. This corresponded to approximately 1.9% of the 2019 corporate income tax revenue of 32 billion euros (before the COVID 19 pandemic). However, the assumptions made in the Ifo study have been criticized as being too optimistic. In particular, the assumption that the negative effects of Pillar One on the German tax revenue could be balanced by Pillar Two seems doubtful, given that at least most countries are likely to practice "cherry picking" of the most favorable rules, as in the past.

However, on July 1, 2021,[1137] the OECD published a statement to the effect that in-scope companies should be defined only by minimum turnover thresholds, but not by types of revenue. The new content of Pillars One and Two was published on October 8, 2021, and 139 OECD/G20 member states had agreed to it as of November 4, 2021. Nevertheless, the details are still subject to further (significant) changes. The basic rules as of July 4, 2022, are summarized below, which are still subject to supplements and amendments due to ongoing discussions even for Pillar Two. Further supplements and amendments are to be expected, which are not yet covered by the EU Pillar Two Directive.

2. Pillar One

Pillar One[1138] shall redistribute international taxation rights in favor of market/user states for in-scope companies. In-scope companies shall be MNEs with a global turnover of over 20 billion euros and profitability (i.e., profit before tax/revenue) of more than 10%, contingent on successful implementation including of tax certainty as to Amount A, with the relevant review beginning seven years after the agreement will have come into force, and the review being completed in no more than one year. To achieve this goal, Pillar One shall create new tax nexus rules that shall allow a market/user jurisdiction to tax a significant share of group-wide (residual) profits even without the physical presence of an MNE's corporations, if the MNE derives at least 1 million euros revenue from that jurisdiction. For smaller market jurisdictions with a GDP lower than 40 billion euros, the nexus threshold shall be set at 250,000 euros. For in-scope MNEs, 25% of residual profit — defined as profit in excess of 10% of revenue — shall be allocated to market jurisdictions with nexus using a revenue-based allocation key. Revenue shall be sourced to the end market jurisdictions where goods or services are used or consumed. To facilitate the application of this principle, detailed source rules for income from specific categories of transactions (not income from the extraction of mineral resources or regulated financial services) shall be developed. Amount B aims to standardize the remuneration of related-party distributors that perform baseline marketing and distribution activities in a manner that is aligned with the arm's length principle. Double taxation is to be avoided and in-scope MNEs are to benefit from mandatory binding dispute prevention and resolution mechanisms. Pillar One is to be implemented via a multilateral instrument that was intended to be developed and opened for signature in 2023 but was delayed. Despite initial political agreement on the broad architecture of Pillar One from over 130 countries, implementation details are still being negotiated, with a focus on complex issues such as the elimination of double taxation and the stability of the new system. As noted, the initial timeline aimed for implementation in 2023, but discussions and technical work are ongoing, suggesting a much later practical deployment. It should be noted that political support for Pillar One is declining rapidly in both developing and industrialized countries.

Comment (1): The MAPs agreed on in bilateral tax treaties are not suitable for settling multilateral disputes, as such procedures are not really efficient and only bilateral in nature. Even

[1134] See https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-two-blueprint-abb4c3d1-en.htm.

[1135] OECD Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors — October 2020, Annex ID of October 12, 2020, Tax Challenges Arising from Digitalization — Economic Impact Assessment; *see* Executive Summary | Tax Challenges Arising from Digitalization — Economic Impact Assessment: Inclusive Framework on BEPS | OECD iLibrary (oecd-ilibrary.org).

[1136] See https://docplayer.org/201304524-Nationale-steueraufkommenswirkungen-einer-neuverteilung-von-besteuerungsrechten-im-rahmen-der-grenzueberschreitenden-gewinnabgrenzung.html.

[1137] See https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf.

[1138] See Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy of October 8, 2021 (https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.htm).

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if the countries concerned were to agree on a new multilateral dispute resolution procedure and domestic tax administrations worldwide were to adapt to it, the procedure would not necessarily be better, quicker or more efficient, but would instead result in a significant increase in the number of double taxation cases. It is doubtful whether ICAP (see XV.D.1.k., above) would be helpful at least with respect to routine activities. Thus, it is crucial that the intended mandatory binding dispute prevention and resolution mechanism be implemented and executed successfully. Otherwise, it is to be expected that Pillar One will turn out to be disadvantageous in particular for export-driven economies such as Germany's.

Comment (2): Each corporation is expected to research and document in detail all facts relevant to determining whether it is within the scope of Pillar One, and, if so, to what extent and with respect to what profits. This would represent a significant additional bureaucratic burden.

An EU draft Directive for implementing Pillar One has not yet been published.

3. Pillar Two

Pillar Two[1139] introduces global minimum taxation for large internationally active groups (more than 750 million euros in group sales in at least two of the four fiscal years preceding the tested fiscal year), regardless of where they are based or in which countries their business activities take place. The key component of Pillar Two is the Global Anti-Base Erosion (GloBE) rules, which include the Income Inclusion Rule (IIR) and the Undertaxed Payments Rule (UTPR). As of now, several jurisdictions have begun the process of legislating these rules into their national laws, while others are still in the consultation phase. The OECD has published detailed guidance to assist jurisdictions in the implementation process. However, there remains variability in adoption timelines and approaches, with some countries announcing plans to implement the rules by 2023 or 2024. The main features of Pillar Two are set out below.

The GloBE rules ensure that the low-taxed income of subsidiaries or PEs is taxed at a minimum effective tax rate (ETR) of 15% for purposes of the IIR and the UTPR. Specifically: (i) the IIR is similar to CFC rules but does not differentiate between active and passive income; and (ii) the UTPR (i.e., a limitation on the tax deductibility of otherwise tax-deductible expenses or an assessment of an additional top-up tax) shall apply if the IIR does not achieve a minimum effective tax rate of 15%.

The IIR allocates, at the level of the ultimate parent entity (UPE), a top-up tax that represents the difference between the ETR paid in the country concerned and the minimum ETR of 15%, on the excess profits in that country.

As a backstop to the IIR, the UTPR applies only in specific circumstances where the top-up tax is not charged for under an IIR. The application of a UTPR in a UTPR jurisdiction shall result in that jurisdiction imposing an additional cash tax expense on the undertaxed group entity (a "Constituent Entity"), which is required to achieve the 15% minimum ETR in the UTPR jurisdiction. The additional tax generated by the UTPR shall be assessed only by UTPR jurisdictions and shall need to be split up among the UTPR jurisdictions concerned. This should also motivate low-tax jurisdiction to join the group of jurisdictions implementing the UTPR (or the IIR).

The GloBE rules shall provide for an exclusion from the UTPR for MNEs in the initial phase of their international activity, defined as MNEs that have a maximum of 50 million euros in tangible assets abroad and that operate in no more than six other jurisdictions. This exclusion is limited to a period of five years after an MNE comes within the scope of the GloBE rules for the first time. For MNEs that are within the scope of the GloBE rules when they come into effect, the five-year period will start when the UTPR rules come into effect. Further, an MNE Group shall not need to calculate its ETR in a jurisdiction if its tax revenues in that jurisdiction are less than 10 million euros and its average profits are less than 1 million euros.

The ETR test is applied on a jurisdictional basis and uses a common definition of covered taxes and a tax base determined by reference to financial accounting income (with agreed adjustments consistent with the tax policy objectives of Pillar Two and mechanisms to address timing differences).

Pillar Two became effective in 2023, with the UTPR coming into effect in 2024.

Comment: The global introduction of effective GloBE minimum taxation will pose considerable challenges, and not only for the multinational corporations concerned, but also for national tax administrations. Both will face considerable administrative difficulties with high compliance and administrative costs. The Pillars initiatives are may very well overstress the capacity of both taxpayers and tax authorities to adapt both technically and as regards content. In particular, the interaction of the undertaxed payment rule with the income inclusion rule, the switch-over rule, and the possible application of CFC rules would be almost unmanageable, because of the considerable documentation efforts required and the difficulty of proving what tax payments have been made in other jurisdictions. Further, Pillars One and Two will apply to all industries, not only to the "digital industry," as originally contemplated. As such these rules will create a huge additional bureaucratic administrative burden for corporations within their scope and increase the tax risks for taxpayers and their officers due to a significant increase in the number of (more or less) vague reporting obligations. The G20/OECD measures also create a split tax system that differentiates between MNEs and SMEs. Moreover, the new rules for the global taxation of an MNE group are not in line with domestic tax regimes of jurisdiction that treat each respective group corporation as a taxpayer rather than the group. These may be the reasons why an increasing number of countries are becoming more reluctant to implement the full set of Pillar Two rules, but are nonetheless willing to take the opportunity simply to increase their domestic corporate income tax rates. It, therefore, seems somewhat unlikely that the overwhelming bureaucratic efforts — first at the level of multinational corporations and second at the level of the domestic tax administration — will generate additional tax revenue in Germany, as low-tax jurisdictions increase their tax rates correspondingly. In short: corporations and PEs in Germany and the European Union that form part of an MNE group are over-

[1139] OECD — Tax Challenges Arising from the Digitalisation of the Economy Global Anti-Base Erosion Model Rules (Pillar Two) published at: https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.pdf.

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whelmed by this additional bureaucratic work, which would shift tax revenue to other jurisdictions.

Comment: It should be noted that political support for Pillar Two is declining rapidly in both developing and industrialized countries due to the complexity of the new rules, which is overwhelming for both taxpayers and tax administrations. As the United States opposes Pillar Two in its current form,[1140] Europe (i.e., the European Union, Liechtenstein, North Macedonia and Switzerland), Australia, New Zealand, South Korea and Turkey have introduced Pillar Two via, respectively, the EU Minimum Tax Directive and their domestic laws. These countries now face severe challenges, in particular, because of strong US opposition (and the lack of support from many other countries). The Trump administration characterizes the Pillar Two rules, and in particular the UTPR, as a tax measure that discriminates against US MNEs. This may give the US tax administration the opportunity to apply Section 891 of the Internal Revenue Code (IRC), which allows the US President to double the regular US tax rates on the US income of citizens and corporations resident in countries that are found to discriminate against US MNEs by introducing Pillar Two rules. It will be relatively easy for countries that have introduced Pillar Two rules via their domestic laws to respond to this. However, the position is quite different for EU Member States, which are bound to the EU Minimum Tax Directive. Adapting or abolishing the EU Minimum Tax Directive would be very difficult to achieve because of the European Union's highly complex and time-consuming legislative procedures. Critics of the Pillar projects may well feel justified in their criticisms. However, this will not help to resolve what is a very serious issue. Unless a solution is found, the European Union would seem to have put itself and its Member States in an isolated position insofar as the prospects for EU-based individuals and corporations are concerned. It remains to be seen whether the CJEU will uphold complaints against the Minimum Tax Directive on the grounds that the European Union has exceeded its competence in this respect, as it is in principle not responsible for direct taxes (see XV.H.1., below). However, this will be of no help in the near future — either to Germany or to any other EU Member State.

H. Global Minimum Tax

1. The EU Pillar Two Directive

After the OECD adopted the Global Anti-Base Erosion Model Rules as model rules for the second pillar of the BEPS 2.0 project December 20, 2021,[1141] with a view to implement the IIR and the UTPR in the respective Member States,[1142] the EU followed suit on December 22, 2021, with a draft Directive on Ensuring a Global Minimum Level of Taxation for Multinational Groups in the Union (the "Pillar Two Directive").[1143] The draft Pillar Two Directive was subject of intense negotiations among the 27 EU Member States. A second draft was published on March 12, 2022,[1144] but not agreed upon on March 15, 2022. As of July 4, 2022, the EU Council had not been able to reach agreement on the draft Pillar Two Directive. Finally, on December 12, 2022, the EU agreed upon a final draft, which was published in the EU Law Gazette on December 22, 2022.[1145] These new rules generally apply in respect of fiscal years beginning after December 31, 2023, with the exception of the UTPR, which applies for fiscal years beginning after December 31, 2024. During a transitional period of up to three years, some reliefs are provided.

However, the Pillar Two Directive does not reflect the ongoing discussion at OECD level on Pillar Two. Further supplements and amendments are to be expected, which are not yet covered by the EU Pillar Two Directive whose changes require an unanimous resolution of the Council, which is highly unlikely. It seems that the Pillar Two Directive was issued prematurely, which obviously is in conflict with the original intention of the Pillars project to establish one new binding standard for international tax laws. Instead, a number of different Pillar Two-based regulations have been, and will need to be, established, in addition to aligning with the further applicable standard tax rules currently in effect. Even within the group of the EU Member States, each bound to the Pillar Two Directive, different interpretations of the Directive by the respective domestic lawmakers and tax administrations are bound to emerge and will likely impact the intended outcome of a new uniform standard for direct taxation.

The Pillar Two Directive is intended to ensure that the rules are introduced as uniformly as possible in the EU Member States and to transpose the requirements developed at OECD level into EU law. In contrast to the OECD's Pillar Two, the draft Pillar Two Directive will apply also to purely domestic groups of companies ("Large Scale Domestic Groups"), not only to MNEs. As a consequence, the Pillar Two Directive interferes with the sovereignty of each EU Member State which are ultimately responsible for the legislation regarding direct taxes (as per Article 114(2) TFEU), unless the approximation of such laws, regulations or administrative provisions of the Member States directly affect the establishment or functioning of the internal market (Article 115 TFEU). The EU Commission follows an increasingly extensive interpretation of the exemption of the basic principle (no authority of the EU for direct taxes) in Article 115 TFEU. This appears to be critical, as the EU is not a federal state, but only a confederation of states. A political majority has not yet been found in favor of amending the European Treaties to change this. Further, the CJEU claims to be the only competent court that can rule on these issues related to the European Treaties and therefore takes precedence over the

[1140] See https://www.whitehouse.gov/presidential-actions/2025/01/the-organization-for-economic co-operation-and-development-oecd-global-tax-deal-global-tax-deal/ and https://www.whitehouse.gov/presidential-actions/2025/01/america-first-trade-policy/.

[1141] See https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.pdf. With respect to OECD's commentary on this, see https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-commentary.pdf.

[1142] The STTR is a DTA article that gives the source state extended taxing rights with respect to certain payments and, therefore, is not part of OECD's GloBE Rules of December 20, 2021.

[1143] Proposal for a Council Directive on Ensuring a Global Minimum Level of Taxation for Multinational Groups in the Union of December 22, 2021.

[1144] See https://data.consilium.europa.eu/doc/document/ST-6975-2022-INIT/en/pdf.

[1145] Council Directive (EU) 2022/2523 of December 14, 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union, L 328/1.

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national constitutional courts in this respect. This is an increasingly hot topic which should be monitored closely.

The Pillar Two Directive provides for the following simplified application steps:

(i) First, the UPE checks whether it falls within the scope of the Pillar Two Directive.

(ii) Second, the companies in the group ("Constituent Entities") determine their profit in accordance with the provisions of the Pillar Two Directive — i.e., a separate tax base must be determined based on one of the accepted accounting standards ("Qualifying Income"). The accepted accounting standards are the international financial reporting standard (IFRS) and the national accounting standards of Australia, Brazil, Canada, China, all EU Member States, all EEC Member States, Hong Kong (China), India, Japan, Mexico, New Zealand, Russia, Singapore, South Korea, Switzerland, the United Kingdom and the United States. However, consolidating the results properly requires a huge effort.

(iii) Third, the Constituent Entities determine their taxes attributable to the Qualifying Income — the Pillar Two Directive specifies which taxes are to be included ("Covered Taxes"). It should be noted that the Pillar Two Directive takes into account additions deriving from national CFC regimes, such as the German CFC rules (see XV.B., above).

(iv) Fourth, the Effective Tax Rate (ETR) for purposes of the Pillar Two Directive is determined based on the Qualifying Income and Covered Taxes; subsidiaries in the same country of residence are considered together (the "Jurisdictional Approach").

(v) Fifth, the ETR is used to determine the amount of tax to be levied separately for each jurisdiction under the minimum taxation rules (the "Jurisdictional Top-Up Tax").

(vi) Sixth, the total Jurisdictional Top-Up Taxes are levied either by way of the IIR at the level of the parent company or the UTPR at the level of the individual Constituent Entities.

(vii) Seventh, the Top-Up Taxes can be raised either by the low-tax jurisdiction ("Qualified Domestic Minimum Top-Up Tax") or, failing that, by the tax jurisdiction of residence of the parent company.

(viii) Eighth, carve outs for companies with substantial business operations change the entire character of Pillar Two, away from a competition for book profits towards a competition for real investments.

The IIR, UTPR and Qualified Domestic Minimum Top-Up Tax are the "Minimum Taxes."

Comment: The seventh point, above, is a game changer as Germany — like other high-tax jurisdictions — will probably not generate additional corporate income tax revenue worth the effort. Thus, the entire Pillar Two project seems to have only a defensive character limiting the international tax competition to the advantage of high-tax jurisdictions like Germany.

The Pillar Two Directive gives rise to separate additional declaration obligations for each Constituent Entity. In principle, each Constituent Entity is obliged to make a declaration of its own data and the data of the entire group, unless such data has been fully and entirely filed by the Ultimate Parent Entity or another Constituent Entity. Special attention should be paid to the national implementation of the penalty rule: in contrast to the proposals, the Pillar Two Directive does not include a penalty payment should a Constituent Entity make a false declaration, but rather it leaves this matter to the domestic legislature of each EU Member State, which have to provide for a "proportionate and dissuasive" penalty regime. In this context, it should be noted that a false declaration pursuant to Pillar Two is to be qualified as tax fraud with all of the attendant consequences for the entity and its managing directors and staff working on this topic.

2. The Minimum Tax Act

The Minimum Tax Act,[1146] which entered into force as of the beginning of the year 2024, allows Germany to impose a top-up tax onto a Germany-based entity that belongs to certain large multinational or domestic groups ("Constituent Entity").[1147] The purpose of the top-up tax is to ensure that the profits of the group will be taxed on a certain minimum level (15%) in all of the jurisdictions where the Constituent Entities operate. The Minimum Tax Act fulfills the minimum requirements of the OECD's Global Anti-Base Erosion Rules (GloBE) Rules[1148] and the EU Minimum Tax Directive.[1149]

a. Basic Rules

(1) Qualifying Multinational or Domestic Group

The multinational or domestic groups to which the Minimum Tax Act is applied must have an annual turnover of at least 750 million euros. The threshold must have been met on at least two of the previous four financial periods.[1150] Group turnover is defined based on group accounts prepared based on International Financial Reporting Standards (IFRS) or other acceptable or authorized accounting standards.[1151]

Governmental entities, international organizations, pension funds and non-profit organizations are "Excluded Entities" and thus outside of the scope of the Minimum Tax Act. The same applies to investment funds and real estate investment vehicles if these are ultimate parent entities in a group. Certain subsidiaries of the above-mentioned exempted entities are also

[1146] Act on the Implementation of Council Directive (EU) 2022/2523 of the Council to Ensure a Global Minimum Level of Taxation and Other Accompanying Measures (*Mindestbesteuerungsrichtlinie-Umsetzungsgesetz*) of December 21, 2023, BGBl. 2023, No. 397.

[1147] For purposes of the Minimum Tax Act, the term "entity" includes any legal entities or legal arrangements that prepares separate financial accounts. German situated Constituent Entities include typically German companies, partnerships or German permanent establishments of nonresident entities as well as joint ventures. Pursuant to Sec. 3 para. 1 as amended by the Annual Tax Act 2024, a single German Constituent Entity is sufficient, i.e., a single entity forms a "group".

[1148] Tax Challenges Arising from the Digitalisation of the Economy Global Anti-Base Erosion Model Rules (Pillar Two), OECD December 14, 2021 ("OECD GloBE Rules").

[1149] Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union ("EU Minimum Tax Directive").

[1150] Minimum Tax Act, Sec. 1, para. 1.

[1151] Minimum Tax Act, Sec. 7, para. 4.

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Excluded Entities. Excluded Entities can be opted to be temporarily regarded as Constituent Entities.[1152]

(2) The IIR

The top-up tax is principally levied based on the so-called Income Inclusion Rule (IIR). This means that a German situated ultimate parent entity of a group must pay top-up tax relating to the low-taxed foreign Constituent Entities or relating to the parent entity itself, if it is considered to be a low-taxed entity. Alternatively, a German intermediate parent entity in a group may be subject to top-up tax relating to the low-taxed foreign Constituent Entities or relating to the intermediate parent entity itself, if it is considered to be a low-taxed entity, unless the ultimate parent entity of the group or another intermediate parent entity of the group, which is a direct or an undirect parent entity of the German intermediary parent entity, has been subject to a top-up tax based on a qualified IIR in another country. If a foreign low-taxed entity is owned through an intermediate parent entity which is subject to top-up tax based on a qualified IIR in another country, the German top-up tax is lowered by the top-up tax paid in the other country.[1153]

(3) The UTPR

Secondly, the top-up tax may be levied based on the so-called Undertaxed Profits Rule (UTPR). This means that the German situated Constituent Entities must pay top-up tax relating to the low-taxed foreign Constituent Entities, in case the ultimate parent entity of the group is situated in a country, where the ultimate parent entity is not subject to a qualified IIR or in case the ultimate parent entity is an Excluded Entity. The German situated Constituent Entities must also pay top-up tax relating to a low-taxed foreign ultimate parent entity if it is not subject to a qualified IIR in its residence country. The top-up tax to be paid is allocated between the German Constituent Entities based on their proportional amount of the number of the total employees and total net value of the tangible assets of the German Constituent Entities (excluding any investment funds and real estate investment vehicles). The obligation to pay top-up tax under the UTPR is secondary to the obligation to pay top-up tax under the IIR, meaning that the top-up tax under the UTPR relating to the low-taxed Constituent Entities is zero, if all of the ultimate parent entity's ownership interests in such low-taxed group entity are held directly or indirectly by one or more parent entities that are required to apply a qualified IIR in respect of that low-taxed Constituent Entity.[1154] The rules concerning the top-up tax under the UTPR are applied as of the financial period starting after December 31, 2024.[1155]

The German Minimum Tax Act does not currently include the transitional UTPR safe harbor rules published by OECD in July 2023,[1156] where it was recommended that Constituent Entities with an ultimate parent entity situated in a jurisdiction with a statutory corporate income tax rate of at least 20% would not be subject to the UTPR in 2025 and 2026.

(4) The QDMTT

Finally, the German situated Constituent Entities may be subject to a Qualified Domestic Minimum Top-up Tax (QDMTT), which means that these entities must pay top-up tax to the extent these entities themselves are deemed as low-taxed entities.[1157]

Based on the EU Minimum Tax Directive, the implementation of the QDMTT is optional, but Germany has chosen to levy this tax in order to protect its tax base.

When calculating the QDMTT, the same rules are generally applied than when calculating the top-up tax based on IIR and UTPR, including applying the accounting standards of the ultimate parent entity and applying the substance-based income exclusion (see below).[1158]

b. Computation of Top-up Tax

(1) Qualifying Income or Loss

In order to determine which entities are low-taxed, a qualifying income or loss is calculated for each Constituent Entity by making certain adjustments to the financial accounting net income or loss of the entity prior to any consolidation adjustments for eliminating intra-group transactions as determined under the accounting standard used in the preparation of the consolidated financial statements of the ultimate parent entity of the group.[1159] These adjustments include net tax expenses, certain dividend income and capital gains/losses, certain revaluation gains/losses, gains and losses relating to certain asset transfers in reorganizations, certain foreign currency gains/losses, illegal payments, fines and penalties, prior period errors and changes in accounting principles, accrued pension expenses and expenses relating to certain hybrid financing arrangements. In case the intra-group transactions have not been made based on the arm's length principle, corresponding adjustments are made when calculating the qualifying income/loss. Certain refundable tax credits are deemed as income. Constituent Entities' income and losses in a certain country may be consolidated, if such entities belong to a tax consolidation group in the country.[1160] Further, the method for calculating the qualifying income includes special provisions relating to insurance companies and banks, corporate restructurings, joint ventures, multi-parented groups, transparent entities, eligible distribution tax systems, investment funds and real estate investment vehicles, shipping activity as well as permanent establishments.[1161]

(2) Adjusted Covered Taxes

Once the qualifying income or loss has been calculated for each Constituent Entity, one must determine the amount of adjusted covered taxes for each entity to calculate its effective tax level. The adjusted covered taxes are calculated by adjusting the income and similar taxes (excluding any top-up tax) in

[1152] Minimum Tax Act, Sec. 5.
[1153] Minimum Tax Act, Secs. 8 ff.
[1154] Minimum Tax Act, Secs. 11 ff.
[1155] Minimum Tax Act, Secs. 101, para. 2.
[1156] Tax Challenges Arising from the Digitalisation of the Economy — Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), July 2023. Inclusive Framework on BEPS, OECD.
[1157] Minimum Tax Act, Secs. 90 ff.
[1158] Minimum Tax Act, Sec. 90 para. 3.
[1159] Minimum Tax Act, Secs. 15 ff.
[1160] Minimum Tax Act, Sec. 37.
[1161] Minimum Tax Act, Secs. 30–43.

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Constituent Entity's financial accounts with certain items such as, for example, adding covered taxes accrued as an expense in the profit before taxation in the financial accounts and deducting tax expense with respect to income excluded from the computation of qualifying income or loss as well as tax relating to uncertain tax position, unless it has been paid. Taxes in Constituent Entity's financial accounts are adjusted also with regards to certain tax credits as well as to differences of deferred taxes due to differences in qualified income/loss and actual taxable income/loss of the Constituent Entities. Further, the method for allocating the covered taxes includes special provisions relating to permanent establishments, transparent entities, controlled foreign corporations, hybrid entities and taxes accruing to owners' books relating to distribution of profits.[1162]

(3) Effective Tax Rate and Top-up Tax

The effective tax rate of the group in each of its operating countries is calculated by dividing the sum of adjusted covered taxes of the Constituent Entities in the country with the sum of qualifying income and losses (excluding any investment funds and real estate investment vehicles). In case the effective tax rate of the country is less than 15%, a top-up tax will be calculated relating to the country (jurisdictional top-up tax). The jurisdictional top-up tax is calculated by multiplying the excess profit (net qualifying income less substance-based income exclusion) with top-up tax percentage (15% less the effective tax rate of the group in the country) and deducting from this any QDMTT collected by this jurisdiction.[1163] The substance-based income exclusion is calculated by multiplying the sum of payroll costs of the Constituent Entities with 5%.[1164] This amount is added to the amount, which is calculated by multiplying the sum of tangible assets of the Constituent Entities in the country with 5%.[1165]

In case the effective tax rate of the country is negative, the excess negative amount is carried forward to the following financial periods to be deducted from the effective tax rate of the country for the purpose of calculating the jurisdictional top-up tax. Finally, the jurisdictional top-up tax may be adjusted based on any corrections made to the jurisdictional effective tax rate and top-up tax from previous financial periods. The top-up tax relating to each Constituent Entity in a low-taxed jurisdiction will be calculated by dividing the jurisdictional top-up tax proportionally with the Constituent Entities in the country based on their qualified income amounts.[1166]

In case the average turnover of the Constituent Entities in a country is less than 10 million euros and the average qualifying income is less than 1 million euros, the group may annually opt to apply the top-up tax for all the Constituent Entities (except any stateless business units and investment units) in this country to be zero.[1167]

Further, the Minimum Tax Act has special provisions concerning minority-owned Constituent Entities,[1168] group restructurings (mergers, demergers, entities joining and leaving a group, transfers of assets and liabilities),[1169] fair market value adjustments of assets and liabilities,[1170] joint-ventures,[1171] multi-parented groups,[1172] transparent entities,[1173] ultimate parent entities applying deductible dividend regime,[1174] eligible distribution tax systems,[1175] and investment funds and real estate investment vehicles.[1176]

c. Reporting Obligations

Each German Constituent Entity is obligated to file with the Federal Central Tax Office an annual top-up tax return and a minimum tax report electronically. The German Constituent Entities may also nominate one designated German Constituent Entity to file the top-up tax return and the minimum tax report on behalf of the other German Constituent Entities. This obligation does not, however, exist, if the top-up tax return and the minimum tax report has been filed either by a foreign ultimate parent entity or a designated foreign filing entity in a country having an information exchange agreement with Germany. In that case, the German Constituent Entities (or the nominated entity) must notify the Federal Central Tax Office which Constituent Entity is filing the top-up tax return and the minimum tax report.[1177]

In case a German Constituent Entity must pay top-up tax, it must file a top-up tax return with the Tax Administration.[1178]

Comment: The "top-up tax return" is based neither on the GloBE Rules nor the EU Minimum Tax Directive but is simply a national additional control measure enacted by Germany to assist the Tax Administration in collection of the top-up taxes in time rather than wait for the required information to flow to the Tax Administration through international exchange of tax information channels from foreign tax authorities.

The top-up tax return, the minimum tax report, the notification of the filing entity and the top-up tax return must be filed with the Tax Administration within 15 months after the end of the financial period. For the first returns and notifications (concerning the first financial period starting after December 31, 2023), this deadline is 18 months.[1179]

German Constituent entities may be subject to a punitive tax increase (0.25% of the increased top-up tax per month) in case of late filing of the top-up tax return and a late filing fee (30,000 euros in the maximum) in case of late filing of the min-

[1162] Minimum Tax Act, Secs. 44–52.

[1163] Minimum Tax Act, Secs. 53–56.

[1164] Minimum Tax Act, Sec. 58–59. This percentage is higher, declining annually from 10% to 5% during the transition period extending to year 2032 (Minimum Tax Act, Sec. 62, para. 1).

[1165] Minimum Tax Act, Secs. 58, 60. This percentage is higher, declining annually from 8% to 5% during the transition period extending to year 2032 (Minimum Tax Act, Sec. 62, para. 2).

[1166] Minimum Tax Act, Sec. 54.

[1167] Minimum Tax Act, Sec. 56.

[1168] Minimum Tax Act, Sec. 55.

[1169] Minimum Tax Act, Secs. 63–64.

[1170] Minimum Tax Act, Sec. 66.

[1171] Minimum Tax Act, Sec. 67.

[1172] Minimum Tax Act, Sec. 68.

[1173] Minimum Tax Act, Sec. 65.

[1174] Minimum Tax Act, Sec. 70.

[1175] Minimum Tax Act, Sec. 71.

[1176] Minimum Tax Act, Secs. 72–74.

[1177] Minimum Tax Act, Secs. 75–76, 94–97.

[1178] Minimum Tax Act, Secs. 95–96.

[1179] Minimum Tax Act, Sec. 75 para. 3 and Sec. 95 para. 2.

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imum tax report.[1180] The Minimum Tax Act provides for treaty-overriding rules, which supersede any applicable tax treaty.[1181]

d. Transitional Rules

The Minimum Tax Act includes numerous transition rules relating to the calculation of the top-up tax, reporting obligations and penalties.[1182]

Comment: The common approach to the GloBE Rules requires that various implementations and interpretations of these rules must be globally similar. The OECD has continued the work on the GloBE Rules publishing guidance on the interpretation and recommending certain transitional rules. As German constitutional requirements[1183] restrict the extent to which all of the OECD developments can be followed in domestic tax practice, some of these developments will probably require further legislative action in Germany.

e. Outlook

As Germany is obliged to implement the OECD Administrative Guidelines, which have been successively developed since the publication of the OECD Model Rules in December 2021, into national law within 24 months of their publication, the very first draft bill for a Minimum Tax Adjustment Act was published on December 6, 2024. The bill not yet been passed by Parliament. Further developments should be monitored closely in particular against the background of the decision of the US government to opt out of the Pillar Two Project and, if US MNEs become subject to the Pillar Two rules, its unilateral counter-measures.

[1180] Minimum Tax Act, Sec. 98, General Fiscal Code (*Abgabenordnung*), Sec. 152.

[1181] Minimum Tax Act, Sec. 100.

[1182] Minimum Tax Act, Secs. 82–89.

[1183] See IV.A.1., above, for a discussion of the German legislative process.

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XVI. Avoidance of Double Taxation

A. *In General*

German resident individuals are taxed on their worldwide income. Citizenship is not relevant for these purposes.[1184] A German citizen who is not resident in Germany is only subject to limited taxation on his or her domestic source income.[1185] The position as regards corporations is similar. A corporation that has its registered seat or effective place of management in Germany is taxed on its worldwide income. A corporation that does not have its registered seat or effective place of management in Germany is taxed only on its German domestic-source income. Where there is no applicable tax treaty, the international double taxation of German resident individuals and corporations is principally relieved by unilateral credits for foreign taxes paid on foreign-source income.[1186] Germany's treaties usually follow the Organisation for Economic Cooperation and Development (OECD) Model Convention. For purposes of negotiating a treaty with another country, Germany has developed its own Model Treaty, which is based on the OECD Model Convention.[1187] Germany's older treaties exclusively employ the exemption method for the avoidance of double taxation, while its more recent treaties tend to employ the credit method for some items of income and the exemption method for others (for further details, see C., below). When considering the application of Germany's treaties, it is also necessary to take into account certain German domestic legislation that can override treaty provisions in certain circumstances.[1188]

The Federal Constitutional Court has held that legislation overriding treaty provisions does not violate Germany's constitution.[1189]

B. *Foreign Tax Relief*

1. *Credit Method*

If there is no applicable tax treaty, or if the applicable treaty does not cover the item of income concerned, income derived from sources in a foreign country is included in the taxable income of a German resident recipient. However, foreign income taxes paid in the foreign country may be credited against the German tax due with respect to such income, up to the amount of the German tax on that income (this limitation is applied on a per country basis).[1190] Excess foreign tax credits are not refundable and may not be carried back or forward. No tax credits are granted in the case of foreign income that was not taxed in the source country. Expenses are only deductible to the extent they are economically related to the foreign income. A resident individual who earns foreign investment income that is subject to the 25% flat rate tax may claim a foreign tax credit limited to 25% of all foreign investment income (i.e., this limitation is applied on an overall basis).[1191]

There is no foreign tax credit for any foreign (withholding) tax paid with respect to dividends paid by a foreign corporation to a resident corporation that are excluded from the taxable income of the resident corporation.[1192] An individual taxpayer who receives a foreign dividend of which only 60% has to be included in taxable income may, subject to the restrictions of the per country limitation, claim a credit for the *full* foreign dividend withholding tax imposed in accordance with the terms of the applicable tax treaty (if any) (i.e., not just for 60% of the foreign withholding tax). In all instances, it is important to note that only foreign income taxes that have been paid with respect to foreign-source income as defined by German domestic tax law or by the terms of an applicable treaty are eligible for the foreign tax credit.

If a tax treaty precludes the foreign Contracting State from taxing an item of income or reduces the tax rate that may be applied in that State, the taxpayer must make a claim for exemption or reduction of the foreign tax, if necessary by applying for the initiation of a competent authority procedure; the taxpayer cannot, instead, claim a German foreign tax credit for the unrelieved foreign tax.

a. *Foreign Source Income*

For purposes of the foreign tax credit, the following items of income are considered to be derived from foreign sources, as defined in Section 34d of the Income Tax Act (*Einkommensteuergesetz* — EStG):

(i) Income from agriculture and forestry carried on in a foreign country, as well as income of the kinds referred to below in (iii) to (vii) that qualifies as income from agriculture and forestry.

(ii) Business income derived through a foreign permanent establishment (PE) or a foreign permanent representative as defined under German domestic law (in Sections 12 and 13 of the General Tax Code (*Abgabenordnung* — AO)); income of the kinds referred to below in (iii) through (vii) that qualifies as business income; fees for extending guarantees to nonresident debtors; and income derived from the operation of ships or aircraft in international commerce.

(iii) Income from independent services exercised or utilized in a foreign country, and income of the kinds referred to below in (iv) through (vii) that qualifies as income from independent services.

(iv) Income from the disposal of:

- Goods that form part of the fixed assets of a business and are located in a foreign country; or
- Shares in a corporation that has its principal place of business or statutory seat in a foreign country or shares in a corporation in which more than 50% of the share

[1184] The sole exception relates to German citizens who are employed by a German government agency; EStG, Sec. 1(2).
[1185] See EStG, Secs. 1(4), 49.
[1186] EStG, Sec. 34c.
[1187] Federal Ministry of Finance, Basis for negotiation of agreements for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital (August 2013).
[1188] See especially EStG, Sec. 50d(8) to (13).
[1189] Federal Constitutional Court — 2 BvL 1/12 of December 15, 2015, DStR 2016, 359.
[1190] EStG, Sec. 34c.
[1191] EStG, Sec. 32d(5).
[1192] KStG, Sec. 8b(1).

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value at any time during the 365 days preceding the sale is based directly or indirectly on foreign-situs real estate if the shares are to be allocated to the seller. For purposes of calculating the 50% quota only the book value of the foreign-situ real estate (not its market value) is relevant.

(v) Income from dependent services (employment) that are performed outside Germany or that, without having been performed in Germany, are utilized in a foreign state, and income paid by foreign public funds with respect to current or past employment (income paid out of domestic public funds is deemed to be domestic-source income, even if the services concerned are rendered abroad).

(vi) Income from capital investment, if the debtor's residence, principal place of management or statutory seat is located in a foreign state, or if the capital investment is secured by foreign-situs real estate.

(vii) Income from the leasing or letting of real estate or movable property that forms an economic entity if the asset is located in a foreign country or if rights have been granted to use the asset in a foreign country.

(viii) Certain sundry items of income linked to a foreign country.

b. Foreign Income Taxes

Only foreign income taxes that correspond to German income tax and that are levied in the foreign source country concerned at a national, regional or municipal level are creditable. It should be noted that no tax credit is available for purposes of German trade tax. This can be an issue for corporations where the foreign tax paid exceeds the corporate income tax (15%) plus the solidarity surcharge (5.5% on corporate tax). In this case, it might be worth considering deducting the foreign tax as a business expense (see 2., below).

Foreign income taxes that do not correspond to German income tax do not qualify for credit but may be deducted as business expenses (see 2., below). The same applies to income taxes levied by a tax treaty partner country that are not covered by the relevant treaty.[1193]

A list of foreign income taxes imposed by non-treaty countries that have been recognized as creditable is published as Exhibit 6 to the Income Tax Regulations.

2. Deduction Method

Foreign income taxes that are not eligible for credit may be deducted in determining income.[1194] In addition, a taxpayer may elect to deduct creditable taxes instead of claiming a foreign tax credit.[1195] The deduction is available only for foreign income taxes actually paid, not for notional taxes creditable under a tax sparing provision in a tax treaty (most of Germany's treaties with developing countries contain tax sparing provisions for dividends, interest and/or royalties). The deduction is not available for foreign taxes incurred by an individual on foreign investment income eligible for the flat rate tax.[1196] The foreign tax is treated as a deduction in computing total taxable income and, therefore, reduces the tax base in principle also for trade tax purposes. However, where the deducted foreign tax relates to an item of income that is excluded from the trade tax base, the deduction is reversed for trade tax purposes.[1197]

C. Tax Treaties

1. Income Tax Treaties and Estates and Gift Tax Treaties

a. In General

Where a tax treaty applies, individual and corporate taxpayers that qualify as residents of either Germany or of the other country with which Germany concluded the treaty may claim the advantages of the provisions of the relevant treaty.

Further, Germany has, alongside many other jurisdictions, ratified the OECD/G20 Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI). (For a discussion of the MLI, see XVI.D., below.)

Tax treaty negotiations are led by government officials from the German Ministry of Finance. After negotiations are concluded, the agreement must be politically approved in each country, after which the German legislature must adopt an implementing law to make the tax treaty applicable law in Germany.

A tax treaty can only be terminated, amended or suspended in accordance with its provisions and the general provisions of German international law. For termination, the same steps are required as for the ratification of a treaty. This is the main reason for the attractiveness of a domestic treaty overriding domestic tax provisions, a position that is supported by the German Federal Constitutional Court.[1198]

Comment: In practice, problems may arise in cases where foreign entities are not recognized by German law, as is the case with foreign trusts and other foreign entities which are characterized by elements of corporations and partnerships (e.g., the U.S. LLC).

b. Income Tax Treaties

Germany has entered into income tax treaties with nearly 100 countries. For a complete list of Germany's tax treaties, see International Tax Treaties or the website of the Federal Ministry of Finance.[1199]

Traditionally, Germany's income tax treaties allocated the taxation of items of income to either the country of source or the country in which the taxpayer was resident and exempted such income from taxation in the other country. However, beginning with the Germany-U.S. income tax treaty of 1954,[1200]

[1193] EStG, Sec. 34c(6).
[1194] EStG, Sec. 34c(3).
[1195] EStG, Sec. 34c(2).
[1196] EStG, Sec. 32d(5), (6).
[1197] GewStG, Sec. 8 no. 12.
[1198] Federal Constitutional Court — 2 BvL 1/12 of December 15, 2015, DStR 2016, 359.
[1199] See https://www.bundesfinanzministerium.de/Web/DE/Themen/Steuern/Internationales_Steuerrecht/Staatenbezogene_Informationen/staatenbezogene_info.html.
[1200] Convention Between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation with Respect to Tax-

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Germany's treaties increasingly adopted the tax credit method as well. Thus, Germany's modern income tax treaties exempt certain items of foreign-source income from income tax, while granting a foreign tax credit with respect to other foreign-source income. Germany's own Model Treaty[1201] still provides in principle for the exemption method and for the credit method regarding taxes paid in the treaty partner country but only in the case of dividends, capital gains from the sale of shares held in foreign corporations more than 50% of whose assets consist of real estate located in Germany, the remuneration of board members, the income of artists, sportspersons and musicians from their performances, and royalties and pensions in certain circumstances.[1202] Business income, dividend income and gains from the sale of shares are subject to the exemption method only, if obtained by manufacturing, processing or assembling goods or merchandise, exploring for and extracting mineral resources, banking or insurance operations, trading or providing services.[1203]

Germany's income tax treaties with developing countries often contain rules that leave the source country with more taxing rights than do its treaties with developed countries, and some contain tax-sparing provisions under which foreign taxes that have not actually been paid are creditable against the income tax liability of the resident recipient of the income concerned. Most of Germany's income tax treaties limit the tax credit to the amount of withholding tax on dividends, interest and/or royalties that the developing country is authorized to impose under the income tax treaty concerned; to the extent the tax actually imposed in the developing country is lower than that authorized by the treaty, tax sparing comes into play.

The application of most (but not all) of Germany's tax treaties extends to net worth tax (now repealed) and/or trade tax even if the treaty partner country does not impose an equivalent tax (see, for example, the Germany-U.S. tax treaty).

c. *Inheritance and Gift Tax Treaties*

In contrast to income tax treaties, Germany has entered into a very small number of inheritance tax and/or gift tax treaties. As of January 1, 2023, Germany has concluded only six such treaties with Denmark (on inheritance and gift tax), France (inheritance and gift tax), Greece (inheritance tax with respect to movable assets of Greek and German citizens only), Sweden (inheritance and gift tax), Switzerland (inheritance tax only), and the United States (inheritance and gift tax). In principle, and subject to the terms of an applicable tax treaty, an inheritance left by a deceased person, regardless of where the inheritance is situated, is subject to German inheritance tax if the decedent was a resident of Germany at the time of death. As far as gift tax is covered by the tax treaty, in principle and subject to the applicable tax treaty, the state of residence of the donor would be entitled to tax the donation.

The main features of Germany's inheritance and gift tax treaties are that immovable property is generally subject to inheritance and gift tax in the country in which the immovable property is situated, whereas other assets held by the deceased or donor are usually subject to taxation in the country in which the deceased or donor had their residence. Movable business property of a permanent establishment (PE) in another treaty partner country may generally be taxed in that other country.

d. *Treaty Interpretation*

In Germany, the tax administration and the Federal Tax Court disagree over how to make use of the OECD Commentary to the OECD Model Convention, when interpreting the articles of a tax treaty. The Federal Tax Court, as announced in a 2018 decision, takes the view that for the interpretation of an article of a tax treaty which corresponds to the OECD Model Convention, the tax administration should refer to the version of the OECD Commentary applicable when the respective treaty was agreed upon.[1204] The court's decision of July 11, 2018, was only published in the Federal Tax Gazette in 2023, nearly five years after it was issued, and is, therefore, now binding on the German tax authorities. Nevertheless, at about the same time, the Federal Ministry of Finance published a decree on April 19, 2023,[1205] which explicitly refers to the said court decision and — in contrast to that decision — states that the *current* version of the OECD commentary shall now be a binding interpretative aid to understanding the articles of the tax treaty in question.

Comment: The position of the Federal Ministry of Finance will lead to different results in the interpretation of the wording of tax treaties by the tax courts and the tax administration. It seems that in spite of publishing the decision of the Federal Tax Court of July 11, 2018, in the Federal Tax Gazette, the decision shall not be generally binding for the tax administration. This understanding would be in line with the strong trend of treaty overrides by the German legislature, i.e., that effects from binding existing tax treaties can be overruled later by simple domestic laws (as confirmed recently by the Federal Constitutional Court).[1206] According to the said decree, it seems that now the tax administration shall also be authorized by the Federal Ministry of Finance to overrule tax treaties by interpretive means, if this can be based on a later version of the OECD Commentary of the OECD Model Convention. Even if this view is in line with the OECD's understanding, it is questionable and challengeable against the background of the rule of law and will certainly increase uncertainty in the application of international tax laws.

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es on Income, signed on July 22, 1954 and terminated with effect from January 1, 1990.

[1201] Federal Ministry of Finance, Basis for negotiation for agreements for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital (August 2013).

[1202] Federal Ministry of Finance, Basis for negotiation for agreements for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital (August 2013), Art. 22(1) no. 3.

[1203] Federal Ministry of Finance, Basis for negotiation for agreements for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital (August 2013), Art. 22(1) no. 4.

[1204] BFH, decision of July 11, 2018, file no. I R 44/16, BStBl. 2023 II (sic!), 430.

[1205] BMF, decree of April 19, 2023, BStBl. 2023 I, 630.

[1206] Federal Constitutional Court, decision of December 15, 2015, file no. 2 BvL 1/12, DStR 2016, 359.

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2. *Taxation of Business Income*

a. *Permanent Establishment*

Germany has a domestic definition of a PE in Section 12 of the General Tax Code. All of Germany's tax treaties contain elaborate definitions of what constitutes a PE. Most of the treaties follow the PE definition contained in Article 5 of the OECD Model Convention. In general, the treaty definition of a PE is narrower than the domestic definition. Germany's treaties generally state that a company resident in Germany that is an affiliate of a company resident in the other Contracting State does not *of itself* make the first company a German PE of the second company.[1207] However, there is an ongoing discussion as to whether an affiliate acting as a commissionaire on behalf of a foreign group member (for example, a Swiss principal) can be deemed a PE under Article 5(5) and (6) of the 2014 OECD Model Convention. In some treaties, it is explicitly stated that a PE cannot be deemed to exist if the commissionaire earns an arm's-length fee (see in particular the Germany-Austria tax treaty). Otherwise, it is uncertain whether a commissionaire can be considered independent if it is mainly acting on behalf of another group member. The German revenue office also takes the position that a commissionaire is acting in the name of its principal, although this is an incorrect position in terms of German commercial law. There are, however, no German court cases on this issue. In practice, during audits, the German tax authorities focus more or less on the transfer price for the services of the commissionaire. It should be noted that a deemed PE is not subject to German trade tax.

Comment: In its 2017 Model Tax Convention, the OECD has adopted a significantly broader definition of the term "permanent representative" in revised Article 5 (5) and (6) with the effect that, in a treaty context, an affiliate acting as a commissionaire exclusively or almost exclusively on behalf of closely related enterprises gives rise to a PE for a principal resident in the other treaty country. However, this does not necessarily qualify as a PE under German domestic law and, therefore, does not necessarily trigger a trade tax liability in Germany, as under German domestic law the principal's permanent representative is different from a PE.[1208] It should be noted, however, that a permanent representative could nevertheless trigger nonresident income tax liability in Germany for the principal under German domestic law.[1209]

A PE in Germany subjects the taxpayer to German nonresident income taxation and trade tax. The allocation of tangible and in particular intangible assets between the various German and foreign PEs cause intense disputes with the tax authorities. The transfer pricing guidelines apply also to PEs, which are treated similar to an affiliated company (i.e., per the Authorized OECD Approach). In particular, employees or managing directors who work from home in a country other than that in which the employer company's is tax resident could easily and unwittingly give rise to a PE of the company in the country in which they work. While Germany currently does not have any specific digital PE rules, there is a trend on the part of the tax courts and the tax authorities to "soften up" what is required in physical terms to create a PE in Germany.[1210] Further developments should be monitored closely.

Comment: To avoid PE status, establishing a subsidiary may be worth considering. However, a subsidiary requires more legal compliance work and is more complicated to be established and operated than a PE. A PE is, in particular, more flexible than a subsidiary, even if the Authorized OECD Approach applies. Tax-wise, a subsidiary and a PE are treated very similarly. The main differences between a PE and subsidiary are legal and organizational, as a subsidiary requires, for example, a managing director, whereas a PE does not; the PE requires only the existence of a contact person on site, which is a less demanding condition. Global employment companies and other similar tools could be used for subsidiaries and PEs similarly, but trigger in both cases additional challenges because of transfer pricing issues, social security issues, labor law issues and, thus, increase the level of compliance work.

As many employees commuting across a border either daily or less frequently were forced to work at home due to the restrictions following the COVID 19 pandemic, from a tax treaty perspective, this could easily give rise to a permanent establishment (PE) of the employer abroad[1211] and the relocation of taxation rights to the employee's country of residence.[1212] The Federal Ministry of Finance agreed with Germany's neighboring countries, i.e., Austria, Belgium, France, Luxembourg, the Netherlands, Poland and Switzerland, to avoid this consequence by means of bilateral agreements. These bilateral agreements were valid for a limited period only and were terminated as of June 30, 2022. For all other treaty countries, the standard rules continued to apply, which may result in employers having unanticipated PEs and/or a change in the allocation of taxation rights with respect to salaries paid and the legal obligation to withhold wage tax on behalf of employees. For the case of work at home, The German Ministry of Finance published a decree in 2023,[1213] according to which an employee working at home shall in principle not trigger a PE for his or her employer, even if the employer pays for the expenses of working at home or has agreed with the employee on a rental agreement (unless the employer is in fact authorized to enter the rooms of the employee) or if the employee has no other workplace offered by the employer. This position represents a surprising turnaround for the Federal Ministry of Finance compared to its decree of April 19, 2023,[1214] which resulted in conflicts with tax jurisdictions which follow the broader understanding of the OECD with respect to the definition of a PE according to the OECD model treaty. In particular, with respect to foreign PEs of German companies (outbound-structures), if the foreign tax jurisdiction taxed the German company with its profits to be allocated to its foreign PE, while the German tax administration did not accept the existence of such foreign PE and in-

[1207] OECD Model Convention, Art. 5(7).
[1208] AO, Sec. 13.
[1209] EStG, Sec. 49(1) no. 2 lit. a.
[1210] See BFH, decision of June 7, 2023, file no. I R 47/20 (locker for tools as a PE).
[1211] OECD Model Convention, Art. 5(5).
[1212] OECD Model Convention, Art. 15(1), (2).
[1213] Decree of February 5, 2024, BStBl. 2024 I, 177.
[1214] Decree of April 19, 2023, BStBl. 2023 I, 630, according to which the German tax administration follows the respective currently updated model commentary of OECD model treaty, even if this version of the model commentary was not yet published for the year under dispute.

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stead taxed the German company with its worldwide income. In this case, a foreign subsidiary would be more recommendable than renting separate office space. This is because a foreign PE (which will be established beyond doubt by renting office space) is less clear than a subsidiary with respect to the allocation of intangible assets to the foreign PE and could, therefore, result in unpleasant disputes with the German tax administration with respect to German exit tax. It should be monitored closely, whether the German tax administration interpret a PE of a foreign company in Germany similarly or differently (for taxing the profits to be allocated to the German PE in spite of the different interpretation of a foreign PE).

b. Industrial and Commercial Profits

Industrial and commercial profits allocable to a German PE may be taxed in Germany. Industrial and commercial profits that are properly allocable to the PE of a German taxpayer in the treaty partner country, are exempt from German tax (under a significant number of Germany's treaties including, for example, the Germany-Switzerland tax treaty, this applies only if the PE engages in active business operations). As a consequence of the exemption of such profits of a German taxpayer, losses incurred by a foreign PE in a treaty partner country may not be set off against taxable domestic profits. However, in *Lidl Belgium*, the Court of Justice of the European Union (CJEU) required final losses of a PE in another EU Member State to be included for purposes of German taxation.[1215] Later, the CJEU took the opposite position and held that Germany is not required to allow a deduction for such final losses.[1216] More recently, the CJEU again took its former position and held that Germany is required to allow a deduction for final losses.[1217] This latest CJEU decision prompted the Federal Tax Court (*Bundesfinanzhof* — BFH) to refer the issue to the CJEU again.[1218] On September 22, 2022, the CJEU decided[1219] that the final losses of a PE, whose profits/losses are tax exempt due to the exemption method provided by an applicable tax treaty (sic), cannot be deducted for tax purposes by the headquarter in its home jurisdiction, even if such losses cannot be used anymore in the foreign jurisdiction where the PE was located. Nevertheless, the CJEU confirmed that its decision in the case "Bevola and Trock" of June 12, 2018, still applies, if — as in this case — the final losses were not tax exempt because of an applicable tax treaty, but because of the domestic law of the home jurisdiction in which the headquarter is located.

Comment: Whether the applicability of a tax treaty is a convincing criterion for the tax deductibility of final foreign losses can be disputed with good reasons. However, it seems that the CJEU has made its final decision insofar for the time being. Nevertheless, the tax deductibility of foreign losses in scenarios different from the one in the case decided by the CJEU should be disputed again (e.g., whether the non-deductibility of foreign losses is based both on a unilateral provision and a tax treaty provision or whether Germany can make use of its right of taxation because of a fallback provision in its treaty overriding domestic tax provisions). Further, it is disputed whether the non-deductibility of final foreign losses are in breach of the EU Charter of Fundamental Rights and/or the German Constitution (principle of equality, taxation according to ability to pay).

While income from real estate is not normally included in "industrial and commercial profits," even if the property is used in a PE, interest, dividends, royalties and/or capital gains constitute part of industrial and commercial profits if they are properly attributable to the activities of a PE. From a German point of view, this requirement will be met if the asset giving rise to the income or whose disposal gives rise to the capital gains is held by the taxpayer specifically to promote the business of the PE.[1220]

3. Investment Income

a. Dividends

German dividend withholding tax is imposed at the regular rate of 25% of the gross dividend (plus an income tax surcharge of 5.5% on the 25%), irrespective of whether the dividend is fully exempt from corporate income tax (if paid to a corporate shareholder holding a participation of at least 10%) or qualifies for a 60% dividends-received exclusion (if paid to an individual shareholder). However, most of Germany's tax treaties grant a reduction of the rate to 5% for dividends paid with respect to corporate shareholdings of at least 10% (though there may be some variation depending on the language of the particular treaty) and to 15% in all other cases. Some of Germany's treaties may reduce the withholding tax rate to 0% (for example, the Germany-Switzerland tax treaty,[1221] as well as the Germany-U.S. tax treaty if the requirements of the "super limitation on benefits" clause are met — see XVI.C.5.b.(1), below).

Under the EU Parent-Subsidiary Directive,[1222] as implemented in Germany, the withholding tax on dividends distributed by German subsidiaries to their EU Member State parent companies has been reduced to 0%.

The domestic withholding tax rate must be applied unless the recipient provides an exemption or reduced rate certificate (see also the discussion of treaty/directive shopping at XV.A., above). Under all of Germany's tax treaties, an application for a refund must be filed no later than the end of the fourth calendar year following the year in which the relevant tax was withheld.[1223]

b. Interest

Interest on an ordinary loan is usually not subject to withholding tax if the recipient is not a German resident. If there is any domestic withholding tax obligation, under most of Germany's tax treaties, interest from German sources paid to a res-

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[1215] CJEU, file no. C 414/06, BStBl. 2009 II, 692.

[1216] CJEU of December 17, 2015 — *Timac Agro*, file no. C 388/14, BStBl. 2016 II, 362.

[1217] CJEU of June 12, 2018 — *Bevola and Jens W. Trock*, file no. C 650/16, BStBl. 2017 II, 709.

[1218] BFH, decision of November 6, 2019, file no. I R 32/18.

[1219] CJEU, decision of September 22, 2022, file no. C-538/20, IStR 2022, 767.

[1220] Federal Ministry of Finance, Letter of December 29, 1999, BStBl. 1999 I, 1076, Sec. 2.4.

[1221] As amended by the Protocol signed on October 27, 2010, Art. 1.

[1222] Council Directive 2011/96/EU of November 30, 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different member states, as amended; EStG, Sec. 43b.

[1223] AO, Secs. 37, 47, and 169; EStG, Sec. 50d(1).

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ident of the treaty partner country is exempt from German income tax. The debtor is, nevertheless, required to withhold tax (where applicable) at the normal rate and a claim must be made for a refund of the tax withheld. The refund procedure is identical to that provided for in the case of dividends (see a., above).

Interest on profit participating loans and convertible bonds is subject to withholding tax. As a rule, Germany's tax treaties preserve Germany's right (as the source country) to tax such interest at the unreduced rate. In addition, the EU Interest and Royalties Directive[1224] provides for a zero rate of source country tax on interest payments between related companies situated in different EU Member States.[1225]

c. Royalties

Royalties from German sources paid to a licensor resident in the treaty partner country are exempt from German withholding tax under most of Germany's tax treaties, provided the intangible industrial property right giving rise to the royalties is not attributable to a PE of the licensor in Germany. If German withholding tax is eliminated or reduced under the terms of an applicable treaty and the licensor wishes to receive the gross amount of the royalties without withholding, the licensor may furnish the licensee with an exemption or reduced rate certificate, which is issued by the Federal Central Tax Office (*Bundeszentralamt fuer Steuern*) on application by the licensor (for the form that has to be used by the licensor, see the Worksheets). Under the Germany-United States tax treaty, a slightly different form must be used (see the Worksheets). In addition, the EU Interest and Royalties Directive provides for a zero rate of source country tax on royalties paid between related companies situated in different EU Member States.[1226] Due to the ongoing digitalization of the German tax administration, after December 31, 2022, the application form may only be filed electronically with the Federal Central Tax Office.[1227]

d. Capital Gains

Generally, capital gains may be taxed only in the country in which the seller is resident. However, capital gains from the sale of real property or of assets forming part of the assets of a PE may be taxed in the country in which the real property is situated or the PE is located. Germany's newer treaties often also grant the right to tax capital gains arising from the disposal of shares in a real estate holding corporation to the country in which the real estate is situated if more than 50% of the corporation's assets consist of real estate situated in that country.

e. Other Income

A number of Germany's tax treaties contain a catch-all clause similar to Article 21 of the OECD Model Convention, under which all items of income not specifically covered by the treaty concerned may be taxed only by the Contracting State of which the taxpayer is a resident. Such provisions cover, in particular, income from sources in a third country, as well as rental income from movable assets for which no specific provisions exist, unless such income is covered by the term "royalties." Where no such express treaty provision exists, the taxpayer must seek unilateral double taxation relief in its country of residence.

4. Procedure for Claiming Tax Treaty Benefits

a. Income Subject to Withholding Tax

Where a nonresident individual or corporation earns an item of income from German sources that is subject to withholding tax, the payor must (as a rule) withhold German tax at the domestic rate, unless the foreign payee has provided the payor in advance with an "exemption certificate" issued by the Federal Central Tax Office.[1228] If the payor is provided with a valid exemption certificate, the payor may deduct withholding tax at the reduced treaty rate as evidenced in the certificate. Alternatively, the foreign payee may claim a refund of withheld tax. Such a claim must also be filed with the Federal Central Tax Office. See XV.A.1., above, regarding the changes due to the Deduction Tax Relief Modernization Act (*Abzugsteuerentlastungsmodernisierungsgesetz* — AbzStEntlModG).[1229]

The Federal Central Tax Office issues an exemption certificate where an application is made on an official form (see Worksheet 5). The form must be accompanied by a certificate of residence issued by a competent authority of the state of residence of the applicant.[1230] Where the nonresident has earned German-source dividends, the application must also be accompanied by a certificate issued by a bank or the dividend paying corporation evidencing the amount of tax withheld. Due to the ongoing digitalization of the German tax administration, after December 31, 2022, the application form may only be filed electronically with the Federal Central Tax Office.[1231]

The same procedure applies for refund claims.[1232] Applications for refunds must be filed not later than four years after the end of the calendar year during which the claimant earned the income. Refunds earn interest at the rate of 6% p.a. Interest starts to run 12 months after the end of the month during which the refund claim, together with all required evidence, is filed.[1233]

b. Income Not Subject to Withholding Tax

Where a nonresident earns German-source income that is not subject to withholding tax, such as capital gains on shares or income from a PE, there is no specific procedure for claiming tax treaty benefits. Instead, treaty benefits must be claimed in the course of the standard assessment procedure, for example, by filing an annual tax return.

5. Treaties Between Germany and the United States

a. Germany-United States Tax Treaty

The Germany-U.S. tax treaty was ratified by the exchange of instruments of ratification in Washington, D.C., on August

[1224] Council Directive 2003/49/EC of June 3, 2003 on a common system of taxation applicable to interest and royalty payments between associated companies of different member states, as amended.
[1225] EStG, Sec. 50g.
[1226] EStG, Sec. 50g.
[1227] AbzStEntlModG, Sec. 50c(5), Sec. 52(47a).
[1228] EStG, Sec. 50d(1).
[1229] AbzStEntlModG, Sec. 50c(5), Sec. 52(47a).
[1230] EStG, Sec. 50d(4).
[1231] AbzStEntlModG, Sec. 50c(5), Sec. 52(47a).
[1232] AbzStEntlModG, Sec. 50c(5), Sec. 52(47a).
[1233] EStG, Sec. 50d(1a).

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21, 1991, and amended in 2006,[1234] in general, with effect from January 1, 2008.

From a German tax perspective, the Germany-United States tax treaty offers the following principal benefits to U.S. citizens, residents and corporations:

(i) Industrial and commercial profits of a U.S. enterprise can be taxed in Germany only if the enterprise has a German PE:

• German taxation of such profits can be avoided if the relevant activity comes within the scope of the express exclusion from the term "permanent establishment" contained in Article 5(4); this applies, in particular to outlets engaging in activities that are of a merely preparatory or auxiliary character for the enterprise;

• An agent with independent status will not constitute a PE even if it has and exercises habitually an authority to conclude contracts in the name of the U.S. enterprise, provided the agent acts in the ordinary course of its business; this encompasses activities, such as the letting of containers by a shipping agent that is within the scope of a major shipping agency, although only a few agents can engage in such leasing activity[1235] (however, see the general discussion of deemed PEs, especially in relation to Swiss principal structures at 2.a., above); and

• A U.S. company that is a partner in a German general or limited partnership is considered to have a PE in Germany if the partnership has a PE under the terms of the Germany-U.S. tax treaty, even though the treaty does not expressly deal with this issue.[1236]

(ii) Dividends distributed by a German corporation to a U.S. corporation that holds directly (and not via a foreign partnership) at least 10% of the voting shares in the German corporation will attract withholding tax at the regular rate of 25% plus income tax surcharge, but the U.S. corporation can claim a reduction of the rate to 5%. In the case of portfolio dividends, the rate of withholding tax is 15%. It should be noted that Article 28 contains a limitation on benefits clause (see below for more details). The amended treaty also provides for a zero rate where various rigorous prerequisites (12-month holding period, direct participation of at least 80%, plus a "super limitation on benefits" clause) are met.[1237]

(iii) Interest paid by a German subsidiary to a U.S. affiliate on an ordinary loan is exempt from German withholding tax.

Comment: As there is no German withholding tax on ordinary interest paid to nonresident creditors under German domestic law, a U.S. parent company can also interpose a tax haven subsidiary when lending to a German subsidiary.

(iv) Royalties paid by a German resident to a U.S. licensor are also exempt from German withholding tax. This exemption is granted only if the tests imposed by the limitation on benefits clause in Article 28 are met. The exemption is important because the domestic rate would otherwise be applied. In this context, the term "royalties" includes rentals for the use of industrial, commercial or scientific equipment, and gains from the disposal of property that gives rise to such royalties. Motion picture royalties, however, are classified as business income.[1238] Under a new interpretation by the German tax authorities of German tax law that has been in force for decades (see VI.B.4., above), these rules in principle apply also to royalties paid by a non-German resident to a U.S. licensor, if the licensed right is registered in Germany, even if the licensed right is not used in Germany.

(v) The salary of an employee seconded by a U.S. company to Germany is exempt from German income tax provided: the employee remains a U.S. resident; the employee's stay in Germany does not exceed a total of 183 days during a calendar year; the employee remains on the payroll of the U.S. corporation; and the employee's salary is not charged to or borne by a German PE of the employer. The salary is so borne if it is paid by or, as such, charged to the PE; if it is merely included in management or service charges, it will not be deemed to be borne by the PE.[1239]

For German taxpayers, the most important benefits of the Germany-U.S. tax treaty relate to instances in which income from U.S. sources is exempt from German income tax. Such exemptions concern, in particular, income derived from a U.S. PE, income derived from U.S.-situs real property and dividends from U.S. corporations in which a German corporate shareholder owns a direct interest of at least 10% of the voting stock.[1240] This rule is similar to German domestic tax rules, under which dividends received by a corporate shareholder's are tax exempt if the corporation held at least 10% of the shares at the beginning of the calendar year.[1241]

A partnership is not a taxable entity for purposes of either the Germany-United States tax treaty or for German income taxation purposes. This means that treaty benefits with respect to income derived by a partnership are granted to the extent an individual or corporate partner in the partnership is entitled to treaty benefits.[1242] Because an interest of a German resident in a U.S. partnership or in a German partnership that maintains a U.S. PE constitutes a U.S. PE for the German resident,[1243] the income attributable to the U.S. PE is exempt from German income tax, even if the income is distributed to the German resident. This explains the widespread use of partnership structures for direct investment in the United States by German family businesses and other small or medium-sized businesses.

Gains from the exercise of stock options granted by a German employer to a German resident individual seconded to

[1234] Protocol signed on June 1, 2006.

[1235] BFH decision of September 23, 1983, file no. III R 76/81, BStBl. 1984 II, 94.

[1236] BFH decision of January 29, 1964 file no. I R 153/61 S81, 1964, BStBl. 1964 III, 165.

[1237] Germany-U.S. tax treaty, Art. 10(3). See also XVI.C.5.b.

[1238] Germany-U.S. tax treaty, Art. 7(7).

[1239] BMF, decree of September 14, 2006, BStBl. 2006 I, 532.

[1240] Germany-U.S. tax treaty, Art. 23(3)(a).

[1241] KStG, Sec. 8b(1), (4).

[1242] Germany-U.S. tax treaty, Art. 1(7).

[1243] BFH decision of January 29, 1964, BStBl. 1964 III, 165.

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work for a U.S. subsidiary arising in a taxable year following the year in which the employee returned to Germany have been held to be tax-free in Germany, as far as the gain relates to services rendered in the United States.[1244] The exercise gain is to be apportioned on a time spent basis. Pensions and other similar remuneration derived and beneficially owned by a resident of a Contracting State in consideration of past employment are taxable only in that State.[1245]

b. 2006 Protocol to the Germany-United States Tax Treaty

The amendments made to the Germany-U.S. treaty by the Protocol signed on June 1, 2006, which generally took effect from January 1, 2008, are discussed in (1) to (4), below.

(1) Direct Investment Dividends

Until its amendment by the 2006 Protocol, the Germany-U.S. tax treaty limited withholding tax rates to 15% on portfolio dividends and to 5% on dividends paid to shareholders owning at least 10% of the stock of the dividend-paying company. The amendments made by 2006 Protocol left these two categories largely in place but added a new category of direct investment dividends eligible for zero withholding tax. The new zero rate applies to dividends received by a company that has owned (directly) shares constituting at least 80% of the voting power of the dividend-paying company for a 12-month period ending on the date on which entitlement to the dividends is determined. In addition, to qualify for the zero rate, the taxpayer must qualify for treaty benefits under one of the following:

(i) The public trading test (including the subsidiary test);

(ii) The ownership/base erosion and active trade or business tests;

(iii) The derivative benefits test; or

(iv) Competent authority discretion.[1246]

The public trading test requires a strong nexus with the country of residence. Under the new rule, if a corporation seeks to qualify for tax treaty benefits by way of the public trading test, the corporation's stock must be regularly traded on a recognized stock exchange, and either the corporation's stock must be primarily traded on a recognized stock exchange in the residence country or the corporation's place of primary management and control must be in the residence country. A corporation's place of primary management and control is in the residence country if executive officers and senior managers exercise day-to-day responsibility for more of the strategic, financial and operational policy decisions for the corporation in that country than in any other country.[1247] The ownership/base erosion test provides that "qualified owners" include only persons resident in the same country as the person claiming treaty benefits. No exception from the base erosion test is provided for arm's-length payments for services or tangible property.

(2) "Triangular" Provision

The Germany-U.S. tax treaty, as amended by the 2006 Protocol, includes a "triangular" provision similar to those included in other recent U.S. treaties. Under this provision, income received by a third-country PE of a treaty country resident is not entitled to full treaty benefits if the combined tax paid in the residence country and the PE country is less than 60% of the tax that would have been due if the income had been received directly by the residence country home office. The provision generally applies to all as opposed to just certain types of income (such as interest and royalties). When applicable to dividends, interest and royalties, the provision results in a 15% rate of withholding tax, instead of the more favorable rates.[1248] As to other items of income, treaty benefits are denied altogether.

(3) Mandatory Binding Arbitration Mechanism

The 2006 Protocol adds a mandatory binding arbitration mechanism for settling certain issues that cannot be resolved through the normal competent authority process.[1249] Germany has experience with the arbitration of transfer pricing disputes under the EU Arbitration Convention. Under the provision in the amended Germany-United States tax treaty, issues relating to individual residence, PEs, business profits, associated enterprises and royalties generally must be submitted to binding arbitration if they cannot be settled within two years. The arbitration panel consists of three members: each competent authority appoints one member and these two members appoint a third. This third member, who cannot be a citizen of either treaty country, chairs the panel. After the appointment of the chair, each competent authority has 90 days to submit a proposed resolution and a position paper, and another 90 days to submit a reply. The panel must adopt the resolution of one of the two parties (a model often referred to as "baseball arbitration") within nine months of the chair's appointment. The panel's determination is binding on the competent authorities, but the taxpayer has the right to opt out of the process until 30 days after the issuance of the determination. All parties to the proceedings must agree to terms of confidentiality and the arbitration panel will not provide a rationale for its determination, which is said to have no precedential value. By limiting the possible determinations to one of the two parties' submissions, the model is intended to encourage each party to moderate its position. The taxpayer does not have the right to submit a proposed determination, but the Protocol does give the taxpayer the right to walk away from the process and to reject the panel's determination.

(4) Other Provisions

While the zero-rate, limitation-on-benefits and arbitration provisions are the most significant changes, the amended Germany-U.S. tax treaty also includes a number of other important changes, generally in line with recent U.S. treaty practice. For example, the 2006 Protocol addresses many cross-border pension issues and includes now standard U.S. provisions dealing with hybrid entities, regulated investment companies (RICs), real estate investment trusts (REITs) and information ex-

[1244] Germany-U.S. tax treaty, Art. 15.
[1245] Germany-U.S. tax treaty, Art. 18.
[1246] Germany-U.S. tax treaty, Art. 10(3).
[1247] Germany-U.S. tax treaty, Art. 28(2)(c).
[1248] Germany-U.S. tax treaty, Art. 28(5).
[1249] Germany-U.S. tax treaty, Art. 25(5) and (6).

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change. One of the amended provisions also requires that the principles of the OECD transfer pricing guidelines be used in determining the profits attributable to a PE. Given the consternation that has been caused by the OECD's project on the attribution of profits to a PE, some taxpayers may find this provision a point of concern.

c. *Germany-United States Estate, Inheritance and Gift Tax Treaty*

The Germany-U.S. estate, inheritance, and gift tax treaty entered into force on June 27, 1986.[1250] It was the first of Germany's treaties to cover *inter vivos* gifts and applied retroactively to estates of decedents that died and to gifts consummated after December 31, 1978. On December 14, 1998, a Protocol to the treaty was signed that is designed to reduce, if not eliminate, the disadvantages to surviving spouses that do not hold U.S. citizenship resulting, since 1988, from the U.S. Technical and Miscellaneous Revenue Act of 1988 (TAMRA).

Before the entry into force of the Germany-U.S. estate, inheritance, and gift tax treaty, the most serious cases of double taxation concerned the estates of German residents who held portfolio investments in U.S. securities (see XIII.B., above). This situation has been remedied by the United States giving up its jurisdiction to impose estate taxes on the estates of nonresident aliens with respect to securities issued by U.S. corporations.[1251]

The Germany-U.S. estate, inheritance, and gift tax treaty contains extensive rules for determining the residence of a decedent or donor as well as that of a beneficiary. The rules are modeled on the OECD Model Double Taxation Convention on Estates and Inheritances and on Gifts of 1982 and contain one exception that is worth noting: under the treaty, U.S. citizens (and members of their households that meet the same criteria) who were residents of Germany for not more than 10 years before the taxable event will not be deemed to be German residents.[1252]

The Germany-U.S. estate, inheritance, and gift tax treaty lists four types of assets to which specific rules apply (immovable property, assets forming part of a PE, ships and aircraft, and interests in partnerships). All other assets may, in principle, only be taxed in the country of residence of the decedent or donor. However, the catch-all clause of Article 9 is subject to a savings clause in favor of Germany insofar as the taxation of German resident beneficiaries and donees is concerned.[1253] If, in these instances, the United States or Germany, as the case may be, taxes assets other than immovable property, assets of a PE, or partnership interests deemed to be located within their jurisdiction under Articles 5, 6, and 8, they must grant a credit for taxes imposed in the other state.[1254] Article 10 deals with personal exemptions and deductions.

An area on which the parties agreed to disagree was the status of transfers to or from an estate or trust.[1255] Because, under German succession law, title to and possession of the assets of a decedent transfer to the beneficiaries automatically, there is no equivalent to an estate for purposes of German inheritance tax. Nor does German civil law recognize an equivalent to a common law trust. The Germany-U.S. estate, inheritance and gift tax treaty permits both states to continue to apply their rules, with the possibility of competent authority proceedings in cases of double taxation. Furthermore, German beneficiaries can elect within five years to be treated as if they had received the taxable benefit at the time of the transfer; German beneficiaries will make this election where a substantial foreign tax credit would otherwise be lost.[1256] Such a loss arises if the transfer of assets into a trust would not constitute a taxable event for German gift and inheritance tax purposes as was often the case in the past. However, since 1999, such a transfer is a taxable event.[1257]

D. OECD Multilateral Instrument

In Paris on June 7, 2017, Germany signed the "Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the "Multilateral Instrument" or MLI). The MLI entered into force on July 1, 2018.

Germany has designated 35 of its tax treaties out of a total of 96 tax treaties as "covered tax agreements." Of the 35 treaty partners, 32 have made corresponding decisions, meaning that there are 32 German covered tax agreements at this stage. Since the United States is not among the signatories to the MLI, the Germany-U.S. tax treaty is not a covered tax agreement.

Once both parties to a covered tax agreement have ratified the MLI, the MLI (or, more precisely, those provisions of the MLI that both parties have correspondingly designated as applicable) is to be applied alongside the tax agreement. The applicable provisions of the MLI will become effective either automatically after six months have elapsed since the ratification of the MLI by both countries or only once both countries have notified the OECD that the domestic procedures have been completed.

Comment: It is understood that Germany will opt for the notification procedure.

Germany has since ratified the MLI. The German parliament passed a corresponding implementation act on October 8, 2020 (approved by the second chamber on November 6, 2020), which reduced the number of German covered tax agreements to 14. The next step will be for each of the 14 tax treaties[1258] designated in the MLI implementation to be amended in further legislative procedures. Before the amendments are confirmed, Germany will conduct consultation procedures with the other countries to reach agreement on the effects of the MLI. Only then will the amendments to the respective tax treaty become effective, provided the respective other country has also notified the corresponding tax treaty resulting from amendments due to the MLI and implemented the MLI domestically. The

[1250] BGBl. 1986 II, 860.

[1251] Germany-U.S. estate, inheritance, and gift tax treaty, Art. 9.

[1252] Germany-U.S. estate, inheritance, and gift tax treaty, Art. 4(3), as amended by Protocol of December 14, 1998.

[1253] Germany-U.S. estate, inheritance, and gift tax treaty, Art. 11(1), as amended by Protocol of December 14, 1998.

[1254] Germany-U.S. estate, inheritance, and gift tax treaty, Art. 11 (2)–(7).

[1255] Germany-U.S. estate, inheritance, and gift tax treaty, Art. 12.

[1256] Germany-U.S. estate, inheritance, and gift tax treaty, Art. 12(3).

[1257] ErbStG, Secs. 3(2), 7(1).

[1258] The Germany-Austria, -Croatia, -Czech Republic, -France, -Greece, -Hungary, -Italy, -Japan, -Luxembourg, -Malta, -Romania, -Slovakia, -Spain and -Turkey tax treaties.

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applicability of the MLI to German tax treaties needs, therefore, to be considered on a case-by-case basis.

Officials of the Federal Ministry of Finance have indicated that it is planned to enact separate bills for each of the covered tax agreements to secure clarity on the rules applicable in relation to each treaty partner.

At the time of signature of the MLI, Germany submitted a provisional (long) list of expected reservations and notifications. For example, the following articles of the MLI will not apply to Germany's covered tax agreements:

(i) Article 3 — Transparent Entities;

(ii) Article 4 — Dual Resident Entities;

(iii) Article 11 — Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents;

(iv) Article 12 — Artificial Avoidance of Permanent Establishment Status through Commissionaire Arrangements and Similar Strategies;

(v) Article 14 — Splitting-up of Contracts; and

(vi) Article 15 — Definition of a Person Closely Related to an Enterprise.

As regards the MLI provisions directed at treaty abuse, Germany will apply: Article 6 — Purpose of a Covered Tax Agreement; Article 7 — Prevention of Treaty Abuse opting for the Principal Purpose Test; Article 8 — Dividend Transfer Transactions (introducing a minimum holding period of 365 days); Article 9 — Capital Gains from Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property; and Article 10 — Anti-Abuse Rule for Permanent Establishments in Third Jurisdictions.

As regards the MLI provisions dealing with the definition of a PE, Germany has reserved the right to apply none of them, except for Article 13(1) reducing the scope of the PE exemptions provided for in Article 5(4) of the OECD Model Convention (and choosing to apply Option A under Article 13(1)).

As regards the MLI provisions dealing with dispute resolution, Germany has opted against Article 16(1) sentence 1 — Mutual Agreement Procedure; has opted for Article 17 — Corresponding Adjustments; and has chosen to apply Article 18 Part VI Arbitration (subject to several reservations with respect to the scope of the cases that will be eligible for arbitration).

The Law on the Application of the Multilateral Convention of November 24, 2016 and Further Measures passed the German Bundestag (First Chamber) and the Bundesrat (Second Chamber).[1259] The Act deals with the modifications to Germany's in scope tax treaties (i.e., the treaties with Croatia, the Czech Republic, France, Greece, Hungary, Japan, Malta, Slovakia and Spain, which have ratified the BEPS-MLI) by offering an official list of the "matchings" agreed between Germany and the treaty partner country prepared from a German perspective only. Meanwhile, Germany has also deposited with the OECD its notification confirming the completion of its internal procedures for the entry into effect of the provisions of the Convention.

[1259] BGBl. 2024 I, No. 205.

E. *Exchange of Information*

All tax treaties entered into by Germany based either on the OECD Model Treaty or the German Model Treaty include an exchange of information clause similar to Article 26 of the Germany-U.S. income tax treaty, which is foreseeably relevant for carrying out the provisions of the treaty or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the contracting states, their political subdivisions, or local authorities. Any information received is treated as confidential and may be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment, collection, enforcement, or prosecution in respect of the taxes covered by the treaty, or in the determination of appeals in relation to these taxes. A contracting state is not required to carry out administrative measures at variance with the laws and administrative practice of either state. Furthermore, there is no obligation to supply information which is not obtainable under the laws or in the normal course of the administration of either state. The contracting states are not required to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process. Also, the exchange of information is not to be construed to permit a contracting state to obtain or provide information that would reveal confidential communications between a client and an attorney, solicitor, or other recognized legal representative where the communications are produced for the purposes of seeking or providing legal advice or for use in existing or contemplated legal proceedings. Slight differences may arise nevertheless in particular with respect to procedural details.

In addition to tax treaties, Germany has signed specific exchange of information agreements with Andorra, Anguila, Antigua and Barbuda, Bahamas, Bermuda, British Virgin Islands, Cayman Islands, Cook Islands, Gibraltar, Grenada, Guernsey, Isle of Man, Jersey, Liechtenstein, Monaco, Montserrat, San Marino, St. Kitts and Nevis, St. Lucia, St. Vincent and Grenadines, Turks and Caicos Islands, which enable the exchange of information on request or automatically, depending on the specific terms agreed upon. They cover a range of data that is foreseeably relevant to the administration and enforcement of the domestic tax laws of the parties involved. The exact number and nature of such agreements can evolve as Germany and other jurisdictions negotiate and update their international tax cooperation strategies.

Further, Germany has signed with the U.S. the US Foreign Account Compliance Act (FATCA) in 2013[1260] and is party of the OECD multilateral Agreements on Common Reporting Standards for Automatic Exchange of Financial Accounting Information (CRS Agreement) since 2014.[1261]

[1260] BGBl. 2014 I, p. 1222.
[1261] Effective since January 1, 2016, BGBl. 2015 I, p. 2531.

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XVII. Income Tax Surcharge

A. *In General*

An income tax surcharge of 5.5%,[1262] designed to contribute to the high costs of the process of reunifying Germany, is imposed in the Federal Republic. The surcharge is applied to income tax and corporate income tax assessed, as well as to withholding taxes imposed.[1263] The Federal Tax Court decided on January 17, 2023[1264] that the solidarity surcharge rules for the years 2020 and 2021 had not violated the Constitution and, therefore, did not refer the case at hand to the German Constitutional Court and, instead, dismissed the appeal.

Since January 1, 2021, the surcharge has applied only to individuals subject to income tax if the income tax base exceeds 16,956 euros or 33,912 euros for taxpayers filing joint returns (2021, 2022), 17,543 euros or 35,086 euros for taxpayers filing joint returns (2023), and 18,130 euros or 36,260 euros for taxpayers filing joint returns (2024 cont.); similar thresholds apply to wage tax withheld on behalf of an individual (except flat-rate wage taxes). The income tax surcharge, however, still applies to income tax exceeding these threshold amounts, withholding taxes and corporate income taxes.[1265] The Federal Constitutional Court again decided on March 26, 2025 that this split application of the solidarity surcharge is also in line with the constitution.[1266] The comments in XVII.A.1. to B., below apply to the limited number of cases to which the income tax surcharge still applies.

1. *Taxpayers Covered*

The surcharge is imposed on both resident and nonresident individual and corporate taxpayers that are subject to income tax or corporate income tax by way of assessment or by way of withholding.

2. *Basis for Surcharge*

The basis for the imposition of the 5.5% surcharge is the income tax/corporate income tax assessed or the withholding tax imposed. With respect to resident corporations, the basis is the corporate income tax actually assessed. This means that the surcharge will be based on the corporate income tax actually assessed at the rate of 15%.

Where income tax is collected by way of withholding, the surcharge is payable with respect to payments that attract withholding tax.

B. *Impact of Tax Treaties*

Where a withholding tax is reduced or eliminated under the terms of a tax treaty or pursuant to a European Union (EU) Directive, the treaty provisions or the provisions pursuant to the EU Directive, as the case may be, prevail. The surcharge is not intended to override such provisions.

1. *Dividends*

Where a German corporation distributes a dividend, it must deduct dividend withholding tax at the rate of 25%,[1267] subject to a claim for refund of the excess over the applicable tax treaty rate. As the treaty rate for individuals is generally 15% of the gross dividend,[1268] the surcharge levied with respect to dividend distributions will be fully refunded to a nonresident applying for a refund under a treaty.

Moreover, in the case of a dividend distributed to a EU Member State parent company, under the EU Parent/Subsidiary Directive, the withholding agent can immediately apply the exemption from withholding tax if it has obtained a prior certificate from the Federal Central Tax Office (*Bundeszentralamt fuer Steuern*). In this case, the surcharge will not be applied at all. The same rules apply where distributions made to a parent company in a tax treaty country qualify for the reduced rate of 5% or 0% under the applicable treaty.

2. *Interest*

Germany levies no general withholding tax on interest paid to nonresident creditors, so that the surcharge can be applied only to withholding tax imposed on particular items of interest, such as interest on convertible bonds or income bonds, interest on participation rights and interest on participating loans. To the extent such withholding tax is reduced or eliminated under the terms of a tax treaty, the surcharge will be fully refunded.

3. *Royalties*

Under German domestic law, the rate of withholding tax on royalties paid to nonresident licensors is 15%.[1269] Under most of Germany's tax treaties, the withholding tax rate on royalties is reduced to zero;[1270] under a few treaties, however, withholding tax may apply at the rate of 5% or 10%. Where the treaty rate is zero and a certificate of exemption is filed with the debtor with respect to the royalties before payment of the royalties, the surcharge will not be applied. In all cases where the withholding tax is reduced but not completely eliminated, the rules discussed at 1., above, will apply. The same applies under the EU Interest and Royalties Directive.

4. *Corporate Board Members*

Under German domestic law, the rate of withholding tax on remuneration paid to nonresident board members is 30%.[1271] As most of Germany's tax treaties follow the rules in Article 16 of the Organisation for Economic Cooperation and Development (OECD) Model Convention and do not restrict Germany's jurisdiction to impose the 30% withholding tax, the 5.5% surcharge will be levied on the tax withheld and no re-

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[1262] Solidarity Surcharge Act (*Solidaritaetszuschlaggesetz* — SolzG), Sec. 4.

[1263] SolzG, Sec. 3.

[1264] Federal Tax Court, decision of January 17, 2023, file no. IX R 15/20, BStBl. 2023 II, 351.

[1265] SolZG, Sec. 4, as amended by the Law on the repayment of the solidarity surcharge 1995 (*Gesetz zur Rueckführung des Solidaritaetszuschlags 1995)* of December 10, 2019, BGBl. 2019 I, 2115.

[1266] Federal Constitutional Court, decision of March 26, 2025, file no. 2 BvR 1505/20.

[1267] EStG, Sec. 43a(1)(1).

[1268] Compare OECD Model Convention, Art. 10(2).

[1269] EStG, Sec. 50a(2).

[1270] Compare OECD Model Convention, Art. 12(1).

[1271] EStG, Sec. 50a(2).

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fund will be available, except in particular situations, where a treaty does restrict the imposition of German withholding tax.

5. *Artists, Entertainers and Athletes*

The rate of withholding tax on remuneration paid to artists, entertainers and athletes for performances or participation in sporting events in Germany is 15%, subject to a tax-free threshold of 250 euros per performance.[1272] This tax threshold applies to each individual or legal person in the case of a corporation involved in the event. Under most of its tax treaties, Germany has retained its right to impose such withholding tax and the surcharge of 5.5% of the withholding tax will be imposed without a refund being available.

[1272] EStG, Sec. 50a(2).

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XVIII. COVID-19-Pandemic and Other Instances of Legal and Tax Assistance

A. Tax Relief Measures

The Corona Tax Relief Acts I[1273] and II[1274] provided a wide variety of measures to help taxpayers. These measures include in particular:

(i) Concessions in the form of the reduction and/or deferral of income tax prepayments;

(ii) An increase in the income tax loss carryback ceiling from one million euros (two million euros for taxpayers filing joint income tax returns) to five million euros (10 million euros in the case of joint returns) for tax losses of the years 2020 and 2021;

(iii) The introduction of declining balance depreciation for wear and tear of movable fixed assets produced or acquired after December 31, 2019 and before January 1, 2022;

(iv) Extension of the reinvestment period from three to four years for investment deductions under Section 7g of the Income Tax Act (*Einkommensteuergesetz* — EStG);

(v) Various tax measures to attract more purchases of electric cars;

(vi) An increase in the trade tax debt that can be set off against income tax debt (but not corporate income tax debt);

(vii) An increase in the trade tax allowance for interest expenses;

(viii) Extension of the retroactive period under the Transformation Tax Act from eight months to 12 months for a change of legal form to a partnership and contributions-in-kind made to a corporation in exchange for new shares that were agreed on or filed with the responsible commercial register in the year 2020 or 2021;

(ix) A temporary increase in the assessment basis for the research allowance from two million euros to four million euros;

(x) A reduction in the value added tax (VAT) rates from 19% to 16% and from 7% to 5% from July 1, 2020 until December 31. 2020;

(xi) A reduction in the VAT rates for restaurant and catering services (except for drinks) to the lower VAT rate, i.e., from 16% to 5% from July 1, 2020 until December 31, 2020 and from 19% to 7% from January 1, 2021 until June 30, 2021;

(xii) A tax-exempt bonus payment of up to 1,500 euros in addition to an employee's salary for the time period from March 1, 2020 until December 31, 2020;

(xiii) An increase in the short-time allowance for salary payments to the maximum of 80% of the difference between the actual and the target salary from March 1, 2020 until December 31, 2021; and

(xiv) A one-time increase in the child allowance.

The main effect of the Corona Tax Relief Act III[1275] is to extend the tax concessions granted by the Corona Tax Relief Acts I and II, in particular:

(i) An extension of the reduced 7% VAT rate for restaurant and catering services (except drinks) to December 31, 2022;

(ii) A second one-time increase in the child allowance;

(iii) A further increase in the income tax loss carryback for the years 2020 and 2021 from five million euros (10 million euros for taxpayers filing joint income tax returns) to 10 million euros (20 million euros in the case of joint returns); and

(iv) The preliminary suspension of the enforcement of tax debts due and eased preconditions for tax deferrals.

The Corona Tax Relief Act IV[1276] provides for tax concessions additional to those granted by the Corona Tax Relief Acts I, II and III, in particular:

(i) The extended loss offset will be extended until the end of 2023: the maximum amount of loss carryback will be increased to ten million euros, or to 20 million euros in the case of joint tax assessment. In addition, the loss carryback period will be permanently extended to two years from 2022; the losses will be carried back to the immediately preceding two years;

(ii) The investment periods for tax-deductible investment allowances under Section 7g of the German Income Tax Act (EStG), which were set to expire in 2022, and the tax investment periods for reinvestments under Section 6b of the EStG will be extended by a further year;

(iii) The option to use the declining balance method of depreciation for movable fixed assets is extended by one year for assets acquired or manufactured in 2022;

(iv) The tax incentive for tax-free subsidies for short-time work will be extended by three months until the end of March 2022;

(v) The existing home office flat rate rule will be extended by one year until December 31, 2022;

(vi) Special employer benefits granted under federal or state rules to employees in certain facilities — primarily hospitals — in recognition of the performance of special services during the Corona crisis are tax-exempt up to 3,000 euros; and

(vii) The deadline for filing 2020 tax returns in advised cases will be extended by a further three months. Conse-

[1273] First Act Implementing Tax Relief Measures to Address the Corona Crisis (Corona Tax Relief Act I), of June 19, 2020, BGBl. 2020 I, 1385.

[1274] Second Act Implementing Tax Relief Measures to Address the Corona Crisis (Corona Tax Relief Act II), of June 29, 2020, BGBl. 2020 I, 1512.

[1275] Third Act Implementing Tax Relief Measures to Address the Corona Crisis (Corona Tax Relief Act III), of March 10, 2021, BGBl. 2021 I, 330.

[1276] Fourth Act Implementing Tax Relief Measures to Address the Corona Crisis (Corona Tax Relief Act IV), of June 19, 2022, BGBl. 2022 I, 911.

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quent on this, the declaration deadlines for 2021 and 2022 will also be extended, though to a lesser extent.

B. The Stabilization and Restructuring Framework

The Act on the Stabilization and Restructuring Framework (the "Corporate Stabilization and Restructuring Act," StaRUG),[1277] which was published on December 22, 2020, applies with effect from January 1, 2021, and basically governs restructuring law (which applies before the insolvency law) while simultaneously implementing the EU Restructuring Directive in Germany. Its provisions tie in seamlessly with the suspension of the obligation to file for insolvency by the COVID-19 Insolvency Suspension Act. Unlike the Corona Tax Relief Acts, the StaRUG was not specifically adopted to support the economy due to insolvencies arising from the COVID 19 pandemic lockdowns, but it should nevertheless help to cope with these issues.

As provided for by the EU Restructuring Directive,[1278] the StaRUG regulates early risk identification and early crisis management by managing directors. In addition to the provisions on early risk identification, the StaRUG also provides for an early warning system including a statutory duty for tax advisors, auditors and lawyers who, in preparing annual financial statements, become aware of obvious indications of the existence of a reason for insolvency. The law aims to avoid the disadvantages of insolvency, such as potential loss of reputation, high costs, and restrictions on management's freedom of decision. Nevertheless, selected restructuring instruments from insolvency law are to be available to a corporation facing this situation. In essence, the StaRUG can be used to establish a sustainable financing structure that is adapted to a corporation's respective capacity. This is achieved, as required, by systematic contributions from creditors.

The core measure provided for in the StaRUG is the restructuring plan, which will become binding if approved by at least 75% of the voting rights within each of the respective voters' group. The restructuring plan offers almost the same possibilities as an insolvency plan, which is why the restructuring plan is also very similar to the insolvency plan in terms of content. A restructuring plan, which can be implemented at the stage of imminent insolvency, can include all liabilities of a company, subject to a few exceptions (for example, employee claims and company pension schemes). However, there is no obligation to include all liabilities, so that, for example, it is also permissible to include only financial creditors. The shareholders can also be included in the restructuring plan. A wide variety of arrangements can be contemplated, for example, debt waivers, deferrals, the adjustment of conditions, debt-to-equity swaps, capital increases and even capitals cut involving the issue of new shares to investors.

As already stipulated in the EU Restructuring Directive, the aim of any restructuring plan must be, first, to eliminate insolvency or the threat of insolvency and, second, to ensure the ability of the corporation concerned to continue as a going concern. It is, therefore, precisely the avoidance of insolvency and the ability to continue as a going concern that must be presented in concrete terms in the restructuring plan.

As of May 1, 2021, the standard rules again apply.

[1277] Act on the Stabilization and Restructuring Framework (Corporate Stabilization and Restructuring Act, *Unternehmensstabilisierungs- und -restrukturierungsgesetz* — StaRUG) of December 22, 2020, BGBl. 2020 I, 3256.

[1278] Directive (EU) 2019/1023 of the European Parliament and of the Council of June 20, 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency, and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency).

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TABLE OF WORKSHEETS

Worksheet 1	Model Articles of Incorporation for a Wholly-Owned GmbH.
Worksheet 2	Income Tax Return 2022 for Nonresident Individuals. (N.B. The link provided is to the form management system of the Federal German Fiscal Administration, where one can find the relevant form.)
Worksheet 3	Income Tax Return for Resident Individuals. Note: As from 2023, the Corporate Income Tax Return, Trade Tax Return and VAT Return must be filed electronically and are, therefore, no longer available in the Federal Ministry's data-base of tax forms.

Working Papers for this Portfolio can be found online at https://bloombergtax.com.

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