

Turnbull & Jürgang

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YOUR BUSINESS ASSIGNMENT IN GERMANY

A short-form Tax and
Business Guide for foreign Companies
and Individuals
in Germany

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Audits
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Business Consulting

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PREFACE

About us

Dear Reader,

Turnbull & Irrgang GmbH is a nationwide audit and tax consulting company largely based in northern Germany. The firm was established by Dr. Peter E. Turnbull in 1974 and now employs approx. 50 people.

We specialise in serving especially medium-sized and larger business operating in a wide range of industry sectors, including international business, business owned by public authorities, non-profit associations and foundations as well as private clients.

Our range of services comprises audit, tax consulting, business advice and trustee services. Legal services for company and business law including mergers and acquisitions are rendered by the affiliated business lawyers Dr. Irrgang & Hellhake, lawyers and tax consultants.

Our national and international network enables us to provide a comprehensive service to our clients, also worldwide, maintaining our professional independence.

Internationally we are a member of MOORE STEPHENS International Limited. The international network of MOORE STEPHENS International Ltd. is presently ranked approx. 16th in the world-wide league table of accounting firms. Since its establishment nearly 100 years ago, MOORE STEPHENS International has developed to approx. 500 offices in over 90 countries with more than 13.000 partners and staff.

In Germany with the umbrella firm MOORE STEPHENS Deutschland AG, Berlin, there are 17 member firms with over 60 offices and over 1.200 partners and staff which brings us in a good position within the German ranking table of accounting firms and networks in Germany.

About this Guide

Our guide shall provide you with an initial overall view of the German tax law in connection with the set up of business activities in Germany resp. the transfer of residence to Germany. The guide focuses on the taxation of companies with respect to the different legal forms as well as the taxation of individuals.

Moreover you will find information about German company, industrial and social security law.

Investment Incentives

There are various programs available regarding the support of foundations and settlement of companies in Germany.

Financial support is granted by many different institutions. In this connection please note that generally no specific measures regarding the foundation or settlement of a company should be carried out before the applications for investment incentives were filed.

Financial support is granted in many ways, for instance as equity support, business start-up loans, guarantees, participations, low-interest loans, investment grants, cash contributions and business advice.

A complete presentation of all active programs with the demand to be complete and up to date would by far exceed the scope of this guide, especially as the relevant terms and conditions are frequently changing.

Investors aiming at investment incentives should contact the regional business promoting companies as well as their regular banks and us. More over, there are further contacts, e.g. economic ministries on a federal and state level, and the chambers of industry and commerce (IHKs) available.

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I. INTRODUCTION TO TAXATION IN GERMANY

As for corporations, the link to taxation in Germany is the legal domicile or the place of management in Germany.

The world-wide income of a corporation normally is taxable from the beginning of its formation to the end of its liquidation.

As for individuals, the essential link to a tax liability in Germany is whether or not an individual is permanently domiciled in Germany. Individuals who have their residence/domicile (Wohnsitz) or customary abode (gewöhnlicher Aufenthalt) in Germany are subject to full tax liability, so-called 'unlimited taxation'.

The basis for the German taxation is the total world-wide income of the tax payer. There are exceptions for income from foreign sources, especially in connection with tax treaties.

In the year of arrival or departure of an individual, the world-wide income is only taxable from the date of arrival until the date of departure. The income earned before arriving or after leaving Germany during the calendar year is subject to special tax calculation rules (domestic/foreign sources).

Non-residents with income from sources in Germany are subject only to the so-called 'limited taxation'.

Gifts or inheritances in Germany exceeding certain amounts may be subject to gift and inheritance tax (Schenkungs-/Erbsteuer). Point of contact is the person (home) or the property's location (home).

In this context it should be noted that the European law and the jurisdiction of the European Court influences domestic German tax law more and more. Certain provisions are already declared not applicable and/or must be changed.

The following outline is intended as general information only and cannot serve as a substitute for personal and specific detailed information and professional advice.

II. LEGAL TYPES OF COMPANIES

1. General

German law provides for a great variety of enterprise forms: the individual merchant or single trader and several forms of partnerships and corporations with limited liability.

If foreign companies operate in Germany, they either prefer to start through a representative office or to establish their business in the legal form of a corporation, the limited liability company (Gesellschaft mit beschränkter Haftung). Another important legal form of a corporation is the public stock corporation (Aktiengesellschaft).

In addition to these two types of corporations, two other types of associations frequently operate in German business: the general partnership (Offene Handelsgesellschaft) and the limited partnership (Kommanditgesellschaft). The legal affairs of these companies are regulated in special sections of the German Commercial Code (Handelsgesetzbuch). Another important legal form is the GmbH & Co. KG, composed of a Kommanditgesellschaft and a Gesellschaft mit beschränkter Haftung. Foreign legal entities (e.g. the Ltd. from the UK) are allowed to operate in Germany.

If you intend to set up a corporation or any other legal type of company in Germany, individual and detailed qualified legal and tax advice is mandatory.

2. Representative Office

The representative office, in the sense of a permanent establishment (e.g. branch office), is established by meeting special demands for registration of the intended commercial activity with the municipal authorities.

The following records must be enclosed with the application for registration of a trade or business:

a) Company Register Excerpt

of the applying company (in German translation). The applying company's name (firm), domicile and purpose as well as the date of its foundation and its legal representatives must be stated in the commercial register excerpt.

b) Power of Attorney

The power of attorney need not to be certified for the application. The power of attorney must be signed by at least one of the legal representatives stated in the commercial register excerpt.

c) Articles of Association

of the applying company (if applicable).

d) Lease Contract

concerning the business premises (if applicable).

e) Presentation of Passport and Confirmation of Registration

of the applicant (head of the representative office). The confirmation of registration can be obtained from the local German registration office.

Officially certified translations are not required for the registration of a representative office.

Further applications for registration are to be filed with the tax office, social security insurance institutions, workmen's compensation board and employment office.

3. Limited Liability Companies (Gesellschaften mit beschränkter Haftung - GmbH)

The limited liability company is the legal form in which foreign companies in Germany normally organise their business operations.

The formation of a limited liability company and its legal relationships are regulated by the German Law concerning Companies with Limited Liability (Gesetz betreffend die Gesellschaften mit beschränkter Haftung - GmbHG).

A GmbH is a corporation where the liability of the shareholders is limited to the full payment of the shares subscribed by them. The corporation itself limits its liabilities to its own assets.

The articles of the corporation must be set up and signed before a notary public, at least one individual or corporation subscribing the shares. If there is only one founder, there are additional legal requirements to be fulfilled. The company is to be registered in the local Commercial Register for the area in which the company is domiciled.

The minimum capital requirements are € 25,000 statutory capital, € 100 minimum per shareholder. One quarter of the statutory capital with a minimum of € 12,500 must be paid in on formation. If there is only one founder, additionally a security has to be registered relating to the part of capital not paid in. The payment can be made in cash or in kind which in the latter case requires an audit. A company which is in the process of incorporation (a company which has not yet been registered) is not considered to be a legally independent entity.

For activities carried out before registration in a certain way a liability of the company in foundation or of the managing director(s) too comes into consideration for differences to the capital stock. By the registration or in case the GmbH finally should not be registered, creditors may lay claim to those who have been acting for the GmbH. Upon registration, all positions relating to transactions between foundation and registration are passing to the company. According to a draft law starting on January 1, 2006, the minimum statutory capital shall be decreased to € 10.000 especially to ensure the attractiveness of this legal form.

The GmbH needs at least one or more managing directors (Geschäftsführer) to act for the corporation and to manage it. Their power of representation toward third parties is unlimited and not limitable but it is frequently restricted for inner relationship by the articles and by the employment contract of the company to usual routine business affairs.

Shareholders' decisions are generally reached at a so-called shareholders' meeting (Gesellschafterversammlung). If all shareholders agree relating to a corresponding regulation within the statutes, a shareholders' decision may also be reached by circulation procedure. The voting rights of the shareholders are generally determined by the extent of their share in the company's capital.

The articles may provide for the GmbH to have a voluntary supervisory board (for larger companies with more than 500 employees legally required) for which the regulations of the Stock Corporation Law (Aktiengesetz - AktG) are then applied to a greater extent.

The annual financial statements of a GmbH must be audited if an existing GmbH exceeds two of the following three criteria at two following balance sheet dates: Sales exceeding € 8,030 mio in the preceding 12 months before the balance sheet date, balance sheet total exceeding € 4,015 mio, more than 50 employees in the average of the preceding year. For newly established GmbHs the first balance sheet date is applicable.

4. Public Stock Corporations (Aktiengesellschaften - AG)

More and more companies are operating in Germany in the legal form of a public stock corporation. The form of the stock corporation normally is used to sell shares without notarial formal requirements at the stock exchanges, by unofficial dealings or privately.

The formation of a public stock corporation and its legal relationship are regulated by the German stock corporation law (Aktiengesetz - AktG). The minimum capital of an AG is € 50,000.

The AG must have a management board (Vorstand) and a supervisory board (Aufsichtsrat) with at least three members. The management board which is appointed by the supervisory board is empowered to decide all matters relating to routine business affairs. It is appointed by the supervisory board and responsible to it.

The legal power of the shareholders of an AG is exercised at regular shareholders' general meetings (Hauptversammlung). The shareholders have the authority to act by resolutions as prescribed by the AktG or by the articles of association.

5. Information on Public Record

Generally the following information is available in the Commercial Register

- company's name
- nature of activities
- company's domicile
- share/stock capital
- general manager(s)/managing director(s) and their scope of authority
- changes in the Articles of Association
- holder of a special statutory authority
- financial statements

Companies must publish their financial statements, although the level of detail required depends on certain size criteria. Large companies and GmbH & Co. KGs must publish their complete financial statements in the publication "Bundesanzeiger". Small and medium sized companies and GmbH & Co. KGs are only required to publish an announcement that the financial statements have been filed with the Commercial Register.

6. Accounting and Audit

Accounting

The managing director(s) are responsible for the maintenance of reasonable accounting records and for the preparation of financial statements. The financial statements must be approved by the shareholders, usually at the company's annual general meeting.

Audit

The financial statements and the management report of medium-sized and larger companies and GmbH & Co. KGs must be audited by an independent auditor (which we are). The managing director(s)/board of directors/supervisory board is assigning the auditor, based on the election by the shareholders' meeting. The auditor's report is designed to state whether the financial statements, the management report and the bookkeeping comply with the legal requirements and the articles of association and whether they give a "true and fair view" of the company's state of affairs at the date of the balance sheet as well as of the financial result of the audit period.

III. TAXATION OF COMPANIES

1. Profit/Net Income

The profit or net income of a company in Germany may be simply defined as follows:

$$\begin{array}{r} \text{Sales/income} \\ \text{less expenses} \\ \hline \text{Profit/net income} \\ \hline \hline \end{array}$$

In general the expenses include all business operating monetary expenses, depreciation, write-offs and decreases of the value of business assets. Certain expenses are not deductible and are increasing the taxable income and the effective tax rate. The tax year in Germany is the calendar year. Companies with a different fiscal year are required to report their income within the calendar year in which their fiscal year ends.

Within many legal provisions with various tax and investment incentives covered by German legislation, you have several ways of influencing the business and tax performance results of your company.

For further detailed information and tax planning aspects about the numerous possibilities to control profit or net income, tax allowances or subsidies, it is advisable to seek professional advice. Some additional information has been summarised for you in the following chapter III. 7 (page 12).

2. Corporation Income Tax

A corporation (e.g. AG, GmbH) is liable to corporation income tax. A partnership (e.g. OHG, KG) is not itself liable to tax on income. Only its partners are liable to income tax, if they are individuals, or to corporation tax, if the partners are corporations.

The corporation income tax rate is 25 per cent fixed. The distribution of income has no influence on the tax rate.

In the case of profit distributions, a withholding tax (capital yields tax) of normally 20 per cent of the cash dividend is withheld in addition to the 25 per cent corporation income tax payable by the corporation. The aforementioned tax rates are increased by the so-called “solidarity surcharge” of 5.5 per cent of the tax. A reduction of the withholding tax (capital yields tax) even to zero is applicable under several tax treaties.

Capital yields tax as well as the solidarity surcharge withheld on capital yields tax are credited to the personal or corporation income tax of the shareholders if they are liable to German “unlimited“ taxation (resident shareholders).

50 % of the income distributed to the shareholders are tax free if the shareholder is an individual subject to unlimited taxation in Germany. The distribution is 100 per cent tax free if the shareholder is a German corporation.

Important: Domestic corporations which hold shares of domestic or foreign companies may sell their shares tax exempt in Germany. This is not relevant for certain investment funds.

Shareholders who are liable to “limited” taxation (foreign shareholders) may have special provisions in their home country to receive credit for paid foreign (German) taxes. Detailed information about provisions in connection with foreign income taxation must be left to individual advice.

3. Trade Tax on Income

In addition the income of a company is subject to a community trade tax on income levied by the municipal authorities.

Trade tax on income is deductible when computing the taxable income for the corporation income tax and for the trade tax itself. For individual entrepreneurs or private companies/partnerships a trade tax credit results in a tax reduction of the proprietor's or partner's income tax and solidarity surcharge.

The tax basis for the trade tax is not normally the same as the tax basis for the corporation income tax. Certain items are not deductible for this tax and are accordingly added back to income (e.g. interest on "long-term" liabilities can only be deducted at 50 per cent).

Detailed information about trade tax deductions and additions to the taxable income of corporation income tax are matters for individual advice.

The tax rates vary depending on the municipal trade tax levy rate (Gewerbsteuerhebesatz). In Hamburg, the tax levy rate is actually based on a municipal rate of presently 470 per cent which results in a gross rate of 23.5 which finally results in an effective rate of 19 per cent in consequence of its tax deductibility.

4. Example of a Simplified Computation of the German Corporation Income Tax and Trade Tax on Income

	Dividend Distributed €	Taxes of Corporation and Share- holder €	
a) Taxable income before taxes on income	1,000		
b) Trade tax on income (levy rate: 470 %) ^(*)	-190	190	
c) Income before corporation tax and after trade tax	810		
d) Corporation income tax 25 % of 810	-203	214	}
e) Solidarity surcharge 5.5 % of 203	-11		
f) Income available for distribution	596		
g) Withholding tax 20 % of € 596 ^(**)	-119	126	}
h) Solidarity surcharge 5.5 % of 119 ^(**)	-7		
i) Cash dividend received by shareholder	<u>470</u>	<u>530</u>	
k) Tax credit	<u>126</u>	- 126 ^(***)	
l) Dividend including withholding tax refunded	<u>596^(***)</u>		
m) Total German tax		<u>404^(***)</u>	under certain circumstances creditable for the shareholder

(*) Hamburg 2005 levy rate as example

(**) Reductions available under several Double Taxation Treaties

(***) E.g. for foreign shareholders who are entitled to full tax credit resp. full refund of withholding tax

5. Value-Added Tax

Sales of goods and the rendering of services are generally subject to value-added Tax (VAT). The normal VAT rate is presently 16 per cent of the net price (i.e. gross price without VAT). A reduced rate of 7 per cent applies to certain goods and services, e.g. food (except in restaurants).

VAT charged to a company e.g. by suppliers is normally deductible. Accordingly, only the net amounts of VAT for own sales or services less VAT charged to the company are payable to the tax authorities.

The import of goods into Germany is subject to the same VAT rates, but also deductible for companies. This tax is so-called Import Turnover Tax (Einfuhr-Umsatzsteuer) and payable at customs. In addition, customs duties and for certain products excise taxes are levied. The export of goods is exempt from VAT.

For certain services rendered in Germany from entrepreneurs non-resident in Germany, as well as normally for building works and supplies, taxation resp. tax-liability is shifted to the recipient of services (so-called reverse-charge).

In cases of trade between the EU member states the Import Turnover Tax is replaced by a purchase tax, i.e. the import is not taxable but the purchase. In the case of import, the importer has to calculate and to remit the VAT purchase tax (Erwerbsteuer) to the domestic tax office. As he is entitled for deduction of prepaid VAT, there is generally nothing to remit before the resale.

Instead of the former frontier formalities, within the EU a control system recording all intra-EU-imports and -exports is established, e.g. the so-called European VAT identification number which you need in connection with intra-EU imports or exports.

6. Other Taxes

In the following we briefly outline some other taxes which may arise from your business activities. Detailed information about these taxes should be obtained from a professional tax consultant.

The **real estate transfer tax** (Grunderwerbsteuer) arises in case of the sale or other transfer of land and buildings. The tax rate is 3.5 per cent of the valuable consideration or the value of the land and buildings.

The **real estate tax** (Grundsteuer) is collected by the municipal authorities. Tax objects are land and buildings. The tax rates vary depending on the levy rates of the municipal authorities. In Hamburg the 2005 rate based on a municipal rate of 540 per cent is normally 1.9 per cent annually of the tax basis for business land and buildings (quarterly payments). Basis for this taxation are special values of land and buildings which are significantly below market value. The tax is deductible as business expense.

The **payroll/wage tax** (Lohnsteuer) is to be withheld from the payment of salaries and wages to the employees. The amount of wage tax withheld as well as solidarity surcharge and church tax (if applicable) must be paid by the company to the tax authorities. Also the legally prescribed social security levies (employer's and employee's shares) must be withheld and paid to the statutory bodies. More detailed information is in section VI. (page 24).

7. Special Issues

Hidden Profit Distributions

All transactions between the corporation, its shareholders and affiliated companies or persons under tax aspects have to pass the "arms-length" test, i.e. the terms and conditions for all intercompany transactions, especially prices, must be the same as those agreed upon with independent third parties. The taxable profit of a corporation therefore cannot be reduced by transactions which are not appropriate under tax aspects or actually not carried out. These matters are more and more critically reviewed by the German tax auditors.

Losses

Losses may be carried forward indefinitely and carried back one year (exempt trade tax). The loss carry-forward and carry-back are only available to the company which has incurred this loss. The loss carry-back for the time being is limited to € 511,500, the loss carry-forward annually usable is limited as well: annually up to € 1,000,000, but additionally 60 % of the remaining annual positive income.

Affiliated Companies

Considerable tax advantages apply when one or more German corporations, the subsidiaries, are all year round financially integrated (VAT: also economically and administratively) into another German company from the beginning of their fiscal year and a written profit and loss pooling agreement (Ergebnisabführungsvertrag) has been concluded for at least five years. This relationship is commonly called “Organschaft” (integrated companies/organic unity).

In this event, the profit of a subsidiary company accrues directly to the parent company and is only taxed by the parent company (VAT, corporation income tax and trade tax). A loss of a subsidiary company will be offset against any profits of other integrated companies or the parent company which may decrease total tax payments and increase the liquidity position of the organic unity. If the above contract (Ergebnisabführungsvertrag) is missing, the organic unity is only applied for VAT purposes.

An organic unity accepted under tax aspects can be established earliest for that fiscal year when the profit and loss pooling agreement is actually registered in the trade register.

Under certain conditions also foreign corporations and partnerships can establish an organic unity and act as the holding company for this purpose.

Affiliated national and international companies have to keep specific records for deliveries or services among each other. Through this obligation the tax authorities intend to have the basis for comprehensive reviews of the **inter-company pricing**. If the obligations of documentation should be infringed, special surcharges provided in the law shall move the companies to an appropriate collaboration with the tax authorities.

IV. COMPANY - EMPLOYEES RELATIONSHIPS

1. Tax Relationship

The employees of the company are subject to the payroll/wage tax levy (Lohnsteuererhebung). The wage tax is a withholding tax for salaries and wages and represents a kind of prepayment for the personal income tax payable annually on the employee's entire taxable income.

The company is obligated to withhold this tax from the monthly cash salary payment (gross wage) and other taxable benefits under the employment contracts, and to report and remit this tax to the tax office (additionally solidarity surcharge and - if applicable - church tax).

Many of the foreign companies operating in Germany apply the "net-after-tax-system" ("Nettolohnvereinbarung") in compensating their foreign employees. This system means that a net salary is granted, whereby the employer pays all related German income (wage) taxes and social security levies (employer's and employee's shares) connected with the employment. Under certain conditions the employee's share of the old age pension insurance can be refunded after the return to his/her home country. You will find further information about the German social security system under 2. and in chapter VI. (page 24).

Employees of a company domiciled in Germany must submit a wage tax card (Lohnsteuerkarte). Based on this card the wage tax is calculated. The annual income from employment and the taxes and contributions withheld are reported directly by the employer to the financial authorities for the employee's annual personal income tax return.

The wage tax card is issued by the municipality where the employee is registered with his domicile. The application for the card may be made personally or by an authorised person (e.g. the employer). The application does not require any form, but the following documents must be submitted:

- passport
- stamped copy of German registration form
- work permit, if applicable
- birth certificate, also of spouse and of children, if any.

2. Social Security Relationship

The German social security system includes the following insurance provisions:

- a) compulsory old age insurance
- b) unemployment insurance
- c) health insurance
- d) care insurance
- e) workmen's compensation insurance.

It applies generally to all individuals employed by an employer domiciled in Germany.

The contributions to the workmen's compensation insurance are fully payable by the employer. The contributions to the insurance (lines a) to d) above) are to be paid half by the employee and half by the employer. Starting from July 2005, employees have to bear an additional health insurance contribution.

Basis of the contributions are the employee's earnings. Percentage rates and the maximum limits to the contributions annually and monthly are listed under chapter VI. (page 24).

Insurance contributions (lines a) to d)) must be withheld from the monthly salary payment and the benefits which are inside the scope of the German social security system under the employment. They are to be reported and remitted to the social security institutions

In very special cases foreign employees working in Germany may not be subject to the German social security system: e.g. if the employment with the foreign parent company continues, and if the employees are delegated to the German subsidiary under this employment contract for a limited period of time (delegates, e.g. technicians who are visiting the German subsidiary for e.g. three months to train German employees in changes of the repair facilities for new products). With several foreign countries there are social security treaties existing which regulate the delegation of employees.

3. Legal Relationship

German labour law is not easy to handle - there is no standard "Labour Law Code". The regulations are included in many individual laws. The following is therefore limited to a few particularly important points.

In accordance with the Labour-Management Relations Act (Betriebsverfassungsgesetz), the employees of companies with normally at least five employees which are entitled to vote have certain limited rights of participation in business and personal matters, affecting employee benefits.

In this connection the most important institution for foreign firms is the works council (Betriebsrat). The works council is elected by request of one or more employees. Employees are entitled to vote when they are 18 years old and are not managerial employees. The employer cannot prevent the election of a works council. It is not possible to terminate members of a works council. Works councils have important rights of advising, representation and co-determination in important questions concerning personnel and organisation. In practice, co-operation between management and works council can help to generate a good and productive social and working climate between employer and employees.

For large GmbH-Companies with more than 500 employed persons, a supervisory board must be established. In accordance with the Works Council Bill, one third of the members must be representatives of the employees. The employees' representatives who are elected by the employees have the same rights as the representatives of the shareholders in the supervisory boards. For corporations with more than 2,000 employed persons, a supervisory board with 50 per cent employee representatives must be established.

In the event of sickness the employer must continue payment of the employee's salary for a period of six weeks. After this period, further payment is made from the legal health insurance or an equivalent private health insurance fund, provided that the relevant conditions are fulfilled.

General and/or firm specific or trade union general and compensation collective agreements (Tarifvertrag) exist for many industries and must generally be followed.

In accordance with the Federal law fixing employee holidays (Bundesurlaubsgesetz), each employee is entitled to at least 24 working days (4 weeks – Saturday counts as working day) of paid vacation per year. Generally, employment agreements or union contracts provide for additional paid holidays of up to a total of about 30 days, as well as for a bonus of one month's salary (13th salary) or more.

In addition, there are several other laws and special regulations which give certain groups of employees special rights (e.g. motherhood holidays, educational holidays, employer's obligation to rehire an employee who has completed his term of duty in the army).

V. TAXATION OF INDIVIDUALS

1. Individual Income Tax

a) General

Three taxes are affecting an individual's earned income - the personal income tax (Einkommensteuer), the solidarity surcharge (Solidaritatzuschlag) and, if applicable (member of a qualifying church), church tax (Kirchensteuer). The wage tax (Lohnsteuer) as withholding tax for salaries and wages represents a prepayment of the personal income tax.

Individuals are normally required to file their annual individual income tax return in Germany until May 31 (September 30 if filed through a tax consultant) of the following calendar year. The filing date can usually be extended upon application.

There is no obligation to inform the tax authorities of the arrival in Germany.

Married taxpayers should normally file a joint tax return if both spouses are subject to unlimited taxation (for non-EU- or EEC-citizens if the spouse is also living in Germany; for EU- or EEC-citizens, if the spouse is living in the EU or EEC). In this case the tax is calculated at a lower rate, the so-called "splitting rate for married persons".

For children certain exemptions are granted for income taxation. The exemptions are specified under d) below. However, a family allowance (Kindergeld) is paid upon a written application with the German department for family allowance of the unemployment office.

Church tax is levied on income tax (varying rates: 8 to 9 per cent) of members of certain religious denominations (primarily the Roman Catholic, Lutheran and Reformed Protestant churches).

b) Income from Employment

As far as a “limited” taxpayer is concerned, regarding several tax treaties income from employment in Germany can be exempt from German income tax. Requirements: maximum stay in Germany 183 days per calendar year, payment of the compensation by an employer resident outside of Germany, compensation is not allowed to be borne by a permanent establishment of the foreign employer in Germany. For persons who are members of a German corporation board of directors or supervisory board the above exclusion from the German income taxation does not apply.

Income from employment of persons who are subject to “unlimited“ German taxation is normally fully taxable. However, several expenses in connection with employment are deductible, e.g.:

- commuting expenses (between home and work);
- expenses for an additional household in Germany if the family home is still living outside of Germany;
- travel expenses for visiting the family or certain telephone expenses to keep contact with the family;
- expenses for professional books, magazines or training.

If the expenses in connection with employment do not exceed the amount of € 920 annually, a lump sum of € 920 will automatically be deducted.

c) Income from other Sources

If the taxpayer is subject to “unlimited“ taxation, in addition to the employment income generally the total world-wide income from other sources than employment is taxable. Income from other sources are e.g. dividends, interest income, investment income, rental income, business income, income from partnerships, short-term capital gains etc.

Expenses in connection with earnings from such other taxable activities are normally deductible from the tax base.

Germany has concluded tax treaties with many countries all over the world, under which business income and rental income from foreign sources for an unrestricted taxable individual is generally tax exempt in Germany; if not, a credit for foreign taxes may be available.

The question whether or not the foreign source income of an individual may be exempt from German taxation under the rules of tax treaties must be left to individual advice.

Capital gains or losses from the sale of German private property are generally tax exempt. Exceptions when gains from the sale of private non-business property are considered taxable income are short-term gains from the sale of (not owner-occupied) real estate when sold within ten years after acquisition. Taxable are also stocks and many other investments if sold within one year after acquisition.

The deduction of losses from the sale of such private property is limited to the total amount of short-term capital gains during the same and the following calendar years, a loss carry-back to the preceding year is possible (as far as comparable income is available in the preceding year).

Capital gains from the disposition of German business property and from the sale of shares in a corporation in which the shareholder had an interest, directly or indirectly, of 1 per cent minimum within the last five years are taxable independent of the duration of holding.

As outlined above, the foreign source income of an individual who is subject to “unlimited“ German taxation may be exempt from German taxation under the rules of tax treaties. The specific exemptions must be left to individual advice.

Interest and dividend income received by an unlimited taxable individual from any sources in the world is taxable in Germany. For foreign taxes withheld at source, tax credits with certain limitations are granted.

German banks are obliged to withhold 30 per cent on all interest payments. These amounts will be credited to the annually payable income tax (like the wage tax). You have to fill in an application form of release at your bank to avoid the withholding up to the allowances amounting to € 1.421 for singles and € 2.842 for married persons. Up to these amounts, income from interest and dividends is tax exempt. Each German bank must confirm all your yields in a summarised (annual) certificate.

The review of other income items for possible exemption from German taxation should be done on an individual basis.

d) Taxable Income

The German Income Tax Law provides certain lump-sum amounts for deductible expenses normally incurred by unlimited taxable persons. For example, the lump-sum amount for expenses connected with employment income is € 920 p.a. (Arbeitnehmerpauschbetrag). A lump-sum amount is also available for expenses which are predominantly provisions for the future, the so-called “Special Expenses“ (Sonderausgaben). Special expenses might include contributions to the social security institutions, to a German accident insurance, to a German third party and car liability insurance. You are also allowed to deduct 30 per cent of school fees for private schools as well as expenses for tax consulting. Normally, the deduction of effective special expenses is limited to an amount depending on the family status of the taxpayer. The minimum deductible is the lump-sum amount.

Further lump-sum amounts and limited amounts are provided for expenses which reduce the economical efficiency, so-called “Extraordinary Deductions“ (Außergewöhnliche Belastungen). Extraordinary deductions are e.g. non-reimbursed medical expenses or financial support of individuals. The method of deduction of extraordinary expenses (lump sum or detailed proof of amounts spent) is depending on the category of the expenses.

Other lump-sum amounts are deductible, e.g. an allowance for children in the amount of € 304 monthly and for care-taking of € 180 monthly in the case of married, unlimited taxable persons. This amount is provided only if the tax effect is higher than the payment of the family cash allowance. Children who qualify for these lump-sum amounts are children who have not reached their 18th year of age. For older children, special requirements must be fulfilled (attending school, university, professional training, military etc.).

The following table shows the income tax payable on the 2005 taxable income:

Total Taxable Income 2005 (after all deductions) €	Single Taxpayer*) €	Married Taxpayer without Children *)**) €
7.664	0	0
15.329	1,625	0
20.000	2,850	796
30.000	5,807	3,084
40.000	9,223	5,700
50.000	13,096	8,542
60.000	17,286	11,614
70.000	21,486	14,916
80.000	25,686	18,446
90.000	29,886	22,204
100.000	34,086	26,192
110.000	38,286	30,372
120.000	42,486	34,572

*) The “solidarity surcharge“ of 5.5 per cent of the tax amounts is levied additionally (e.g. € 1,625 income tax plus € 89 surcharge = total € 1,714) and is not included in the above computation.

For members of a church-tax authorised religious community, additionally church tax must be paid (varying rates 8 to 9 per cent of income tax - e.g. € 1,625 income tax plus € 89 surcharge plus € 130/€ 146 church tax = total € 1,844/€ 1,860).

***) Also the spouse must be resident or have his/her customary abode in Germany (for non EU or EEC-citizens) or in the EU or EEC (for EU or EEC-citizens).

The marginal maximum income tax rates are:

beginning with 2004:	45.0 per cent plus solidarity surcharge (and church-tax if applicable)
beginning with 2005:	42.0 per cent plus solidarity surcharge (and church-tax if applicable)

To prepare German individual income tax returns of English speaking individuals, we use a questionnaire in the English language asking for the relevant personal tax data.

2. Other Taxes

Other taxes affecting an individual's income may be those which are described under sections III. 3. (page 8), 5. and 6. (page 11) above.

These types of German taxes arise in connection with certain specific activities of an individual only. For example, if an individual is running a trade or business in Germany, generally Trade Tax and Value Added Tax are levied by the tax authorities. In case of acquisition of real estate located in Germany, a one-time real estate transfer tax of 3.5 % per cent of the acquisition costs will become due. Additionally a reasonable current real estate tax based on the tax value of land and buildings will arise.

VI. SOCIAL SECURITY SYSTEM

Social Security Contribution

The German social security system includes the compulsory old age insurance, unemployment insurance, health insurance, care insurance and workmen's compensation insurance.

The social security charges apply generally to German and non-German employees if employed by an employer domiciled in Germany.

In 2005 contributions to the compulsory old age and unemployment insurance are to be made up to a ceiling of € 62,400 of the employee's annual earnings (monthly € 5,200) at a rate of 19.5 per cent for old age insurance and 6.5 per cent for unemployment insurance resp. up to a ceiling of € 42,300 annually (monthly € 3,525) 1.7 per cent for care insurance. The contributions are payable half by the employee and half by the employer. Under certain conditions the employee's share of the old age insurance will be refunded upon application two years after the return of a foreign employee to his home country.

Generally, the health insurance is compulsory for all employees, except as a rule for those with an expected 2005 income from employment exceeding € 46,800 annually/€ 3,900 monthly. Contributions are paid at varying rates (total approximately 14-15 per cent up to a ceiling of annually € 42,300 (monthly € 3,525), of which each, the employer and the employee, have to pay 50 per cent). Starting from July 2005 employees must pay an additional health insurance contribution of 0.9 per cent.

The employer must still pay the employer's contributions on the above basis of assessment of € 62,400, even if the employee earns more than the ceiling amount of € 62,400 and even if the employee has taken private coverage under the social security system.

The workmen's compensation insurance is compulsory for all employees. Contributions are payable by the employer only.

Special regulations (ceilings) are applicable within the Newly-formed German States (Neue Bundesländer) regarding the old age insurance and unemployment insurance.

Disclaimer

In preparing this publication, every effort has been made to offer current, correct and clearly expressed information. However, this guide can only provide a general information. Readers are encouraged to consult professional advisors before making any decisions. All information without our obligation.

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