

INBOUND INVESTMENT IN GERMANY

DR. CLAUDIA KREBS

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AGENDA

1 Introduction:
Different Types of Taxes

2 Business Investment in
Germany

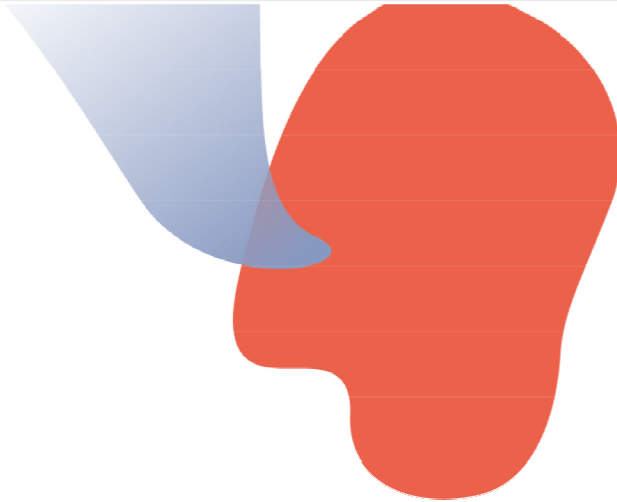
- 2.1 Permanent Establishment
- 2.2 Corporation
- 2.3 Partnership
- 2.4 Comparison of Investment Possibilities
- 2.5 Treatment of losses in German tax law
- 2.6 Limited deductibility of expenses
- 2.7 International aspects
- 2.8 Termination of business activity in Germany

3 Investment in German Real
Estate

- 3.1 Direct Investment
- 3.2 Indirect Investment
- 3.3 Real Estate Transfer Tax

4 Inheritance / Gift Tax

DIFFERENT TYPES OF TAXES



1 INTRODUCTION: DIFFERENT TYPES OF TAXES

Unlimited tax liability



- For individuals with domicile or habitual residence / companies with seat or management in Germany
- Worldwide income is subject to German tax

Limited tax liability


- For all other individuals / companies with German sourced income
- Only German sourced income is subject to tax

1 INTRODUCTION: DIFFERENT TYPES OF TAXES

Individual Income Tax

- For individuals 
- Tax rate: Up to 45 % 
- Tax base: Annual net profit

Corporate Income Tax

- For corporates 
- Tax rate: 15 % (flat rate)
- Tax base: Annual net profit

Solidarity Surcharge: 5,5 % of Income Tax

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1 INTRODUCTION: DIFFERENT TYPES OF TAXES

Trade Tax

- For individuals and companies with commercial activity (levied in addition to IIT/ CIT)
- Tax rate: Approx. 14 % (depends on company seat)
- Tax base: Annual net profit as calculated for IIT/ CIT purpose with certain amendments
 - Limitation of tax deductibility for certain expenses (if overall amount exceeds 100 k EUR):
 - 25 % of interest costs
 - 12,5 % of rental costs for immovable property
 - 5 % of rental cost for movable property
 - 6,25 % of license payments
 - Dividends can be exempted under certain conditions
 - Rental income can be exempted in case of pure leasing activity

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1 INTRODUCTION: DIFFERENT TYPES OF TAXES

Value Added Tax

- Similar to other EU member states
- Tax rate: 19 %

Real estate transfer tax

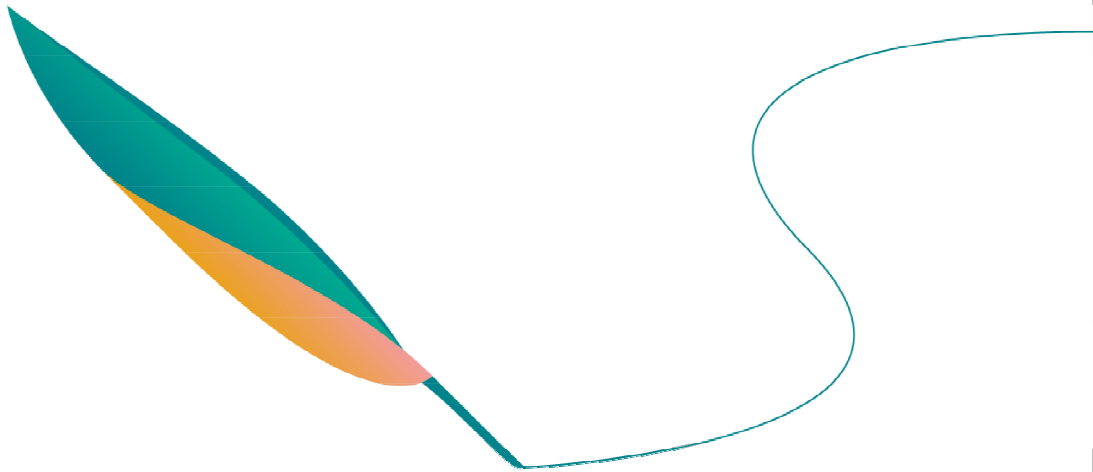
- Tax base: Purchase price / fair market value of property
- Tax rate: From 3,5 % up to 6,5 % (depends on location of the property)
- Also, purchase / transfer of shares in real estate companies can be affected by real estate transfer tax

1 INTRODUCTION: DIFFERENT TYPES OF TAXES

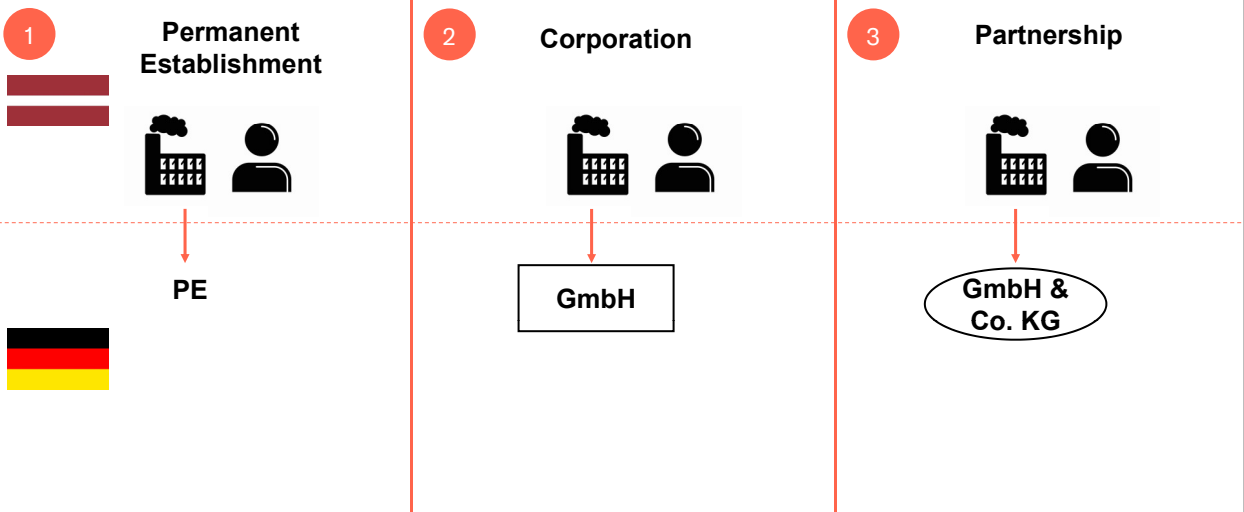
Inheritance / Gift Tax

- For inheritance resp. gifts between individuals
- Tax rate: Depends on family relationship between the heir/decedent resp. donor/donee and amount of inheritance/ gift (from 7 % to 50 %)
- Tax base: Amount of inheritance/ gift
 - Cash: Nominal value
 - Property: Different valuation methods
 - Companies: Different valuation methods and exemptions for business assets

DIFFERENT POSSIBILITIES TO INVEST



DIFFERENT POSSIBILITIES TO INVEST



2.1 PERMANENT ESTABLISHMENT

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PE



- General criteria for a permanent establishment:
 - Business activity
 - Fixed place of business
 - Business carried out through this fixed place of business
 - Permanent establishment includes e.g.
 - Location of management
 - Offices
 - Factories
 - Branches
- Specific PE scenarios:
 - Construction PE: Construction activity that exceeds a certain period of time (e.g. in DTA Germany-Latvia: 9 months)
 - Agency PE: Agent acting on behalf of an enterprise, who has the authority to conclude contracts in the name of the company (currently under discussion)

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2.1 PERMANENT ESTABLISHMENT

1



PE



- Leads to limited tax liability in Germany
 - Income generated by PE is subject to German IIT or CIT (considering DTA in force)
 - For purpose of determining the profit attributable to German PE, the PE has to be treated as a separate legal entity
- own accounting obligations for tax purpose
- Business between the PE and Latvian company has to be considered and calculated at arm's length principle

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2.2 CORPORATION

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NON-TRANSPARENT ENTITY FOR TAX PURPOSES



GmbH



- Corporations (GmbH/ AG) are subjects to CIT in Germany
 - The level of the shareholder has to be considered separately
- Tax burden:
 - Level of corporation
 - Corporate income tax plus solidarity surcharge (~16 %)
 - Trade tax (~14 %)
 - Overall tax burden at the level of the company: ~30 %
 - Level of shareholder
 - No taxation if earnings are retained at the level of the company
 - Dividend distribution/ removal of business assets (e.g. cash): Taxation of net dividend in the amount of 25 % (flat rate) (total tax burden: ~48 %)
 - Tax rate can be reduced due to DTT or Parent – Subsidiary Directive
- The behavior between the shareholders and the corporation has to be in the same manner as between independent parties (i.e. conclusion of agreements, calculations of payments made between each other)

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2.3 PARTNERSHIP

3

TRANSPARENT ENTITY FOR TAX PURPOSES



GmbH &
Co. KG



- Leads to limited tax liability in Germany
 - Income with German source is taxable (considering DTA in force)
- Partnerships (OHG, KG, GmbH & Co.KG) are treated as transparent entities for tax purposes in Germany
 - Partnership itself is only subject to trade tax
 - The shareholders of the partnership are subject to tax with the profit generated by the partnership based on their share in the partnership
 - Individual as partner → IIT
 - Corporation as partner → CIT
 - plus solidarity surcharge
- Withdrawal/ distributions by the shareholder are not subject to further taxation

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2.4 COMPARISON OF INVESTMENT POSSIBILITIES

TAX DIFFERENCES THROUGH CHOICE OF LEGAL FORM (ONLY TAX BURDEN IN GERMANY)

	PE		Corporation		Partnership	
	Investor = Latvian Individual	Investor = Latvian Corporation	Shareholder = Latvian Individual	Shareholder = Latvian Corporation	Shareholder = Latvian Individual	Shareholder = Latvian Corporation
Retained earnings	47,48%	29,83%	29,83%	29,83%	47,48%	29,83%
Distributed earnings			40,36%			

2.6 LIMITED DEDUCTIBILITY OF EXPENSES

- Interest barrier rule
 - Net interest costs (interest costs less interest income) above 3 million EUR are only deductible up to 30 % of EBITDA
 - Exceptions:
 - Companies that do not belong to a group
 - Group companies that have an equity ratio not lower than group equity ratio
 - Approach considers interest costs and EBITDA for multiple periods (can be carried forward)

- Royalty restriction
 - Partial prohibition of deduction for royalty expenses, if certain criteria are fulfilled:
 - License payments between related parties (at least 25 % of shares)
 - Anomalously low taxation (preferential regime with less than 25 % (effective tax rate)
 - Exception: Nexus-approach (licensor does have enough substance and research activity)

2.7 INTERNATIONAL ASPECTS

- Dividends
 - According to German tax law (based on Parent-Subsidiary Directive of the EU) there is no withholding tax on dividends if the following requirements are fulfilled:
 - German subsidiary and foreign parent company are both corporations
 - Parent company directly holds shares of domestic subsidiary of at least 10 % for a period of minimum 12 months
 - If the criteria above are not fulfilled, withholding taxes on dividends are limited according to the DTA Germany-Latvia in the amount of
 - 5 % if parent company holds shares of at least 25 %
 - 15 % in all other cases

2.7 INTERNATIONAL ASPECTS

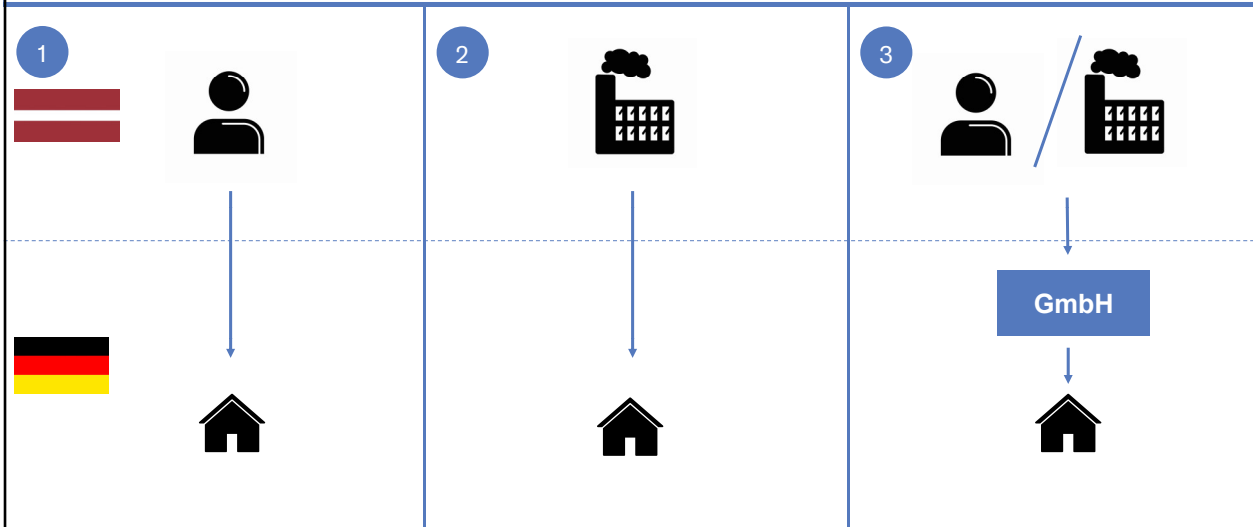
- Interest / Royalties
 - According to German tax law (based on Interest and Royalties Directive of the EU) there is no withholding tax on interests and royalty payments under the following circumstances:
 - German subsidiary and foreign parent company are both corporations
 - Parent company holds shares of domestic subsidiary of at least 25 %
 - If the criteria above are not fulfilled, withholding taxes on dividends are limited according to the DTA Germany-Latvia in the amount of
 - Interest: 10%
 - Royalties:
 - 5% in the case of license payments for the use of industrial, commercial or scientific equipment
 - 10% in all other cases

2.8 TERMINATION OF BUSINESS ACTIVITY IN GERMANY

- The right of taxation of capital gains results from the termination of business activity depends on the legal form of the entity in Germany
 - Permanent establishment & Partnership:
 - Capital gain is subject to tax in Germany according to DTA Germany-Latvia
 - Corporation:
 - Capital gain is not taxable in Germany according to DTA Germany-Latvia

3 INVESTMENT IN GERMAN REAL ESTATE

DIFFERENT POSSIBILITIES TO INVEST



3.1 DIRECT INVESTMENT

1

PURCHASE OF GERMAN REAL STATE BY A LATVIAN INDIVIDUAL (private assets)



- Taxation of current income
 - Rental income is subject to limited tax liability in Germany
 - Subject to individual income tax plus solidarity surcharge
- Sale of domestic property
 - Tax-exempt when holding period of more than 10 years
 - Exception: Commercial property transaction (in general when 3 properties are sold within a 5-year period)
 - Capital gain is subject to income tax plus solidarity surcharge

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3.1 DIRECT INVESTMENT

2

PURCHASE OF REAL STATE BY A FOREIGN COMPANY



- Taxation of current income
 - Income with German source leads to a limited tax liability in Germany
 - Lease of domestic property
 - Subject to corporate income tax plus solidarity surcharge
 - Trade tax would only be charged if there is an additional commercial activity (like e.g. caretaking or cleaning activities)
- Sale of domestic property
 - Subject to corporate income tax plus solidarity surcharge

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3.2 INDIRECT INVESTMENT

3

PURCHASE OF REAL STATE BY A GERMAN SUBSIDIARY



GmbH



- Corporation with seat or management in Germany leads to an unlimited tax liability in Germany
- Lease of domestic property
 - Subject to corporate income tax plus solidarity surcharge
 - Trade tax would only be charged if there is an additional commercial activity (like e.g. caretaking or cleaning activities)
- Sale of German real estate by GmbH → see slide 22
- Sale of shares in German GmbH
 - Consequences depend on legal form of shareholder of German subsidiary:
 - Corporation: Corporate income tax plus solidarity surcharge
 - Individual: Individual income tax plus solidarity surcharge

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3.3 REAL ESTATE TRANSFER TAX

DIRECT TRANSFER OF LEGAL TITLE TO REAL ESTATE

- Transfer of property:
 - Subject to property transfer tax in the amount of 3,5 % up to 6,5 % of the purchase price (depends on location of the property)
- Exception: Transfers within family (also inheritance/ gifts)
- Expenses are additional purchase costs

DIRECT OR INDIRECT TRANSFER OF INTERESTS IN A PARTNERSHIP

- Transfer of shares will be deemed as a transfer of the real estate itself and thus be subject to real estate tax, if
 - 95% or more of the shares are transferred
 - within a period of 5 years

DIRECT OR INDIRECT TRANSFER OF STAKE IN A PARTNERSHIP OR CORPORATION TO ONE PERSON

- Transfer of a real estate holding partnership or corporation is subject to real estate tax if
 - At least 95% of the stakes are transferred
 - Stakes are transferred in a single transaction

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3.3 REAL ESTATE TRANSFER TAX

DIRECT OR INDIRECT UNIFICATION OF STAKE IN A PARTNERSHIP OR CORPORATION BY ONE PERSON

- Transfer of a single or multiple stakes of a real estate holding partnership is subject to real estate tax if
 - 95% of the stakes in the estate holding partnership / corporation are unified in the hand of one person
 - single person, a group or controlling corporation and one or more controlled corporations
 - Transfer is sufficient if 95% stake will result in the person / group receiving the stake after transaction

DIRECT OR INDIRECT TRANSFER OF ECONOMIC PARTICIPATION

- Real estate transfer tax is triggered, if
 - A person holds directly or indirectly 95% or more of the shares in a corporation or interests in a partnership as a result of transaction or measure
 - Even if less than 95% is transferred within this transaction

CURRENT DEVELOPMENTS

- Legislator efforts to implement more stringent standard
 - In future already purchase of 90 % of shares within a 10-year period shall be enough to trigger real estate transfer tax
 - Concrete provisions are not available yet



STRATEGIC SUCCESSION PLANNING

Unlimited tax liability

- If the deceased / donor or beneficiary / donee is resident in Germany worldwide assets are subject to German tax

Limited tax liability

- Otherwise only domestic assets are subject to tax
- Domestic assets include e.g.
 - Land and buildings
 - Business property of a permanent establishment or such property owned through a permanent agent in Germany
 - Shares in a resident company (AG/ GmbH) if the non-resident shareholder, alone or together with related persons, has a direct or indirect interest of at least 10%

4 INHERITANCE / GIFT TAX

TRANSFER OF DOMESTIC BUSINESS ASSETS OR COMPANY SHARES

- In general subject to inheritance / gift tax
- Under certain conditions a tax exemption can be reached:
 - Value of maximum 26 million EUR per acquisition (in case of higher value tax exemption melts down – only operative assets are exempted)
 - Retention period of seven resp. five years
 - Continuation of wage payments in the same amount compared with status quo within the retention period
- Otherwise: Fair value of business assets decisive for determination of tax base
 - Primary determination through transactions made by third parties
 - Alternative: Calculation through discounted cash flow method

4 INHERITANCE / GIFT TAX

TAX ALLOWANCES

- Depends on the relationship of the decedent / donor to the heir / donee

Relationship	Tax Allowance
Husband	500.000 EUR
Children	400.000 EUR
Grandchildren	200.000 EUR
Parents and grandparents	100.000 EUR
All other persons	20.000 EUR

4 INHERITANCE / GIFT TAX

TAX RATES

Amount of Inheritance/ Gift	Tax Rate		
	Tax Class 1 (Husband, Children, Grandchildren, Parents, Grandparents)	Tax Class 2 (Siblings and their Children, Step-parents, Parents-in-law, Children-in-law, Divorced Husbands)	Tax Class 3 (All other Persons)
Up to 75.000 EUR	7 %	15 %	30 %
Up to 300.000 EUR	11 %	20 %	30 %
Up to 600.000 EUR	15 %	25 %	30 %
Up to 6.000.000 EUR	19 %	30 %	30 %
Up to 13.000.000 EUR	23 %	35 %	50 %
Up to 26.000.000 EUR	27 %	40 %	50 %
Over 26.000.000 EUR	30 %	43 %	50 %

