

## Expatriates

### Overview

- 1 INTRODUCTION**
- 2 ENTRANCE VISA AND WORK PERMIT**
- 3 DETERMINATION OF SALARY PACKAGE**
- 4 CONTRIBUTIONS TO THE GERMAN SOCIAL SECURITY SYSTEM**
- 5 GERMAN RULES OF APPLICABLE LABOUR LAW**
- 6 GERMAN INCOME TAX RULES**
  - 6.1 UNLIMITED LIABILITY TO GERMAN INCOME TAX
  - 6.2 LIVING ABROAD, WORKING IN GERMANY?
  - 6.3 EXIT TAX?
  - 6.4 INCOME AND DEDUCTIBLE EXPENSES
    - 6.4.1 *Calculation of Income*
    - 6.4.2 *Deductible Expenses*
      - 6.4.2.1 Job related expenses
      - 6.4.2.2 Special deductible expenses
      - 6.4.2.3 Extraordinary expenses
    - 6.4.3 *Tax rate*
    - 6.4.4 *Filing of Tax return and payment of tax*
  - 6.5 NO WAGE TAX?
  - 6.6 SPLIT OF INCOME BETWEEN SEVERAL COUNTRIES

## 1 Introduction

Foreign investors desirous to expand their business to a foreign country are faced with numerous problems; in fact, it appears that the challenge is as demanding as the establishment of an altogether new business, at home, except for the fact that they know their products and services which have already evidenced their success at home, and which gives some confidence in similar performance abroad. However, even if so, it may very well be necessary to adapt the product, the packaging, the marketing strategy or other to the different expectations of clients and consumers abroad.

Amongst the decisions to be made is the one in which form the business abroad shall be run. In case Germany is the target country, a whole variety of forms are available, starting from the employment of an independent sales agent for the rather simple import of your products, via the representative office or branch (registered with the trade register or not) to the establishment of a subsidiary, all of which have distinct advantages and disadvantages over the other and having consequences on the economic performance. As a rule, one may anticipate that the more complex the structure, the higher are the start up costs, but the higher the overall profit may be.

At a given stage of the expanding process, the entrepreneur may like to profit from the knowledge and expertise of his staff, abroad, and he decides to send some of his managers or other to Germany. Again, some additional questions arise, amongst which are: 1) Entrance Visa and work permit regulations, 2) determination of the income of your

employee with regard to contributions to the social security system, the taxation of income, exit tax regulations at home and in Germany.

## **2 Entrance Visa and work permit**

As a rule, any foreigner desirous to commence a remunerated employment in Germany is required to apply for a visa, unless he is a national of one of the EC – Member states who enjoy the unrestricted liberty of settlement. Hence, it may be a good idea to detach someone who holds a passport of such member state.

In the negative, the visa allowing a dependent employment in Germany must be applied for, generally at the German Embassy or Consulate General of the country of departure. Unfortunately, this visa is granted only under the condition that the respective work permit is issued by the locally competent labour authority (“Arbeitsamt”) of the City where the employment shall be performed. In case the applicant has special knowledge in the field of information technology evidenced by respective university degrees, is going to work for a German based employer, and will earn at least 39,600 € per year, the employee may file an application for the “Green Card” which form (in the German language, however) he may find on the INTERNET at [www.arbeitsamt.de](http://www.arbeitsamt.de).

The “Green Card” is a provisional work permit which guaranties the issuance of the final work permit, and upon which the entrance visa is granted. Within three months, the final work permit must be applied for on a special form, and which is granted for a limited period of time. Likewise, the visa is granted for the same period, by the locally competent foreign police (“Ausländeramt”) where the employee is going to take his residence.

Essentially, the work permit is granted on the basis of interest of and necessity for the German labour market, in general. The conditions vary from time to time, and with respect to the nationality of the applicant.

After his arrival in Germany, the employee is held to register his residence with the City (“Einwohnermeldeamt”) by presentation of the rent contract with his landlord, as all Germans have to do. At the same time, he should apply for the form fixing the conditions to impose wage tax (“Lohnsteuerkarte”) according to his marital status, number of supported children, and religious believe to impose church tax.

## **3 Determination of salary package**

The determination of the salary is one of the most difficult tasks of staff management as quite a number of contrasting interests have to be taken into account. The task is even more complex in the case of expatriates: the employee quite understandably expects to sort of keep the standard of living he is accustomed to, at home, and which he can afford by his current income; differences in buying power in general, and different spending habits abroad may make the realisation of this goal quite expensive. In addition, the employee may expect the coverage of some additional costs for his family which are caused by his being stationed abroad (language courses, tuition fee for an international [boarding] school, and some others).

In practice, it appears adequate to agree on some “net spendible income” near the income of an employee in a comparable position at home, and to add those additional

costs on a net basis which the employer is prepared to bear. This total net package should then be topped up by such additional amount as is necessary to pay for the unavoidable tax and other burdens, all of which may add up to rather astonishing amounts per year. As the total costs of employment depend in part on the taxes and duties due abroad, the back ground information below may assist to better determine such costs.

#### 4 Contributions to the German Social Security System

Any person employed in a dependent position by an employer based in Germany, and regularly executing his employment in Germany, i.e. having his or her regular place of work in Germany, is liable to contribute to the German social security system. The contributions comprise:

For the year 2002:	Contribution in % of salary	Up to gross salary p.a.
Health insurance	Ca. 13.5 %	40,500 €
Old age & care insurance	1.7 %	40,500 €
Pension scheme	19.1 %	54,000 €
Unemployment benefits	6.5 %	54,000 €
<b>Total:</b>	<b>40.8 %</b>	

When commencing his work, the employee must select one of the legal health insurance companies, amongst which he can freely choose. As the basic coverage is fixed by law, one may very well select the one with the lowest premiums. However, as the coverage is basic, though altogether adequate, the employee may like to take an *additional* private health insurance for some additional comfort (e.g. dental work, single room in hospital) and personal care and attention by the MP or in hospital.

If the monthly salary is in excess of the base sum quoted in the above list, the employee may as well choose to entirely opt out of the legal health insurance and take full coverage from a private insurer: the rather high contributions to the legal system are in part caused by the fact that the entire family of the employee is covered (wife plus any number of dependent children) whereas the private insurance is taken on a person by person basis. Thus, if the employee is single or married without children, opting out may be a good choice; however, it is important to note that there is no way to get back into the legal system, once left.

In many cases the employee will have a private health insurance at home. In such case it may be wise to either extend the coverage to his stay in Germany, or to apply for an interruption of this contract rather than a reciliation, thus avoiding a health check with higher premiums or exclusion of risks upon his return home.

The employer is responsible to file the necessary applications to the various insurance bodies, preferably prior to the payment of the first salary.

Both employer and employee have to bear one half of the contributions. If the employee has opted out of the legal health insurance scheme, he is entitled to an income tax free payment of one half of his premiums, up to one half of the average contributions to the

legal health insurance scheme. Premiums to the above mentioned additional private health insurance must be fully paid by the employee.

The liability to the German social security system is expanded to cases where the regular place of work in Germany is transferred abroad, for a period of time limited in advance, or to perform a special, pre-defined project. Thus, German workers on construction sites abroad or experts in the various fields of aid for development may continue their membership in the system and profit from its advantages.

Similarly, and for the expatriate much more interesting, the system excludes cases where the regular place of work outside Germany is transferred into Germany, for a period of time limited in advance, or to perform a special, pre-defined project. Generally, such period of time is defined in the bilateral conventions on the social security system, as regularly amended, which Germany has concluded with quite a number of foreign states. Whereas the older conventions provide for a 24 months' period, the more recent ones provide for a period of 60 months.

Such a transfer of employment is particularly attractive for both the foreign company which indirectly or directly has to bear the employer's part of the contributions, and the employee who will generally have no return from his contributions: the number of monthly payments is usually too small to qualify for any payments from the system (except for the health insurance), and they may at best be added to the total of months contributed in his home system – if this at all of interest. (Within the EC – Member states, the situation is generally different!).

The transfer of employment requires a special agreement between the current employer, abroad, and the employee, preferably in writing for evidence purposes vis-à-vis the German authorities. The most important clause is that employer and employee keep their respective positions during the stay in Germany, in particular that the current employer continues to pay the salary, and that the employee continues to report to a superior in the company of the employer.

Upon the expiration of the fixed period, the same may be started in another EC – Member country where the employer maintains an additional business as nearly all EC – Member states have similar rules; however, this must definitively be checked locally, well in advance.

## **5 German Rules of Applicable Labour Law**

Parties are generally free to determine the applied labour law, however, within the limits of public policy ("ordre public"). An additional limit is provided by art. 30 of the Introductory Code of the Civil Code: the application of any foreign law may not set aside the obligatory rules and regulation of the law of the state where the labour is performed, i.e. German labour law rules.

Apart from some rules of public health and safety, sanitary regulations, accident avoidance rules and some others applicable only in special jobs, the following rules appear to be of general interest to the foreign employee and employer:

- a) fully paid sick leave,
- b) fully paid maternity leave,

- c) additional leave for young mothers,
- d) special rules for employees' inventions,
- e) rules on office / factory hours per day / week,
- f) restrictive rules governing the termination of the labour contract,
- g) post contract anti competition clauses are valid only against payment of damages.

Interestingly enough, clauses in collective bargaining agreements may be set aside by the agreement on a foreign labour law.

## 6 German Income Tax Rules

### 6.1 Unlimited Liability to German Income Tax

Upon his arrival in Germany, the transferred manager will become liable to German income tax on an unlimited basis, i.e. on his entire, world wide income, as he is going to establish his residence in Germany in the terms of sec. 8 Taxes and Duties Procedure Act<sup>1</sup>, at least because he is going to have his habitual abode in Germany, in the terms of sec. 9 of the act, because his stay is going to last more than 183 days.

German income tax is assessed for the entire fiscal year identical with the calendar year. However, if the liability to German income tax starts only in the course of the year, only the income received from the arrival until the end of that calendar year will be considered; thus, the rather high progressive tax rate on the higher income (for the entire year) can be avoided.

When moving abroad, people usually have quite a number of additional expenses which the employer may like to refund, but which may not or only in part be tax deductible, in Germany. Consequently, it may be a good choice

- a) to settle in Germany as late in the year as possible, and to enjoy the comparatively low tax rates at home, and
- b) to have as many expenses as possible refunded to the employee before his arrival in Germany.

### 6.2 Living abroad, working in Germany?

A number of tax payers working in the area of Duesseldorf / Cologne choose to live in neighbouring Belgium or Netherlands, and commute daily to their office. Despite their residence abroad, by application of sec. 1 para. 3 Income Tax Act, such tax payer may apply to be liable to German income tax on an unlimited basis

- a) if at least 90 % of the entire income of the tax year is subject to German Income Tax, or

---

<sup>1</sup> Although the German title of the act „Abgabenordnung“ refers only to duties, the main importance of the act is the regulation of the administrative procedure on the assessment of any tax; hence, I choose a translation which appeared to better reflect the broader application of the act.

b) if income from sources outside Germany does not exceed 6,000 €

At first sight, the clause appears to have some disadvantage. However, the clause ensures that the tax payer will profit from all advantages the law provides for national tax payers, and which are not applicable for tax payers living abroad, in particular their marital status and the number of their dependent children.

### 6.3 Exit Tax?

A number of countries impose an exit tax when a tax payer is going to leave. Usually, the exit tax can be avoided if some liens to the country are kept; those liens are generally referred to as “centre of living interests”. It is noteworthy that the establishment of one residence or of the habitual abode in Germany, in the terms of the German law, does not necessarily lead to give up the residence on the country of departure. In any case, special care should be taken to avoid such exit tax at home, as it may turn out to be excessively costly.

### 6.4 Income and deductible expenses

#### 6.4.1 Calculation of Income

The Income Tax Act deems income from dependent services all and any remuneration in cash or in kind that is actually received in connection with the employment. Obviously, the salary qualifies in first place.

In addition, the employer may like to grant a company car: unless there are very strict, evidenced rules in writing which are meticulously observed throughout the year, the tax authorities take a private use of the company car for granted for which 1% of the average retailer’s list price<sup>2</sup> is added to the income. In addition, a lump sum of 0,XX € per kilometer of distance for commuting is added.

If the employer rents a house for his staff, such rent is added to his income, including consumables or not, as the case may be.

With due regard to the limited stay in Germany, and depending on the age of the employee’s children, it may be advisable not to send the children to one of the state run schools in Germany, but to a private institution in Germany or abroad for which considerable tuition and boarding fees, if applicable, are due. Obviously, those fees are added to income if directly born by the employer; in theory, this is true even in cases where the children will be going to an institution outside Germany some of which offer quite openly “off shore” payment facilities, whatsoever this might mean, in practice.

---

<sup>2</sup> Any kind of discount etc. is disregarded, as is any special equipment, e.g. cell phone.

## **6.4.2 Deductible Expenses**

### 6.4.2.1 Job related expenses

As a rule, the employee may deduct from his income all expenses that he makes in connection with his employment and which are not primarily influenced by his private or social life (so called "Werbungskosten"). Expenses for investments are fully deductible if the cost of acquisition are lower than 400 € (e.g. printer for the lap top); in other cases, the costs must be written off for the anticipated economic life time of the item (e.g. personal computers during four years). As cryptic and vague the rule is, as abundant are jurisprudence and scholarly writings on this topic, as for quite obvious reasons tax payers are very much inclined to label as much as possible of their life style expenses as necessary, at least as useful for their job.

As far as expatriates are concerned, the following items are of special interest:

- a) Any and all expenses incurred to establish the unlimited liability to German Income Tax are deductible, i.e. in particular all transportation costs for the household, car, and air fare for the employee and his family, as evidenced by invoices or receipts. Although there does not exist an explicit limit, there appears to exist some kind of implicit limit beyond which the expenses go beyond any reasonableness. Interestingly enough, the very same applies when the tax payer leaves Germany at the end of his term.
- b) According to sec. 3 no. 16 Income Tax Act, any tax payer may receive from his private employer such payments free of income tax which corresponds to the amounts paid tax free to public servants, by their authority. As far as expatriates are concerned, the regulations of the "Decree on Expenses for International Relocation"<sup>3</sup> enacted for German diplomatic staff posted abroad, are of particular interest. The Decree provides for a number of lump sum payments for various items which the public servant is entitled to receive free of income tax. Such items are:
  - (1) Damages for rent (sec. 5)
  - (2) Contract costs housing (sec. 6)
  - (3) Subsidies to acquire house hold appliances (sec. 7)
  - (4) Language courses for children (sec. 8)
  - (5) Renovation costs for the new home (sec. 9)
  - (6) Lump sums for miscellaneous expenses (sec. 10)
  - (7) Subsidies to acquire clothing (sec. 11)
  - (8) Subsidies for equipment (sec. 112)
  - (9) Subsidies for furniture (sec. 13)
- c) Unfortunately, the Federal Tax Court ruled that employees of private (not public) employers are entitled to get such payments free of income tax only to the extent that the payment actually covers expenses incurred in connection with the

---

<sup>3</sup> Auslandszugskostenverordnung of May 4th, 1991, Federal Gazette 1991, p. 1072, as amended, see Federal Gazette 2001, 4159

employment and which are not primarily influenced by his private living expenses.

#### 6.4.2.2 Special deductible expenses

Every tax payer is entitled to deduct some special expenses from his income, be it in full (e.g. expenses for tax consulting, church tax, donations to charitable institutions), be it up to certain maximum amounts (e.g. premiums for health insurances and – under certain additional conditions – for life insurances).

Regretfully, only 30% of tuition fees can be deducted if paid to a recognised school. Such limitation is particularly annoying as the German school system – totally irrespective of its arguable merits – appears to be somewhat inadequate for children of expatriates as the limited stay in Germany is not really motivating to learn the German language. Thus, one of the privately funded international schools in Germany or a boarding school abroad appears to be the better choice.

#### 6.4.2.3 Extraordinary expenses

On a rather restricted basis, some unusual extraordinary expenses may be deducted, e.g. subsidies for relatives in need, and few others.

### **6.4.3 Tax rate**

You will find the exact way to calculate the income tax on [this site](#) of the home page. Below is reproduced only the income tax on some selected amounts of taxable income:

Taxable income	<b>Single Tax payers</b>		<b>Married Tax payers</b>	
	Tax payable	= Tax rate	Tax payable	= Tax rate
10,000	611	6.110		
20,000	3,235	16.175	1,222	6.110
30,000	6,418	21.393	3,706	12.353
40,000	10,158	25.395	6,470	16.175
50,000	14,440	28.880	9,514	19.028
60,000	19,225	32.041	12,836	21.393
70,000	24,078	34.397	16,436	23.480
80,000	28,932	36.165	20,316	25.395
90,000	33,786	37.540	24,476	27.195
100,000	38,623	38.623	28,880	28.880
110,000	43,477	39.524	33,596	30.541
120,000	48,330	40.275	38,450	32.041
130,000	53,184	40.910	43,304	33.310

The income tax on income in excess of 55,008 € (110,016 € for married tax payers) is 48.5 % of the income minus 9.872 €, in 2003.



#### **6.4.4 Filing of Tax return and payment of tax**

Any individual resident in Germany is held to file an income tax return with the tax authority ("Finanzamt") competent for his place of residence, until May 31<sup>st</sup> of the calendar year following the year in which the income was received. If the tax return is prepared by a tax consultant or chartered accountant, the dead line is extended until Sep. 30<sup>th</sup>; upon special application, the dead line is further extended until the end of February of the second year following.

Depending on the work load of the tax authority, the tax assessment is serviced within four weeks up to some months after filing. Usually, a period of four weeks is granted until the assessed payment is due.

Together with the assessment, the tax authority assesses advances for the income tax for the following years, based on an estimation of the income of those years. If the tax assessment is serviced in the second year after the respective calendar year, the tax payer may be faced with the very uncomfortable situation to have to pay income tax amounting to one year's gross salary, or even more. Consequently, it appears very wise to get a sound estimation of the probable income tax, and to build up some reserve, preferably in a special savings account, or other.

#### **6.5 No wage tax?**

Employers based in Germany are liable to deduct wage tax from all wage paid to its staff. The wage tax is deemed as a down payment on the yearly income tax; it is calculated at such proportionate part of the income tax of the year, as corresponds to the amount of time for which the wage is paid, i.e., somewhat simplified: if the wage is paid on a monthly basis, the wage tax is one twelfth of the income tax that would be due on twelve times the monthly wage.

As the employer of the transferred staff is based abroad, there is no obligation to deduct wage tax; it is entirely up to the transferred staff to pay the entire income tax, upon the assessment after filing the tax return. Every tax payer is obliged to pay quarterly advances on the income tax due for the calendar year.

#### **6.6 Split of income between several countries**

If the employee is responsible for a number of businesses in different states, be it permanent establishments or legal entities, and actually works on their behalf in the respective country, it might be a good idea to split the total income of the person between those different countries, in proportion to the time actually spend in the respective countries: the consequence is that the income in each country may fall into a much lower tax bracket in this country, and that the aggregate amounts of the net income after taxes from each country may be considerably higher. In other words: if the foreign based employer and the employee have agreed on a net income, the total cost of wage will be lower for the employer, with the employee ending up with the same net amount.