Professor
Dr iur. Gustav K.L. Real

WIRTSCHAFTSPRÜFER
STEUERBERATER

WWW.REAL-AUDIT.DE

Corporation Tax in Germany

Overview

1 (Un-) Limited liability to taxation
2 Determination of income
2.1 Financial statements
2.2 Transfer pricing
3 Corporation tax rate
4 Corporation tax of foreign based corporations
5 Model calculation

1 (Un-) Limited liability to taxation

Corporation tax is imposed on the world-wide profit of legal entities having their registered seat in Germany, such as GmbH, AG, and some others. Legal entities having their registered seat abroad and having a structure comparable to the German GmbH or AG, are subject to corporation tax on the profit derived from sources inside Germany, in particular from a permanent establishment.

2 Determination of income

2.1 Financial statements

The basis for taxation is the profit of the year as derived from the financial statements of the corporation, after deduction of the trade tax. However, income from distributed profits of subsidiaries stay tax free; in the case of subsidiaries based outside Germany 95% of such distributed profit stays tax free.

Interests paid on a loan granted by a foreign-based shareholder holding directly or indirectly more than 25 % of the shares, are tax deductible only to the extent that the loan does not exceed 1.5 times the part in the shareholders' equity of the lender which corresponds to his part in the subscribed share capital. The term share holder's equity is to be understood in the sense of secc. 266, 272 German Code of Commerce, i.e. subscribed share capital plus capital reserves plus reserves from retained earnings plus (minus) profits (losses) carried forward.

The same is true for loans granted by entities closely related to the shareholder. If the corporation is a holding company whose object is to finance its subsidiaries, such loans may amount to three times the share holder's equity.

2.2 Transfer pricing

As the 25 % corporation tax is payable by a German subsidiary, thus being binding and final without any chance to further reduce it, foreign shareholders may wish to reduce the profit of their German subsidiary, in particular by increasing prices for goods to be sold and / or by invoicing for services executed by the shareholder in favour of the subsidiary.

Such transfer pricing is generally admitted in Germany, although great care must be taken to provide evidence of the respect of the "arms'-length-principle". It is equally important to design the necessary written agreements as early as possible, preferably at the time of the setting up of the German subsidiary, and to follow exactly the agreed obligations even if this leads to a loss situation of the subsidiary. Although some rather general ideas can be outlined, the necessary adaptation of those rules to the particular situation of the individual foreign investor would make the reproduction of such rules rather theoretical and without further benefit for the investor. However, I will be happy to provide more detailed material upon your individual request.

3 Corporation tax rate

As from 2002, the tax rate is 25% (in 2003, only: 26.5%) irrespective of the profit being distributed or not.

Very special – and rather complicated – rules apply on corporations existing already prior to that year, when Germany applied a higher tax rate on undistributed profits than on distributed profits: as a rule, any remaining excess in corporation tax paid may be reclaimed under the new rules.

4 Corporation tax of foreign based corporations

As opposed to the 25% corporation tax due on the world wide profit of the subsidiary, an additional 25% withholding / source tax (Kapitalertragsteuer) is imposed on the profit distributed to the national or foreign based share holder. However, as most German tax treaties provide for the dividends being taxed in the country where the shareholder is resident / domiciled such source tax may be refunded upon special application. Thus, the trade tax and the 25 % corporation tax on the profit are often the final taxation.

5 Model calculation

On the next page, please find a model of how to calculate Corporation Tax; I provided for a special column to insert the figures for your individual case. However, you should first go to the Trade Tax site in order to better understand the dependency of the amount of Corporation Tax from the Trade Tax payable.

Calculation of corporation tax

The following table gives you an idea of how profits of companies are taxed:

			Your specific case:
Trade Tax (You always have to start here, as the Trade Tax is a deductible item for Corp. Tax!)			
Profit of the year as per statement of profit and loss		1,500.00	
Plus advances on trade and corporation tax		0.00	
Plus additions	75.00		
Minus deductions	340.00	275.00	
		1,235.00	
Basis for calculation 5% of the above =	61.75		
Tax rate, e.g.: 470%	290.22		
Divisor: 290.22 / 1.235 =	234.99	- 235.00	
Trade profit after Trade Tax		1,000.00	
Check of calculation of Trade Tax:			
Taxable Profit		1,000.00	
Basis for calculation 5%		50.00	
Applicable tax rate 470%		235.00	
Corporation Tax			
Profit of the year as per statement of profit and loss		1,500.00	
Minus trade tax – as above		- 235.00	
Plus additions	0.00		
Minus deductions	0.00	0.00	
		1,265.00	
25% company tax		- 316.25	
Balance sheet profit		948,75	
Dividend		948,75	
(25% source tax, if applicable)		- 237.18	
NET DIVIDEND of the shareholder		711.57	