

## German Tax Facts

### Introduction

Taxation in Germany occurs at a national and municipal level. The Ministry of Finance controls the taxation regime and any individual moving to Germany must register with the local registration office.

### Tax Year

1<sup>st</sup> January – 31<sup>st</sup> December.

### Assessment Basis

German residents are taxed on their worldwide income under the concept of unlimited tax liability. There is no self assessment in Germany and individuals are required to file a tax return and will subsequently receive a tax assessment from the tax authorities. Married couples may choose between filing jointly (splitting tariff) or separately, although it is usually advantageous to file jointly. Salary income is taxed in the year it is received.

### Income Tax

Taxable income derives from seven income categories, including trade or business, employment, capital investment, rents and royalties. Any income not defined in tax law is not taxable. Net income is based on all gross earnings during the fiscal year, reduced by allowable expenses related to the income generated in each of the categories, for example expenses related to generation of employment income may be deducted from such employment income. A full offset of losses between income categories is available within certain restrictions.

Various general deductions for expenses may subsequently be applied including tuition fees, charitable donations and insurance premiums. Deductions can also be made for 'extraordinary burdens' from dependents. Further tax relief is available for taxpayers with children.

Net taxable income is then taxed at progressive rates over and above the tax free allowance at rates of between 15% and 45% (2007). The tax amount due is then subjected to a further 5.5% solidarity surcharge, which was introduced to finance the reconstruction of east Germany after German reunification in 1990.

Income tax and the solidarity surcharge on employment income are withheld at source by the taxpayer's employer; the amount withheld is determined by the details on an individual's wage tax card issued by the local registration office.

### Taxation of Investment Income

Interest and dividend income received from German or from non-German sources are taxable in respect of German residents, subject to a tax free allowance. Investment income forms part of taxable income currently still taxed at the progressive income tax rates. German sourced dividends are subject to a withholding tax of 20% and interest paid by German banks is subject to a withholding tax at 30% as well as the solidarity surcharge (5.5%) for credit against the personal tax liability. Any foreign tax on interest may also be credited against any further tax liability.

Furthermore only 50% of gross dividends received are currently taxable, but at the same time only half of the dividend related expenses are deductible. Foreign tax on dividends can be credited up to certain amounts.

With effect from January 1, 2009, the entire dividend (i.e. not only 50%) and any interest income received will be taxed at a flat tax rate of 25% (plus solidarity surcharge of 5.5% thereon).

### Tax on Property Rental Income

Rents received, less allowable expenses, form part of an individual's taxable income. Under tax treaty provisions rental income received from sources abroad is mostly exempt, but is taken into account in assessing the individual's personal tax rate under the progressive system applied to income. Foreign rental losses can neither be offset against positive income from other domestic sources nor reduce the tax rate on other income at the time. However, it can be utilised to offset future positive rental income from the same foreign sources.

### Wealth Taxes

There are no wealth taxes.

**Capital Gains Tax**

Capital gains in Germany are currently only taxable on transactions which are deemed speculative; therefore only the sale of shares within 12 months after acquisition (provided that the shares are privately held and the individual did not hold at least 1% of the company's total share capital at any time during the last 5 years prior to the sale) and property (not used for residential purposes only) within 10 years after acquisition is subject to income tax at progressive rates. Only 50% of any gain/loss on shares is currently taken into account and there is a small tax free threshold. Any losses within the same period can offset gains with 1 year carryback and unlimited carry forward.

With effect from January 1, 2009, the entire capital gain (i.e. not only 50%) will be taxed a flat tax rate of 25% (plus solidarity surcharge of 5.5% thereon) irrespectively of the holding period. However, this new tax regime only applies on shares acquired on or after January 1, 2009. The taxation of capital gains resulting from the sale of property remains unchanged.

**Inheritance and Gift Tax**

Inheritance and gift taxes apply to assets passing on death and during an individual's lifetime, but with a tax free allowance and several reliefs and exemptions. The tax rate depends upon the value of the property and the relationship of parties involved and ranges from 7% to 50% on a progressive scale.

**Regional and Municipal Taxes**

German municipalities levy a land tax on properties on a yearly basis. The tax base is the assessed unitary value to which a multiplier is applied which varies from district to district. The resultant tax is generally very low.

**Property Taxes**

In addition to the municipal tax above a further tax may be applicable to 'second residence' properties, with the tax being based upon the annual rent. Rates vary from 5% to 20%. Various exemptions exist for third and any additional residences in city/municipal areas.

**Stamp Duty/Property Transfer Tax**

A tax is levied on the transfer of real estate based upon the purchase price, at a rate of 3.5%. No other stamp duty is applicable.

**Sales Tax**

Sales tax is generally added at a standard rate of 19% to the sale price of goods. Some sales are exempt and other goods are subject to sales tax at a lower rate of 7%.

**Social Security Contributions**

All employees working in Germany are subject to social security contributions, which cover a range of state benefits including statutory pension funds, unemployment insurance, health insurance, and old age Medicare insurance.

In aggregate an individual and their employer will be liable to total social security contributions of approximately 40%. The contributions are split evenly between employee and employer, with ceilings being applied to the amount of contribution. In addition, employees at the age of 23 and older without children are subject to an additional contribution to the old age Medicare insurance of 0.25%. Furthermore, all employees have to pay an additional amount of 0.9% to the health insurance.

**Other**

An obligatory Church Tax is levied on various religious communities. The rate is 8% or 9% of the amount of income tax depending on the municipality where the tax is payable and is deductible from taxable income.

An individual with business activities may be subject to trade tax. The effective rate varies between 12% and 20% depending on the municipality.

## Taxation of Expatriates Living in Germany

The basis for taxation in Germany is determined by an individual's residence status. Individuals who are residents of Germany are subject to 'unlimited tax liability', from the very first day of arrival in Germany, except insofar as a tax treaty assigns the right to impose tax on any income in favour of another country. An individual will be considered a resident of Germany with 'unlimited tax liability' under two circumstances:

They take up residence in Germany by, for example, purchasing or renting a property for future indefinite use, or  
They stay for more than 183 days per year in Germany (either uninterrupted or in aggregate over the course of the fiscal year).

The German Income Tax Law offers very important deductions, which often apply to expatriates and which are unknown in other countries. These include income related expenses which are deductible from taxable income received by an employee, e.g. moving expenses, rent for a German apartment, expenses for returning to the home country, flights home under the 'double household regime' and telephone costs.

Germany has an extensive network of double tax treaties. Agreements for preventing double taxation of income and assets are in existence with over 70 countries.

Inheritances and gifts are often taxable in both Germany and the expatriate's home country. However, in some cases, national legislation allows taxes paid in one country to be deducted from the tax in the other country.

German social security contributions do in principle not apply to individuals:

Seconded to Germany for a limited period (6 to 8 years) and  
To work on behalf of a foreign (non-German) employer on their payroll and account and  
If the costs of the assignment are charged to the host company, this is only possible with a cost-plus agreement to avoid German social security.

The decision as to whether the provisions for a secondment are met is made, on application, by the local health insurance authority.

## Taxation of 'Non-Residents' Living in Germany

Individuals who are not resident in Germany will be subject to 'limited tax liability' only on such income from German sources that are listed in the German Income Tax Act. A non-resident taxpayer will have to file a return and receive an assessment only if their German income is not subject to withholding tax. Where income is subject to withholding tax, the income tax liability is normally settled through the withholding system and no returns or assessments are required.

The solidarity surcharge also applies to non-residents, but non-residents are not subject to church tax.

In the case of dividends sourced in Germany and payable to non-residents withholding tax applies at 20%. However, the tax due may be less due to double taxation treaties. Nevertheless the German payer generally has to withhold tax at the higher rate of the two countries. Where the withholding tax has been deducted, the taxpayer may apply for a refund of the tax withheld in excess of the withholding tax applicable under the relevant double taxation treaty. Interests sourced in Germany and paid out to non-residents are not subject to withholding tax at the source.

In the case of inheritance tax when neither the deceased person nor the donor are resident in Germany only certain assets situated in Germany are taxable, e.g. real estate and business assets.

### Applications for more favourable treatment

Non-resident individuals who derive at least 90 % of their taxable income from German sources or where the non-German income does not exceed a certain level may apply for more favourable taxation in Germany in a manner similar to the taxation of German residents.

A non-resident spouse of a resident tax payer can be treated as resident in Germany if this is more beneficial provided that the resident tax payer is a citizen of an EU/EEA member state and the spouse lives in a member state of the EU or EEA.

## Expatriate Financial Planning

While, as a whole, the German tax regime for non-residents is less onerous than the regime for Residents, with only German sourced income and gains being subject to tax, an expatriate should take care over the number of days spent in Germany during any tax year and plan carefully when to register with the Population Registry.

In addition, if you are an expatriate currently living in or considering moving to Germany, you should review your finances with a suitably qualified financial advisor. In particular, if you are about to move to Germany, you should plan and review your finances before making the move. You may wish to consider offshore investments, including offshore life products, in order to manage your tax liability and/or control when tax charges are made, as well as considering options available to you for estate planning. However, the German tax consequences of any offshore investments should be reviewed carefully prior to making an investment as there are specific provisions in the German tax law applicable on foreign investment funds. Under these provisions any growth in the value of the fund unit may be taxed in the hands of the unit holder irrespective of any disposal of the units or a distribution of income from the fund.

Whilst the specific benefits of an offshore life product will depend upon your individual circumstances they do offer a number of potential benefits:

- Investments in an offshore life product grow virtually free of tax throughout the time the product is held, suffering only a small amount of irrecoverable withholding tax on investment funds located in certain countries.
- They allow you, in general, to manage when you take benefits and potentially to defer the benefits to a period that may be more advantageous to you from a taxation perspective.
- Offshore products often feature a strong range of the life company's own individual offshore funds and managed offshore funds specifically tailored to fit with the spread in clients' attitudes to risk. Offshore products also offer access to household name fund managers, including many international and specialist fund managers.
- An offshore product has the flexibility to adapt to changes in your individual circumstances, including changes in your residency status.
- Most companies offering offshore life products are subsidiaries of global financial services companies.
- The offshore life companies are regulated in first class jurisdictions which benefit from strong regulatory controls.

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