Country Profile: Germany

1  Economy / Foreign Investments

1.1 Introduction
The Federal Republic of Germany is a democratic country with a highly developed economy in central Europe. It has established a social market economy which is based on the concept of a free market economy. Germany pursues a very open approach to international trade and thanks to its central location it offers many opportunities for business activities throughout Eastern and Western Europe.

Due to the high level of qualification of German employees and the high level of social security, labour costs are relatively high and represent the main cost factor of production in Germany. The social security system provides for pension insurance, health insurance, unemployment insurance and nursing insurance. The employees are often organized in unions in order to assert their interests against company policy. Statute law gives the employees a right of co-determination in relation to certain activities of their employers.

1.2 Investment Incentives and Taxation
The German Federal Government makes strong efforts in order to maintain Germany as an attractive location for foreign investment. Governmental influence on the market is to be decreased by way of deregulation and privatization of traditionally state-owned enterprises like railway, postal and telecommunication services. Price regulations and other restrictions connected with energy supply and telecommunication services have recently been abolished allowing free competition for all investors. Please find detailed information about taxation and investment incentives in chapter 3 below.

1.3 Germany as an EU Member State
One of the "big eight" industrialized nations, the Federal Republic of Germany is a founder-member of the European Union. The harmonization of economic policy, of legal and taxation systems, and of social conditions in the member states of the Union has formed a single European market allowing freedom of movement of capital and labour. Germany has a very open attitude towards foreign investment. As an EU member state it grants general non-discriminatory tariff preferences to most of the industrial and developing countries. The import of certain products may however be subject to quotas or anti-dumping tariffs.
The effective start of economic and monetary union was on January 1, 1999, on which date the rates of conversion between the EURO and the participating national currencies were irrevocably fixed and the EURO became a currency in its own right. In the not so far future the European Union will be joined by Poland, the Czech Republic and Hungary as new members.

2 Business Organizations
German commercial law provides a number of different forms of companies to conduct business in Germany. There are no restrictions on foreign investors as to which form of commercial entity they use. The chart below gives an overview of the variety of forms of commercial entities in German commercial law:

In the following the most important characteristics of the different forms of commercial entities are described:

2.1 Sole Proprietorship
The sole proprietorship requires a typical commercial business that has to be registered in the commercial register. It is owned and operated by a single individual who is personally liable for all debts and losses that arise in relation to the business.
2.2 Civil Law Association (Gesellschaft bürgerlichen Rechts, GbR)

The civil law association is the most general form of entity typically used by two or more individuals for non-commercial or professional purposes, for particular transactions or for purposes limited by time.

Corporate Entity: No.
Minimum Capital: No regulations.
Property: Partners own all partnership property in joint tenancy.
Registration: No regulations.
Management/Representation: In general all partners are entitled to participate in management and to represent the partnership if the agreement so provides.
Supervision: All partners have a right to supervise certain activities, even if not entitled to manage the partnership.
Liability: All partners are fully, jointly and severally liable for all debts.
Profit and loss: In general all partners participate in the profit and loss of the partnership in equal shares unless an agreement to the contrary has been made.

2.3 General Partnership (Offene Handelsgesellschaft, OHG)

Corporate Entity: No, but partnership may carry on business, acquire, hold and dispose property, and sue and be sued in its firm name.
Minimum Capital: No regulations.
Property: Partners own all partnership property in joint tenancy.
Registration: The partnership must be registered in the commercial register.
Management/Representation: In general all partners are entitled to participate in management and to represent the partnership if the agreement so provides.
Supervision: All partners have a right to supervise certain activities even if not entitled to manage the partnership.
Liability: All partners are fully, jointly and severally liable for all debts.
Profit and loss: Subject to any agreement to the contrary, profits are distributed to partners in proportion to their capital contributions up to a figure equal to a fixed percentage of those contributions. Profits still available once this distribution has been made are distributed to the partners in equal shares.
2.4 Limited Partnership (Kommanditgesellschaft, KG)

Corporate Entity: No, but partnership may carry on business, acquire, hold and dispose property, and sue and be sued in its firm name.

Minimum Capital: No regulations.

Property: Partners own all partnership property in joint tenancy.

Registration: The partnership must be registered in the commercial register.

Management/Representation: All general partners are entitled to manage and to represent the partnership. The limited partners may participate in the management if the agreement so provides.

Supervision: All partners have a right to supervise certain activities even if not entitled to manage the partnership.

Liability: At least one general partner is fully liable. The liability of the limited partners is limited to their contribution to the partnership.

Profit and loss: Subject to any agreement to the contrary, profits are distributed to partners in proportion to their capital contributions up to a figure equal to a fixed percentage of those contributions. Profits still available once this distribution has been made are distributed to the partners in accordance to their capital contribution, in so far as this is reasonable in all circumstances.

2.5 Limited Liability Company (Gesellschaft mit beschränkter Haftung, GmbH)

The limited liability company is the most common form of corporation in Germany. The GmbH law offers a high flexibility and is preferred by foreign companies for their German subsidiaries.

Corporate Entity: Yes.

Minimum Capital: DM 50,000.00 / 25,000.00 Euro. One - fourth of the capital, but at least DM 25,000.00/ 12,500.00 Euro must be paid into the company.

Property: As a corporate entity the company is the owner of its property.

Registration: The company must be registered in the commercial register.

Management/Representation: One or more managing directors are appointed as provided in the Articles of Incorporation. They represent the company alone or together.

Supervision: A supervisory board has to be appointed only if provided in the Articles of Incorporation. It is mandatory if the company has more than 500 employees.
Annual Meetings: The annual shareholders´ meeting summoned by the directors is entitled to decide on the appointment and release of directors, the approval of the financial statements and to review and evaluate the activities of the management.

Liability: The liability of the GmbH is limited to its capital stock.

Profit: In general the profit of the company is allocated to the shareholders in proportion to their shareholding if the shareholders´ meeting decides on a pay-out of profits.

2.6 Stock Corporation (Aktiengesellschaft, AG)

Corporate Entity: Yes.

Minimum Capital: DM 100,000.00 / 50,000.00 Euro. One-fourth of the capital must be paid.

Property: As a corporate entity the company is the owner of its property.

Registration: The company must be registered in the commercial register.

Management/ Representation: The stock corporation is represented by a board of directors who is responsible for the management of the company.

Supervision: A mandatory supervisory board has to be appointed by the shareholders´ meeting. The functions of the supervisory board are to inspect the books and records of the company, to approve certain decisions and to monitor the business activities of the board of managers.

Annual Meetings: The annual shareholders´ meeting summoned by the board of directors is entitled to decide on the appointment and release of managers, the approval of the financial statements and the distribution of profits and the reorganization and liquidation of the company.

Liability: The liability of the AG is limited to its capital stock.

Profit: In general the profit of the company is allocated to the shareholders in proportion to their shareholding if the shareholders´ meeting decides on a pay-out of profits.
3 Taxation

3.1 Introduction
In Germany tax rates appear to be comparatively high. However, the tax burden is alleviated by a number of rules relating to certain branches of industry and business activities. In order to harmonize German tax rates with international standards the government is currently pursuing a gradual tax reform program, scheduled for the years 1999/2000/2002 and also a reform of business taxation. The first tranche has become law effective from April, 1999, and is supposed to be followed by a number of amendments. Further steps seem now to be uncertain, however, since the governing party has lost its majority in one of the two houses and therefore is dependent on compromises when making further changes in tax rules.

In the following description all amounts are still computed in DM as German tax law will introduce the Euro as the currency of reference not earlier than 2002.

3.2 Income Taxation
3.2.1 Corporate
Corporate taxpayers are subject to corporation tax (Körperschaftsteuer) and trade tax (Gewerbesteuer). A surcharge (Solidaritätszuschlag) is levied on the corporation tax due.

Corporations resident in Germany because of a registered office or a place of central management here are subject to corporation tax on their worldwide income (unless tax treaties provide for an exemption), while non-resident corporations are subject to taxation on income only from sources in Germany. In 1999 the rate of corporation tax for resident or non-resident companies is generally 40%. There is no special rate for capital gains.

Where a distribution of profits to shareholders is made, the corporation tax rate on those profits is reduced to 30%. A capital investment earnings tax of 25% is also deducted from this distribution. These deductions in respect of tax are then credited to the resident shareholders.

According to governmental plans, the corporation tax on distributions is to be reduced to 25% and the shareholders tax credit on dividends is to be abolished. Instead, the shareholder must apportion 50% of the value of dividends received to his general income, which falls to be taxed by way of the general income tax.
In general, corporations carrying on business in Germany are also subject to trade tax on their domestic income. The tax rate depends on a fixed federal rate of 5% and a multiplier, fixed by the municipalities (e.g. 1999: Berlin 390%, Frankfurt/M. 515%). On average, the trade tax is equal to 16.67% of taxable income for corporate tax purposes. Double taxation on distributions to shareholders who are themselves subject to the trade tax is avoided by the way of an exemption in their favour.

An annual solidarity surcharge of 5.5% is levied on the amount of corporate income tax assessed. This surtax may be abolished in the last step of the tax-reform.

Although trade taxes are not common internationally the planned abolition of this tax currently seems not impossible.

3.2.2 Taxation of Individuals
3.2.2.1 General Income Tax

The tax liability of individuals depends on their residence, while citizenship is (generally) not a controlling factor. Residents are subject to taxation on their worldwide income (unless tax treaties provide for an exemption). A person is presumed to be resident where he or she has his/her (non-temporary) place of abode. A stay of more than six months will lead to a presumption of residence.

There are seven classes of income subject to resident’s income tax: income from agriculture and forestry, trade or business income, income from independent personal services, income from employment, investment income, rental income and other income exhaustively itemized in the Income Tax. Income falling outside these classes (e.g. social security benefits and certain sums payable as compensation for loss of employment) is not taxable. In the case of non-residents the classes of taxable income are narrowly defined.

The general income tax rate has a multistep-linear-progressive form. The current and future rates for single individuals/married couples filing joint returns are shown as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Non-taxable income</th>
<th>Lowest Band</th>
<th>Highest Band</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>13.067/26.135</td>
<td>23.9%</td>
<td>53.0% over 120.041/240.083</td>
</tr>
<tr>
<td>2000</td>
<td>13.499/26.999</td>
<td>22.9%</td>
<td>51.0% over 114.695/229.391</td>
</tr>
<tr>
<td>2001 (planned)</td>
<td>14.093/28.187</td>
<td>19.9%</td>
<td>48.5% over 107.568/215.136</td>
</tr>
<tr>
<td>2003 (planned)</td>
<td>14.500/29.000</td>
<td>17.0%</td>
<td>47.0% over ??/??</td>
</tr>
<tr>
<td>2005 (planned)</td>
<td>15.000/30.000</td>
<td>15.0%</td>
<td>45.0% over ??/??</td>
</tr>
</tbody>
</table>
3.2.2.2 Taxation of Business Income

Domestic trade or business profits of individuals earned independently or in a partnership are subject both to the general income tax and to the trade tax. The sum falling to be taxed is differently calculated in the case of each tax. There are also special provisions affecting the rates of tax.

The first 48,000 DM of business income is exempt for trade tax purposes. The next 24,000 DM is liable to trade tax at a rate of 1%, rising to the general federal rate of 5% by way of 24,000 DM bands.

In so far as income is subject to the trade tax, liability of that income to the general income tax is reduced as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Business income component must exceed DM of total income subject to general income tax</th>
<th>Reduced rate for general income tax on this income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>93,743</td>
<td>45%</td>
</tr>
<tr>
<td>2000</td>
<td>84,834</td>
<td>43%</td>
</tr>
<tr>
<td>2001 (planned)</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

According to the planned business income tax reform, the reduced rate was to be 35% from 2001 on. However, the supreme tax court has held this legislation to be unconstitutional and has demanded its repeal. Instead, the possibility is being discussed of granting the taxpayer (or taxpayers, in the case of a partnership) the option to switch to being taxed under the corporation tax system in respect of business income. Businesses not opting for the corporation tax are supposed to gain a trade tax credit on general income tax rate.

3.2.2.3 Payroll-Taxes and Social Security Levies

There is no separate wages tax in Germany, but tax on income arising from employment has to be deducted by the employer from the gross salary on the employees behalf, who therefore can claim a tax credit. Employees are categorized in tax classes to which different deductions and allowances apply, recorded on a tax card issued by the municipality that has then to be given to the employers.
The German social security system provides for pension insurance, health insurance, unemployment and workmen’s compensation insurance. In general all employees working in Germany are subject to pay mandatory contributions, regardless of their citizenship or the residence of the employer. Contributions are paid in equal amounts by employer and employee, each one bears 50%, except for the workmen’s insurance which is entirely borne by the employer. The basis of assessment is the employee’s gross monthly earnings.

The contribution rates from 2000 are: pension insurance 19.3%, health insurance up to 15.7%, unemployment insurance 6.5% and workmen’s compensation insurance between 1 and 4%.

The employer is generally liable for the total payments and deducts the employee’s part from wages or salaries.

### 3.3 Real Estate and Inheritance/Gift Taxes

The real estate tax (Grundsteuer) is an annual tax levied by local authorities on real property, payable by the owner. The tax is assessed by reference to a valuation of the property for this purpose made in 1964, in conjunction with a rate (2.6% - 3.5%) set at federal level as multiplicand and a multiplier (between 300% (Aschaffenburg) and 600% (Berlin) for the year 1998).

A real estate transfer tax (Grunderwerbsteuer) is imposed on inter vivos transfers of real property situated in Germany and on transfers of rights and licenses connected therewith. Taxable transfers also include the acquisition of a shareholding greater than or equal to 95% in any company or partnership owning real estate in proportion to its value in relation to that of other assets of the company.

The capital transfer tax (Erbschaft- und Schenkungsteuer) is levied on transfers of property in cause of death or on inter vivos gifts or for other certain purposes, like transfers to foundations if the sometimes quite significant tax exempt amounts are exceeded. Transfers subject to the tax are principally the transfers anywhere in the world of residents as transferor or as transferee, as well as the domestic transfers of non-residents. The tax is generally assessed on the net worth of the property, in general determined either by the present market value or by the value for income tax purposes. There are a couple of exemptions, especially for business property and shares and depending on the relationship of transferor and transferee.
The tax rate is progressive and divided into three classes also depending on the relationships involved (e.g. transfer between father and child from 7% to 30%, between unrelated persons from 17% to 50%). Transfers within ten years are cumulated to determine the tax-rate. Accordingly, the personal allowances are available every ten years.

3.4 **Tax Treaties**

The income tax treaties serve to mitigate double taxation, reduce withholding tax rates and facilitate information exchange between treaty nations.

In order to prevent double taxation, the treaties may override the national liability for taxation. Typically, these treaties grant the right to tax the income either to the country of source or the country of residence, while they exempt the income from tax in the other state (which is however taken into account when assessing the rate at which tax in to be levied). Exemption rules are common for business profits, royalties, capital gains and remunerations for dependent personal services.

Alternatively the treaties provide a relief from a double tax burden by allowing a foreign tax credit. Tax credits are common for dividends with minimum holding requirements and interest.

Income Tax treaties have been signed with all major industrial countries. There are no German treaties for some smaller Asian and African countries (like Bhutan, Tanzania, Malawi) and European territories (like Monaco, Liechtenstein, Montenegro).

**Tax treaties for capital transfer tax** are currently signed with: Denmark, Greece, Austria, Sweden, Switzerland and the US.

3.5 **Value Added Tax („VAT“ - Umsatzsteuer)**

Generally, the taxpayer is any entrepreneur who is engaged independently in a trade or business or a profession with the objective of deriving income therefrom; whether incorporated or not, regardless of citizenship, residence and principle place of management. The place of the taxable transaction is the decisive factor for the purposes of liability to VAT.

The entrepreneur’s supply of goods and services are chargeable transfers whether or not in connection with his trade or business. There are certain rules that deal with the taxation of transfers within the EU. Special rules and allowances also apply to transactions concerning real estate or securities, or interests in e.g. partnerships or certain branches of industry.
There is a 16% general rate and a reduced rate of 7% that applies in particular to food deliveries. The entrepreneur has principally to file his tax-return monthly, and the VAT paid on chargeable inputs is deducted herein. There are special rules for small businesses.

The formal duties in Germany are very complex and strict and disregarding them may lead to tax being levied even where transactions have not been entered into, or to the VAT element in chargeable inputs being disqualified from deduction.

3.6 Investment Allowances/Investment Grants and other Subsidies

Between 1991 and 1998 investment in the former East Germany has largely been encouraged by special rules on depreciation. From 1999 these rules have been integrated into a consistent law for investment allowances. These payments are tax-free. On the other hand, investment grants are to be treated either as taxable income or as a reduction from the depreciation base.

There are Investment Allowances of 10% for new plant and materials for small and medium-size crafts and of up to 20% for service businesses and trade companies. There are generally allowances of 10 to 15% on the costs of modernization of dwellings in town centers or certain zones, where the dwelling was constructed before 1990, and the works are to be finished by 2001 or 2003, up to a maximum figure of DM 1,200 or 4,000 per square meter. There are also allowances for owners who modernize flats in owner-occupation.

The regulations for the Common Task Program for Improving the Regional Economic Structure are subject to change every year. These Investment Grants are intended to be used for investments by small and medium-sized companies in certain regions. The grants may amount to more than 20% of the invested amount.

There are a couple of further programs granting cheap loans with reduced interest rates for certain branches (e.g.: housing, new technologies) and certain regions. The conditions of these programs are subject to rapid change.