BEYOND BORDERS:

Navigating Germany

Dear Clients and Partners,

We are pleased to bring you the latest edition of our **Beyond Borders: Navigating Germany Newsletter**, designed to keep you well-informed about significant developments and strategic considerations in the German landscape.

As your trusted advisors, we are committed to providing you with valuable insights that can help navigate the complexities of international business operations with relation to Germany. In this issue, we focus on several key topics that are particularly relevant for companies engaging with the German market.

As always, our goal is to provide you with insightful analysis and updates that help streamline your operations and strategic decisions in the German market.

In this issue, we delve into critical topics including:

» **Real Estate Investment into Germany** as a foreign individual / foreign corporation
» How to **set up a corporation in Germany**
» **Risking an unintended tax nexus** in Germany
» An expert **guest article** from Dr. Matthias Dittmar (IFC) on the tax research allowance as a liquidity tool in Germany

We trust that the information provided in this newsletter will be beneficial to you and support your business endeavors.

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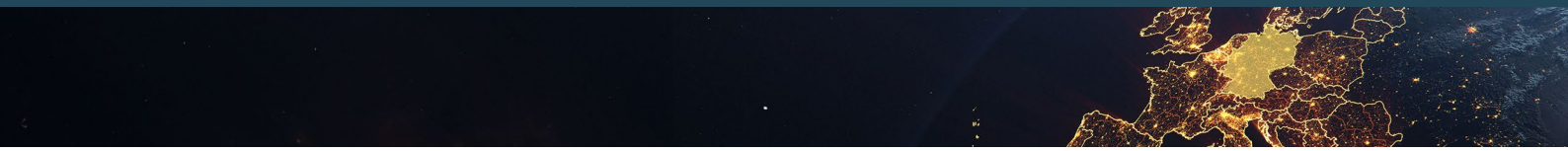

REAL ESTATE INVESTMENT INTO GERMANY AS A FOREIGN INDIVIDUAL / FOREIGN CORPORATION

Germany offers a stable and attractive environment for real estate investment, with its strong economy, transparent legal system, and robust property market.

However, foreign investors need to be aware of the tax and other regulations governing real estate transactions to optimize their investments and avoid risks.

This article provides an overview of the key tax considerations, including property acquisition tax, ongoing taxation of rental income, and tax on property disposals.

Understanding these regulations is essential for ensuring compliance and maximizing returns in the German real estate market.

1. CONSIDERATIONS WHEN PURCHASING REAL ESTATE IN GERMANY

In general, real estate in Germany may be purchased and owned by German and foreign individuals as well as German and foreign entities.
In order to purchase a property, the purchase contract needs to be concluded before a notary.
Once the purchase price is paid and the respective property transfer tax, land register fees as well as the notary fees are paid, the title of the property is transferred to the new owner.

Real Estate transfer tax (RETT):
Generally, any transfer of German property triggers the German real estate transfer tax. This is true for a direct transfer of the asset as well as in case of a share deal of an entity owning real estate. Further, there are several exemptions with respect to the property transfer tax.
The rate of the German real estate transfer tax varies between the different states and ranges from 3.5 % to 6.5 % of the property value.

Other transaction costs:
It is important to note, that besides the real estate transfer tax there are other significant transaction costs, when purchasing real estate in Germany:

- **Notary fees:** Approx. 1 % - 1.5 % of the purchase price
- **Realtor fees:** Depending on the nature and location of property the rates can very 3 % - 8 % of the purchase price
- **Land register fees:** Approx. 0.5 % of the purchase price

Property tax:
When owning real estate in Germany, an **annual property tax** is due, which is applied on the assessed value of the property. The assessment follows a different approach in the different provinces.

In order to determine the property tax, the assessed value is multiplied by 0.0035 as well as a multiplier specified by the municipality the property is located in. Therefore, the property tax rate will be different, depending on the specific location of the property.

2. TAXATION OF RENTAL INCOME FROM REAL ESTATE IN GERMANY

Based on the German income tax act, any income derived from renting of real estate located in Germany is taxable in Germany. Therefore, a foreign individual (who is neither resident nor domiciled in Germany) owning real estate in Germany is subject to limited tax liability in Germany and has to file a respective income tax return.

Since most of the double taxation treaties concluded by Germany with other jurisdictions provide for the taxation of real estate income in the country where the real estate is located, no double taxation should result in this respect.

The **income tax rates for individuals in Germany** (depending on the income) can reach up to 45%. While German tax residents can deduct a basis personal allowance amount, an individual with only limited tax liability in Germany can not deduct this amount and the full profit (after deduction of respective expenses) will be taxed in Germany.

As a **corporation** with rental income from real estate located in Germany, the above regulations of the double taxation treaties apply accordingly. Therefore, the respective income is taxable in Germany.

In general, a corporation in Germany is subject to corporate income tax as well as trade tax. While the corporate income tax rate is 15 % throughout Germany, the rate of the trade tax varies between the different municipalities (the average is approx. 14 %). However, if the foreign corporation does not constitute a permanent establishment in Germany from a tax perspective, no trade tax is applied on the rental income derived and this income is therefore only subject to German corporate income tax of 15 %.

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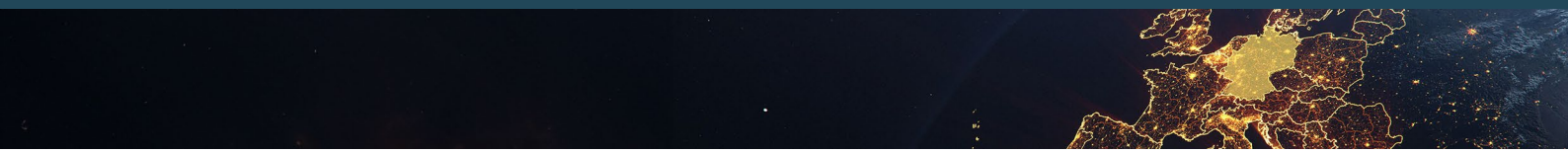

3. SELLING REAL ESTATE IN GERMANY

With respect to selling of real estate in Germany, the general remarks above apply with respect to the taxability of the respect income in Germany.

However, it is important to note that under certain circumstances, real estate located in Germany and sold by an individual can be sold tax free.

If the respective property is owned for more than **ten years**, the profits from the sale of the property is **not taxable in Germany**.

If the property was **exclusively used for own living purposes** and has not been rented at any point in time between purchase and sale, the profit from the sale of the property is **not taxable in** Germany independent of the period of ownership.

In addition to the above, the sale of the property is also **not taxable in Germany**, if the property was used for **own living purposes in the year of the sale as well as the two preceding years**.

4. OTHER CONSIDERATION RESULTING FROM OWNING REAL ESTATE IN GERMANY

- **Inheritance and gift tax:**
  If real estate owned by an individual who is not a tax resident of Germany is gifted to or inherited by an individual who is also not a tax resident of Germany, the transfer might still be subject to German inheritance / gift tax.

HOW TO: SETTING UP A CORPORATION IN FORM OF A GMBH IN GERMANY

Anyone can establish a business in Germany - irrespective of nationality or place of residence. There is no specific investment legislation in Germany, nor is there a minimum percentage of German shareholdings (sponsorship) required for foreign entrepreneurs setting up a business.

Foreign investors can choose between a variety of legal forms for conducting business in Germany. German company law offers a suitable legal structure for every type of business. One of the most important and common corporate forms under German law being the GmbH ("Gesellschaft mit beschränkter Haftung").

The GmbH combines high flexibility with relatively few obligations. Further, setting up a GmbH is straightforward and can be accomplished in just a few steps. To set up a GmbH the involvement of a German notary is required.

The following articles describes the main characteristics of a GmbH as well as the high-level process of setting up a GmbH in Germany.

A GmbH – basically a limited liability company – is the most common type of legal entity in Germany. It provides shareholders with limited liability, protecting their personal assets from business risks. Setting up a GmbH involves several steps which are outlined hereinafter and is very straight-forward. However, compared to other jurisdictions, it the timeframe of several week for setting up and registering a GmbH should be taken into account.

1. MAIN FEATURES AND CHARACTERISTICS OF A GMBH

Share capital

A GmbH requires a minimum share capital of **EUR 25,000**.

Limited liability

The shareholder's **liability is limited** to the amount of their original share capital.
The shareholders are not liable for the company's debts.

Shareholders

At least one shareholder is required for setting up a GmbH.
The shareholder(s) can be a private individual or a legal entity.
The nationality and residence of the shareholder(s) and the managing director(s) of a GmbH are irrelevant.

Business address

A GmbH must have a **German business address** and a local representative.

Management

A GmbH is managed and represented by its managing director(s) ("Geschäftsführer").
The managing director(s) are appointed by the shareholders ("Gesellschafter").
A shareholder can also be a managing director.
A managing director can be directed by the shareholders' resolution.

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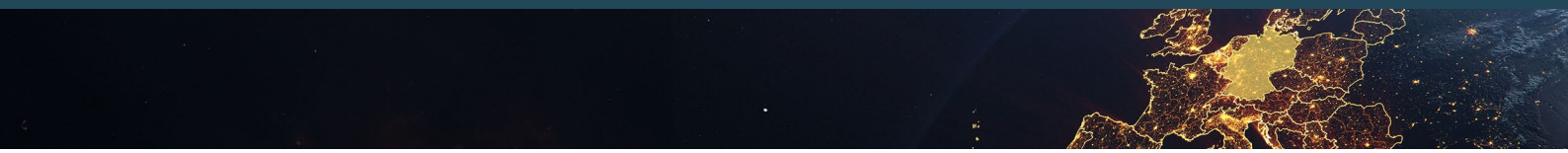

While the process of setting up a GmbH in Germany is quite straight forward, it should be noted that the process from application to the company register to registration takes approx. 2 weeks. To receive the tax number, it can however take **6-8 weeks**.

4. PROCESS OF SETTING UP A GMBH IN GERMANY

Certain documents are required for the incorporation of a GmbH: Typically, the notary will ask for documentation verifying the existence of any parent company or shareholder as well as the power of representation for persons acting on behalf of it. If applicable, an excerpt of the foreign commercial register as well as articles of association of the foreign parent company will be required.

It should be noted that specific requirements regarding the authentication and translation of documents apply in case of a foreign parent company. This depends on the legal form as well as the origin of the foreign shareholders.

In general, the process of setting up a GmbH in Germany divided in the following steps:

- **Step 1**: **Drafting** of the **Articles of Association**
- **Step 2**: Notarization of the Articles of Association
- **Step 3**: Opening of a **bank account** and **deposit the share capital** in the bank account
- **Step 4**: Provide a **confirmation of the share capital payment** to the notary
- **Step 5**: **Registration** with the Commercial Register
- **Step 6**: **Trade Office Registration**
- **Step 7**: **Tax Registration** (Tax Number / VAT ID No.)

Articles of association
A necessary document for setting up a GmbH are the articles of association, which shape the identity and constitution of the company. As a GmbH is a very flexible type of corporation, there are only a few mandatory components, which have to be included in the articles of association:

- Amount of share capital,
- Shareholders and the number of respective shares held,
- Business name,
- Registered office,
- Business purpose.

Once drafted, the articles of association must be notarized.

Share capital of a GmbH
A GmbH requires a **minimum share capital of EUR 25,000**. At the time of registration, at least half of the minimum capital (i.e. EUR 12,500) must be actually and verifiably deposited on a bank account. The share capital is not a deposit that must continuously be kept, but moreover to certain extent, can be used for the company's business operations. In addition to a cash deposit, the share capital can also be contributed in kind (e.g. real estate, patents, machinery).

Registration of the new company
After filing the documents with a German notary and the payment of the share capital, the notary will initiate the registration with the German commercial register ("Handelsregister"). Once registered in the commercial register, the GmbH becomes a legal entity, and the limited liability for the shareholder(s) exists.

It is important to note that prior to the finalized registration with the German commercial register, the entity does **not enact its limited liability**. Therefore, prior to the successful registration, the **shareholders are subject to unlimited liability**. We therefore strongly recommend avoiding any business activities prior to registration.
In addition, a registration with the German trade chamber ("Gewerbeamt") and the German fiscal authorities is required.

3. CONCLUSION

Setting up a GmbH in Germany is a structured yet straightforward process, offering flexibility and strong legal protection for its shareholders. While the process can take several weeks, particularly for receiving the necessary tax number, the benefits of limited liability, ease of operation, and flexibility in corporate structure make the legal form of a GmbH an attractive option for both domestic and foreign entrepreneurs doing business in Germany. By following the necessary steps and adhering to the outlined requirements, business owners can in a straightforward manner establish a GmbH in Germany and operate within one of Europe's strongest economies.

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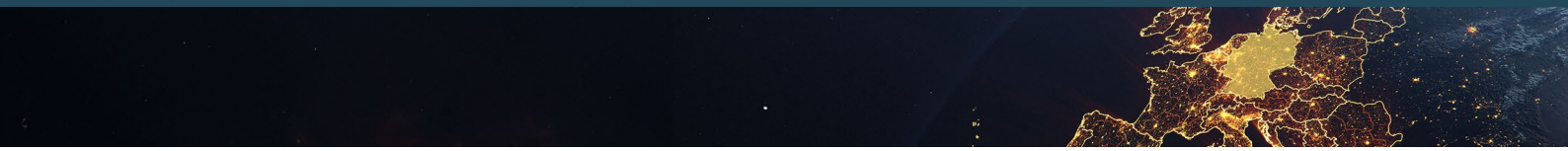

RISKING AN UNINTENDED TAX NEXUS IN GERMANY

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However, foreign investors need to be aware of the tax and other regulations governing real estate transactions to optimize their investments and avoid risks.

This article provides an overview of the key tax considerations, including property acquisition tax, ongoing taxation of rental income, and tax on property disposals.

Understanding these regulations is essential for ensuring compliance and maximizing returns in the German real estate market.

In today's globalized economy, it is increasingly common for businesses and individuals to engage in cross-border activities. However, such international expansion and business operations in foreign markets can trigger unexpected tax obligations. One of the most common issues companies face is creating an unintended tax nexus, which subjects them to German tax laws and potentially results in significant tax liabilities. This article examines the risks of inadvertently establishing a tax nexus in Germany, how it can occur, and what businesses need to know to avoid or manage this risk effectively.

1. WHAT IS A TAX NEXUS?

A tax nexus, often referred to as a 'permanent establishment' (Betriebsstätte), is the level of economic presence in a country that triggers local tax obligations. In Germany, the concept of a permanent establishment is defined by both domestic law and international tax treaties, notably the German Fiscal Code (Abgabenordnung) and Germany's network of double taxation treaties (Doppelbesteuerungsabkommen, DBA).

In essence, if a foreign company has sufficient physical presence or economic activity in Germany, it may create a tax nexus. Once established, the company could be required to pay German corporate taxes on income attributable to that nexus, regardless of its residence country.

In addition a tax liability can also arise, if a foreign based corporation is managed from within Germany. This is an often overseen issue, especially relevant for German companies that set up a foreign based corporation. The German tax code treats foreign corporations as tax resident of Germany if the effective place of management is in Germany.

Whereas a permanent establishment subject the related German source income to German limited taxation, a tax residence subjects the corporation as a whole to unlimited taxation in Germany.

2. HOW IS A TAX NEXUS CREATED?

There are several ways a business can inadvertently create a tax nexus in Germany. Key triggers include:

- **Physical Presence**
  If a company has a fixed place of business in Germany, such as an office, branch, warehouse, or even equipment (like servers), it is likely to be classified as having a permanent establishment. This would subject the company to taxation in Germany on income attributable to that physical presence.

- **Personnel Activities**
  Employees or representatives who conduct business on behalf of the company in Germany could also create a tax nexus. For instance, if employees frequently travel to Germany for business purposes, engage in decision-making, or even negotiate and conclude contracts on German soil, they could cause the company to have a taxable presence.

- **Agent Activities**
  Even without a formal presence, if the company has a dependent agent (like a distributor or representative) acting on its behalf in Germany, a tax nexus can be established. Germany's tax authorities will consider whether that agent is habitually concluding contracts or playing a key role in negotiating the terms of agreements.

- **Managing Director in Germany**
  A foreign based corporation can still be a German resident corporation if the entity has its effective place of management in Germany. This can be the case if e.g. the sole managing director lives and works in Germany and all relevant decisions are made within Germany. The relevance of this issue has significantly increased post-COVID due to the increase in remote work.

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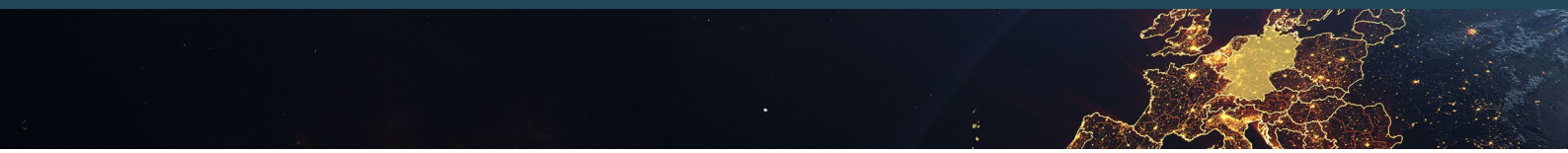

3. THE CONSEQUENCES OF AN UNINTENDED TAX NEXUS

If a business inadvertently creates a tax nexus in Germany, it becomes liable for corporate income tax (Körperschaftsteuer), trade tax (Gewerbesteuer), and potentially value-added tax (VAT) on the income derived from its German operations. Corporate income tax is levied at a rate of 15%, and trade tax rates vary by municipality, but generally range between 14% and 17%.

In addition to facing tax liabilities, companies may also be subject to penalties for non-compliance, such as failing to register for taxes or file tax returns in Germany. This can result in hefty fines, back taxes, and interest charges. Moreover, businesses that have double taxation agreements (DTAs) between Germany and their home country may face complex issues in determining where and how income is taxed, potentially leading to double taxation if not properly managed.

4. AVOIDING AN UNINTENDED TAX NEXUS

Avoiding the risks of creating a tax nexus requires careful planning and consideration of a company's activities in Germany.

Key to this is to actively monitor the business activities. We have seen several cases, where at the onset neither a PE was constituted nor the effective place of management was established in Germany, however within several years the company had unintendedly constituted a PE in Germany.

Therefore businesses should closely monitor their employees' travel, digital operations, and physical presence in Germany. By limiting activities that could be construed as conducting business in Germany, companies can reduce the risk of creating a permanent establishment.

In addition instead of employing dependent agents in Germany, companies can use independent agents or distributors. This distinction is crucial, as independent agents acting in the normal course of their own business typically do not create a tax nexus for the foreign company.

5. CONCLUSION

Creating an unintended tax nexus in Germany can expose businesses to unforeseen tax liabilities and penalties. The key to mitigating this risk is proactive planning and understanding the triggers that could establish a taxable presence. By carefully monitoring cross-border activities, using independent agents, and leveraging international tax treaties, companies can manage their exposure to German tax obligations.

Given the complexities of German tax law and the evolving nature of international taxation, businesses should regularly consult with tax experts to ensure compliance and to avoid costly mistakes. Proactive steps today can prevent unintended tax burdens in the future, allowing businesses to focus on their growth and success in the German market.

GUEST ARTICLE

TAX RESEARCH ALLOWANCE AS A LIQUIDITY TOOL

The **tax research allowance** is an essential tool to promote research and development (R&D) in Germany. Companies can recover a portion of their R&D expenses through tax incentives, providing financial relief and boosting liquidity. This benefit applies to businesses of all sizes and sectors, as long as they are subject to taxation in Germany. The allowance is particularly advantageous for small and medium-sized enterprises (SMEs) due to enhancements introduced by the **Growth Opportunities Act** starting March 28, 2024.

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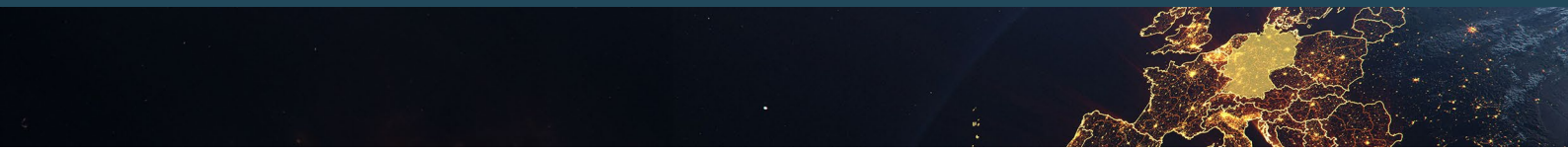

1. BENEFITS OF THE RESEARCH ALLOWANCE FOR COMPANIES

The research allowance plays a critical role in supporting businesses financially and reducing the risk associated with R&D projects. **Typically, the allowance covers 25% of eligible costs**, primarily personnel expenses. However, for SMEs, this rate increases to **35%** starting in March 2024. This boost is designed to help smaller businesses with limited R&D budgets access innovation more easily and remain competitive.

Another important advantage is the inclusion of **contract research** in the eligible costs. When companies outsource their R&D activities, **up to 70%** of these costs can be claimed as an eligible cost base. This flexible solution is particularly beneficial for smaller companies that may need to work with external R&D providers.

Furthermore, the research allowance is broad in scope, covering **basic research, industrial research, and experimental development**. This ensures that companies benefit from the allowance at all stages of their innovation journey – from the initial concept to the development of a market-ready product.

One of the most notable strengths of the research allowance is its **retroactive applicability**. Companies can apply for funding for up to **four previous fiscal years**, a feature that is nearly unique in the German funding landscape. Moreover, the **research allowance can be combined with other funding programs**. Companies can apply for additional grants as long as they avoid double funding for the same expenses. This flexibility offers a solid foundation for financing R&D activities.

2. CHALLENGES IN APPLYING FOR THE RESEARCH ALLOWANCE

Despite its many advantages, applying for the research allowance can be challenging. The process is **twofold**: First, companies must obtain a **certification** from the **Certification Office for Research Allowance (BSFZ)**, which confirms that the R&D project is eligible for funding. Once the certification is received, companies can submit their tax incentive application to the tax office.

Navigating the detailed requirements for eligible R&D projects and preparing the necessary documentation demands precision. Companies without extensive experience in R&D funding may face uncertainties about whether their project qualifies and how to best structure their application. Common mistakes, particularly formal ones, can lead to delays or even rejections.

3. SUPPORT FROM INSIGHTFUNDING (IFC)

To address these challenges, **InsightFunding (IFC)** provides specialized support for businesses applying for the research allowance.

IFC's experienced consultants help companies structure the entire **application process**, ensuring that all key details are properly documented and submitted. This significantly increases the chances of receiving a positive certification from BSFZ.

InsightFunding guides businesses **from initial planning to final application submission**. This includes preparing applications, calculating financial data, responding to BSFZ inquiries, and creating the documentation needed for tax office submission. Their comprehensive support not only reduces the workload for businesses but also minimizes the risk of delays or rejections due to formal errors.

Even with the breadth of services provided, companies historically only needed to commit **20 working hours** in collaboration with IFC. InsightFunding manages the bulk of the process, allowing businesses to focus on their core operations.

4. CONCLUSION

The research allowance is an invaluable tool for promoting R&D projects in Germany, fostering both innovation and the competitiveness of the German economy. SMEs, in particular, benefit from increased funding options. While the application process can be complex, professional assistance from InsightFunding (IFC) simplifies the procedure significantly.

With IFC's comprehensive support, companies can maximize their benefits from the research allowance while minimizing the risk of errors or delays. This, in turn, strengthens the liquidity and innovation capacity of companies over the long term.

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