

# Taxation of Enterprises in Germany

Bahns

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The liquidation profit is subject to corporate income tax and trade tax of EUR 30,000 (30 % of EUR 100,000).

## E. Unlimited and limited corporate income tax liability

A country can only claim a **right of taxation** if there is a **sufficient nexus** between the taxable event and the **territory of that country**. Within the scope of their national tax law systems, the countries define the nexus based on which they claim the right of taxation. 60

In Germany, a distinction is made between unlimited corporate income tax liability (→ mn. 62) and limited corporate income tax liability (→ mn. 103) according to the objective scope of the matters that are included in domestic taxation. 61

### I. Unlimited corporate income tax liability

Corporations are subject to unlimited corporate income tax liability if their **place of management** (cf. § 10 GTC) or their **registered office** (cf. § 11 GTC) is in Germany (cf. § 1(1) CIT Act). Unlimited tax liability of the corporation is triggered by the presence of **one of these two characteristics**. 62

The existence of the place of management in Germany means that a corporation resident abroad<sup>13</sup> can also become subject to unlimited tax liability in Germany (dual residence).<sup>14</sup> 63

#### 1. Place of management or registered office in Germany

##### a) Place of management

The place of management is the centre of commercial executive management (§ 10 GTC). The decisive factor is where the **controlling will** of the corporation is formed, i.e. where the measures of some importance necessary for the **management in commercial matters** are decided and instructed.<sup>15</sup> Management measures include the factual, organisational and legal transactions involved in the ordinary course of business (day-to-day business). 64

This is generally the place where the person **authorised to represent** the company performs the executive activity incumbent upon him. It is therefore not important where the decisions made become effective or the prescribed measures are carried out. Instead, it is solely a matter of where all **measures** of some importance necessary for the management of the company are **instructed**. 65

<sup>13</sup> Regarding the classification of a foreign company as a corporation for German tax purposes (comparison of legal type) see e.g. BFH 4.4.2007 – I R 110/05, BStBl. II 2007, 521; BFH 25.5.2011 – I R 25/82, BStBl. II 2014, 760; → Ch. 8 mn. 98.

<sup>14</sup> Cf. e.g. BFH 5.11.2014 – IV R 30/11, BStBl. II 2015, 601.

<sup>15</sup> Cf. e.g. BFH 16.12.1998 – I R 138/97, BStBl. II 1999, 437.

- 66 In geographical terms, the controlling will of a corporation is generally formed where the **office of the managing director(s)** is located.<sup>16</sup> The deciding of technical issues is of less importance.
- 67 If **all acts of business management** are carried out at a specific, identifiable location, the centre of activity can be clearly determined. Cases in which the activities are carried out at **different locations** are problematic. In such cases, the centre of business management is to be located where, according to the overall picture of the circumstances, the most significant place is located in organisational and economic terms.<sup>17</sup>
- 68 In the case of a **division of the executive activities** into commercial and technical management, it is not the location of the top technical management (e.g. CTO) that is important, but where the commercial management (e.g. CEO) is located.<sup>18</sup>
- 69 The determination of **company policy and decisions of particular economic importance** (e.g. major investments) are not decisive.<sup>19</sup>
- 70 Due to their short duration, activities on **business trips** do not constitute a different place of management.<sup>20</sup> As it is the day-to-day business that is important, it does not constitute management if the shareholder issues individual specific instructions for the management.
- 71 If carried out in Germany, activities that could give rise to a place of management in Germany are, for example, the handling of financial transactions, the preparation of annual financial statements, bookkeeping or the permanent involvement in the ordinary course of business.
- 72 In **international enterprises**, day-to-day business is generally decided by the local company, while strategies, corporate policies and major investments are often decided at the **corporate headquarters** located in another country. Nevertheless, the local company does not have its management at the foreign headquarters of the group, but at the place of activity of its managing director.
- 73 The office of the managing director is decisive. In the case of several managing directors, the office of the **managing director in charge** is the relevant office.<sup>21</sup> If there is **no official office**, the place of management may be located at the **manager's home**.<sup>22</sup>

**Example: Place of management of a foreign corporation**

German citizen A is the managing director of B-Ltd., which is a corporation based in England. B-Ltd. operates in various states. A has lived in London for years, but moved back to Germany at the beginning of 2021, from where he also manages the day-to-day business of B-Ltd. Since the company has no offices, A acts from his home.

**Solution notes:** With the return of the managing director A to Germany and the exercise of his activity in Germany, the place of management of B-Ltd. has relocated to Germany. Also the home of A can constitute a place of management. B-Ltd. has therefore become subject to unlimited tax liability in Germany. Consequently, all income of B-Ltd. may initially be taxable in Germany (cf. § 2(2) CIT Act). However, the allocation of profits for German taxation may be restricted by existing double taxation treaties.

- 74 Every corporation must have a management and therefore a place of management.<sup>23</sup>

<sup>16</sup> Cf. e.g. BFH 5.11.2014 – IV R 30/11, BStBl. II 2015, 601

<sup>17</sup> Cf. e.g. BFH 23.1.1991 – I R 22/90, BStBl. II 1991, 554.

<sup>18</sup> Cf. e.g. BFH 23.1.1991 – I R 22/90, BStBl. II 1991, 554.

<sup>19</sup> Cf. e.g. BFH 17.7.1968 – I R 121/64, BStBl. II 1968, 695.

<sup>20</sup> Cf. e.g. BFH 23.1.1991 – I R 22/90, BStBl. II 1991, 554.

<sup>21</sup> Cf. e.g. BFH 23.1.1991 – I R 22/90, BStBl. II 1991, 554.

<sup>22</sup> Cf. e.g. BFH 16.12.1998 – I R 138-97, BStBl. II 1999, 437.

<sup>23</sup> Cf. e.g. BFH 16.12.1998 – I R 138-97, BStBl. II 1999, 437.

The place of management is at the same time a management **permanent establishment** 75 (according to the definition in § 12 sentence 2 no. 1 GTC).

In the view of the tax authorities, **all assets** that cannot be attributed to any other 76 permanent establishment of the enterprise – provided it has other permanent establishments – from a functional point of view are to be allocated to the management permanent establishment (head office) as a matter of priority (central function of the head office).<sup>24</sup> The consequence of this allocation requirement is ultimately that the state in which the place of management is located has the right to tax the net income generated by these assets (cf. Article 7(1) sentence 1 OECD MTC).

In practice, the tax authorities sometimes attempt to establish the place of management 77 based on a (**supposedly**) **de facto managing director**. They refer to persons other than the managing directors, such as the **controlling shareholders of a corporation**. However, de facto management can only be assumed if the third party takes over the tasks usually incumbent on the managing director and permanently determines the day-to-day business of the enterprise through his decisions. This is likely to be the case only in absolute exceptional cases.

### b) Registered office

The registered office of a corporation is at the place determined by **law, articles of as-** 78 **sociation, foundation deed** or similar (§ 11 GTC). Contrary to the place of management, it is not the actual circumstances but the legal provision in the articles of association that is decisive. This is also referred to as the statutory seat. The place of the registered office of an enterprise is only at the same time the place of management if there is an actual, local link with the management of the enterprise.<sup>25</sup>

A corporation must therefore be classified as being subject to unlimited corporate 79 income tax in Germany if its articles of association state that it has its registered office in Germany, but otherwise has no connection to the domestic territory.

For **unlimited tax liability**, the registered office or place of management in Germany 80 is sufficient. If the registered office and place of management are located in different countries, there is usually unlimited tax liability in both countries (dual residence).

### c) Immigration and emigration of a corporation

The registered office (cf. § 11 GTC) and the place of management (cf. § 10 GTC) play a 81 role in case of immigration (*Zuzug*) and emigration (*Wegzug*) of a company.

According to the view expressed here, the tax law classification of a foreign entity 82 as a corporate tax subject does **not depend** decisively on the **civil law treatment** of the immigration and emigration cases.<sup>26</sup> Rather, a **tax-specific interpretation** of § 1(1) CIT Act is applied.

#### aa) Immigration to Germany

Immigration means that a **foreign corporation** (established abroad) moves its **regis-** 83 **tered office and/or place of management** to Germany.

It becomes subject to unlimited corporate income tax liability (cf. § 1 CIT Act), but 84 this alone does not constitute a taxable event, i.e. it does not yet realise taxable income. This also applies if the foreign corporation maintains a **permanent establishment in Germany** with which it was previously subject to limited corporate income tax liability

<sup>24</sup> Cf. e.g. BMF dated 24.12.1999, BStBl. I 1999, 1076, mn. 2.4.

<sup>25</sup> Cf. e.g. BFH 28. 2.1990 – I R 120/86, BStBl. II 1990, 553.

<sup>26</sup> Cf. in this respect the judgments of the European Court of Justice, e.g. ECJ 9.3.1999 case C-212/97, ECLI:EU:C:1999:126 *Centros*; ECJ 5.11.2002 case C-208/00, ECLI:EU:C:2002:632 *Überseering*.

in Germany. In the context of immigration, Germany neither loses the right to tax a gain from the disposal or use of assets nor is this right to tax limited.

85 If **assets** of the corporation become subject to taxation in Germany for the first time due to the relocation, they are generally recognised at their **fair market value** (cf. §§ 4(1) sentence 8, 6(1) no. 5a PIT Act).

86 If the immigration results in a **change from limited tax liability** to unlimited tax liability during a fiscal year, the domestic source income must be determined separately (cf. § 7(3) sentence 3 CIT Act). The net income subject to limited tax liability is not included in the assessment for unlimited tax liability.

87 With respect to the **immigration** three scenarios can basically be distinguished:

- Relocation of registered office and place of management to Germany,
- Relocation of only the registered office to Germany, and
- Relocation of only the place of management to Germany.

88 In all cases it is required that, according to the comparison of legal types, a corporation (or legal person within the meaning § 1(1) CIT Act) is given.

89 (1) *Relocation of registered office and place of management to Germany.* If a corporation founded abroad relocates both its registered office (cf. § 11 GTC) and its place of management (cf. § 10 GTC) to Germany, it would become subject to unlimited corporate income tax liability in Germany (at least in case of EU companies).

90 (2) *Relocation of only the registered office to Germany.* If a corporation formed abroad relocates its statutory registered office (cf. § 11 GTC) to Germany while retaining its place of management (cf. § 10 GTC) abroad, it should also become subject to unlimited corporate income tax liability in Germany (at least in case of EU companies).

91 If the corporation is also subject to unlimited tax liability in the foreign country due to its foreign place of management, this results in **dual residence** of the corporation which may have to be dissolved in accordance with Article 4(3) OECD MTC.

92 (3) *Relocation of only the place of management.* If a foreign corporation moves its place of management (cf. § 10 GTC) from abroad to Germany and retains its foreign registered office (cf. § 11 GTC), the foreign corporation should be subject to unlimited corporate income tax liability in Germany (at least in case of EU companies).

93 If the corporation is also subject to unlimited tax liability in the foreign country due to the registered office, this results in **dual residence** of the corporation which may have to be dissolved in accordance with Article 4(3) OECD MTC.

#### **bb) Emigration to a foreign country**

94 Three scenarios can also be distinguished when a corporation with registered office (cf. § 11 GTC) and place of management (cf. § 10 GTC) in Germany emigrates to a foreign country:

- Relocation of registered office and place of management to a foreign country,
- Relocation of only the registered office to a foreign country, and
- Relocation of only the place of management to a foreign country.

95 If the **right to tax** of the Federal Republic of Germany with respect to the gain from the disposal or use of an asset is **excluded or limited**, this is deemed to be a disposal or grant of an asset at **fair market value** (cf. § 12(1) sentence 1 CIT Act, § 4(1) sentence 5 PIT Act) and results in **taxation of the capital gain**. An exclusion or limitation of the right to tax exists in particular if an asset previously attributable to a **domestic permanent establishment** of a corporation is attributed to a **foreign permanent establishment** of such corporation (cf. § 12(1) sentence 2 CIT Act).

(1) *Relocation of registered office and place of management to a foreign country.* For a corporation that moves its place of management (cf. § 10 GTC) and registered office (cf. § 11 GTC) abroad, the unlimited corporate income tax liability ends. The taxation is governed by specific rules (cf. §§ 11 and 12 CIT Act; → mn. 53). 96

(2) *Relocation of only the registered office to a foreign country.* If the corporation only relocates its registered office (cf. § 11 GTC) abroad, the unlimited tax liability in Germany remains. In this respect, it is sufficient that the place of management within the meaning of § 10 GTC continues to be in Germany. 97

If the corporation is also subject to unlimited tax liability in the foreign country due to the registered office, this results in **dual residence** of the corporation which may have to be dissolved in accordance with Article 4(3) OECD MTC. 98

(3) *Relocation of only the place of management to a foreign country.* If the corporation merely relocates its place of management (cf. § 10 GTC) to a foreign country while the registered office (cf. § 11 GTC) remains in Germany, its unlimited corporate income tax liability continues. As stipulated in § 1(1) CIT Act, it is sufficient that one of the two characteristics (here: the registered office) continues to be in Germany.<sup>27</sup> 99

If the corporation is also subject to unlimited tax liability in the foreign country due to the place of management, this results in **dual residence** of the corporation which may have to be dissolved in accordance with Article 4(3) OECD MTC. 100

## 2. Consequence of unlimited corporate income tax liability

In the case of unlimited tax liability of a corporation, its **worldwide income** is subject to corporate income taxation (cf. § 1(2) CIT Act), i.e. both domestic and foreign income. Within the scope of unlimited tax liability, all tax benefits contained in national law are applied. In particular, the principle of taxation according to the economic capacity of the corporation applies without restriction. 101

As unlimited tax liability includes **domestic and foreign income**, it taxes the entire economic capacity. Therefore, within the scope of unlimited tax liability, all factors that reduce economic performance and that are to be considered under national law are to be recognised. 102

## II. Limited corporate income tax liability

Corporations are subject to limited corporate income tax liability if they have neither their place of management (cf. § 10 GTC) nor their registered office (cf. § 11 GTC) in Germany, but generate income that has a certain nexus with the German tax net (cf. § 2 no. 1 CIT Act). The limited tax liability is therefore dependent on whether **domestic source income** (*inländische Einkünfte*, cf. § 49(1) PIT Act, for details → Ch. 8 mn. 154) is generated. 103

### Example: Domestic source income of a foreign corporation

A-Ltd. (corporation) has its registered office (cf. § 11 GTC) and place of management (cf. § 10 GTC) in England. However, it operates a permanent establishment (cf. § 12 GTC, Article 5 OECD MTC) in Germany from which it generates commercial income (cf. § 15 PIT Act).

<sup>27</sup> Cf. e.g. BFH 23.6.1992 – IX R 182/87, BStBl. II 1992, 972.

**Solution notes:** The commercial income derived from the permanent establishment in Germany constitutes domestic source income (cf. § 8(1) sentence 1 CIT Act, § 49(1) no. 2(a) PIT Act). The permanent establishment creates a sufficient nexus with the German tax net. The income therefore establishes a limited corporate income tax liability of A-Ltd. in Germany (cf. § 2 no. 1 CIT Act). This income is also allocated to Germany under the applicable DTT (cf. Article 7(1) sentence 1 DTT between Germany and UK). The income of the permanent establishment is subject to corporate income tax and trade tax.

## F. Assessment period

- 104** Corporate income tax is an annual tax and must be determined for **each calendar year** (cf. § 7(3) CIT Act). The determination period is the period in which income of the corporation is subject to German taxation. The determination period is therefore generally the calendar year. Under procedural law, the determination period is also called the assessment period (cf. § 31(1) sentence 1 CIT Act, § 25(1) PIT Act).

## G. Objective tax exemptions

- 105** German corporate income tax law knows only a few but important objective tax exemptions. Tax-exempt is, for instance, the following income:
- tax exemption of 95% for (open and hidden) profit distributions from domestic and foreign corporations to a (domestic or foreign) corporation (cf. § 8b(1), (5) CIT Act; → mn. 248),
  - tax exemption of 95% for gains from the disposal of shares in domestic and foreign corporations by a (domestic or foreign) corporation (cf. § 8b(2), (3) CIT Act; → Ch. 7 mn. 224),
- 106** Through the reference to the Personal Income Tax Act for the computation of income (cf. § 8(1) CIT Act), all objective tax exemptions of personal income tax law would in principle also be relevant for corporate income tax. However, as many tax exemptions are designed only for **natural persons**, the tax exemptions contained therein are limited to a few exceptions (e.g. tax exemption of restructuring income pursuant to § 3a PIT Act).
- 107** In addition, **personal tax exemptions** apply to certain legal persons, which, however, are not discussed in this book in detail (cf. § 5 CIT Act). For example, the tax exemption for non-profit, charitable, or ecclesiastically active corporations, associations of persons and asset funds is of importance (cf. § 5(1) no. 9 CIT Act).

## H. Hidden profit distributions and hidden contributions

- 108** The result of the corporation and therefore also the profit available for distribution to the shareholders can be influenced by the corporation and/or its shareholders without this (initially) being apparent to the outside world. There are basically **two scenarios**:

- The shareholders may **withdraw assets or other benefits** from the corporation whereby this transaction is not or not fully disclosed at the corporation as profit distribution (without an effect on income). Instead, the benefits reduce the taxable income by increasing the corporation's expenses (e.g. payment of an unusually high interest rate for a shareholder's loan) or reducing its income (e.g. sale of a property to the shareholder below fair market value). Such transactions would trigger hidden profit distribution (*verdeckte Gewinnausschüttungen*, cf. § 8(3) sentence 2 CIT Act; for details → mn. 108) by the corporation to the shareholders.
- The shareholders may **provide the corporation with assets or other benefits** that are not or not fully recognised and treated as contributions by the shareholders, but reduce the corporation's expenses or increase its income. Such transactions would trigger hidden contributions (*verdeckte Einlagen*, cf. § 8(3) sentences 3 et seqq. CIT Act) by the shareholders to the corporation.

Hidden profit distributions and hidden contributions have in common that (i) they lead to reductions or increases of the business property (*Betriebsvermögen*) of the corporation, (ii) are outside the business sphere and (iii) are caused by the relationship between the corporation and the shareholder. 109

Just like the provisions on withdrawals (cf. § 4(1) sentences 3 et seq. PIT Act; → Ch. 3 mn. 366) and contributions (cf. § 4(1) sentence 8 PIT Act; → Ch. 3 mn. 400) in relation to **business property** of natural persons (and partnerships), the concepts of hidden profit distributions and hidden contributions are intended to neutralise any increases and reductions in the income of the corporation that are triggered at the level of the corporation. 110

The neutralisation of the hidden profit distributions and hidden contributions occurs outside the balance sheet of the corporation (off-balance).<sup>28</sup> 111

The concepts of hidden profit distributions and hidden contributions are among the **important regulations** for determining the income of the corporation in the **national and international context**. In the international context, these regimes are supplemented by the adjustment provision of the FT Act (cf. § 1 FT Act, especially § 1(1) sentence 4 FT Act; → Ch. 8 mn. 542). 112

## I. Hidden profit distributions

Hidden profit distributions by corporations to their shareholders (or related parties) do not reduce the income of the corporation (cf. § 8(3) sentence 2 CIT Act).<sup>29</sup> 113

### 1. Aim of the concept of hidden profit distributions

The aim of the concept of hidden profit distributions is to ensure that the **complete separation** between the independent corporation and its shareholders, as implemented in company law, is also recognised in tax law. It is to ensure that, for tax purposes, the corporation can pursue its own commercial interests in relation to the parties involved. 114

To the extent the profit of the corporation has been reduced by the fact that it had to pursue **interests of the shareholders** that contradicts its own interests as an independent person. In so far, this reduction in profit of the corporation is corrected for tax purposes by the principle of hidden profit distribution. This principle also applies in **cross-border transactions**. 115

<sup>28</sup> Cf. e.g. BFH 29.6.1994 – I R 137/93, BStBl. II 2002, 366; BFH 12.10.1995 – I R 27/97, BStBl. II 2002, 367.

<sup>29</sup> Cf. for more details on hidden profit distributions Rengers in Brandis/Heuermann, Ertragsteuerrecht, 12/2023 Munich, § 8 CIT Act; Neumann in Rödter/Herlinghaus/Neumann, Körperschaftsteuergesetz, 2<sup>nd</sup> edn, Cologne 2023, § 8 CIT Act.



**Example: Hidden profit distribution in cross-border transactions**

A (natural person), an engineer resident in France, is a shareholder in German B-GmbH (corporation). A has developed a special manufacturing process which he makes available to B-GmbH. B-GmbH pays licence fees to A that exceed an arm's length remuneration. The license fees reduce the profit of B-GmbH.

**Solution notes:** The licence payments by B-GmbH to A constitute hidden profit distributions (cf. § 8(3) sentence 2 CIT Act) of B-GmbH to the extent they exceed an arm's length remuneration. In this respect the profit of B-GmbH is increased by an off-balance adjustment. Even if the payments have been made abroad, the profit of B-GmbH must be increased accordingly by the fair market value of the hidden profit distribution. In addition, capital withholding tax of 26.375 % (cf. §§ 43, 43a PIT Act) must in principle be withheld and paid by B-GmbH to the competent tax office.

## 2. Requirements of hidden profit distribution

116 The term 'hidden profit distribution' is not defined by law. A hidden profit distribution is understood to be a decrease in tax equity that occurs at the corporation or a prevented increase in tax equity which is caused by the corporate relationship, affects the amount of the difference in the comparison of business property and is not in connection with an open distribution.<sup>30</sup>

### a) Decrease in equity or prevented increase in tax equity

117 A decrease in tax equity or a prevented increase in tax equity is given if and to the extent the corporation either **incurs expenses** that are to be assessed as a distribution of income to the shareholders, or if and to the extent it **does not receive appropriate remuneration** for a supply or other service it has rendered to the shareholder.

118 In both cases, the decrease in equity must be determined based on the **tax balance sheet** of the corporation as it would be drawn up without taking into account the hidden profit distribution. The decisive factor for a hidden profit distribution is an **effect on the business property** (*Betriebsvermögen*; cf. § 4(1) sentence 1 PIT Act) of the corporation. The reduction within the meaning of § 4(1) sentence 1 PIT Act must be suitable for triggering income from capital investment for the shareholder (cf. § 20(1) no. 1 sentence 2 PIT Act).<sup>31</sup>

119 If and to the extent, on the other hand, the transaction is shown in the tax balance sheet exclusively on the assets side or exclusively on the liabilities side (e.g. a pure exchange on the assets or liabilities side), there is no hidden profit distribution.

120 A hidden profit distribution does not exist if and to the extent the corporation would also have accepted the reduction in equity or the prevented increase in equity **under otherwise identical circumstances** vis-à-vis a **non-shareholder** if it had exercised the due diligence of a **prudent and conscientious business manager**.

121 This may be the case if the corporation and the shareholder have agreed on an appropriate remuneration in another manner. The prerequisite for the recognition of such a **benefit compensation** (*Vorteilsausgleich*) is that there is a legal link between and consideration from a mutual contract.<sup>32</sup> In the case of a controlling shareholder, a clear and

<sup>30</sup> Cf. R 8.5(1) sentence 1 CIT Guidelines.

<sup>31</sup> Cf. e.g. BFH 7.8.2002 – I R 2/02, BStBl. II 2004, 131; BFH 10.4.2013 – I R 45/11, BStBl. II 2013, 771.

<sup>32</sup> Cf. e.g. BFH 8.6.1977 – I R 95/75, BStBl. II 1977, 704; BFH 1.8.1984 – I R 99/80, BStBl. II 1985, 18.