The German Tax System

Like almost every other tax system, the German tax system is considered to be confusing and complicated. Some say that 70% of the world's tax law literature is about German tax law. Although this statement may not be correct, the claim nevertheless indicates the complexity of German tax law. This article provides a general overview of the German tax system. [1]

1. General

In Germany, taxes are levied by the federal, state and local governments. The main taxes payable in Germany are income tax on every employee's income, corporations tax, trade tax on income, value added tax (GST), inheritance/gift tax and real estate tax. The main sources of German tax law are the Einkommensteuergesetz (Income Tax Act), Körperschaftssteuergesetz (Corporations Tax Act), the Umsatzsteuergesetz (GST Act) and the Erbschaftsteuer- und Schenkungsteuergesetz (Inheritance and Gift Tax Act). Over and above these taxes, certain levies must be paid, for example, for health insurance, unemployment insurance and superannuation. In addition, the German federal ministry of finance issues guidelines and decrees.

2. Residency Requirement

Not every person or corporation in Germany is subject to German tax. German tax law distinguishes between persons (individuals and entities) that are residents of Germany and persons that are non-residents for tax purposes. An individual is a resident of Germany for tax purposes if they have their domicile in Germany. Citizenship is not relevant in this regard. A corporation is a resident of Germany for tax purposes if it has its place of management or legal seat in Germany. A corporation that has neither its place of management nor legal seat in Germany is a non-resident. Resident status for tax purposes is assumed if the taxpayer is considered a resident of Germany (note: due to the double taxation agreement between Australia and Germans, Australian tax resident do not need to pay income tax in Germany (only in Australia), if they have stayed for less than 183 days in Germany). Taxpayers who are not resident in Germany are usually not obliged to file tax returns unless they have certain income in or from Germany. For example, foreign residents are subject to German income tax if they have rental income derived from property in Germany.

3. Income tax

3.1. Sources of Income

Under the German system, residents are subject to unlimited income tax on the income derived from the following sources of income:

1. Agriculture and forestry;
2. Trade and business;
3. Independent personal services;

[1] All taxes and thresholds amounts stated in this article are current as at 1 July 2013.

4. Employment;
5. Capital investment;
6. Rents and royalties; and
7. "other income", as specified and strictly limited by law to certain types of income such as income from private transactions and income of a recurring nature (e.g. pensions).

For each of these seven sources of income, the income is calculated separately. Profits that do not fall within one or other of the seven income sources are tax free (e.g. lottery winnings).

3.2. Income from employment

Income derived from employment is one of the seven income sources. The income tax on income derived from employment, called "wage tax", is collected by deduction at source by the employer. When the employment begins, each employee must provide a wage tax card (Lohnsteuerkarte) to the employer. The employer is required to deduct the appropriate wage tax from each payment of remuneration, based on tables that take into account the tax class and an appropriate proportion of the allowances claimed on the wage tax card. Although the employee owes the tax, the employer is responsible for withholding and remittance of the tax to the tax department.

3.3. Tax Rates for individuals

Income tax rates vary from a minimum tax rate of 14 % for income exceeding EUR 8,130.00 to 42 % for income above EUR 52,882.00 for single individuals. Income above EUR 250,731.00 is taxed at 45%. In this regard it should be noted that the German tax system allows partners to be assessed together with the benefit that their individual a thresholds are combined. For example, if only one partner works and the other one stays at home, the working partner receives the benefit of the other partner's tax threshold of EUR 8,130.00. In addition, a 5.5 % solidarity surcharge on income tax is levied. The solidary surcharge was introduced in connection with the German re-unification, and has the purpose of assisting the eastern parts of Germany in their economic development.

3.4. Corporations Tax

Corporations tax is income tax payable on the income of companies. A standard corporation tax rate of currently 15 % applies to both the company's retained (undistributed) profits and its distributed profits. However, if profits are distributed to shareholders, the shareholders must in turn pay income tax on these distributions. However, only 60 % of the payout to the shareholder is subject to income tax, while the other 40 % remains tax-free. The solidarity surcharge of 5.5% is also levied on corporations tax.

4. **Trade Tax**

All businesses in Germany are subject to trade tax. The tax is calculated on the basis of the operating profit. The trade tax is levied by local governments and every local government sets the rate for the tax applicable in its municipality. The tax rate is usual between 9% and 20%. In the past, local authorities attempted to attract business by setting a very low trade tax rate. As a consequence, a minimum tax rate of 9% was introduced in 2004.

5. **Inheritance/ Gift Tax**

Generally, inheritance or gift tax is payable if either the deceased/donor or the beneficiary/donee is:

- an individual with a domicile or a habitual residence in Germany;
- a German citizen who has been living outside of Germany for less than five years;
- a German citizen who lives abroad and receives payments from the German government; or
- a corporation, association or entity with a place of management or a registered office in Germany.

German inheritance tax is also payable if the deceased owned certain assets in Germany (e.g. real estate and certain kinds of shares) even though neither the deceased nor the beneficiary reside or have resided in Germany.

German inheritance tax law creates three tax classes of beneficiaries. The relationship between the beneficiary and the deceased (or donor and donee) determines the tax class to which the beneficiary/donee belongs. Different tax exempt thresholds and tax rates apply to each tax class. The tax payable depends on the class and the value of the inheritance/gift, and ranges between 7% and 50%.

6. **Real Estate Tax**

Anyone who owns land in Germany must pay real estate tax. This tax is based on the value of the land and the building(s) erected on it. The applicable tax rate is determined by the relevant local governments and is usually between 1% and 2%.

7. **GST**

GST in Germany is levied on the provision of goods and services in the country. The current rate of GST in Germany is 19%. A reduced tax of 7% applies to the sale of particular items such as foods, magazines and books.

8. **Administration**

Taxes are administered and collected by the Federal Ministry of Finance, the Ministry of Finance of the states and by local tax offices. Every taxpayer must be registered with the tax office and each taxpayer is provided with an individual tax file number.

9. **Tax returns**

The German tax system is not based on self-assessment (with the exception of GST). After the end of each tax year (the German tax year is the calendar year), each tax resident must submit a tax return. In general, tax returns are due on 31 May unless a tax adviser has been instructed to lodge the tax return, in which case the due date is 31 December.

10. **Levies**

10.1. Health Insurance

In Germany, generally every employee must be a member of a health fund. Employees who earn less than EUR 4,350.00 per month must be part of a statutory health insurance (Gesetzliche Krankenversicherung). The monthly premiums are deduced from the employee's wages and paid by the employer. The current statuary contribution is 15.5% of gross income up to a maximum of EUR 313.65 per month. The employee pays 8.2% of the contribution which is deducted from their wages, and 7.3% is paid by the employer on top of the salary. Employees who earn more than EUR 4,350.00 per month may opt out of the statutory health system and join a private health fund. The employer must then contribute towards the premiums paid by the employee to the private health fund.

10.2. Unemployment insurance

Employees must also contribute to the national unemployment insurance, which is administered by the Federal Ministry of Employment. If an employee becomes unemployed after 12 months of continuous employment, they are entitled to payments from this insurance (around 75% of their last net income). The current statutory contribution is 3% of the gross income which is deducted on a monthly basis by the employer.

10.3. Superannuation

Employees must also contribute to the statutory pension insurance (Gesetzliche Rentenversicherung). The monthly payments are paid by the employer directly to the statutory pension insurance. One half of the contribution is deducted from the employee's monthly salary and the other half is paid by the employer on top of the monthly salary. The current statutory contribution is 18.9% of the gross income (i.e. 9.45% must be paid by employer and 9.45% by the employee).

10.4. Conclusion

German tax law requires residents and certain non-residents to pay tax in Germany. In addition, German law also requires the payment of certain levies for other services. Whether taxes or levies are payable in individual circumstances needs to be assessed for each individual case separately. The question of an individual's or corporation's tax position should be discussed with a lawyer or accountant to achieve the best possible outcome.

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