M Law Group

Your German Sub

Information for US parent companies and home offices with German operations
an MLawGroup Publication

Issue 02/2007

Germany is taking significant steps to improve the investment environment for national and international companies by implementing lower tax rates comparable to other states in Europe.

As part of this tax reform, 2008 will bring new tax regulations for German corporations. The new regulations will, among others, provide for

- lower corporate income tax rates (see no. 1 below)
- safe haven for interests as deductible expenses (see no. 2 below)
- survival of loss carry forward following a change of control (see no 3. below) and
- tax exemptions for dividends and capital gains (see no. 4 below).

1. Lower Corporate Income Tax Rates

The corporate income tax will be reduced from 25 % to 15 % for business years starting January 1, 2008. Local trade income taxes will also be reduced but will no longer be deductible in determining taxable income.

The exact tax rate for a corporation will still depend on where the corporation is located. Large communities typically ask for higher rates, as example

Munich: 32.98 % = 15 % corporate income tax
+ 0.83 % new states tax
+ 17.15 % local tax

Smaller communities typically provide for lower rates. Just outside of Munich interesting sites with advantageous conditions are for example:

Ismaning (software and semiconductor cluster):
28.08 % = 15 % corporate income tax
+ 0.83 % new states tax
+ 12.25 % local tax

Martinsried (biotech cluster):
26.33 % = 15 % corporate income tax
+ 0.83 % new states tax
+ 10.50 % local tax.

2. New Thin Capitalization Rules

The current thin cap rules for corporations will be replaced as follows: A balance between interest earned and interests paid up to the amount of EUR 1 Mio. per year can be fully deducted by the corporation as interest expense. If the balance exceeds

Please do not hesitate to contact us for any comments you might have or if you require more detailed information.

MLawGroup
Maximilianstraße 31
80539 Munich, Germany

DR. HUBERT BESNER
hubert.besner@mlawgroup.de
Tel: +49 89 24 213 103
Fax: +49 89 24 213 213

RAINER KREIFELS
rainer.kreifels@mlawgroup.de
Tel: +49 89 24 213 105
Fax: +49 89 24 213 213

DR. FLORIAN VON BAUM
florian.vonbaum@mlawgroup.de
Tel: +49 89 24 213 101
Fax: +49 89 24 213 213

>> www.mlawgroup.de

EUR 1 Mio., the exceeding amount can be deducted as expense (i) in full if the interest-profit-ratio of the corporation equals the interest-profit-ratio of its foreign affiliates or, otherwise, (ii) up to 30 % of the corporation's EBITDA.

3. Survival Of Loss Carry Forward In Change Of Control Cases

In general, the use of a loss carry forward following a change of control will depend on the percentage of shares transferred in a five year period. If the volume of share transfers of all outstanding shares of the corporation:

- remains below 25 %, the loss carry will remain fully available;
- is between 25 % and 50 %, the loss carry forward will be reduced on a pro rata basis; and
- is more than 50 %, the loss carry forward shall no longer apply.

This is an important change because the former provisions regulating this issue were unclear and ambiguous.

4. Partial Tax Exemptions For Dividends And Capital Gains

40 % of dividends and capital gains received by an individual from the holding or selling of shares in other companies will be exempted from taxation and only the remaining 60 % will be subject to income tax. Consequently, 60 % of all business expenses associated with the holding or selling of shares can be deducted from taxable profits.

Dividends and capital gain, earned by a corporation from the holding or selling of shares in other companies will remain to be exempted from taxation. It is remarkable that this important tax exemption has survived the business taxation reform, especially so as experts had worried that it would be abolished entirely in the course of such reform.

*****