

# The Legal Framework in Germany

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Investors Essentials: Residence, Company Formation, Tax, and Labor

January 30, 2009



GERMANY  
TRADE & INVEST

## I. Entry & Residence

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# I. Entry & Residence

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German residence law has a liberal attitude towards foreign investors.

- German law generally makes no distinction between Germans and foreign nationals regarding investments or the establishment of companies.
- There is no specific investment legislation in Germany, nor is there a minimum percentage of German shareholdings required for a foreign investment within Germany.
- General regulations relating to residence and employment in Germany vary depending on the foreign national's country of origin, intended length of stay, purpose of the visit, and the function of the individual applicant.
- For stays of less than 90 days, the visa requirement has been abolished by EC regulation for nationals of approximately 30 states.
- As a rule, all non-EU/-EEA nationals require visas for stays of more than 90 days or for the purpose of taking up gainful employment (employed or self-employed).
- Applications must be submitted to the German missions (embassies or consulates general) in the foreign national's country of residence. Foreign nationals from certain countries can apply after entering Germany.
- All EU citizens can set up business and take up self-employed work in Germany without the requirement of any permit.

# I. Entry & Residence

Types of visa required for setting up and running a business in Germany:

## Setting up a Business

### Schengen “Business Visa”

For activities related to the establishment of a company, foreign nationals merely require a Schengen Travel Visa (*Business Visa*) for short-term stays.<sup>1</sup>

A business visa is sufficient for:

- preparatory activities for setting up a business,
- conclusion and notarization (where necessary) of the company agreement
- commercial register application (through notary),<sup>2</sup>
- trade office notification.<sup>2</sup>

It does **not** permit taking up work.

Accordingly, typical activities of a managing director or other activities (e.g. signing employment contracts) are not permitted.

<sup>1</sup> However, any investor setting up a business in Germany on a Schengen Visa should be aware that this alone does not warrant later issue of a Residence Permit.

<sup>2</sup> Common practice of the Commercial Register and Trade Office is not to require a residence permit for these steps as this is not explicitly required by law.

## Running a Business

### Residence Permit

All activities carried out by managing directors or other senior executives in the course of running a company are considered to be self-employed work.

To take up self-employed work in Germany, a Residence Permit for the Purpose of Self-Employment (*Aufenthaltserlaubnis zur Ausübung einer selbständigen Tätigkeit*) is required.

# I. Entry & Residence

Investors can apply for different residence types subject to the establishment phase.

## Schengen Travel Visa

### Period of Validity

Schengen Travel Visa can be issued for one or more entries over a period of up to 5 years in advance where:

- the length of a continuous visit, or
- the total length of successive visits in the Schengen area does not exceed 90 days per half-year from day of entry.

### Permissible Activities

Permits travel and residence; business visa also permits certain business activities – but not taking up work – in all Schengen states.

### Issuing Authority

Generally to be obtained prior to entry from the German mission abroad.

**Exception:** nationals from countries for which EC has abolished visa requirement for short-term stay.<sup>1</sup>

## Residence Permit

### Period of Validity

Valid for a **limited duration** as set out in the permit. For business founders usually limited to one year; extended after first year if business idea proves sustainable.

### Permissible Activities

All activities related to the specific purpose as set out in the permit.

Usually granted for:

- investments of min. EUR 250,000, and
- the creation of at least 5 new jobs.

If these criteria are not met, an individual assessment of the project takes place.

### Issuing Authority

Applications at German missions abroad prior to entry – issued by the local German foreign nationals office after entry with national visa.

**Exception:** nationals from certain countries may apply for a residence permit after entering Germany.<sup>1</sup>

## Settlement Permit

### Period of Validity

Permanent = no limits on time and place.

### Permissible Activities

No restrictions regarding the purpose of stay.

Automatically includes right to take up gainful occupation, no restrictions on access to the labour market.

### Issuing Authority

Issued by the local German foreign nationals office (usually after holding a residence permit for five years).

- Self-employed foreign nationals may also be granted a settlement permit after holding a residence permit for at least three years.
- Certain highly qualified foreign nationals may be eligible for settlement permit from the outset (see *Residence Permit* for application procedure).

<sup>1</sup> List available under: [www.auswaertiges-amt.de](http://www.auswaertiges-amt.de)

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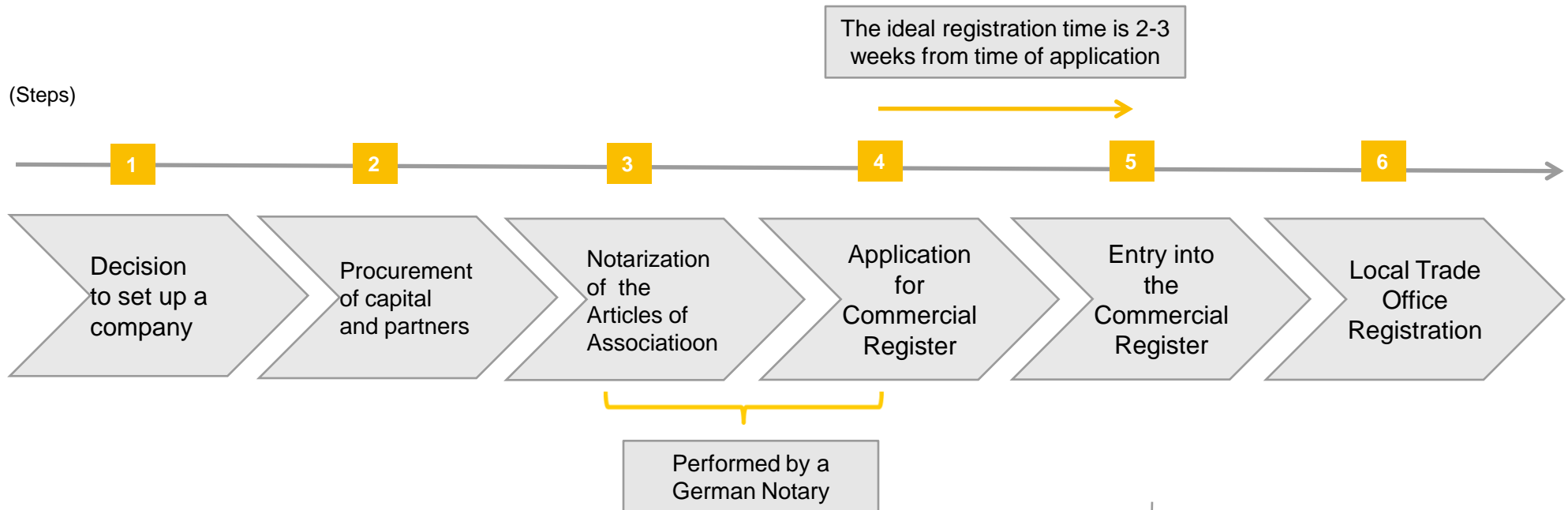
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## II Company Formation

Setting up a company in Germany only takes a few steps.

The timeline for the formation of a company very much depends upon:

- the legal “form” the new business takes (not all steps in the timeline are compulsory for all company legal forms) ;
- the quality of the foreign investor’s preliminary preparations (i.e. document translation).



## II. Company Formation

Before choosing the legal form of the German business, some factors need to be considered.

### 1. Size and Type of the Business

- Is the company small, medium or large?
- Will it conduct professional freelance activities?

### 2. Liability and Minimum Share Capital

- Is a limited liability possible?
- Must all partners bear personal unlimited liability?
- Is a minimum share capital required?

### 3. Founding Formalities and Costs

- Are the founding formalities and costs high, moderate or low?

### 4. Internal Organization

- The possibility to have different types of shareholders
- Decision-making process

### 5. Taxation

- What taxes do I or the company have to pay?
- Personal income tax, corporation income tax, trade tax, solidarity surcharge

### 6. Minimum Number of Partners

- How many partners are required for this company legal form?



## II. Company Formation

There are different legal structures available to companies setting up business in Germany.

Legal/Establishment Form	Legal Liability	Minimum Capital	Number of Persons Required	Establishing Formalities
Dependent Branch Office ( <i>Unselbständige Zweigniederlassung</i> )	Subject to the head office legal company form	None required	Minimum one person	Very low
Autonomous Branch Office ( <i>Selbständige Zweigniederlassung</i> )	Subject to the head office legal company form	None required	Minimum one person	Moderate
Limited Partnership ( <i>Kommanditgesellschaft / KG</i> )	Limited partner: liability limited to shares. General partner: personal unlimited liability	None required	Minimum two partners	Low
German Limited Liability Company ( <i>GmbH</i> )	Limited to share capital	EUR 25,000	Minimum one person	Moderate
Limited Liability Entrepreneurial Company ( <i>“Mini-GmbH”</i> )	Limited to share capital	EUR 1	Minimum one person	Low
Corporate Partnership ( <i>GmbH &amp; Co. KG</i> )	Limited partner(s): liability limited to shares. General partner: GmbH, limited to own limited share capital	None required	Minimum one partner (shareholder of the general partner; GmbH is identical to the limited partners of the KG)	Moderate-High
Stock Corporation ( <i>Aktiengesellschaft / AG</i> )	Limited to share capital	EUR 50,000	Minimum one person	Moderate-High

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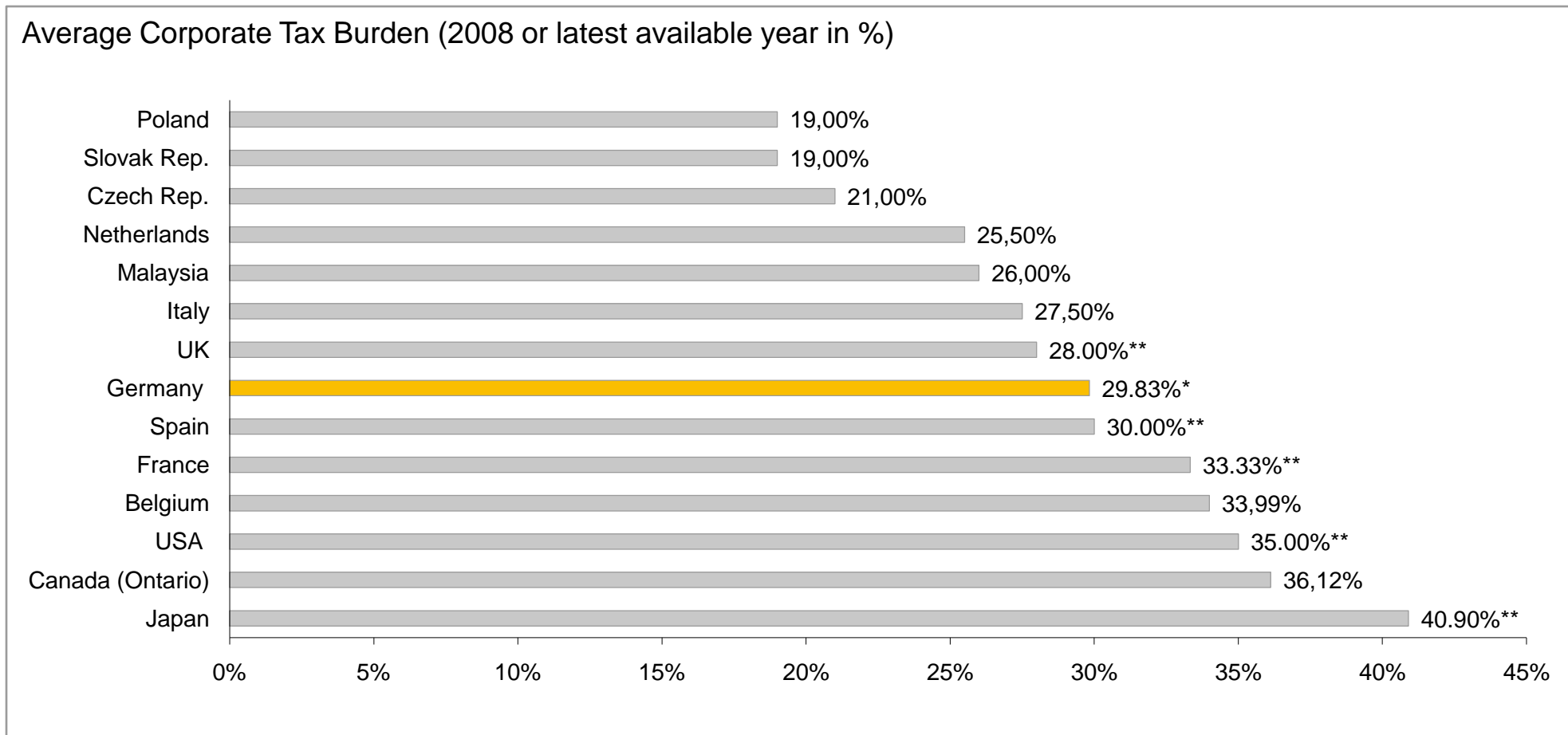
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### III. Taxation

The 2008 German company tax law reform has reduced the average tax burden for corporations from 38.7% to 29.8%.



Including 15 % Corporate Income Tax, 0.83 % Solidarity Surcharge, and 14 % Trade Tax (assumed municipal collection rate: 400%).

\*\* Top corporate income taxation rate; lower starting rates or other special tax rates available. Example USA: progressive rate from 15 % to 35 % (> USD 18,330,000)

The legal form a company takes is decisive upon its income tax liability.

	Corporate Income Tax ( <i>Körperschaftsteuer</i> )	Personal Income Tax ( <i>Einkommensteuer</i> )	Trade Tax ( <i>Gewerbesteuer</i> )
Tax Liability	Corporations ( <i>GmbH, AG</i> )	Partnerships, registered sole proprietors (including all private individuals)	All business enterprises (excluding farming and forestry businesses; no freelance professionals)
Tax Base	Taxable corporate income	German residents: worldwide income (EUR 7,664 tax free)  Non-residents: German income	Business profits ( $\approx$ taxable income) <sup>1</sup>  + certain statutory additions and allowances <sup>2</sup>
Tax Rate	Flat: 15% (regardless of whether profits are distributed or not)	Progressive: 15% - 42% (45 % for every euro above EUR 250,000).	<ul style="list-style-type: none"> <li>▪ 3.5% trade tax assessment rate (uniform federal rate)</li> <li>▪ Municipal collection rate (from the statutory minimum: 200% to up to 490%)</li> <li>▪ Trade tax rate = 3.5% (federal rate) x municipal collection rate</li> </ul>
Solidarity Surcharge	+ 5.5% of Personal or Corporate Income Tax burden ( <b><i>not</i></b> of the income as such)		

<sup>1</sup> Partnerships and sole investors can offset a significant part of their trade tax payments against their personal income tax duty

<sup>2</sup> Business profits reduced by a tax-exempt allowance, amounting to EUR 24,500 for partnerships and sole proprietorships

### III. Taxation

Example calculation for determining the overall tax burden for corporations in Germany.

**Example** (assuming an average municipal collection rate of 400%)

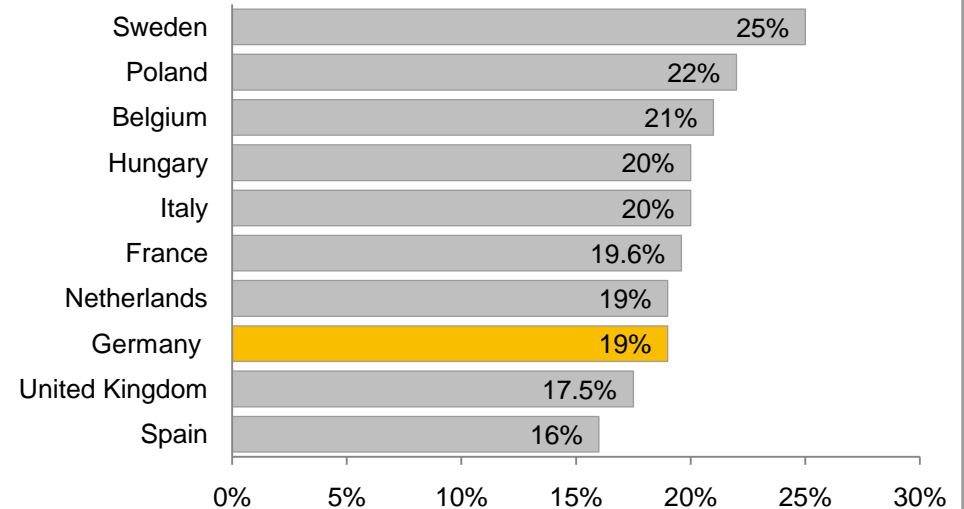
	Tax Burden (in EUR)
Taxable Corporate Income (EUR)	1,000,000
Trade Tax (federal trade tax rate: 3.5%, municipal collection rate depending on the municipality, exemplary rate: 400%) (EUR)	-140,000
Corporate Income Tax (tax rate 15%)	-150,000
Solidarity Surcharge (5.5% of corporate income tax)	- 8,250
<b>Net income</b>	<b>= 701,750</b>
<i>Overall Tax Burden</i>	<i>~ 29.83 %</i>

## Value Added Tax (VAT) in Germany

- VAT is a tax independent of the legal form of the investment.
- VAT received is transferred to the tax authority monthly, quarterly or annually depending on turnover.
- Companies themselves are also generally liable to VAT when purchasing goods or services.
- VAT paid by companies can generally be offset in the VAT return against VAT received through sales.

Tax Liability	Most business enterprises
Tax Base	Delivery of goods and services; VAT for incoming deliveries and services recoverable or deductible as Input VAT.
Tax Rate	19% (7% for certain convenience goods)

**European VAT Rates in Comparison (2007, in %)**



Source: European Commission (2007)

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## IV. Labor Regulations & Social Insurance

A number of different employment models ensure flexibility.

<b>Standard Employment Contracts</b>	<ul style="list-style-type: none"><li>▪ Unrestricted in time, but often include a probationary time of a maximum six months.</li><li>▪ Both sides can terminate the employment contract during the probationary period subject to a two week notice period (without having to give reasons for the termination).</li><li>▪ Companies may offer a fixed-term contract before offering an unrestricted contract.</li><li>▪ No compensation payment for job loss after termination is necessary (unless agreed upon).</li></ul>
<b>Fixed Term Contracts</b>	<ul style="list-style-type: none"><li>▪ Automatically expires at an agreed date (no dismissal required to terminate these contracts).</li><li>▪ No compensation payment for job loss after expiry of the contract is necessary.</li><li>▪ The duration of a fixed-term contract is limited to a maximum of 24 months where no objective reasons justifying a longer limited period exist.</li><li>▪ During the first four years of a company's existence, employment contracts may be limited or extended several times up to a total duration of four years.</li></ul>
<b>Other Models Available</b>	<ul style="list-style-type: none"><li>▪ <b>Temporary Employment:</b> Temporary employment means that a company can hire staff without concluding an employment contract. Instead, the company hires staff from a temporary employment agency by concluding a service contract which regulates the conditions under which the employees are sent to the hiring company.</li><li>▪ <b>Mini-Jobs:</b> Jobs with salaries less than EUR 400 per month or short-term periods of employment (less than 50 days per year).</li><li>▪ <b>Midi-Jobs:</b> Jobs with salaries between EUR 400.01 and 800 per month.</li></ul>



Termination of Employment by the Employer is regulated by the Employment Protection Act.

### The Employment Protection Act

- Establishes certain rules protecting employees from socially unfair regular dismissal.
- Applicable only to companies with more than 10 employees and employees employed for a period of more than six months at the time of dismissal.
- Considers a dismissal socially unfair and hence ineffective if it can not be justified by one of the following reasons:
  - *personal circumstances* of the employee:  
e.g. series of short-term illnesses or long-term illness
  - *misconduct of the employee*:  
e.g. poor performance
  - *pressing operational reasons (business reasons)*:  
e.g. changes in the employer's business organization resulting in redundancies (plant closure, reduction of workforce due to order volume shortages).

In companies where the act is not applicable, employers generally have an unrestricted right to terminate employment contracts within the statutory notice periods.

### Certain notice periods are required by law

- After the probationary period of a new employment contract has ended, the initial notice period is 4 weeks.
- The notice period increases to seven months after 20 years of job tenure in the same company.

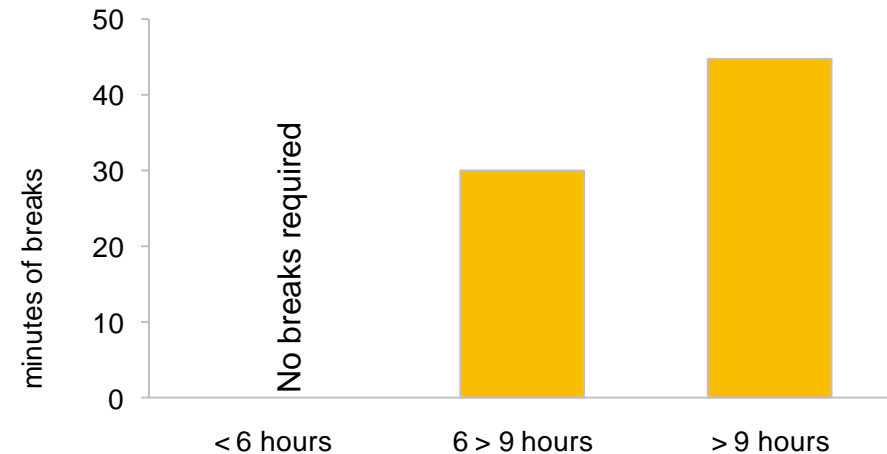
Maximum working time and minimum break regulations are applicable throughout Germany.

### Working Hours

- The maximum working week for employees (excluding management level) is 48 hours a week (8 hours over 6 days).
- 60 hours a week (10 hours over 6 days) is possible provided that the six month average does not exceed 8 hours a day.
- Stricter extended working hour regulations hours apply to night shift work.
- More than 10 hours a day may be agreed upon by collective labor agreements in those economic sectors where working time frequently and significantly consists of on-call duty.

### Working Breaks

Work breaks required per hours of work



- The length of work-breaks depends upon the total hours an employee works during a given day.
  - Breaks may be split, but fractions there of may not be shorter than 15 minutes.
  - Between shifts there are mandatory breaks of at least 11 hours.

Works councils can be formed in companies with five or more employees.

### Regulation of the Works Council

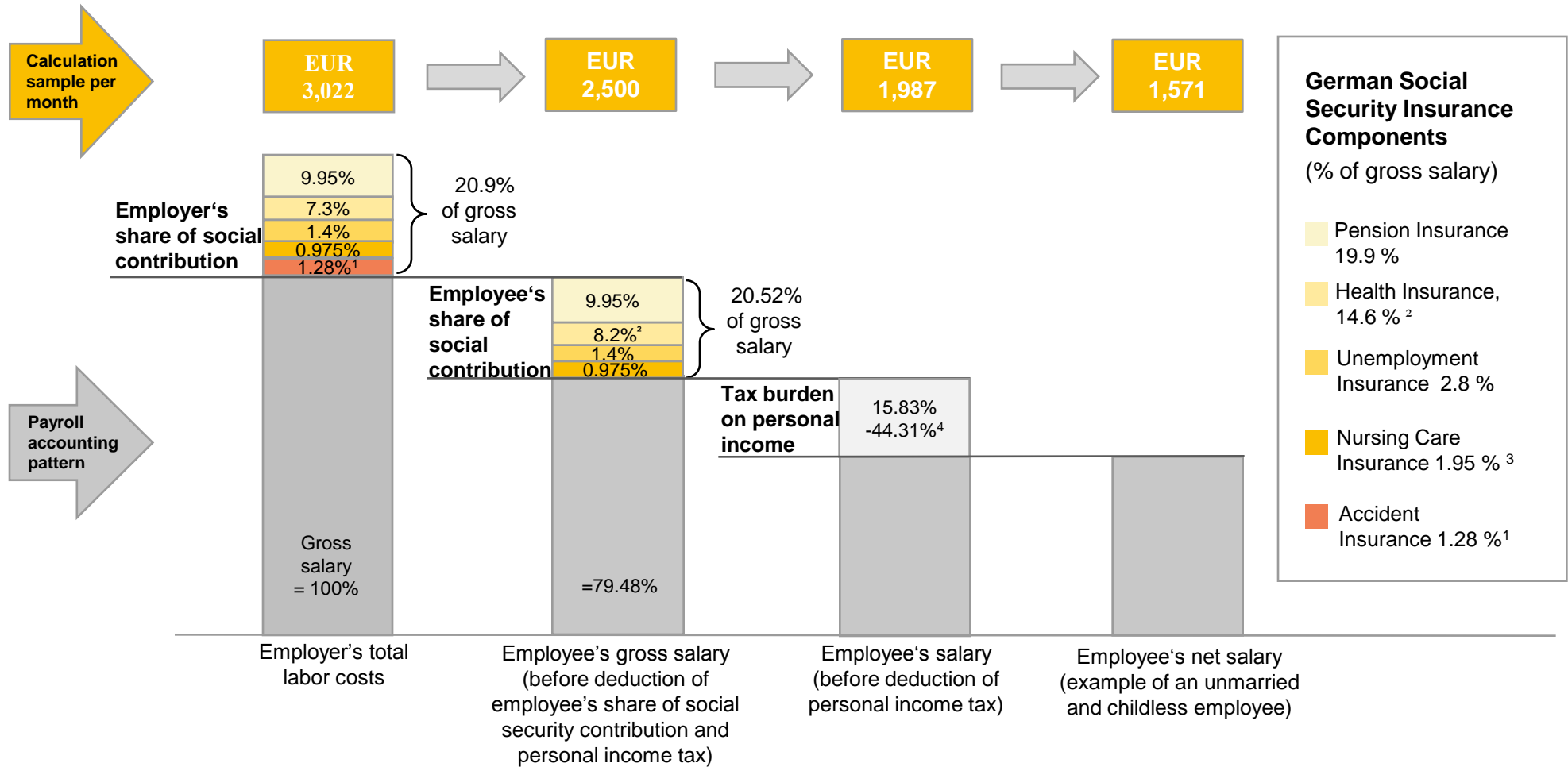
- Establishment of a works council takes place at the request of the employees.
- Councils members are elected for a period of four years.
- Candidates do not need to be union members.

### Rights of the Works Council

- Information and advisory rights in business issues.
- Negotiation of organizational, social, and other related matters.
- Consultation by the employer in human resources issues:
  - In companies with more than 20 employees, works council approval is required for hiring, pay scale grouping, redeployment or similar measures.
  - The works council must be heard (but does not have to grant approval) prior to each dismissal.
- The works council does not become involved in corporate governance.

# IV. Labor Regulations & Social Insurance

In Germany social security contributions are shared roughly 50/50 by employer and employee.



<sup>1</sup> Apportionment quota levied for 2007 according to HVBG (the association of workers' compensation boards)

<sup>2</sup> Employee pays an extra 0.9% on health insurance ( § 241a SGB V)

<sup>3</sup> Childless employees pay an extra 0.25 % on top of their nursing care contributions

<sup>4</sup> Total tax burden ranges from 15.83% - 44.31% (progressive taxation) on annual salary after deduction of social security contribution.

Note: The employer withholds the employee's share of social security contributions from salary and pays it together with his/her own share to health insurance.

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*For further questions about migration to Germany, please contact the German embassy or consulate-general in your home country. Contact details are available via the website of the*

**German Federal Foreign Office:** [www.auswaertiges-amt.de](http://www.auswaertiges-amt.de)

*If legal advice is required, please contact a lawyer or tax advisor. To identify the most appropriate lawyer or tax advisor, please consult:*

**Deutscher Anwaltverein**  
(German Bar Association)  
[www.anwaltverein.de](http://www.anwaltverein.de)

or

**Deutscher Steuerberaterverband**  
(German Association of Tax Advisers)  
[www.dstv.de](http://www.dstv.de)

*or contact*

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