The Business Commitment of a Norwegian Company in Germany: An Examination of investment alternatives from a tax perspective

by Daniel Jäck, Master student at NHH

The German market is large and of great economic importance for Norway. A detailed understanding of the German tax system and the cross-national regulations between Germany and Norway are necessary for Norwegian companies who assess investments projects in Germany. My thesis aims to provide this information. It may also serve as an introduction to the topic for civil servants in the Norwegian Tax Administration who deal with companies that have German affiliates.

Background and Purpose

The relationship between Norway and Germany is characterized by broad political, economic and cultural cooperation. The opportunities for Norwegian companies in the extensive German market are enormous. In order to seize these opportunities without exposing oneself to the risk of the unknown, a profound knowledge about the country's complex legal and political structure is essential. Against this backdrop, the purpose of this master thesis is to provide Norwegian companies with the necessary information about the German tax system in order to support sound investment decisions. However, the paper is not exclusively addressed to Norwegian companies, but also intended to equip the Norwegian tax authorities with new insights that could help them to facilitate internationally operating Norwegian companies.

Scientific Approach

The heart of the thesis is a comparative examination of different investment alternatives from a tax perspective. The underlying analysis is based on defining a common frame of references first. Given this framework, a legal model is applied that allows comparing the different alternatives. In this way, tax consequences of significant aspects are highlighted for the different investment approaches.

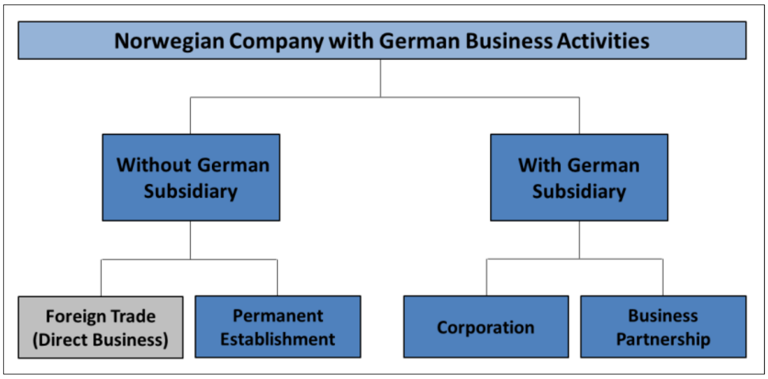
Content

For defining the frame of references and for evaluating the different forms of investment, this paper has identified three major aspects as an assessment base: The *current taxation*, as the most important factor, is especially crucial if the investment has a long-term character. The possibility to *use losses* is particularly interesting when high initial losses are expected or if no positive returns are anticipated in the near future. If the activities in Germany are only laid out for a limited period of time, tax consequences as a result of the *termination of the engagement* have to be taken into consideration.

In order to value different investment decisions, it is also essential to have a basic understanding of the German tax system. The most relevant types of taxes for foreign investors in Germany are the personal income tax, taxing the income of individual persons, the corporate tax, taxing the profits of corporations and the municipal trade tax, taxing the business establishment regardless of their legal form. Besides the German national legislation, also the cross-national regulations between Germany and Norway are crucial factors when analysing different investment alternatives. In this respect, especially the *Double Tax Agreement* (DTA) between both countries is crucial. It has the purpose to prevent undesired double taxation, by granting generally only one of the both countries a right of taxation.

Norwegian companies can enter the German market with various forms of investment. The following three alternatives are tested within the frame of references: A *Permanent Establishment* offers the Norwegian company the opportunity to enter the German market without founding a foreign subsidiary. In case the establishment of a German subsidiary is desired, the Norwegian company has the alternative of a *Business Partnership* or a *Corporation* as a fully independent legal entity. Within these three major alternatives, the analysis distinguishes between a Norwegian shareholder in form of an individual person or a corporation.

Figure 1: Investment alternatives



Preliminary Results

In case a Norwegian individual person is planning a long-term investment in Germany and expects positive returns which shall be reinvested in Germany, a subsidiary in form of a German corporation has advantages in regard to *current taxation*. Is the profit not reinvested but distributed, the tax burden in Germany is still least for a corporation. However, the distributed profit is subject to further taxation in Norway in combination with a German tax credit of the second level (€ 11.105). This has to be taken into account when assessing different tax outcomes. The following table compares the German tax burden with an assumed profit of € 100 and a maximal tax rate. The tax burden of the permanent establishment and the business partnership is including the personal income and municipal trade tax. The business profit of the corporation is on the first level liable to corporation and municipal trade tax. On the second level, the withholding tax on capital investment is subtracted in consideration of the DTA:

Figure 2: Current taxation of different investment alternatives in Germany

	Permanent Establishment		Business Partnership		Corporation	
Current taxation in Germany	Business profit	€ 100	Business profit	€ 100	Business profit	€ 100
	German taxation	€ - 48.175	German taxation	€ - 48.175	German taxation I	€ - 29.825
	After tax Profit	€ 51.825	After tax Profit	€ 51.825	After tax profit company level	€ 70.175
					German taxation II	€ - 11.105
					After tax profit shareholder level	€ 59.07

If the Norwegian business is a corporation itself, the three different investment possibilities will lead to an identical tax burden of € 29.825 in Germany. However, 3 % of the profits, distributed from a German to a Norwegian corporation are liable to taxation in Norway. In addition, it should be noted that a profit distribution from a Norwegian corporation to a Norwegian shareholder in form of an individual person will lead to further taxation in Norway.

In case the German investment is no longer serving its purpose, the activities will be terminated. A capital gain from the disposal or liquidation of a permanent establishment, business partnership or corporation is subject to taxation in Germany. However, the DTA is only allocating the taxation right of the first two alternatives to Germany, while Norway has the taxation right in case of the disposal of a corporation. As a result, a Norwegian shareholder with the intention to terminate its engagement in Germany after a certain period of time should examine if taxation in Germany or Norway would be more advantageous.

Even though the choice of an investment alternative can have a major effect on the tax burden of a business, the decision should also include aspects other than taxation. In many cases, the differences in tax burden and thus the differences in profits might be marginal between the investment alternatives. In such a case, characteristics as liability, seed capital, organisational structure as well as disclosure requirements and auditing duties should be taken into account. All these aspects as well as tax considerations should be included in the analysis and be appropriate to the intended business activity.

Recommendation

A basic understanding of the German tax system is essential when planning to enter the German market. Such knowledge can be gathered by reading relevant literature or information provided by the authorities. However, the author advises firms to seek professional counselling in order to make optimal decisions regarding the most appropriate investment alternative.