

Tax Basics

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Content

- Income tax
- Tonnage tax
- Trade tax
- Turnover tax
- Inheritance tax and gift tax

Income tax

Income from trade or business:

As a rule, the equity investment companies initiated by Hanseatic Lloyd Reederei GmbH & Co. KG are founded with the legal form of a limited partnership. The investors acquire shares in this company as limited partners. In this way they participate in the profits and losses as well as in the hidden reserves of the one-ship company (co-entrepreneurial risk). The collaboration of the shareholders in reaching major decisions is ensured not only through the partnership agreement but also by the trustee and business management agreement. They possess – both directly but also indirectly via the advisory board – the voting rights, inspection rights and rights to object to which a limited partner is entitled under the HGB [German Commercial Code] (co-entrepreneurial initiative). The shareholders must therefore be regarded as co-entrepreneurs; they earn income from trade or business in accordance with § 15 Sect. 1 No. 2 EStG [German Income Tax Law].

As far as the concept is concerned, it is normally assumed that the investors are exclusively natural persons who according to § 1 Sect. 1 EStG are subject to unlimited tax liability.

At the level of the company this income is uniformly and separately determined by the tax office in whose district the permanent establishment of the company is domiciled. Then the prorated results are taken into account in the income tax assessment for the investor by the local tax office for his residence or customary place of abode. Taxation at the level of the investor is applied at the individual rate of income tax. Since 2008, the top rate of income tax from an income of EUR 250,000 (single) or EUR 500,000 (joint assessment) has been 45.0 %.

Total profit for tax purposes

Business income is only recognised by the fiscal authorities if an intent to realise a profit exists. This is examined at the level of the company and of the shareholders on the basis of the total profit. In this context it is necessary to prove that the corresponding equity investment company will with a high probability earn a substantial increase in its company assets by the end of the planning period. In accordance with the principles of the decision of the BFH [German Federal Fiscal Court] dated 21st August 1990, the supposition of a lack of intent to realise a profit would thus be refuted. The examination of total profit is carried out on the basis of the conventional determination of net income.

The lump sum determination of net income after tonnage tax (see also “tonnage tax”) is not taken into account in this context (cf letter of the BMF [Federal German Ministry of Finance] dated 12th June 2002 amended by the BMF letter dated 31st October 2008).

An investor who sells his equity share or who transfers it free of charge before he has achieved a total profit must reckon with his intent to realise a total profit being subjected to a special examination by the fiscal administration. Insofar as an equity investment company has opted for the tonnage tax, no tax is payable on the total profit for tax purposes. Taxation is oriented to the lump-sum tonnage-based net income.

Depreciation and preliminary expense

According to the current German AfA table for depreciation for wear and tear, new ships are written off over a useful lifetime of twelve years. An alternative to the straight-line method of depreciation is to apply declining balance depreciation to assets that were acquired or produced before 31st December 2007. Here it is possible to write down twice the straight-line depreciation for wear and tear (max. 20 % p.a.). According to the “Law to Promote Growth and Employment”, a declining balance method of depreciation up to three times the linear AfA depreciation amount (max. 30 % p.a.) can be applied to movable assets of the business assets that are acquired or produced after 31st December 2005 and before 1st January 2008. Accordingly, ships that are delivered during this period could according to the AfA depreciation table be written down at max. 25 % p.a. Only the straight-line method of depreciation is possible for assets that were acquired or produced in the year 2008. Within the framework of the “Law to Implement Fiscal Regulations of the Package of Measures to Secure Employment through Strengthening Growth”, the declining balance method of depreciation up to two and a half times the amount of linear depreciation for wear and tear (max. 25 % p.a.) was re-introduced. Accordingly, ships that are delivered in 2009 or 2010 can, according to the depreciation table, be written down by some 21 %. In turn only linear depreciation can be applied to assets acquired or produced in 2011.

If a so-called “Loss Allocation Company” bases its own operating concept on a substantially longer actual period of use compared with that stated in the AfA tables, the period of use on which the operating concept is based must be applied (see the “General Preliminary Remarks to the AfA Depreciation Tables” as per the letter of the Federal Ministry of Finance dated 6th December 2001).

According to the “5th Building Owner Decree” (see letter of the Federal Ministry of Finance [BMF] dated 20th October 2003), for tax purposes all project planning expense for an ocean-going ship must be stated under assets because as a rule the classical one-ship companies constitute so-called “buyer funds” without any appreciable possibilities for the investors to exert influence. Depreciation under the tax laws is applied over the actual period of use of the investment.

Tax loss offsetting

According to the “Act to Restrict the Setting Off of Losses in connection with Tax Deferral Models” dated 22nd December 2005, losses from so-called “Tax Deferral Models” can only be set off against later positive income from the same income source (§ 15b of the German Income Tax Law, EStG). This regulation applies to all “Tax Deferral Models” which the taxpayer joined after 10th November 2005. A “Tax Deferral Model” within the meaning of the law exists if, on the basis of a model-based design (pre-fabricated concept), tax advantages are to be achieved in the form of negative income. Insofar as the company has opted for the tonnage tax, § 15b EStG is not applicable.

Tax treatment of dividend payments

According to the tax laws, these are withdrawals that are not subject to tax. Thus dividends are also not subject to the new final withholding tax as from 2009. The shareholder pays tax on his taxable share in the result from the one-ship company. If the dividend payment gives rise to a negative capital account in the tax balance sheet or if this is increased, tax must always be paid on the dividend payment in accordance with § 15a Sect. 3 EStG as well as on the share in the profit if in the preceding ten years offsettable losses were allocated and no liability according to § 171 Sect. 1 HGB exists. Insofar as the companies opted for the tonnage tax from the very beginning, no offsettable losses were allocated and the dividend payments are not subject to taxation according to § 15a Sect. 3 EStG. This is however viewed differently by one section of the fiscal administration. Liability of the investor vis-à-vis creditors of the one-ship company comes into effect under the pre-conditions of §§ 171, 172 Sect. 4 HGB, among other things in the case of withdrawals at a time during which the capital account has fallen below the amount of the liability. The general meeting of the shareholders decides the amount of the dividend payment depending on the liquidity situation.

Tonnage tax

To adjust to European shipping law and to strengthen the competitiveness of German shipping companies, in 1999 the so-called “tonnage tax” was introduced within the framework of the Maritime Shipping Adjustment Law in the form of § 5a EStG.

The tonnage tax is not a special kind of tax, but only a prescribed method of determining taxable income. The lump-sum profit from operation of ships that are registered in the German register of shipping including any earnings from the sale of the vessel are assessed on the basis of the ship size (net tonnage) if a corresponding application is filed by the equity investment company. These positive results for tax purposes also arise if the equity investment company in fact achieved no positive results. A sliding-scale tariff is applied to the number of net tons and this is multiplied by the number of operating days of the ship in the business year. The sliding-scale tariff is as follows (amount per 100 net tons p.d.):

- up to 1,000 net tons:	EUR 0.92
- over 1,000 to 10,000 net tons:	EUR 0.69
- over 10,000 to 25,000 net tons:	EUR 0.46
- over 25,000 net tons:	EUR 0.23

Opting for the tonnage tax is always possible with retroactive effect from 1st January of the current year. To be able to do this, in particular the following pre-conditions must be fulfilled: The ship must be registered in the German register of shipping for the greater part of the time, management of the ship must be carried out in Germany, and the ship must be operated in international traffic, among others. There is no compulsion to fly the German flag. Within the framework of the "Maritime Alliance" between the maritime economies, the political powers and the labour unions, among other things the ship-owners have promised to operate a part of their fleet under the German flag. Correspondingly, it is assumed that the political powers will retain the tonnage tax.

From the beginning of the fiscal year in which the option is exercised, an equity investment company is obliged to calculate the profit according to § 5a EStG for ten years.

According to the Accompanying Budget Law 2004, the application for the determination of net income in accordance with § 5a EStG can from the year 2006 only be filed in the year in which the ship enters service – or after that only after expiry of a further ten years. Any profits earned before the ship enters service are not taxed; losses can be neither compensated nor netted.

The law has envisaged the following provisional regulation: All ships that were ordered/purchased by 31st December 2005 can declare by 31st December 2007 at the latest whether the lump-sum determination of net income according to § 5a EStG is to be applied. These so-called "already existing cases" could exercise their option within three years and then be bound to this option for ten years. The period during which the option can be exercised began when "income from the operation of merchant ships in international traffic is achieved" for the first time, i.e. when the number of operating days under German registration exceeds the number of other operating days. Correspondingly, 2006 was the last tax assessment period in which losses could still be claimed against tax, in which case the claiming of losses is limited by § 15b EStG (cf information stated under "Income from trade or business").

In the case of the "combi-model" that was still possible until 2006 (normal taxation to begin with, later an option in favour of the tonnage tax), the hidden reserves existing at the time of the switchover must be transferred to a differential amount for the ship ("tonnage tax reserve") as the difference between the part value (fair market value) and the book value. The differential amount must be dissolved among other things on selling the share or at the latest when the ship is sold and is subject to the normal personal rate of tax. The differential amount is ascribed on a pro-rata basis to the shareholders who held a share at the time when the option was exercised.

Besides the differential amount for the ship, a differential amount must, if applicable, also be formed for foreign-currency liabilities if the exchange rate prevailing at the date of the balance sheet is lower than the rate applied for tax valuation purposes at the time of switching over to the tonnage tax. The differential amount for foreign-currency liabilities must be successively dissolved in parallel with the redemption payments made in each year, and the amount of the dissolution is added to the tonnage-based net income. Insofar as the option for the tonnage tax is exercised in the year of the purchase contract/building contract, no differential amounts can arise.

The ship or the limited partner's equity share can be sold at any time. Any tax liability with regard to the profit or loss from the sale of the ship or of the shares by the shareholder is satisfied by the lump-sum profit calculated in accordance with § 5a EStG (i.e. it is tax-free), however all differential amounts must then be dissolved and taxed. In the opinion of the fiscal administration, the amount of the dissolution is not eligible for preferential treatment according to §§ 16, 34 EStG. Besides the determination of net income in accordance with § 5a EStG, a tax balance sheet from the commercial balance sheet must still also be drawn up. This is decisive for assessing the intent to realise a profit at the level of the company and of the shareholder as well as for determining the loss compensation volume in accordance with § 15a EStG and until 2008 also for determining the values for the purposes of inheritance tax and gift tax (see also "Inheritance tax and gift tax").

Special operating expenses of the shareholder (e.g. interest on borrowed financing funds, travel expenses) are not deductible within the framework of the tonnage tax. Exempted from this are expenses that are directly related to special business receipts and/or special remunerations that according to § 5a EStG must be attributed to the profit. Special remunerations paid by the company to its shareholders are however not attributable to the profit insofar as it is a question of the remuneration for ship operation and management activities that is to be paid to the authorised ship operator if the authorised ship operator is himself a limited partner in the equity investment company. In a letter of the German Ministry of Finance dated 31st October 2008 (new "Tonnage Tax Decree 2008") it was resolved that, with effect from the tax assessment period 2008, only a remuneration for ship operation of up to 4 % of the gross freight rates is covered by the tonnage-based net income. Any chartering commission that is to be paid in addition to the remuneration for ship operation must always be attributed to the tonnage-based net income.

Fundamentally, under the tonnage tax it will be advantageous to operate a profitable ship for a long time in order to be able to enjoy the tax advantages for the same length of time.

Trade tax

According to § 2 Sect. 1 GewStG [Trade Tax Law], an equity investment company is subject to trade tax as a commercially active partnership when all the pre-conditions of § 15 Sect. 2 EStG are fulfilled, Preparatory acts within the meaning of Section 18 Par. 1 GewStR [Trade Tax Guidelines] are fundamentally not subject to trade tax. Accordingly, a one-ship company is liable to trade tax as a business establishment from the time when the ship was delivered/taken over.

Insofar as the profit is determined in accordance with § 5a EStG, according to § 7 GewStG this profit calculated as a lump-sum forms the basis for determining the amount of trade tax. The taxable trade earnings are finally arrived at after adding special remunerations and deducting the costs related to the latter and after deduction of the trade tax-free amount of EUR 24,500. There are no further trade tax additions and deductions to be taken into consideration. Correspondingly, the deduction regulation in accordance with § 9 No. 3 GewStG for determining trade tax within the framework of tonnage tax is not applicable (in this connection a case is pending at the Federal Fiscal Court under the File Ref. IV R 10/11).

Profits from sale or from abandonment are always exempt from trade tax insofar as they accrue to natural persons who hold a direct share in the company. Furthermore the sale of the ship or the sale of the whole share by the shareholder forms part of the profit calculated as a lump-sum in accordance with § 5a EStG and to this extent the tax liability has already been satisfied. Insofar as the fiscal administration detects any positive "differential amounts" according to § 5a EStG, these would need to be dissolved subject to trade tax at the company level during the operating phase or when the ship is sold. This was decided by the Federal Fiscal Court in its ruling dated 13th December 2007. On the basis of the "Tonnage Tax Decree 2002" (BMF letter dated 12th June 2002) the fiscal administration had granted a reduction of the trade earnings in the amount of 80 % of the differential amount according to § 9 No. 3 GewStG. According to the new "Tonnage Tax Decree 2008" (BMF letter dated 31st October 2008) with effect from the tax assessment period 2008 the trade earnings reduction regulation of § 9 No. 3 GewStG cannot be applied to the dissolution of differential amounts.

The shareholders are fundamentally entitled to offset the trade tax according to § 35 EStG. However this regulation is not applicable to the lump-sum tonnage-based net income after opting for the tonnage tax. However, when differential amounts are dissolved in accordance with § 5a Sect. 4 EStG, in deviation from the usual procedure the tax reduction according to § 35 EStG is to be applied (cf letter of the German Ministry of Finance dated 24th February 2009).

According to the "Corporation Tax Reform Law 2008", with effect from 1st January 2008 trade tax is no longer deductible as a business expense. At the same time, the trade tax index number was lowered to a uniform 3.5 % (until 31st December 2007 there was a sliding-scale tax index number up to 5 %). Within the framework of tonnage tax, the lowering of the trade tax index number leads to a lower trade tax burden, whereas the non-deductibility of trade tax as a business expense has no effect due to the lump-sum calculation of net income.

Turnover tax

The purchase of a ship is not subject to turnover tax. According to § 4 No. 2 in conjunction with § 8 Sect. 1 UStG [Turnover Tax Law], the chartering out of ships is exempted from turnover tax. According to § 15 Sect. 3 No. 1 a UStG, turnover-tax-free chartering out does not result in the exclusion of the possibility of deducting prior turnover tax insofar as the purchased items or services are connected with operation of the ship.

According to the ruling of the German Federal Fiscal Court dated 1st July 2004 and a letter of the German Ministry of Finance dated 4th October 2006, an equity investment company is entitled to claim all prior turnover tax that was associated with the issuing of shares in the company. In the past the fiscal administration has in some cases failed to permit the deduction of prior turnover tax. Should prior turnover tax amounts not be deductible despite the ruling of the Federal Fiscal Court and the BMF letter, this would increase the acquisition cost and/or the business expenses.

Inheritance tax and gift tax

The acts of bequeathing or making a gift of assets are subject to inheritance tax and gift tax respectively.

The Law to Reform Inheritance Tax to Regulate the Valuation of Property (ErbStRG) dated 24th December 2008 introduced new regulations for inheritance tax and gift tax with effect from 1st January 2009. In particular, the evaluation of the assets that are bequeathed or transferred by way of a gift was fundamentally changed. Furthermore, there were some significant corrections, among other things to the tax-free amounts and rates of taxation.

According to these, transfers of shares without payment (gift or inheritance) relating to business assets must always be assessed at the fair market value. However, the inheritance tax reform law continues to provide for preferential treatment for business assets with regard to inheritance tax, namely the so-called "regular exemption" with a deduction of 85 % of the fair market value and a holding period of seven years or the so-called "exemption option", under which the legal taxpayer must opt for a deduction of 100 % of the fair market value and a holding period of ten years.

According to the decree of the Ministry of Finance of Baden-Württemberg dated 27th June 2005, these tax advantages only apply in the case of investors who are registered in the commercial register ("direct limited partners"). This opinion is no longer held by at least a part of the fiscal administrations of the German Federal states. According to a decree of the Ministry of Finance in Bavaria dated 16th September 2010, the tax advantages should also be applied to the trustee limited partners. Corresponding decrees have however not yet been published by all the German Federal states.

Within the framework of the "Growth Acceleration Law", with effect from 1st January 2010 the law pertaining to inheritance and gift tax was reformed once again. In the field of business assets, in particular the holding period for "regular exemption" was reduced to five years and that for the "exemption option" was cut to seven years.

In principle, the fair market value must be determined on the basis of recent sales between outside third parties. As an alternative, the fair market value can also be verified according to the simplified gross receipts method as per §§ 199 - 203 Valuation Law or by applying a method that is customarily used in normal business transactions. This means that the fair market value could also be determined in a written expert opinion.

If the concrete intention to make a gift exists, in each case a tax consultant should be called upon in order to avoid any unwanted tax consequences.