



KLEPPECK WELBERS WINKEL + PARTNER  
STEUERBERATUNGSGESELLSCHAFT

KWWM Kleppeck, Welbers, Winkel & Partner Steuerberatungsgesellschaft

Kurfürstendamm 179 . 10707 Berlin  
T.: 030 885 735-0 . F.: 030 885 735-98  
Web: [www.kwwm.de](http://www.kwwm.de) . E-Mail: [willkommen@kwwm.de](mailto:willkommen@kwwm.de)

## **Starting a Business in Germany**

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Copyright: Dipl.-Finanzwirt Marianne Kleppeck, Steuerberater, vereidigter Buchprüfer  
Stefan Winkel, Steuerberater

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## I. STARTING UP A BUSINESS

### 1. Preconditions to become self-employed

#### 1.1 Occupational preconditions

For some occupations you have to fulfill special preconditions before you are allowed to practise. For example businesses in catering and the sale of foodstuff need a permit or certificate of non-objection from the health office. For the sale of medicine products you have to pass an exam to become a pharmacist. In other cases the permission of practising is depending on becoming a member of a relevant chamber or Supervisory authority, e.g. lawyers, tax advisors, physicians. Also admissions according to the German Real Estate Agent and Commercial Construction industry Ordinance (MaBV) might be necessary.

In order to become self-employed not only the drafting of contracts is relevant but also the type of profession. For example the work on assembly lines is subject to instructions.

So if you plan to become self-employed, an exact description of your profession would have to be found first and then find out if it belongs either to commercial or freelance occupations.

There are comprehensive handouts where those branches are described including the information which licenses you might need.

#### 1.2 Notification requirements

If you have all the necessary documentation, you should register your business at the Trade Office (Gewerbeamt) in the municipality in which you wish to open your business.

This registration does not mean that you run this business in a fiscal sense and it does not clear the question of permission.

#### 1.3 Tax registration

If you plan to run a business/office with your profession and not only a sideline job, a registration at the tax office will be necessary. Then the tax office will issue a tax number, which among other things is important for invoicing and will determine income tax payments if necessary, prepayments of income tax will be determined in order to avoid high tax payments at the end of the year.

## **2. Differences to employees**

### **2.1 Comparison**

Employees carry out a dependent activity. That means they are bound by instructions referring to place and time of activity as well as that they receive an agreed salary regardless of their performance.

Self-employment is characterized by the facts that you are not bound by instructions, that you are free to conclude contracts, that you are receiving payments for the product or service described in the contract and that you need private health insurance and have to pay the taxes yourself.

### **2.2 Test scheme**

In case you are not sure whether you are self-employed or not you can clarify this question by a so called status determination procedure (Statusfeststellungsverfahren). For that purpose you can contact your health insurance agency which will forward your inquiry to the German statutory pension insurance scheme (Deutsche Rentenversicherung). Or you contact the German statutory pension insurance scheme directly.

### **2.3 Pseudo self-employment**

Often employers prefer to engage self-employed people for their services and vacant jobs if possible because this way they are not responsible for vacation, illness etc, needn't pay social security contributions, this way bigger enterprises try to keep the number of employees low in order to be able to terminate the employment contracts more easily as well as not to be forced to accept a Work Council.

So if in the course of outsourcing an engaged self-employed person could carry out the contractually agreed work as an employee or even has performed as an employee already and has only one contracting authority, so that the engaged person is depending on this contractual partner, a so-called pseudo self-employment is given.

A later audit by the social security agency (Deutsche Rentenversicherung) could lead to payments of social insurance contributions in retrospect. The employer could demand pro rata payments for at least two years from the consignee, the pseudo self-employed person at least.

## **3. Insurances**

### ***3.1 Professional liability insurance***

In each case you should weigh the risks of your profession. A usual liability insurance always is to recommend urgently. Mostly a personal professional liability insurance is necessary, as well. For some occupations an additional pecuniary loss liability insurance might be an admission requirement by the supervisory authority.

### ***3.2 Pension liability insurance***

In opposite to employees self-employed people are not obliged to statutory pension insurance. That means the self-employed person has to take care of pension insurance himself.

There are several options. In case you have been in the statutory pension insurance before it can be continued. There are different variants of continuing your statutory pension insurance. Either you chose a minimal contribution or you decide to pay a higher fixed amount or you chose a so called voluntary insurance. The last variant means that the height of your contributions is dependent on your actual income. This question has to be clarified by consultation of the German statutory pension insurance scheme, Ruhrstr. 2, 10709 Berlin, T.: 0303/8651 or by a special pension consultant. A pension consultant could find out what kind of pension insurance would be possible within the German statutory pension insurance and what effects this might have later on.

Also classic life insurance policies can be considered as an instrument for old-age provision. However, a life insurance should be considered very carefully because on the one hand it might cover risks and protect your family against financial obligations e.g. bank credits in case of death, on the other hand it often is not very profitable. So, you should think carefully what effect you would like to achieve.

Another possibility to reach an old-age provision is the so-called Rürup pension The Rürup pension insurance grants a tax-saving effect for self-employed people as a result of the annual payments. The tax savings are only granted for special insurance products with a certificate. The Rürup pension has strict regulations concerning the required payments and in case of not reaching pension all the paid amounts will be forfeited. The paid contribution is neither eligible as collateral, or inheritable.

### ***3.3 Health and long-term care insurance***

Employees are covered by health and long-term care insurance statutorily. As self-employed you have to take care of your health and long-term care insurance yourself. You don't miss to do that in time because the height of your contributions depend on your entry age so that you could say the younger you are the lower are your contributions.

Please visit the following website for more information: [www.existenzgruender.de](http://www.existenzgruender.de).

## 4. Employees

In case that you think of hiring personnel you have to apply for an employer registration number at the Employment Agency. After receiving your individual registration number you have to conclude contracts with your prospective staff. The employment contract should include type and scope of work, vacation, sick pay as well as the gross pay. Your employees have to be registered for the statutory pension insurance and mostly they also are subject to statutory health insurance. There are lots of statutory health insurance agencies, not only the AOK. The employee may choose which one he prefers. The deductions from the gross salary payable by the employee for social insurance amount total about 20 %. The employer pays further 22 % of the agreed wage for social insurance. From a monthly salary of higher than 4.050,00 Euro (2014) the employee can take out a private health insurance.

For minimally paid employees with earnings until 450,00 Euros (mini-job) the responsible statutory health insurance agency is the Bundesknappschaft. If the employee decides that he wants to pay pension insurance contributions, he usually has no deductions. The employer has to pay lump-sum contributions of around 31 % to the Bundesknappschaft. Mini-jobbers do not have health insurance.

There are special regulations for short-term employments and employments in private households

Please visit the website of Bundesknappschaft (Mini-job centre) for more information in English.

[http://www.minijob-zentrale.de/DE/Service/03\\_service\\_rechte\\_navigation/DownloadCenter/3\\_Rundschreiben\\_etc/3\\_ag\\_anschreiben/englisch.pdf?blob=publicationFile&v=5](http://www.minijob-zentrale.de/DE/Service/03_service_rechte_navigation/DownloadCenter/3_Rundschreiben_etc/3_ag_anschreiben/englisch.pdf?blob=publicationFile&v=5)

## II. MAINTAINING A BUSINESS

### 1. Size of business

#### 1.1 *Sole proprietorship*

To say that a sole proprietorship is given (meaning the business is run on the responsibility of one person), is not a statement about the size of business. A sole proprietor can run a quite large business actually, e.g. a master carpenter can have a business of considerable size with several employees and can nevertheless be a sole proprietor. But often sole proprietorships as we meet them in our daily lives are smaller businesses like flower shops. Here the florist is the one owner of the business and employs one or two part-time workers.

#### 1.2 *Business partnership*

A business partnership means that several natural persons run an enterprise. That can be for instance a medical office which is shared by two doctors (group practice). But that can also be a retail business which is run together by several persons, e.g. a bookshop in the form of a general partnership. Whenever several persons run a business, they can also decide that only one of them is fully liable and the others participate in the company as well but are only liable to a certain agreed limit, a so-called limited partnership.

#### 1.3 *Corporate enterprises*

If you decide to choose another business form, especially with regard to special liability risks, public image or a later transferability of company shares, the establishment of a corporation would seem the thing to do. In general this will be a limited liability corporation (GmbH). In Germany the establishment of a so-called „Gesellschaft mit beschränkter Haftung“ (GmbH) comparable with an Incorporated (Inc.) or a Limited (Ltd.) is common. In a GmbH one or more persons own the common capital stock which has to be paid up. The private limited liability corporation is acting according to the descriptions in its articles of incorporation.

## 2. Sales tax, respectively VAT

### 2.1 Entrepreneur/Small entrepreneur

All self-employed are entrepreneurs in the meaning of the Value Added Tax Act (UStG) and therefore are subject to the regulations of the German Value Added Tax Act. That means all entrepreneurs operating on the market have to observe value added tax in all transactions. Value added tax includes turnover tax and input tax, which can be offset against each other so that entrepreneurs receive the input tax in suppliers' invoices back from the tax office.

In case you plan to be less active on the market you should be aware of the small entrepreneur regulation. A small enterprise does not have to pay any turnover tax to the tax office if its annual turnover does not exceed 17.500 Euros. However, anyone not paying turnover tax cannot claim input tax either. So before you make a decision you should weigh up carefully what would be the most favourable in your individual case and you should consult your tax advisor. The statement of being small entrepreneur is quite binding for the future and changing from entrepreneurship to small entrepreneurship has consequences on VAT.

### 2.2 Place of delivery of goods or performance of services, Reverse-Charge-Procedure

The German Value Added Tax Act is regulated by the European tax law. In this connection the place of performance is decisive for the question if and where turnover tax arises. To clarify whether turnover tax arises or not you have to take into account several factors:

- Is the delivery or the service performed inland or abroad?
- Is the recipient of performance an entrepreneur or a private person meaning a final customer?

More and more the regulations are adapted to the reverse-charge procedure. In the reverse-charge procedure the recipient of performance is responsible for the turnover tax.

### 2.3 Tax exemptions

Apart from the small entrepreneur regulation where turnover tax doesn't arise because of certain minor revenues, there are other tax exemptions for certain professionals and certain activities, e.g. health care professions. Certain exports are exempt from tax, too. For further details you should look through the tax exemptions in the German Value Added Tax Act. In addition tax-exempt entrepreneurs have the freedom of choice in few cases, e.g. entrepreneurs who realize income from rent and lease can accept value added tax liability voluntarily. This can be advantageous in case you are expecting high expenses and therefore high input tax. An example is here the construction of a car showroom by a private person. The renting of the showroom, halls and bureau would be tax-exempt. Since there have to be procured a lot of money to pay the high input tax for the construction works opting for value added tax could improve liquidity.

For more information please also visit:

[http://ec.europa.eu/taxation\\_customs/taxation/vat/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/vat/index_en.htm)

### 3. Invoices

#### 3.1 Necessary components

An invoice is only valid within the meaning of the law and only entitles to deduct input tax if the invoice is issued correctly. Meaning the invoice has to show all necessary information. Please find an example below. For further information please visit the website where all necessary details are shown:

[http://www.existenzgruender.de/englisch/self\\_employment/launch/issuing\\_correct\\_invoices/index.php](http://www.existenzgruender.de/englisch/self_employment/launch/issuing_correct_invoices/index.php).

**Max Mustermann GmbH - Computer & Zubehör**  
Dagobertstraße 13 \* 04711 Köln \* Telefon 0211 / 12345 6 \* Telefax 0211 / 12345 7

Customer-No. 131313  
Delivery-No. 834895  
Invoice-No. 20061132  
Date of issue 31.01.2010

**Invoice**  
We delivered on 11.01.2010 according to the agreed payment and delivery terms.

Quantity	Description	Unit price	Total price	VAT-rate
5	17" TFT-Monitors Acer AS1716	149,00 €	745,00 €	19%
1	Uninterruptible Power Supplies	649,00 €	649,00 €	19%
1	MS Office compendium	49,00 €	49,00 €	7%
Subtotal			1.443,00 €	
plus 19% VAT			264,86 €	
plus 7% VAT			3,43 €	
Total amount			1.711,29 €	

In case of reverse-charge please add: 'This is an intra-EC supply exempt from German VAT according to sec. 6a German VAT Act (UStG).

Payable within 30 days, 2% cash discount for payment within 8 days.

This invoice is taken into account for the determination of the annual bonus according to agreement on 18.12.2005.

VAT ID DE47110815  
Bank connection: Berliner Spasskasse \* Account-No. 1234567890 \* Bank code 100 500 00

### **3.2 Invoice number**

All invoices have to obtain a consecutive invoice number. This number can not be chosen freely or changed within a fiscal year because it proves the tax office that you didn't embezzle revenue. If the invoice numbering shows gaps the financial office could assume that nevertheless the invoices with these missing numbers were issued and would estimate the apparently missing turnovers and would determine turnover tax and income tax on these estimated turnovers. That's why any gaps in invoice numbering are to be avoided. All misprints of invoices have to be documented and kept and a new invoice number has to be allocated; always traceable and consecutive.

With every New Year's Day the numbering can start over.

### **3.3 VAT**

The VAT you have to invoice can vary. The standard tax rate is 19 % and the reduced tax rate is 7 %. Which deliveries or services are subject to reduced taxation you can find in a catalogue, e. g. sale of certain food or creative work.

## 4. Record keeping requirement

### 4.1 *Operating revenue*

Each entrepreneur is obliged to ascertain and record all revenue for taxation purposes. Revenue is all gains from operating activities, cash or in kind. E.g. revenue of a trader is the fees for the sale of goods, revenue of a consultant the charges for the consultancy. The term revenue implies a factual connection with the enterprise/the operating activities of the entrepreneur.

Depending on size and type of business the entrepreneur has to keep more or less detailed records. It has to be clarified in each particular case what the exact requirements are, whether a simple listing with added receipts is sufficient or a book keeping according to tax law has to be set up.

### 4.2 *Operating expenditure*

Operating expenditure is all expenses made in connection with the enterprise/the operating activities of the entrepreneurs. The objectively operational occasion for these expenses is mandatory. The expenses can be voluntary when encouraging businesses or making business possible. They can also be involuntary, e.g. public charges. Again it is not relevant whether they are cash or in kind. The amount of the operational expenditure isn't decisive for the kind and scope of the record keeping. Operating expenditure just has to exist and be verifiable by bills and receipts or contracts or payment transactions.

In case the size and scope of your business/enterprise causes that a simple listing with added bills and receipts is not sufficient and doesn't meet the requirements of tax law you have to supplement your records with bookkeeping and have to comply with fiscal regulations.

### III. PROFIT AND EXPECTABLE TAX BURDEN

#### 1. Profit / Net income

The success of a self-employment can be recognized by the increase of operating assets and profit. According to fiscal provisions the profit or net income has to be determined by offsetting all operational income and expenses of a certain year. There are special provisions in contrast to the commercial method of determination profits, e.g. depreciation or accrual accounting. Unfortunately, going into detail would go beyond the scope of our discussion. Bigger enterprises which are obliged to prepare a balance sheet determine their profit by comparison of all assets appraised according to tax law and all liabilities at the end of the assessment year. Then the assets and liabilities at the beginning of the year are assessed in the same way. The difference between the operating asset at the end of the year and the operating asset at the beginning of the year is the annual profit. The accrual and the composition of the annual profit can be seen in the cash method of accounting.

#### Balance sheet of a furniture retailer as of 31st December 2010

		<b>Balance Sheet</b>			
		as of 31st December.2010		<b>Liabilities</b>	
<b>Assets</b>					
<b>I. Fixed assets</b>				<b>I. Owner's equity</b>	148.440 Euro
1. Property				<b>II. Liabilities</b>	
a) Land	13.000	Euro		1. Bank debts	55.000 Euro
b) Building	127.000	Euro		2. Debts to suppliers	20.900 Euro
c) Storage shed	5.000	Euro		3. VAT debt	800 Euro
2. Automobiles	19.000	Euro			
3. Office equipment	6.000	Euro			
4. Securities	5.000	Euro			
<b>II. Current assets</b>					
1. Trading stock	23.800	Euro			
2. Customer receivables	18.400	Euro			
3. Cash on hand	820	Euro			
4. Cash in bank	7.120	Euro			
	<u>225.140</u>	<u>Euro</u>			
					<u>225.140 Euro</u>

Net income determination according to sec. 4 subsec. 3 EStG

<b>Income statement for XYZ business for the period ending 31st of December 2010</b>	
	\$
<b>INCOME</b>	
Services rendered	<u>94,600</u>
<b>EXPENSES</b>	
Salaries	25,000
Telephone & internet	6,500
Water & electricity	16,000
Property rates and taxes	1,000
Insurance	7,300
Advertising costs	1,000
Fuel	2,500
Stationery	412
Bank charges / interest paid	654
Tax expense	<u>3,414</u>
<b>NET PROFIT</b>	<b>30,820</b>

## 2. Expectable tax burden

The amount of your income tax burden is not only influenced by your profit but also by your personal circumstances. Therefore you have to state diverse individual characteristics in your income tax return, e.g. if you are married or not or how many children you have.

### Computation for 2012 using the example of a sole proprietorship

#### Business:

Tax burden determination	€	€	€
Annual net income (profit)		50.000,00	
Trade tax burden Levy rate 410 %			3.659,25
Income tax burden Entrepreneur, unmarried, no further income			
Income tax	2012		
Taxable income		36.511,00	
Income Tax			4.385,00
Solidarity surcharge			241,17
Total tax burden:			<u>8.285,42</u>

#### Self-employment

Annual net income (profit)		50.000,00	
Trade tax			0,00
Income tax burden Entrepreneur, unmarried, no further income			
Income tax	2012		
Taxable income		36.511,00	
Income tax			7.775,00
Solidarity surcharge			427,62
Total tax burden:			<u>8.202,62</u>

## Computation for 2012 using the example of a corporation (GmbH)

Tax burden determination	€	€	€
Annual net income (profit)		50.000,00	
Trade tax burden Levy rate 410 %			7.175,00
Corporate tax burden:			
Corporate tax	2012		
Taxable income		50.000,00	
Corporate tax	15 %		7.500,00
Solidarity surcharge	5,5 %		412,50
Total tax burden:			<u>15.087,50</u>

The conclusion is that in case of expected profits you have to make provisions to meet the upcoming tax burden timely.



**Disclaimer information**

This publication does not replace an individual consultancy. Obtaining this publication does not conclude a consultancy agreement.

All information have been compiled and edited accurately. Nevertheless no responsibility and hence no liability is taken - not even by the author - for the correctness, the timeliness of data and the completeness of this information.

## Supportive English websites :

- [www.existenzgruender.de](http://www.existenzgruender.de)  
(<http://www.existenzgruender.de/englisch/index.php>)
- [www.deutsche-rentenversicherung.de](http://www.deutsche-rentenversicherung.de)  
([http://www.deutsche-rentenversicherung.de/Allgemein/en/Navigation/englisch\\_index\\_node.html](http://www.deutsche-rentenversicherung.de/Allgemein/en/Navigation/englisch_index_node.html))
- [www.minijob-zentrale.de](http://www.minijob-zentrale.de)  
([http://www.minijob-zentrale.de/DE/Service/03\\_service\\_rechte\\_navigation/DownloadCenter/3\\_Rundschreiben\\_etc/3\\_ag\\_anschreiben/englisch.pdf?\\_\\_blob=publicationFile&v=5](http://www.minijob-zentrale.de/DE/Service/03_service_rechte_navigation/DownloadCenter/3_Rundschreiben_etc/3_ag_anschreiben/englisch.pdf?__blob=publicationFile&v=5))
- [www.ihk-berlin.de](http://www.ihk-berlin.de)  
([http://www.ihk-berlin.de/linkableblob/bihk24/English/en/downloads/2331886/.7./data/Starting\\_a\\_business\\_in\\_Berlin-data.pdf](http://www.ihk-berlin.de/linkableblob/bihk24/English/en/downloads/2331886/.7./data/Starting_a_business_in_Berlin-data.pdf))
- [www.ihk-berlin.de](http://www.ihk-berlin.de)  
([http://www.ihk-berlin.de/English/en/s\\_987412/Business\\_Registration\\_and\\_Work\\_Permit\\_in\\_Germany/2500870/Business\\_and\\_start\\_up\\_entrepreneurs\\_from\\_third\\_countries.html](http://www.ihk-berlin.de/English/en/s_987412/Business_Registration_and_Work_Permit_in_Germany/2500870/Business_and_start_up_entrepreneurs_from_third_countries.html))
- [http://ec.europa.eu/taxation\\_customs/taxation/vat/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/vat/index_en.htm)