



VADEMECUM **2024**

Setting up business from abroad:
focus on personnel

Setting up a business in Germany from abroad is subject to various issues that require clarification in advance. A fundamental distinction has to be drawn first based on where the business is to be established from – from either a so-called third country or from within the EU.

SETTING UP A BUSINESS IN GERMANY FROM WITHIN THE EU

For this purpose, the EU also includes all EEA states (EU states plus Iceland, Norway and Liechtenstein) and Switzerland. Within these states, special laws largely apply that facilitate setting up a business from abroad, e.g. the right to freedom of movement, establishment and trade. This means that EU citizens may pursue self-employed activities, both on a freelance basis and with the intention of operating a business. This means that every citizen of the EU has the right to enter the member states of the EEA (EU plus Iceland, Liechtenstein and Norway) and Switzerland without a visa and to stay and work in these other states virtually without restrictions and without special permission. This regulation places these citizens on an equal legal footing with the nationals of the host state in almost every respect. This right is called freedom of movement. EU citizens must be in possession of a valid identity card or passport to prove their right to free movement.

SETTING UP A BUSINESS IN GERMANY FROM A THIRD COUNTRY (NON-EU COUNTRY)

In general, setting up a business from abroad must always be carried out by a person with a valid residence title or settlement permit. The application for this must be directed to the competent immigration authority. While a residence permit is subject to limited validity, a settlement permit is valid for an unlimited period of time.

Requirements for a residence permit A residence permit can be granted if there is an overriding economic interest in pursuing the planned enterprise. Other reasons for granting a residence permit are the positive effects on the economy to be expected from the activity, secure finance through equity capital and a loan approval.

Requirements for a settlement permit In order for citizens from third countries to obtain a settlement permit, the following requirements must be met in accordance with section 9 (2) sentence 1 of the Residence Act (AufenthG):

- Possession of a residence permit for at least five years establishing permission to pursue gainful employment as an employee or on a self-employed basis. The requirement for taking up employment is that the residence title includes the relevant work permit. Any employed or self-employed activity may be pursued if the permit includes the ancillary provision "gainful employment permitted". If only "employment is permitted" applies, any employment may be pursued except self-employment.
- The applicant's livelihood must be secured.
- The applicant must have made at least 60 months' worth of voluntary or compulsory contributions to the statutory pension insurance.
- The applicant must not have a criminal record.
- The applicant must be able to prove a sufficient level of proficiency in the German language. – It is necessary to demonstrate basic familiarity with the German legal and social system and living conditions.

Business set-up documents Citizens of an EU or third country are essentially free to choose the type of business entity they wish to establish in Germany. For the notary appointment, business founders from abroad require some additional documents, either

- an apostilled translation of the Memorandum and Articles of Association, or
- legalisation of the relevant business set-up documents.

In order for public documents to be recognised internationally, they must be certified by means of the **Hague Apostille**. This is the form of certification used internationally that confirms the authenticity of a public document, a signature or a stamp. This process of authentication is called apostillation. Documents required for setting up a business abroad, for example, have to be additionally legitimised by means of the apostille in order for them to have cross-border validity.

The apostille can only be used between states that are members of the multilateral Hague Convention. For details of the states which are signatory to this convention, see the website of the Federal Foreign Office. Currently, **120 countries are members** of the apostille Convention: almost all European countries, as well as China, Australia, India, Canada, Japan and the USA. Indonesia has joined the list in June 2022. The apostille is issued in the form of a 9×9 cm stamp applied directly on the document to be authenticated and must always be headed "Apostille (Convention de La Haye du 5 octobre 1961)". All other information can be provided in the respective national language.

In order to set up a business, the authorities usually require a translation of the original, so the translation has to be certified.

Outside the multilateral Hague Convention, legalisation is required. This is a more time-consuming procedure since preliminary certification by the issuing authority and the country's consular representation is required.

The application for the apostille must be made by the document holder in the country by which the document is issued. Each member state of the Hague Convention determines itself which authorities are responsible for issuing the apostille.

Note: Even if two states are members of the Hague Convention, the other state can raise concerns, e.g. both India and Germany are members of the Hague Convention, but Germany does not recognise apostilled documents from India. In this case, the legalisation procedure is required.

As a general rule, documents to be apostilled or legalised must **not be older than six months**. In a few exceptional cases, the period may even be as short as three months. Please refer for further information to auren.com/de/en/blog and birgittenmoser.de.

TAX BASIS

If a foreign company opens a branch office/permanent establishment in Germany, its profits must be taxed in Germany. The taxes incurred depend on the business entity type of the head office in the foreign country. They are the same as the taxes that a company with the equivalent German legal status would have to pay.

The profits generated by the branch office/permanent establishment that are taxed in Germany are either exempt from taxation in the other state or are subject to taxation there, in which case the amount of tax paid in Germany is offset against the corresponding tax imposed by the other state. The details of this are derived from the relevant agreement on the avoidance of double taxation (DTA). The following taxes are due in particular: income tax or corporation tax, solidarity surcharge, income tax, business tax and sales tax.

One fundamental consideration is to examine whether a so-called "permanent establishment" is to be avoided.

When do the conditions for a permanent establishment apply? A "permanent establishment" is any **fixed place of business or facility** serving the **activities** of an enterprise (according to section 12 sentence 1 Tax Code – AO). Fixed places of business are characterised by three features:

- Site specificity: this applies if the place of business has a connection to a specific part of the earth's surface; in this context, for example, it is sufficient for a market stall to be regularly set up on the same piece of land for it to be a permanent establishment.
- Permanence: The site specificity must possess a certain degree of permanence. What counts here is the entrepreneur's initial planning: the site specificity does not have to be continuous – recurrence at regular intervals is sufficient.
- Right of disposal: The entrepreneur's right of disposal over the place of business must only be temporary; it should be noted here that right of disposal is not the same as ownership.

In addition to the definition of a permanent establishment in section 12 sentence 1 of the Tax Code (AO), section 12 sentence 2 of the Tax Code provides a non-exhaustive list of places of business that are regularly classified as permanent establishments.

Convention law A permanent establishment is defined differently under national law according to section 12 of the Tax Code as compared to double taxation agreement law (cf. Art. 5 OECD Model Tax Convention). Only if it is a permanent establishment according to both definitions is the permanent establishment subject to tax in Germany.

According to both definitions, the deciding factors are that it is a fixed place of business and that it is permanent. The fixed place of business is defined in both cases in such a way that there must be a reference to the earth's surface and a right of disposal over it. The differences between German law and convention law are as follows: under the German Tax Code (AO), a "facility" (*Anlage*) is also defined as a permanent establishment. Facilities are disregarded under the OECD Model Tax Convention. The second difference lies in the definition of the entrepreneurial activity that is to be carried out at the permanent establishment.

	National concept of permanent establishment	Concept of permanent establishment under convention law	Right of taxation
Requirements for a place of business in Germany fulfilled	(+)	(+)	Germany
	(+)	(-)	Signatory state
	(-)	(+)	Neither Germany nor signatory state

The detailed definition of a permanent establishment results from the relevant double taxation agreement (DTA) and has to be examined on a case-by-case basis.

Legal consequences of a permanent establishment at company level If a place of business is deemed to be a permanent establishment, a tax number must be applied for. Without this tax number, it is not possible as an employer to correctly pay income tax, to retrieve the income tax data of individual employees or to specifically determine the amount of income tax to be paid for them.

Avoidance of a permanent establishment Permanent establishments often come into being unintentionally. The avoidance of a permanent establishment must be planned and examined with great care. Many DTAs contain more detailed provisions that result in a place of business being defined as a permanent establishment. Without a permanent establishment, there can be no business registration in Germany and therefore no

- tax registration either: in this case, employees are required to pay income tax in Germany themselves. This is done through the tax office responsible for the employee's place of residence. No income tax details are required: the employee reports their income tax by submitting an income tax return to the tax office at the end of the year; the tax office then imposes the taxation retrospectively. Alternatively, the employee can arrange with the tax office to make advance payments.

Special case: branch office It is possible to register a branch office in the German Commercial Register. This is then assigned the status of an independent branch office. Branch offices are usually more complex to set up than "normal" permanent establishments, but they offer the benefit of a higher degree of economic and organisational independence. Unlike "normal" permanent establishments, branch offices are required to keep accounts under commercial law in accordance with section 238 Commercial Code (HGB).

If the foreign entrepreneur maintains a permanent establishment in Germany, this results in a number of to-dos:

- Business registration
 - From a legal point of view, the permanent establishment and the foreign parent company form a single unit. Nevertheless, the permanent establishment must be registered in Germany: The business must be registered under section 14 of the Trade, Commerce and Industry Regulation Act (GewO) at the competent trade office in the respective municipality. The entrepreneur is required to complete and submit an officially prescribed form. As a rule, registration is swift (within approx. 2 weeks) and inexpensive (no more than approx. EUR 60.00).
- Tax registration
 - The trade office reports the registration of the permanent establishment to the locally competent tax office. Here it makes sense to initiate registration with the tax office itself at the same. The entrepreneur is issued with a tax number which is used to submit tax declarations and declare time income tax for employees.

- Social security registration

Social security is based on the so-called principle of territoriality, i.e. it is due in the country where the employee works. So if an employee works in Germany, this is where social security contributions will usually have to be paid for them. This means the following are required for a business:

- a company number must be applied for from the Federal Employment Agency and
- the business must register with the employers' liability insurance association (*Berufsgenossenschaft*)

LEGAL FRAMEWORK FOR SOCIAL SECURITY

In Germany, the applicability of German labour law is determined by the place of residence or habitual abode of the person concerned, in accordance with section 30 Social Code (SGB) I.

Social security contributions in Germany are generally divided equally between the employer and the employee, but they are usually paid by the employer. German social security contributions fall into four categories:

- Pension insurance (PI)
- Unemployment insurance (UI)
- Health insurance (HI)
- Nursing care insurance (NCI)

These attract the following contribution rates, to be calculated based on income

Contribution rates 2024				
Pension insurance	Unemployment insurance	Nursing care insurance*		Health insurance
18,6 %	2,6%	3,40%	4,0% Those without children	14,6% (7.3 % employer, 7.3 % employee)+x**

* As of 01.07.2023, 4.00% applies to childless persons, 3.4% to employees with one child (for life) and 0.25% less for each additional child (up to five) up to the age of 25 years. The employer's contribution is always 1.7%.

** Additional Health insurance contribution determined individually by the health insurance companies and also to be paid in equal share by the employer and the employee; 1.7% for 2024.

Members without children	= 4.00% (employee's share: 2.3%)
Members with 1 child	= 3.40% (lifelong) (employee's share: 1.7%)
Members with 2 children	= 3.15% (employee share: 1.45%)
Members with 3 children	= 2.90% (employee share: 1.2%)
Members with 4 children	= 2.65% (employee share: 0.95%)
Members with 5 and more children	= 2.40% (employee share 0.7%)

The contributions are capped at so-called income thresholds. Social security contributions can only be paid in Germany up to a maximum of this limit:

Income thresholds 2024			
West (old federal states)		East (new federal states)	
Health insurance / Nursing care insurance	Pension insurance / Unemployment insurance	Health insurance / Nursing care insurance	Pension insurance / Unemployment insurance
EUR 5,175.00	EUR 7,550.00	EUR 5,175.00	EUR 7,450.00
EUR 62,100.00	EUR 90,600.00	EUR 62,100.00	EUR 89,400.00

In addition to these contributions paid in equal shares, the employer in Germany usually has to pay the so-called Levy 1 and 2 as well as the insolvency fund levy.

The personnel costs for an employee are then calculated as follows:

Example calculation for an income of EUR 2,750.00 gross per month, based on a single employee at the age of 25 in Income Tax Class 1, a church tax affiliation and where the average rate of health insurance apply, employment in Baden-Württemberg or Bavaria as a basis for church tax and Federal Civil Service Act pension insurance/unemployment insurance:

	Employee contribution	Employer contribution
Salary	EUR 2,750.00	
Total gross salary	EUR 2,750.00	
Gross tax amount	EUR 2,750.00	
Gross social security amount PI/UI	EUR 2,750.00	
Gross social security amount HI/NCI	EUR 2,750.00	
- Income tax	EUR 261.83	
- Church tax	EUR 20.94	
- Solidarity surcharge	EUR 0.00	
- Health insurance (HI) (14,6 % + 1,7 % / 2)	EUR 224.13	EUR 224.13
- Nursing care insurance (NCI) (4,00 %, thereof 1,7 % employer)	EUR 63.25	EUR 46.75
- Pension insurance (PI) (18,6 % / 2)	EUR 255.75	EUR 255.75
- Unemployment insurance (UI) (2,6 % / 2)	EUR 35.75	EUR 35.75
Total employee deductions AN	EUR 861.65	
Amount paid out	EUR 1,888.36	

Calculation for an income above the income threshold, based on EUR 7,600.00 gross per month, assuming a married employee in Income Tax Class 4, church tax and one child, employment in Baden-Württemberg or Bavaria as a basis for church tax and Federal Civil Service Act pension insurance/unemployment insurance:

	Employee contribution	Employer contribution
Salary	EUR 7,600.00	
Total gross salary	EUR 7,600.00	
Gross tax amount	EUR 7,600.00	
Gross social security amount PI/UI	EUR 7,550.00	
Gross social security amount HI/NCI	EUR 5,175.00	
- Income tax	EUR 1,761.66	
- Church tax	EUR 140.93	
- Solidarity surcharge	EUR 29.84	
- Health insurance (HI) (14,6 % + 1,7 % / 2)	EUR 421.76	EUR 421.76
- Nursing care insurance (NCI) (with 1 child 3,4 % / 2)	EUR 87.98	EUR 87.98
- Pension insurance (PI) (18,6 % / 2)	EUR 702.15	EUR 702.15
- Unemployment insurance (UI) (2,6 % / 2)	EUR 98.15	EUR 98.15
Total employee deductions AN	EUR 3,242.47	
Amount paid out	EUR 4,357.53	

Levy 1 – Reimbursement for continued pay in case of sickness Levy 1 is paid by businesses with up to 30 employees. Some groups are not included in the calculation of the number of employees, e.g. apprentices, trainees and severely disabled persons. Part-time employees are taken into account on a pro rata basis: for a weekly working time of up to 10 hours with a weighting factor of 0.25, up to 20 hours: 0.50, up to 30 hours: 0.75, over 30 hours: 1.00. The Levy 1 contribution rate is calculated as a share of the gross salary of the respective employee and is borne by the employer alone. In return, the sick employee's health insurance reimburses part of the costs incurred through continued payment of wages in case of sickness. The fewer employees a company has, the greater the burden caused by an employee's absence. Levy 1 is intended to compensate for this.

The employer can choose between different levels of reimbursement. The normal rate of Levy 1 usually offers a reimbursement of some 70 per cent. The reduced Levy 1 contribution rates are lower, but the health insurance company reimburses less in the event of sickness. The level of reimbursement is highest at the increased Levy 1 rate. Depending on the health insurance company, the contribution ranges from 0.9% to 3.2% of the employee's gross pay subject to social insurance contributions.

Levy 2 – Reimbursement for maternity protection periods and employment bans Levy 2 is a compulsory levy on all employers – regardless of the number of employees. The employer pays the levy as a share of the employee's gross pay. The employer is reimbursed by the employee's health insurance for all remuneration to which that employee is entitled during periods of maternity protection. As such, Levy 2 saves employers the financial burden that arises when employees become pregnant. Note: This levy must also be paid by companies who only have male employees.

From the employer's perspective, the differences between the Levy 2 contribution rates charged by the various health insurance companies can lead to significant differences in labour costs. Depending on the health insurance company, the contribution ranges from 0.19% to 0.35% of the employee's gross pay subject to social insurance contributions.

Insolvency fund levy In Germany, employers are required to pay into the so-called insolvency fund levy on a monthly basis. The Federal Employment Agency pays insolvency benefits to employees from this fund if the employer is no longer able to pay the employees' salary due to insolvency. Insolvency benefits are paid to compensate for lost pay for a maximum of three months. In this way, the insolvency fund levy provides the financial basis for insolvency benefits. The rate for this since 2023 is 0.06%.

Employers' liability insurance association contributions Employers' liability insurance associations (Berufsgenossenschaften) have the task of preventing accidents at work and occupational disease as well as work-related health hazards. Employees who have suffered an occupational accident or are suffering from an occupational disease are medically, occupationally and socially rehabilitated by the employers' liability associations. In addition, it is the responsibility of the employers' liability associations to financially compensate for the consequences of accident and illness by means of monetary payments.

The ancillary labour costs for social security to be paid in Germany by the employer in addition to the gross salary therefore comprise a total of approx. 25% in addition to the agreed gross salary.

GENERAL REQUIREMENTS UNDER LABOUR LAW

The main terms of the employment contract are best agreed on in writing for documentation purposes. These are:

- Type and place of activity
- Scope of activity (working hours)
- Amount of remuneration/special payments
- Notice periods/probationary period
- Confidentiality obligations/data privacy conditions, where applicable
- Non-competition clause, where applicable

A distinction is made between the following basic types of contract:

Normal employment contract: full social security and income tax liability. Is used for employees who work full or part-time for a company.

Mini-job contract: This is limited to a maximum monthly income of EUR 538 gross. In its usual form, however, this type of contract only involves additional costs for the employer, who pays 13 % health insurance, 15 % pension insurance and 2 % flat-rate tax for the employee. The basis is usually an agreed hourly wage: if an employee has been promised an hourly wage of 15 euros, they can work 538 euros / 15 euros per hour = 35.87 hours per month. This type of contract is only possible for students, pupils, or employees with another job which is subject to social security contributions. It is not possible to combine two mini-jobs or you have to meet very strict requirements.

Working student: This is only possible for enrolled students who are allowed to work a maximum of 40 hours per week during the semester break and a maximum of 20 hours per week during their studies. The focus must always be on studying. In this case, both parties only have to pay contributions to the German pension insurance scheme, plus levies etc., i.e. 9.3 % for each party.

Short-term employment: This is only possible for a maximum of 3 months for students and pupils and remains completely free of social security contributions.

Internship: A distinction is made here between

a) Internships, which are mandatory by examination regulations, and

b) Internships that serve to get to know a profession.

Case a) is exempt from social insurance,

Case b) is fully subject to social security contributions.

The following points must be observed in detail:

- The minimum notice periods are determined in accordance with section 622 of the Civil Code (BGB); these increase according to length of service (up to two years of service = one month's notice, over two to five years = two months, over five to eight years = three months, etc.). A probationary period of up to six months is regularly agreed on in the employment contract: during this time, the notice period for both parties is only 14 days.

Extraordinary dismissal for serious reasons (e.g. theft) is also possible without notice after prior hearing of the employee.

- If the business (= the organisational unit, not the entire enterprise) has no more than ten employees, the Dismissal Protection Act (KSchG) does not apply. Termination without cause and without payment of severance pay is then generally permissible.
- From a business size of more than ten employees, ordinary dismissals are only permissible if the reasons listed in the Dismissal Protection Act (KSchG) apply (i.e. behavioural, personal or operational reasons). Case law has established a very strong basis for these reasons, making such terminations difficult to enforce in a court dispute. As such the practice of labour law has developed in Germany in such a way that the employer and employee frequently agree on payment of severance pay by mutual consent (in approx. 85% of cases). As a rule of thumb, the calculation applied is 0.5-1x the gross monthly salary per year of the employee's period of service in the enterprise. With few exceptions, such an agreement can only ever be reached by mutual consent, however.
- A fixed-term employment contract is permissible for up to a period of two years without a so-called material reason having to apply. This can also be extended on no more than two occasions within this two-year period. After the end of the fixed term, the employment contract ends without the need for termination.
- The reason for concluding a fixed-term employment contract is usually to mitigate the effects of the limited possibility of dismissal under the Dismissal Protection Act (KSchG). If the business does not have more than ten employees, fixed-term employment contracts are rare, as the statutory notice periods also have to be observed under such fixed-term employment contracts. Only from a business size of more than ten employees are fixed-term contracts often agreed on in order to mitigate the risk of payment of severance pay in the event of dismissal by the employer.

Important: A managing director of a GmbH (limited liability company) is not an employee under labour law, but would be issued with a written executive service contract.

**REQUIREMENTS FOR SETTING UP A BUSINESS IN GERMANY AND
DOCUMENTS/INFORMATION TO BE SUBMITTED**

The following information is required to register the company in Germany and prepare the payroll:

- What business purpose does your company pursue in Germany?
- What tasks are carried out in Germany?
- Do you already have a German tax number or a social security company number?

We can take care of the application for the tax number and company number as well as registration with the responsible employers' liability insurance association for you.

The following information is required for this purpose:

- Last name and first name of the managing director or the person responsible for the company in Germany
- Commencement of activity by employees
- Type of activity pursued by employees

Notifications can be submitted based on this data. If the data is not available by the time of the first payroll, the first pay slip can be issued on presentation of a company number.

The other data can then be submitted and calculated afterwards.