Taxation of Individual Entrepreneurs in Germany

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Introduction

- The German tax system provides several simplifications for individual entrepreneurs, that intend to reduce their administrative burden.
- Those legal provisions proved to be an effective and cost-efficient policy measure for supporting the development of small entrepreneurship in Germany.
- Therefore, the German government changed the eligibility criteria for the simplifications several times (2003, 2008, July 2009), allowing a growing number of individual entrepreneurs to benefit from those measures.

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The Concept of Individual Entrepreneur

There are two types of individual entrepreneurs in Germany:

- Individual commercial entrepreneur (“Gewerbetreibende”)
  = every person, that generates income from commercial business operations
  [legal norm: §15 EStG.]

- „Freiberufler“
  = self-employed person of specific professions, such as medical practitioner, lawyer, notary, tax consultant, scientist, writer, journalist, artist, teacher, lecturer etc.
  („freelancer“ is a proximate, but not accurate translation)
  [legal norm: §18 EStG.]

Important: An individual entrepreneur is no legal person und thus no corporation.

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Simple Accounting

Who is eligible?	• Individual commercial entrepreneur, with a yearly turnover < 500,000 EUR and a yearly profit < 50,000 EUR • „Freiberufler“, regardless of turnover and profit
What is the (optional) simplification?	• Exempted from the obligation to keep double entry accounts • Simplified profit calculation: profit is a simple revenue surplus, i.e. profit = yearly revenues minus yearly expenses • Simplified records: a simple cash receipts and disbursement statement on a pre-printed official form
What is the intention?	• Reduction of administrative burden for entrepreneurs • Reduction of administrative costs for tax authorities
Why is it more simple?	For corporations and for “big” commercial entrepreneurs: Profit is calculated as the difference between the assets at the end of the respective years. Therefore a balance sheet accounting is needed, which is more complex and means higher accounting costs and higher auditing costs.
Legal norm	§§ 140, 141 AO, § 241a HGB, § 4 Abs. 3 EStG

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Income Tax on Cash Basis

Who is eligible?	• Individual commercial entrepreneur, with a yearly turnover < 500,000 EUR and a yearly profit* < 50,000 EUR • „Freiberufler“, regardless of turnover and profit
What is the simplification?	• Profit* is liable to Personal Income Tax (not to Corporate Income Tax) • Profit* is calculated on the basis of settled accounts, i.e. only paid invoices are considered
What is the intention?	• Improve liquidity of entrepreneurs
Why is it more simple?	For corporations and for “big” commercial entrepreneurs: Profit is calculated on the basis of invoice amounts, regardless of payment of invoices. When income tax payment is due before outgoing invoices are paid, a liquidity problem can occur.
Legal norm	§§ 140, 141 AO, § 241a HGB, § 4 Abs. 3 EStG, § 11 EStG.

** profit = revenue surplus, see above slide on “Simple Accounting”*

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Trade Tax Allowance and Compensation

Who is eligible?	Individual commercial entrepreneur
What is the simplification?	• Trade tax allowance: 24,500 EUR Basis for the trade tax is the profit*. Only the amount of profit, that exceeds the threshold of 24,500 EUR, is subject to trade tax. • Trade tax compensation: individual commercial entrepreneurs can deduct their (almost) entire trade tax liability from income tax liability. The trade tax has, therefore, a (almost) neutral impact.
What is the intention?	Reduction of administrative and tax burden for entrepreneurs
Legal norm	$ 11GewStG
Background	All commercial business operations in Germany (regardless of legal company form) are subject to the trade tax (Gewerbesteuer). The trade tax is a local tax and an important revenue source for municipalities. The level of the trade tax rate is set by the municipality.

** resp. revenue surplus, see above slide on "Simple Accounting"*

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Exemption from Trade Tax

Who is eligible?	„Freiberufler“
What is the simplification?	Exemption from trade tax
What is the intention?	Reduction of tax burden for „Freiberufler“*
Legal norm	GewStG
*Further comment	Since individual commercial entrepreneurs can deduct their (almost) entire trade tax liability from income tax liability, the intention of the exemption of “Freiberufler” from trade tax is not quite clear. Therefore, there is a current debate in Germany on abolishing this exemption.

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Exemption from VAT

Who is eligible?	Individual commercial entrepreneur and “Freiberufler”, whose total turnover during the past year was below 17,500 EUR and whose turnover in the current year will presumably not exceed 50,000 EUR.
What is the (optional) simplification?	Exemption from value added tax If entrepreneurs choose to be exempted from VAT, there are neither allowed to charge VAT on their invoices, nor eligible for VAT refunds.
What is the intention?	Reduction of administrative burden for entrepreneurs
Why is it more simple?	Entrepreneurs do not need to create VAT declaration, which saves time and accounting costs.
Legal norm	§ 19 UStG

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VAT Liability on Cash Basis

Who is eligible?	• Individual commercial entrepreneur, yearly turnover < 500,000 EUR* • „Freiberufler“, regardless of turnover
What is the simplification?	• VAT is calculated on the basis of settled accounts, i.e. only paid invoices are considered
What is the intention?	Improving liquidity of entrepreneurs
Why is it more simple?	For corporations and for “big” commercial entrepreneurs: The VAT liability is calculated on the basis of invoice amounts, regardless of payment of invoices. When VAT liability settlement is due before outgoing invoices are paid, a liquidity problem can occur.
Legal norm	§§ 13, 20 UStG
*Further comment	The threshold was 250,000 EUR before 1 July 2009. As response to the economic crisis, the German government raised the threshold to 500,000 EUR. Starting from 1 January 2012, the threshold will be 250,000 EUR once again.

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Conclusions

- The main features of the German tax simplifications for individual entrepreneurs are:
  - Reduction of administrative burden and accounting costs
  - Improving the entrepreneurs' liquidity
- There is no systematic tax advantage for individual entrepreneurs: Accounting and taxation is easier, but tax burden is not (significant) lower.
- Thus:
  - Simplifications contribute to the development of SME in Germany
  - At the same time: No economic and structural distortions
  - And: No major losses in public revenues
- Conclusion: Good system which could be used as a benchmark for other countries.

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List of Legal Norms

Abbreviation	Full name	Translation
AO	Abgabenordnung	Fiscal Code of Germany
EStG	Einkommenssteuergesetz	Personal Income Tax Code of Germany
HGB	Handelsgesetzbuch	Commercial Code of Germany
GewStG	Gewerbesteuergesetz	Trade Tax Code of Germany
UStG	Umsatzsteuergesetz	Value Added Tax Code of Germany

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