

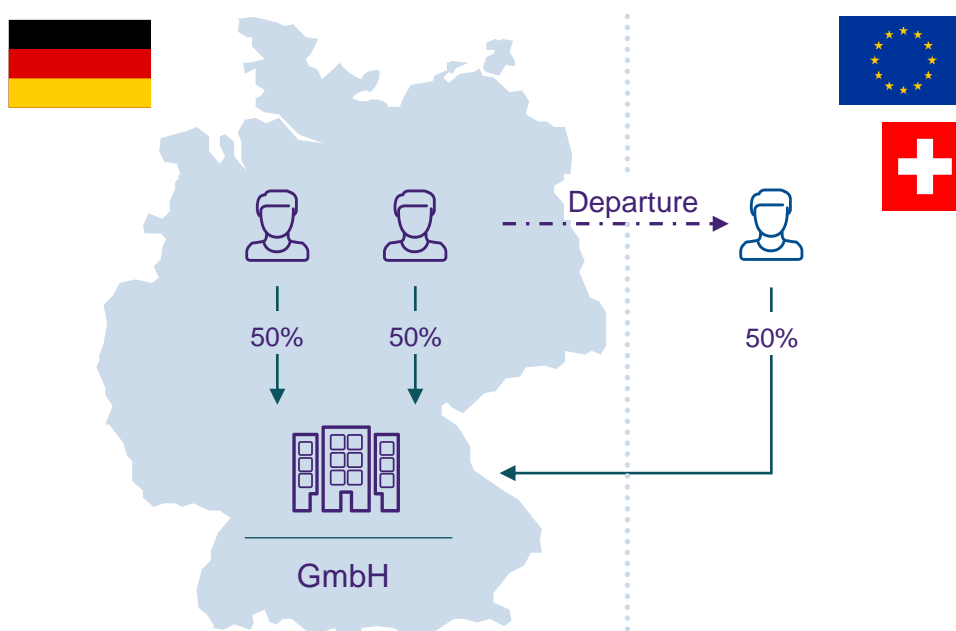
Relocation of residence abroad

Overview for exit taxation



What is involved?

Relocating or abandoning one's domicile/habitual residence in Germany, or even relocating the focus of one's life abroad may trigger a fictitious sale of shares that are held as private assets in corporations (the so-called exit tax). Hidden reserves that exist at the time of departure must be disclosed and tax paid on them - without any inflow of liquidity! The "withdrawal of shares from the corporation's capital" is taxed even if they are gifted to a buyer abroad, or in the case of an inheritance.



Deferral and payment in instalments is only possible on request and is subject to deposit of a security

The tax burden resulting from the exit tax is generally due immediately, whereas the actual taxation only takes place after assessment for income tax. Only by submitting a request can the computed tax be paid in seven equal (interest-free) annual instalments. However, a deferral is usually only granted subject to a security deposit. This can lead to certain obstacles, since the amount of the security may be determined by the tax authorities in individual cases, and the shares involved are not themselves accepted as security.



How is the value determined?

For the calculation of the tax risk or of a potential tax burden, the relevant value must be determined, i.e. the hidden reserves represented by the shares of the corporation. For this purpose, the Valuation Act applies the fair market value of the shares, which is defined as the price that would be achieved in ordinary business transactions in the event of a sale, based on the quality of the asset.

The fair market value is primarily derived from stock market prices or – in the absence of any listing – from sales between third parties (capital increases may also be relevant here). This only applies, however, if a purchase price was agreed within one year prior to the valuation date. As a secondary option, the tax valuation procedures that are expressly permitted in the view of the tax authorities for the purposes of exit tax shall be used.

Earnings value

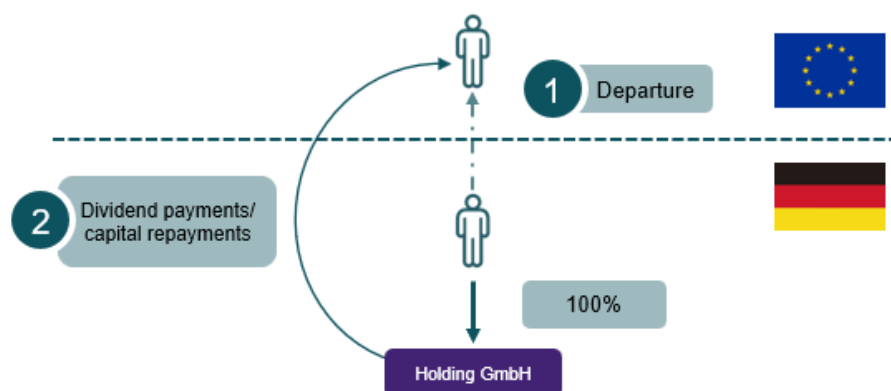
The simplified capitalised earnings method is based on the average annual income (modified for tax purposes) of the past three years, which is multiplied by a capitalisation factor (currently 13.75). Business premises, assets not required for operation and shares in other partnerships or corporations are valued and recognised separately at their fair market values.

Net asset value

The total of all positive and negative assets at fair value (net asset value method) represents the lower valuation limit. Thus, whenever the net asset value is higher than the earnings value, the former must be applied.

Follow-up deadlines to be observed

A deferral no longer applies if an annual instalment is not paid on time, if certain duties of cooperation are not fulfilled, the departing person/entity files for insolvency, the affected shares are sold or transferred or excessive dividend payments or capital repayments are made (of over 25% of the fair market value of the shares).

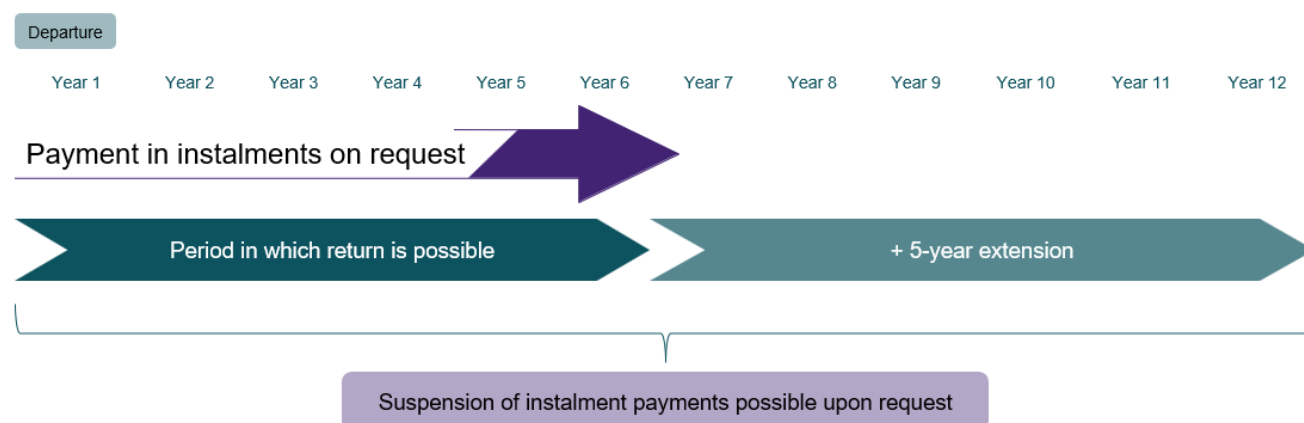




Relief through return relocation option

In the event of a temporary absence and a return within seven years, the tax demand is cancelled retroactively, provided that the termination of the unlimited tax liability was based on a purely temporary absence only. On request, the return relocation rule can be invoked for a period of another five years.

Likewise, annual instalments can be waived on request. This means that annual instalments do not have to be paid for a maximum period of up to twelve years.



However, the return relocation rule is subject to certain conditions:

1. Proof of unlimited tax liability

Unlimited tax liability in Germany must be re-established. This means that a residence or habitual place of abode must be established in Germany.

2. Exclusion of rights of taxation

Under the current wording of the law, the return relocation rule can only apply to “genuine” relocations. The taxation right in Germany must have been removed. If the right of taxation was merely limited, the return relocation rule cannot be invoked. This may result in potentially critical cases (but not exclusively and not in all cases) where dual residency exists.



3. No harmful transactions during the absence

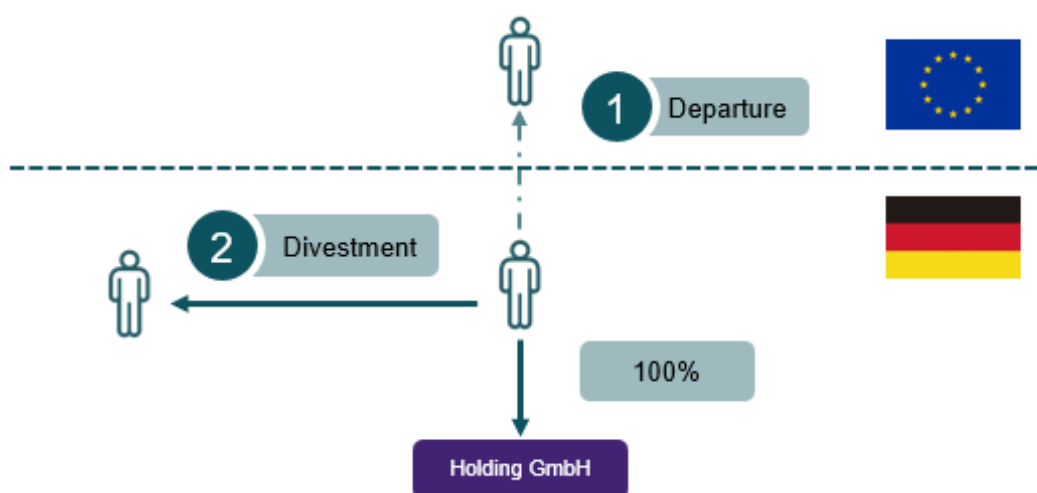
Within the period of temporary absence, the subsequent deadlines must still be observed. If the shares are sold, transferred or invested in company assets during the absence, then the exit tax is due immediately. Nor may there be any dividend payments or capital repayments made that total over 25% of the fair market value of the shares.

4. Re-establishment of the right of taxation upon return

The right of taxation with regard to the sale of the shares must be re-established to at least the same extent as it existed at the time of relocation, or the termination of the unrestricted tax liability. In particular, attention must be paid to restrictions that may arise from a double taxation agreement or a tax credit.

Double taxation despite application of the return relocation rule?

If the return relocation rule is invoked, the exit tax originally determined in Germany is waived, but an exit tax may arise in the foreign state. It should be borne in mind here that double taxation may nevertheless occur in the event of a subsequent sale, given that increases in value can be taxed during the absence abroad and there is no special protection based on a double taxation agreement (perhaps because no such agreement exists, or the agreement does not provide for any special arrangements in this case).





Interest risk under the return relocation rule

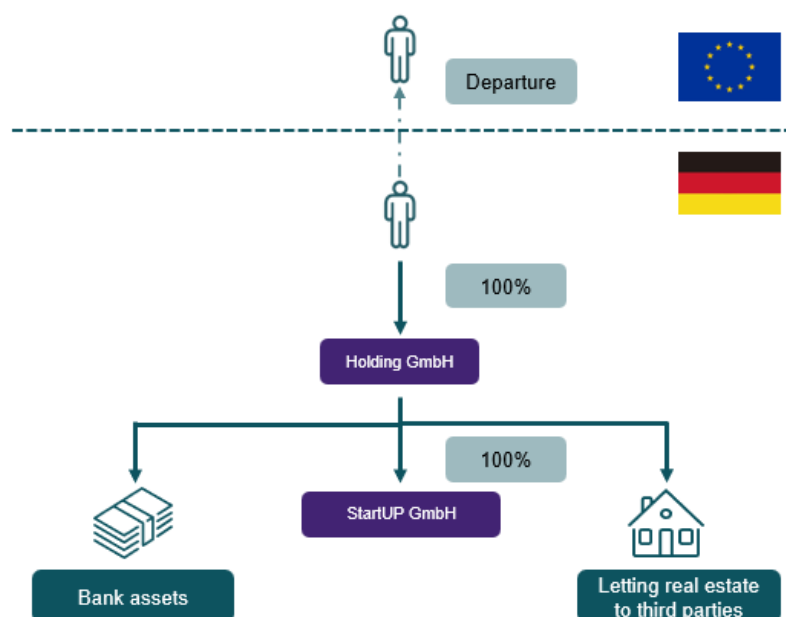
If, contrary to the assumption, no return to Germany actually takes place, or the intention to return no longer applies, interest on arrears will be charged subsequently for the duration of the payment deferral granted, and the tax will be due immediately in full. If the return relocation rule is invoked, and the instalment payment is suspended, there is still an interest risk.

Compliance with duties of cooperation

The departing person/entity must inform the tax office of their current address by 31 July every year and confirm that the shares are still held by them, for example that no sale or further transfer has taken place. Any breach of the reporting obligation results in all tax that has not yet been paid or has been deferred becoming due immediately. Any violation of the subsequent deadlines must also be reported to the tax office within one month of the occurrence of the event.

Special rules in the case of holding (capital) companies

Exit tax often also affects holding companies whose assets include shares in other corporations and other assets, such as real estate or securities. In these configurations, it is particularly worth noting that the relocation of the shareholder may also de facto relocate the administrative headquarters of the holding company, which can lead to substantial effects under company law and tax law.





Caution when dealing with holdings in taxable business assets

Even if holdings in corporations are held as business assets for tax purposes, moving abroad may trigger taxes. This applies in particular to investments in the assets of a commercial holding partnership that does not carry out any commercial activity itself. In these cases, as a result of the relocation, Germany's right to tax the shares is also regularly lost, which triggers a hypothetical withdrawal situation and can lead to a substantial tax burden.

In individual cases, restructuring may be advisable

Depending on the individual situation, restructuring arrangements to avoid triggering exit tax are certainly an option. In addition to the change of form of the corporation, it may be possible, for example, to transfer the shares to a foundation or a managing holding company. In this case, however, the benefits and disadvantages must always be carefully weighed up, together with the costs and complexity. Not every restructuring is feasible or yields a benefit.

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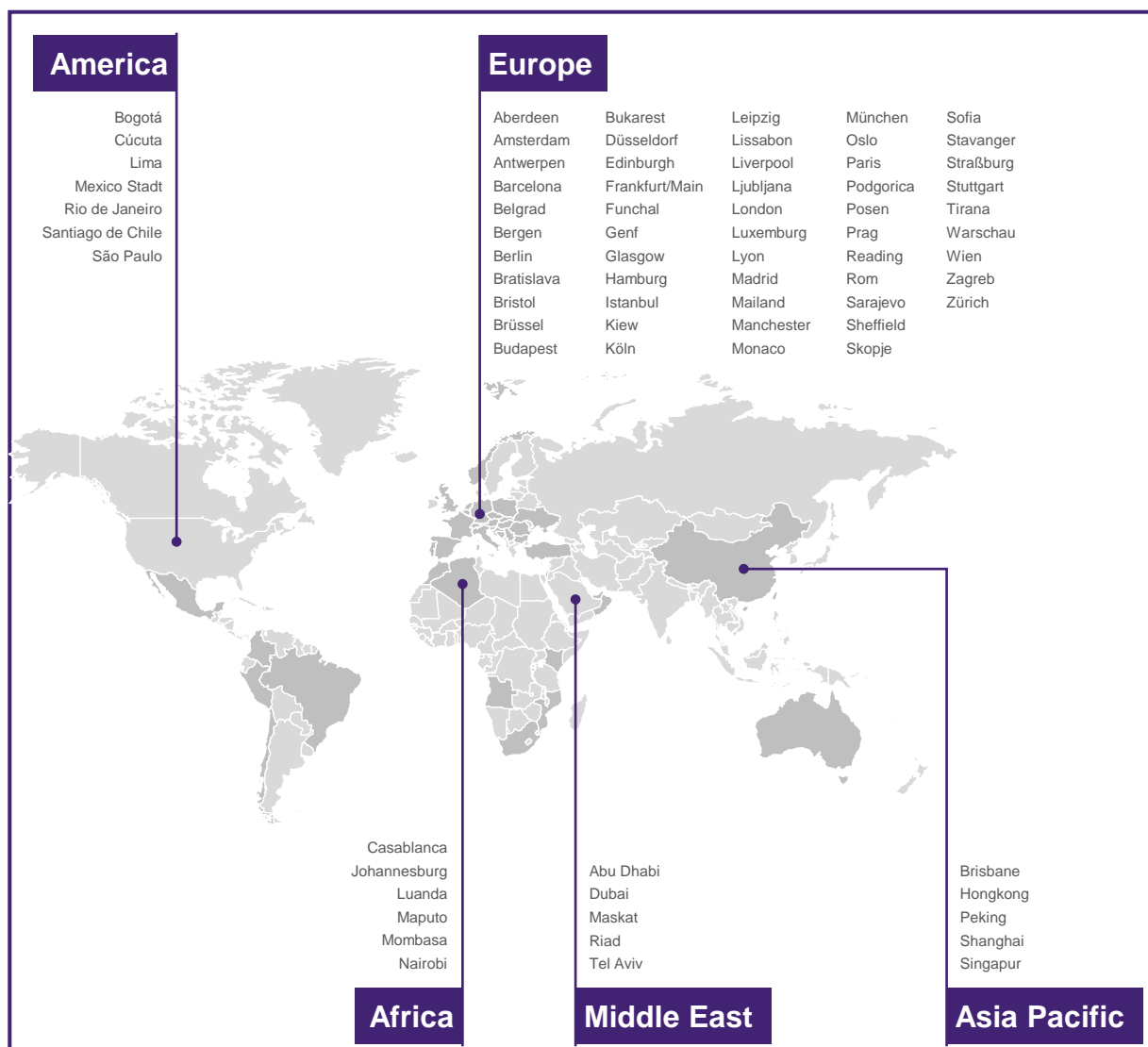
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