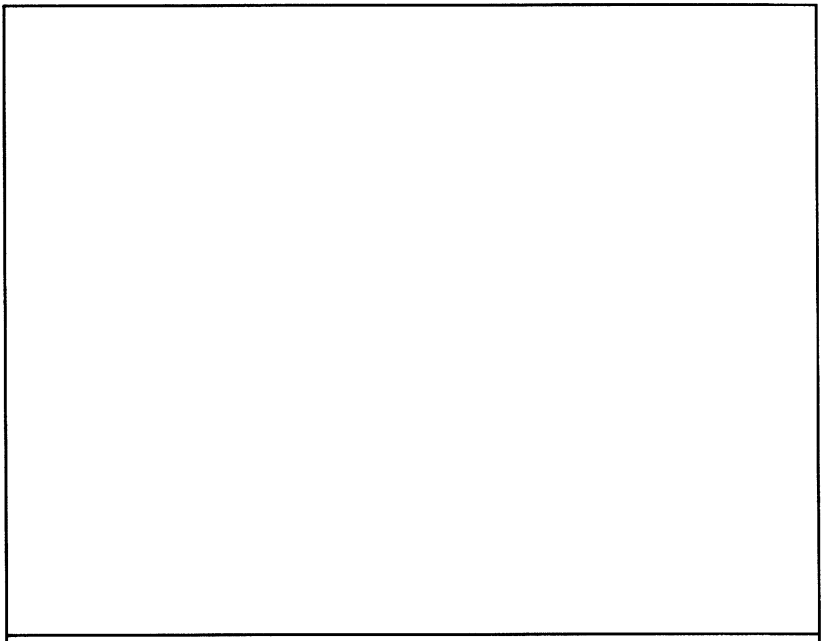

Redaktion: G. F. Schuppert

Thomas Ellwein/Dieter Grimm/
Joachim Jens Hesse/Gunnar Folke Schuppert (Hrsg.)

Jahrbuch zur Staats- und Verwaltungswissenschaft

Band 7/1994

Veröffentlichung der deutschen Landesberichte zum XIV. Internationalen Kongreß für Rechtsvergleichung (Athen 1994)

Nomos Verlagsgesellschaft
Baden-Baden

Die Deutsche Bibliothek – CIP-Einheitsaufnahme

Jahrbuch zur Staats- und Verwaltungswissenschaft. – Baden-Baden: Nomos Verlagsgesellschaft
Erscheint jährl. – Aufnahme nach Bd. 1. 1987
Bd. 7. 1994

ISBN 3-7890-3333-2
ISSN 0340–3718

1. Auflage 1994

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Moris Lehner

Criteria for the Linkage between the Act subject to Taxation and the Taxpayer

(Nationality, Domicile or Residence or Source of Taxation)

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I) Introduction and Overview

The tax law of the Federal Republic of Germany draws a distinction between the taxing of resident and of non-resident persons[1] on income and capital.[2] The taxing of the use of income and capital, on the other hand, is based on the linkage to German domestic territory and the economic activity and/or consumption which is subject to tax.[3]

1) *The Fundamental Distinction between the Taxing of Resident and Non-Resident Persons: Unlimited and Limited Tax Liability*

The distinction between residents and non-residents for the taxation of income and capital gives rise to far-reaching consequences on the material scope of application and the effects of the tax liability.

While residents, who are subject to unlimited tax liability, are taxed on their entire world income, non-residents are merely subject to limited tax liability, and are thus taxed only on German domestic source income. Tax liability under German law, similar to that of most other states,[4] is based on the distinction between two *territorial* bases of linkage.[5] Residence in Germany gives rise to a person-related territorial linkage, i.e. linkage to the *taxable entity.* In the case of individuals, this linkage is established if the individual's domicile or place of habitual abode is within German territory;[6] for legal entities, this linkage is established if the place of management or seat is in Germany.[7] However, where the taxable entity is a non-resident, the territorial linkage to the taxable entity is replaced by a material-related territorial linkage - a linkage to the *taxable subject matter.*[8] As such, territorial factors characterize the linkage of either the taxable entity or the taxable subject matter to German domestic territory.[9] However, this in no way means the realization of the *territoriality principle*[10] along the lines of the generally recognized understanding of a comprehensive, material-territorial *limitation* to tax liability, as applied in varying ways by the laws of Latin American states to both non-residents and residents.[11] Rather, the establishment by residence of unlimited tax liabilty on a taxable entity's domestic and foreign income is the realization of the *universality principle* and/or the *worldwide income principle.*[12] A realization of the territoriality principle pursuant to German tax law, on the other hand, is achieved only in those cases where there is no territorial linkage to the taxable entity because the taxable entity resides outside of Germany.

Significant differences in the *effects of the tax liability* result from the distinction between a resident's materially unlimited tax liability and a non-

resident's limited tax liability. While residents with unlimited tax liability are subject to tax on the *net amount*, non-residents are taxed on the *gross amount* of their German source income.[13] Taxation on the net amount and unlimited tax liability are inextricably connected because unlimited tax liability is based on a territorial linkage to the *taxable entity*; hence, it also takes into account the personal characteristics of the taxable entity, i.e. its ability to pay. As a result, the tax base must be reduced by any incurred business expenses, income-connected expenses, and subsistence and maintenance related expenditures.[14] Taxation on a gross basis, however, corresponds to limited tax liability because limited tax liability is actually, to a great extent, independent from the taxable person. Rather, it is based on the *material-related* territorial linkage to the taxable domestic source income without regard to the individual circumstances and expenditures of the taxpayer.[15]

2) *Important Departures and Exceptions in Domestic and International Tax Law - Role of European Community Law*

The distinction between resident and non-resident persons, which determines whether an unlimited or a limited tax liability results, is a key feature to the system of taxation of income and capital. There are, nevertheless, departures and exceptions to this basic distinction.

a) *Departures in Domestic Law, in particular the International Transactions Tax Act (Außensteuergesetz)*

An important departure in *domestic* tax law from the distinction between residents and non-residents is found in the International Transactions Tax Act *(Außensteuergesetz),* which provides for *extended limited tax liability* for income tax (sections 2 and 5), net worth tax (section 3) and inheritance tax (section 4). Extended limited tax liability is applicable to individuals who have emigrated to low-tax countries and during at least five of the ten years prior to emigration, were subject to unlimited tax liability as German citizens.[16] The provisions in the International Transactions Tax Act on the *inclusion of attributed sums in the tax base* (sections 7 to 14) are also of significance. Pursuant to these provisions, where the seat of a joint stock company is in a low-tax country, its passive investment income is deemed attributed to its shareholders before actual distribution. Such an inclusion of attributed sums in the tax base results in an *extension of unlimited tax liability* to the income from constructive dividends.[17]
Another departure from the fundamental distinction between resident and

non-resident persons is found in the *extended unlimited tax liability* of German citizens who, although no longer resident in Germany, are nevertheless subject to unlimited liability for tax pursuant to section 1(2) of the Income Tax Act *(Einkommensteuergesetz)*. This extended unlimited tax liability is applicable to non-resident Germans who are employed by domestic legal entities created by German public law and who receive wages from domestic public funds.[18]

b) *Double Taxation Conventions*

The taxing of residents in accordance with the rules of unlimited and limited tax liability leads to the situation of international *double taxation* if the same taxable subject matter is subject to both unlimited tax liability in the state of residence and limited tax liability in the state of source.[19] Double taxation conventions concluded by the Federal Republic of Germany with other states[20] avoid or eliminate double taxation within the framework of the solutions and alternatives proposed by the OECD Model Convention.[21] As a rule, when Germany is the state of residence, German double taxation conventions eliminate double taxation through the exemption method.[22] The exemption method results in a restriction on the concept of unlimited tax liability insofar as unlimited tax liability extends to foreign income. Contrary to the general preference for the exemption method, a tendency has developed in German treaty practice over the past two and a half decades towards the elimination of double taxation through the credit method.[23] This method leaves the concept of unlimited tax liability as well as the rate of taxation essentially untouched.[24] With respect to Germany's treaty partners, the European civil law countries have decided in favour of the exemption method in their treaties with Germany. The common law countries and the majority of non-European states, on the other hand, prefer the credit method. If Germany is the source state, treaty provisions often restrict tax liability.[25]

c) *Role of European Community Law*

European Community law has had significant effects on domestic tax law and the international treaty law governing double taxation conventions.
In accordance with the objectives of Article 99 of the European Community (EC) Treaty, Council directives of the European Community played a major role until the end of the 1980s in the harmonization of indirect taxes, in particular, of the *value-added tax (VAT)*.[26] In the area of *direct taxation*, European Community law, through both primary treaty law as well as directives on the harmonization of tax laws, has brought about changes to

domestic tax law.[27] The *principle of non-discrimination*, derived from primary treaty law, is embodied in the freedom of movement (Article 48 of the EC Treaty), the right of establishment (Article 52 of the EC Treaty), and the equal treatment of companies (Article 58 of the EC Treaty). These principles have gained increasing significance for German tax law in the preliminary ruling practice of the European Court of Justice,[28] and are the standards used to scrutinize the unequal treatment of non-resident taxpayers in comparison to resident taxpayers which result from the distinction made between unlimited and limited tax liability.[29]

Secondary Community law, in the form of Council directives, has only recently dealt with direct taxation of internationally active business enterprises. The *Parent-Subsidiary Directive* of July 23, 1990[30] was issued by the Council and has been implemented in German law, leading to changes in the German Corporation Tax Act *(Körperschaftsteuergesetz)*. Similarly, the *Merger Directive*[31] of the same date has also been given effect by the Act on the Taxation of Changes in the Legal Form of a Business *(Umwandlungsteuergesetz)*.[32] The Parent-Subsidiary Directive has even shaped the tax treaties between Germany and the other Member States of the European Community where the inter-company dividend relief, which it provides for, goes beyond the corresponding exemption pursuant to the treaties. The Directive has also had effects on treaty law by stipulating the maximum rate of withholding tax permissible on inter-company dividends.[33] Changes to treaty provisions regarding the exchange of information have also been effected[34] by directives concerning administrative assistance and co-operation.[35] Finally, a multilateral *Arbitration Convention*, concluded on the basis of Article 220 of the EC Treaty, deals with the elimination of double taxation in the area of income adjustment between associated enterprises, and has, effectively, modified the mutual agreement procedure contained in the tax treaties.[36]

II) Tax Liability under the Income Tax Act (Einkommensteuergesetz)

The fundamental distinction between the taxation of residents under the rules of unlimited tax liability and the taxation of non-residents under the rules of limited tax liability[37] is found in section 1 of the *Income Tax Act* (*Einkommensteuergesetz*).

1) *Necessary Conditions for Tax Liability*

a) *Unlimited Tax Liability: Domicile or Place of Habitual Abode within German Domestic Territory*

An individual who has his domicile or place of habitual abode in Germany is subject to unlimited tax liability (first sentence of section 1(1)).

aa) *The Individual Person as Taxpayer*

Only *individuals* are subject to liability for income tax. They are taxed according to the principle of *individual taxation*,[38] which means that pluralities of persons, regardless if connected by business or family ties, are not subject to tax liability under the Income Tax Act. *Partnerships*[39] as such are subject to neither income tax nor corporation tax; rather, the individual partners themselves are taxed on the profits realized by the partnership.[40]

bb) *Territorial Scope (»Inland«)*

»Inland«, for the purposes of section 1(1) of the Income Tax Act, is the state territory of the Federal Republic of Germany. Pursuant to sentence 2 of section 1(1) of the Act, that includes Germany's portion to the continental shelf as long as it is the site of exploration and exploitation of the natural resources of the seabed and the subsoil.[41] In addition, considered as part of German state territory are also custom free zones, free port areas, the three-mile zone, and German ships while sailing in German territorial waters or on the high seas but not during passage through foreign territorial waters.[42]

cc) *Domicile*

Pursuant to section 8 of the German Fiscal Code (*Abgabenordnung*), an individual is domiciled where he or she occupies a dwelling under such circumstances that it can be concluded that the individual will retain and use the dwelling.[43] Contrary to the private law use of the same term in section 7 of the German Civil Code (*Bürgerliches Gesetzbuch*), domicile is determined for tax purposes not by the intent of the taxable person, but rather by the *particular facts*.[44] An individual is not precluded from having more than one domicile at the same time.[45] Necessary for the establishment of domicile is a place suitable for residence over a certain period of time[46] and which corresponds to the standard of living and personal circumstances of the individual.[47] Furnished rooms,[48] living quarters in barracks,[49]

weekend cottages,[50] and mobile homes situated on a camping ground rented for a certain period of time[51] all qualify as dwellings. In addition, section 8 of the German Fiscal Code further requires that the taxable person occupies the dwelling (i.e. that the taxable person actually has the dwelling at his or her disposal with a certain degree of regularity)[52] such that it can be concluded that the taxable person will retain and use the dwelling. Determining factors include the furnishings of the dwelling, and the actual time spent by the taxable person in the dwelling. Interruptions of less than six months to the stays are generally of no consequence.[53] Domicile is *established* regardless of the intent of the taxable person when the requisite objective elements are met. Residence registrations with the police alone are not decisive.[54] The same applies to the relinquishment of domicile. The departure for or return to a foreign country results in a relinquishment of domicile in Germany only if the circumstances indicate that the taxable person will not be returning to Germany.[55] *German employees of the European Community* who settle in another Member State solely to discharge the duties of their office are considered to be domiciled in Germany.[56]

dd) *Place of Habitual Abode*

Besides domicile, another equally important connecting factor which leads to unlimited tax liability is the taxpayer's place of *habitual abode.* Pursuant to section of the German Fiscal Code, a person's habitual abode is wherever he or she is physically present under such circumstances which indicate that his or her stay at this place or in this area is not merely of a temporary nature. A stay which exceeds six months creates the presumption that a habitual abode has been established; short-term interruptions are insignificant. This presumption does not apply, however, if the stay exclusively serves the purpose of visiting, recreation, rehabilitation or other similiar private purposes and the stay does not exceed one year.
Whether a habitual abode has been established is also determined on the basis of objective characteristics.[57] While a *place* is characterized as a certain municipality or even a narrowly defined property or building, the *area* referred to in section 9 of the German Fiscal Code encompasses a larger expanse within German domestic territory.[58] The stay is *not merely of a temporary nature* if it spans a longer period of time, which need not necessarily amount to six months.[59] However, a stay of even five months is not regarded as establishing habitual abode if the length of the stay had been limited to this time period from the outset.[60] Employment activity in Germany leads to the establishment of habitual abode only if a dwelling is kept within Germany to faciliate the performance of the activity. Therefore,

foreign *frontier workers*[61] who return daily to their family residences abroad do not have a place of habitual abode in Germany.[62] In evaluating the circumstances which may indicate that the stay is *not merely of a termporary nature*, the test of whether the individual will retain and use the dwelling must be applied.[63] Even if the circumstances indicate that the stay is temporary, a habitual abode can nonetheless be presumed if the stay exceeds six months.[64] The entire six-month period need not be in the same calendar year.[65] The *establishment of habitual abode* requires the physical presence of the taxpayer in Germany.[66] If the taxpayer leaves Germany without the intent to return and stays abroad for at least six months, a refutable presumption arises for the *giving up of a habitual abode* in Germany.[67]

ee) *Criteria for Treaty Entitlement*

In order for the distributive rules of double taxation conventions to be applicable, the taxpayer must be resident in one of the two contracting states.[68] The German conventions define the residence of a person essentially in accordance with Article 4 of the OECD Model Convention.[69] Even when the taxable person is resident in both contracting states according to their domestic tax laws, German treaty practice determines the *residence for purposes of the convention* largely based on the residence attribution criteria in Article 4(2) of the OECD Model Convention.[70]

b) *Extended Unlimited Tax Liability: German Civil Servants working abroad*

The purpose of *extended unlimited tax liability* is to avoid the disadvantages which may arise out of the limited tax liability of *non-residents* who receive income from Germany.[71] Sections 1(2) and 1(3) of the Income Tax Act regulate *unlimited* tax liability for certain persons who have neither a domicile nor a place of habitual abode in Germany.[72] Beneficiaries of these provisions are *German citizens* (including family members) who are employed by a domestic legal entity created by *public law* and whose salaries are paid from *domestic public funds*.[73] Such beneficiaries are typically officials and other employees of the federal or a state government working abroad with diplomatic or consular status. A condition is, however, that such beneficiaries are subject to limited tax liability or other comparable tax liability in their state of residence (state of employment).[74] If this condition is not fulfilled, the foreign service employee is subject to unlimited tax liability pursuant to section 1(3) of the Income Tax Act only if his or her taxable foreign income does not exceed DM 5000.[75]

c) *Limited Tax Liability: German Source Income of Non-Residents*

Individuals who have neither a domicile[76] nor a place of habitual abode[77] in Germany and are not subject to the extended unlimited tax liability[78] are subject to *limited tax liability*[79] if they receive *German source income* as defined in subsection 49(1) of the Income Tax Act.[80] Sections 50 and 50a contain special provisions on income determination and on the collection of income tax.[81] Important restrictions relating to limited tax liability are also found in tax treaties.[82] Finally, European Community law has gained increasing significance in this area.[83]

aa) *The »Isolating Approach« (isolierende Betrachtungsweise) in Section 49 of the Income Tax Act*

Section 49(1) of the Income Tax Act determines *conclusively*[84] and in conformity with the catalogue of the seven items of income in section 2(1) of the Act,[85] what constitutes German source income for the purposes of the limited tax liability using different *territorial* connecting and determining factors. Pursuant to section 49(2), an »*isolating approach*« (*isolierende Betrachtungsweise*) is taken in this determination.[86] According to this approach, foreign qualifications of income are irrelevant in categorizing income in terms of the items of income listed in section 49(1).

bb) *The Source Rules of Section 49(1) Nos. 1-6 of the Income Tax Act*

Beyond the common territorial linkage, the criteria establishing tax liabililty in section 49(1) of the Income Tax Act are not easy to systemize.[87] The *connecting principles*, however, are more readily distinguishable, although they have been subject to significant modifications and frequent departures. In the case of income from agricultural and forestry activities (section 49(1) no. 1)[88] or from the rental and leasing of German property (section 49(1) no. 6),[89] the necessary linkage to Germany is established by the *situs principle*;[90] limited tax liability on income from the rental and leasing of German property, however, is also established by the *permanent establishment principle*.[91] The permanent establishment principle applies to income from a business enterprise (section 49(1) no. 2a)[92] and is supplemented by the feature of a domestic *permanent agent*.[93] This principle is expansively departed from for business income derived from domestic *transportation services* by foreign shipping and aviation enterprises (section 49(1) nos. 2a and 2b).[94] Departures from the permanent establishment principle also frequently arise, pursuant to section 49(1) no. 2, where business income derived through *artistic or athletic performances*[95] is from German domestic

sources. Included under German source income from a business enterprise are also proceeds from the *disposal of significant interests in domestic joint stock companies* (section 49(1) no. 2e).[96] The non-resident's limited tax liability on income from *independent personal services or employment* (section 49(1) nos. 3 and 4)[97] is established by the *discharge of functions and the exploitation* of the result of the work within Germany territory. Income from *capital assets* (section 49(1) no. 5)[98] is covered by limited tax liability due to the relationship to a *domestic debtor* or to *secured real property situated in Germany*, insofar as the income does not constitute business profits nor income from rental or leasing of property. At the time, income from recurring remuneration (section 49(1) no. 7) is *not* subject to limited tax liability. Income from *speculative transactions* (section 49(1) no. 8)[99] is subject to limited tax liability if the transactions relate to *domestic real property or rights equivalent to domestic real property.* Other income, as referred to in section 49(1) no. 9,[100] includes income from the *utilization of movable property and know-how* in Germany.

cc) *Effects of Double Taxation Conventions*

Double taxation conventions modify the *criteria for tax liability*[101] as established by domestic law as well as the *effects* of limited tax liability, the latter especially with regard to permissible withholding tax rates.[102]
The *source rules* in section 49(1) of the Income Tax Act have been modified by the German double taxation conventions, partly in principle, but primarily in detail. An example of such a modification is the inclusion of a *building site or construction or installation project* under the definition of permanent establishment in many German double taxation conventions (and in accordance with Article 5(3) of the OECD Model Convention) where the duration of the construction or installation exceeds twelve months.[103] This constitutes a departure from section 12 no. 8 of the German Fiscal Code (*Abgabenordnung*), which provides that a duration of six months suffices. Another departure from section 12, which is found in the provisions of German treaties and modelled after Article 5 of the OECD Model Convention, is the exclusion of *activities of a preparatory or auxiliary character* from the term »permanent establishment«.[104] With respect to income from independent personal services, the mere exploitation of the results of the work in Germany is not sufficient to establish a taxing power;[105] required is either a minimum stay of 183 days in the state of performance (*place-of-work principle*) or, in accordance with Article 14 of the OECD Model Convention, a *fixed base* in the source state for the carrying out independent personal services.[106] The place-of-work principle, restricted by the 183-day clause in accordance with Article 15 of the OECD

Model Convention, applies also to income from *dependent personal services.*[107] German taxation conventions contain special provisions for *frontier workers, guest professors, and students.*[108] With respect to income from *capital assets,* the double taxation conventions draw a distinction between dividends and interest. In the case of dividends, the company paying the dividends must be, in accordance with Article 10 of the OECD Model Convention, resident in the source state.[109] Special treaty provisions exist as to the scope of the source state's power to tax intercompany dividends and scattered holdings dividends.[110] Modelled after Article 10(5) of the OECD Model Convention, many German tax treaties contain a *prohibition on extraterritorial taxation of profits.*[111] In accordance with Article 11(1) and 11(5), *interest* must *arise* in the source state.[112] The payer of the interest must therefore be a *resident of the source state*; alternatively, the interest must be paid on *the indebtedness of a permanent establishment or fixed base in the source state and borne by such permanent establishment or fixed base.*[113] With respect to income from the *rental and leasing of property,* German tax treaties differentiate, as does the OECD Model Convention, between *immovable property* (Article 6 of the Model Convention) and *royalties* (Article 12 of the Model Convention). With respect to the former, taxation is based on the *situs principle,*[114] whereas in the case of the latter, it is decisive where the royalties arise.[115]

2) *Important Differences between Unlimited and Limited Tax Liability*

Significant differences between the structure of unlimited tax liability and that of limited tax liability[116] result from the special provisions with respect to the latter.[117] These special provisions have been modified by double taxation conventions.[118] The requirements of European Community law are also becoming increasingly important with respect to the issues surrounding limited tax liability.[119]

a) *Domestic Law*

While resident taxpayers with unlimited tax liability are subject to *net taxation* on a progressive scale of rates up to a maximum of 53 percent, nonresident taxpayers with limited tax liability are subject to a withholding tax at a set rate on the *gross amount* of German source income.[120] This means that in the case of limited tax liability pursuant to sections 50 and 50a of the Income Tax Act, business expenses, income-connected expenses, and personal and family-related charges remain, for the most part, unconsidered.[121] This results from the fact that income tax on the majority of

income types enumerated in section 49(1) is *final as it is deducted at the source from the gross amount of the income* pursuant to section 50(5) and section 50a of the Income Tax Act.
Two groups of cases contain certain *exceptions to the principle of taxation on the gross amount of income* in favour of taxation on the net amount. The first case consists of *employees subject to limited tax liability.* Their personal circumstances are taken into consideration in section 50(4) because these employees defray their living expenses almost exclusively with their wages or salaries. Pursuant to section 50(4) in conjunction with section 50(1), taxpayers subject to limited tax liability can deduct among other expenses, income-connected expenses, a series of special expenses, and also, to a certain extent, maintenance expenses for children.[122] However, the fact that the *split rate* (*Splitting-Tarif*) would still be denied to employees who are married,[123] and that direct assessment (formerly, annual adjustment of wage tax (*Lohnsteuer-Jahresausgleich*)) is not applicable because the source tax on wages and salaries still pose disadvantages.[124] The second situation which provides for certain exceptions from the principle of taxation on the gross amount of income in favour of taxation on the net amount is where income from the *rental and leasing of immovable property*[125] and *business income from permanent establishments in Germany* are subject to limited tax liability. In such cases, the taxpayer is subject to limited tax liability on the basis of *direct assessment* pursuant to the more detailed provisions of sections 50(1) and 50(3). This means, among other things, that business expenses and income-connected expenses are deductible insofar as they are economically connected to the domestic income. Restrictions exist, however, pursuant to section 50(1) with respect to the offsetting of losses, deductions for special expenses and personal expenditures.[126]
A special feature in connection with the *corporation tax credit* is found in section 36(2) no. 3 of the Income Tax Act in that a taxable person subject to limited taxation is excluded from such a credit due to the fact that pursuant to section 50(5) sentence 2, the tax deduction is final. However, a credit is possible according to section 50(5) sentence 3 no. 1 if the income from interest may be treated as operating profits of a domestic business.
Pursuant to section 50(3), taxpayers subject to limited tax liability must pay tax on their income calculated using the Basic Tax Table which provides for a minimum income tax in the amount of 25 percent of the income.

b) *Effects of Double Taxation Conventions*

The effects of double taxation conventions are not just the determination of which contracting state has the *sole* right to tax[127] on the basis of certain

connecting factors;[128] tax treaties also play a role in determining the *effects* of unlimited and limited tax liability.

The German treaty practice has an effect on unlimited tax liablity by way of *profit adjustment* and *allocation of expenses* with respect to permanent establishments[129] and by way of *profit adjustment* between associated enterprises.[130] It is also worth noting that in the treaties, there are frequently *provisos safeguarding progression* on income and property which are exempted from taxation in the state of residence.[131] Finally, treaty provisions on *maximum deductions*[132] and on *credits for taxes not levied*[133] affect domestic provisions on reductions for taxation purposes, and in particular, the tax credit.

The effects of treaty law on *limited* tax liability as set out in domestic law are found primarily in the limitations on withholding tax rates. A rate of 15 percent is normally imposed on *portfolio dividends*, whereas *inter-company dividends* are subject to withholding taxes at a rate of 10 percent.[134] Cross-border *interest* is subject to withholding tax at a maximum rate of 10 to 15 percent if the recipient is resident in a developing country; where the state of residence is an industrialized country, the interest is, as a rule, not subject to German withholding tax.[135] *Royalties* are subject to withholding tax at a range of rates from 0 to 15 percent.[136]

c) *Requirements of European Community law*

Limited tax liability leads to disadvantages for non-residents which German residents do not face.[137] It is generally accepted by German legal writers that the tax scheme is therefore subject to scrutiny under the principle of non-discriminiation in European Community law pursuant to Articles 48, 50 and 52 in conjunction with Article 58 of the EC Treaty.[138] In its first decisions regarding European Community law, the German Federal Fiscal Court *(Bundesfinanzhof)* found that discrimination based on nationality did not arise from the provisions of limited tax liability.[139] It did, however, under certain circumstances, recognize a claim to tax reductions *for reasons of equity.*[140] Only after considering the case law of the European Court of Justice[141] did the German Federal Fiscal Court,[142] following the view of the Cologne Fiscal Court,[143] question the correctness of its own previous decisions. Its doubts arose out of a case which was framed within the context of the *freedom of establishment* under Article 52 of the EC Treaty and dealt with a resident of Belgium who had to pay taxes on over 90 percent of his income in Germany, where he had exercised his profession using a fixed place of business. The doubts raised by the Federal Fiscal Court have not yet been settled by the European Court of Justice. Rather, the European Court of Justice has decided[144] at the request of the Cologne

Fiscal Court[145] that Article 52 is not violated if a *German national*, resident in the Netherlands, with income from independent personal services is subject to limited tax liability in Germany and is liable for higher taxes than a German national subject to unlimited tax liability would be. The Federal Fiscal Court's application of April 14, 1993 for a preliminary ruling,[146] however, did not deal with the requirements of the freedom of establishment in Article 52 of the EC Treaty, but rather, the prohibition on the unequal treatment of workers (*freedom of movement of workers*). At issue is the exclusion of the non-resident taxpayer from the benefits of the annual adjustment of wage tax, direct assessment and income splitting for spouses.[147]

III) The Extended Limited Tax Liability in the German Foreign Transactions Tax Act (Außensteuergesetz)

Closely connected to limited tax liability is *extended limited tax liability*, provided for in sections 2 to 5 of the Foreign Transactions Tax Act (*Außensteuergesetz*). These provisions are aimed at preventing tax advantages for those who emigrate to low-tax countries.[148]

1) *Personal and Material Scope*

Pursuant to section 2(1) of the Foreign Transactions Tax Act, *individuals* are subject to extended limited tax liability if, while maintaining *substantial economic interests* in Germany, they emigrate to *low tax countries* or emigrate without establishing a new domicile for tax purposes. A further requirement is that for at least five of the ten years before the emigration, such individuals were subject to unlimited tax liability[149] as German nationals. *Low taxation* is considered to exist especially where the tax burden on income equivalent to DM 150 000 is lower by more than a third of the tax burden in Germany. The requirement of *substantial economic interest* is met pursuant to section 2(3) if the taxpayer has a certain commercial involvement or existing assets within the domestic territory of Germany, or whose income from Germany amounts to more than 30 percent of his or her total income and is more than DM 120 000.

2) *Scope of Liability for Tax*

Pursuant to section 2(1) of the Foreign Transactions Tax Act, extended limited liability for income tax lasts for ten years. This tax liability encompasses not only income normally subject to limited tax liability[150], but also income which does *not* meet the definition of *foreign income* pursuant to section 34c(1) (section 34d) of the Income Tax Act. Such income includes business income of more than DM 32000, even when it cannot be attributed to a domestic permanent establishment. Pursuant to section 5 of the Foreign Transactions Tax Act, extended limited tax liability is also applicable to cases of indirect *holdings in foreign interposed companies* within the meaning of section 7 of the Act.[151] Finally, extended tax liability also exists for *net worth tax* (section 3 of the Foreign Transactions Tax Act) and *inheritance tax* (section 4 of the Foreign Transactions Tax Act).
Contrary to cases of limited tax liability,[152] there is a *proviso safeguarding progression* in cases of extended limited tax liability where the minimum tax rate is 25 % (section 2(5) of the Foreign Transactions Tax Act).

IV) Tax Liability under the Corporation Tax Act (Körperschaftsteuergesetz)

Similar to the Income Tax Act, the Corporation Tax Act (*Körperschaftsteuergesetz*) also draws a distinction between unlimited (section 1) and limited (section 2) tax liability.[153] The law currently provides for a full credit system with a tax rate of 45 percent for accumulated profits and a rate of 30 percent for distributed profits.

1) *Necessary Conditions for Tax Liability*

A distinction must be drawn between unlimited tax liability of a domestic taxable entity and that of a foreign taxable entity. For the latter, the additional question arises as to what are the prerequisites for limited tax liability.[154]

a) *Unlimited Tax Liability of Domestic Corporations: Place of Management or Seat within German Domestic Territory*

The corporations, associations and conglomerations of assets enumerated in section 1(1) of the Corporation Tax Act, which have their *place of management or seat within German domestic territory*, are subject to unlimited liability for corporation tax.

aa) *Taxable Entities as Defined in Section 1(1) Nos. 1 - 6 of the Corporation Tax Act*

Entities subject to corporation tax[155] as defined in subsection 1(1) nos. 1 - 6 are primarily joint stock companies (stock corporations, limited liability companies) and certain associations, foundations and institutes. Included is also a company in the process of being founded but not yet registered.[156]

bb) *Place of Management*

Section 10 of the German Fiscal Code (*Abgabenordnung*) defines the term »place of management« (*Geschäftsleitung*) as being the »*business' centre of top level management*« (*Mittelpunkt der geschäftlichen Oberleitung*).[157] This definition focuses on the place from which the enterprise is *actually managed*, that is, the place where all important and weighty decisions with respect to the actions of the company are taken,[158] and not the place where these decisions become effective.[159] Where commercial and technical management are separated, the place of commercial management is decisive.[160]

cc) *Seat*

The seat of a corporation, association or conglomeration of assets is the place defined as such by *law or designed as such in its charter.*[161] In contrast to the determination of the place of management on a factual basis, the seat of a taxable corporate entity is determined on a *legal* basis. Relevant provisions dealing with *statutory* seat include section 5 of the Public Limited Company Act (*Aktiengesetz*) for stock corporations, section 3 of the Act on Private Limited Companies (*GmbHG*) for companies with limited liability, and sections 24 and 25 of the German Civil Code for registered associations.

b) *Unlimited Tax Liability of Foreign Corporations*

There is no express statutory regulation of the type of tax liability to which an entity created under *foreign law* but which keeps its *place of management in Germany* would be subject; neither has this issue been settled in German legal literature.[162] The German Federal Fiscal Court has indicated,[163] however, that this question must be determined through a comparison of the entities' legal characteristics, that is, an analysis of whether or not the legal entity created by foreign law is comparable to a taxable corporate entity in accordance with the main concepts of German income tax and corporation tax law. In its decision of June 23, 1992, the Federal Fiscal Court[164] held that a company created by foreign law can be subject to unlimited tax liability in Germany as long as its structure is that of a German joint stock company, even if its place of management is in Germany and it therefore has no legal capacity according to German international private law.

c) *Limited Tax Liability*

Section 2 of the Corporation Tax Act distinguishes between two forms of limited tax liability. While section 2 no. 2 covers all domestic legal entities created by *public law*[165] which have taxable income, section 2 no. 1 deals with corporations, associations and conglomerations of assets which have neither their place of management nor their seat in Germany but have German domestic income. *Domestic income* for purposes of the limited corporation tax liability is, by way of reference in section 8(1) of the Corporation Tax Act, defined in section 49 (2) of the Income Tax Act.[166] Special rules and exceptions exist, however, for income which can not be determined to be separate from the taxable entity, such as income from independent and dependent services.[167]

2) *Special Rules*

Special corporation tax rules exist for the emigration of companies; cross-border mergers, divisions and contribution of assets; cross-border parent-subsidiary relationships; and the establishment of companies in low-tax countries.

a) *Emigration of Companies and Cross-Border Mergers, Divisions and Contributions of Assets*

If a joint stock company transfers its seat and its place of management outside of Germany,[168] the company's capital gains will be taxed according

to section 12(1) and section 11 of the Corporation Tax Act. The mere transfer of the place of management is not sufficient since unlimited tax liability can also be established by a statutory seat in Germany.[169] On the other hand, if the taxable entity's seat is transferred abroad and the place of management remains in Germany, the entity's tax liability must be determined pursuant to a comparison of the entity's legal characteristics.[170]

The deferral of taxation of undisclosed reserves has been facilitated within the European Community by the *Merger Directive* of July 23, 1990.[171] Its provisions on the contribution of assets and the exchange of interest has been implemented by sections 20(6) and 20(8) of the Act on the Taxation of Changes in the Legal Form of a Business (*Umwandlungsteuergesetz*). With respect to mergers and divisions, the domestic law does not yet provide for any legal basis.

b) *Cross-Border Distribution of Profits between Parent and Subsidiary Companies*

Pursuant to section 44d(1) of the Income Tax Act and in accordance with the exception in Article 53(3) of the Parent-Subsidiary Directive of July 23, 1990,[172] Germany may levy a withholding tax at a maximum rate of 5 percent in the case of a parent-subsidiary relationship within the meaning of the Directive. Where an EC-subsidiary distributes profits to its German parent, section 26(2a) of the Corporation Tax Act provides for an *indirect tax credit* in accordance with Article 4(1) of the Parent-Subsidiary Directive. However, since Germany has agreed to *inter-company dividend relief* in all its double taxation conventions with EC Member States,[173] section 26 (2a) of the Corporation Tax Act is significant only where the inter-company dividend relief granted is subject to an *activity proviso.*[174]

c) *Creation of Joint Stock Companies in Low-Tax Countries*

Independence of joint stock companies for tax purposes means that their profits can only be taxed upon distribution to the companies' shareholders. Sections 7 to 14 of the Foreign Transactions Tax Act *(Außensteuergesetz)* provide for the *inclusion of attributed sums in the tax base*[175] in order to prevent this sheltering and deferral effect when domestically controlled joint stock companies (as defined in section 7) in low-tax countries derive *passive investment income.* Such income is that not listed in subsection 8(1) and 8(2) of the Act. For example, income from pure holding and financing companies qualifies. The goal of the provisions is met in that the domestic shareholders become proportionally tax-liable on the income which the

foreign company is to be treated as an intermediate company in terms of section 7 of the Foreign Transactions Tax Act. Independence of the foreign company for tax purposes is maintained by *deeming a distribution of profits.* The Tax Amendment Act (*Steueränderungsgesetz*) of 1992 has extended the scope by extension of tax liability to *special investment income.*[176]

V) Overview of other Direct Taxes: Trade Tax, Net Worth Tax, Inheritance and Gift Tax (Gewerbesteuer, Vermögensteuer, Erbschaft- und Schenkungsteuer)

The trade tax and the real estate tax are charged on existing assets as special taxes on the deemed earning power of a business enterprise's capital. In addition, the deemed earning power of the entire capital is subject to the general net worth tax. The inheritance and gift tax is charged on transferred income.

1) *Trade Tax and Real Estate Tax*

a) *Trade Tax*

Every business enterprise operated within German domestic territory[177] is subject to *trade tax*[178] (section 2(1) of the Trade Tax Act (*Gewerbesteuergesetz*)). Business enterprises are *industrially and commercially active* sole proprietorships and partnerships and, regardless of the type of activity carried out, joint stock companies which maintain a permanent establishment[179] in Germany. Where an enterprise keeps its place of management in a foreign country which has not concluded a tax treaty[180] with Germany, its permanent establishment in Germany is not subject to trade tax insofar as the income from this permanent establishment is free from tax within the framework of limited tax liability (section 2(6) no. 2 of the Trade Tax Act). Foreign permanent establishments of domestic enterprises are not subject to German trade tax. The *person liable for tax* is the entrepreneur for whose account the enterprise is operated (subsection 5(1) of the Trade Tax Act). The residence of the entrepreneur is not relevant. The basis for the tax is a *uniform basic assessment figure* which includes the *business enterprise's profits* and its *capital* (section 14 in conjunction with sections 7 ff. and 12 ff. of the Act). For the purpose of tax calculation, a multiplier set by each

municipality is applied to the basic assessment figure (sections 16 ff. of the Trade Tax Act).

b) *Real Property Tax*

Real property tax is imposed on the ownership of real property as defined in the Valuation Act (*Bewertungsgesetz*). That is, agriculture and forestry businesses, and real property used for business or private purposes (section 2 of the Real Property Tax Act (*Grundsteuergesetz*). The *person liable for tax* is principally the legal owner of the real property, but under certain circumstances, could also be the equitable owner. The *basis of charge* for real property tax is a basic assessment figure which is calculated by the application of a per mil rate (tax index number) to the uniform value of the property determined in accordance with the Valuation Act.

2) *Net Worth Tax*

Net worth tax imposes an additional tax burden on funded income. The net worth itself constitutes only the basis of the tax. Similar to the Income Tax Act and the Corporation Tax Act, the Net Worth Tax Act (*Vermögensteuergesetz*)[181] also makes a distinction between *unlimited* (section 1 of the Net Worth Tax Act) and *limited* (section 2 of the Act) tax liability. Section 2 in conjunction with section 3 provides for *extended limited* tax liability. In conformity to but not in accordance with section 1(2) of the Income Tax Act,[182] *extended unlimited* tax liability is also provided for (section 1(2) of the Net Worth Tax Act). Where the taxpayer is subject to unlimited tax liability, the basis of tax is the total foreign and domestic net worth (section 1(3) of the Net Worth Tax Act) calculated according to sections 114 ff. of the Valuation Act. In contrast, a taxpayer subject to limited tax liability is taxed only on domestic net worth according to the exhaustive list of items in section 121(2) of the Valuation Act. For individuals, the net worth tax rate amounts to 0.5 percent of the taxable net worth calculated, taking into account tax-free allowances (section 6 in conjunction with section 10 no. 1 of the Net Worth Tax Act); and for corporations listed in section 1(1) no. 2 and section 2(1) no. 2 of the Net Worth Tax Act, the rate is 0.6 percent of the net worth.

3) *Inheritance and Gift Tax*

Acquisitions by reason of death, inter vivos gifts, and gifts allocated to particular purposes or persons (endowments) are subject to inheritance and

gift tax.[183] Subject to tax are also family foundations and associations. The rates of tax for spouses and children after deduction of tax-free allowances are 3 percent where the acquisition is valued at DM 50.000, over 10 percent if the acquisition is over DM 1.000.000, and up to 35 percent where the value of the acquisition is over DM 100.000.000. The Act distinguishes between *unlimited* tax liability, which encompasses two forms of *extended unlimited* tax liability (section 2(1) nos. 1 and 2 of the Inheritance and Gift Tax Act (*Erbschaftsteuer- und Schenkungsteuergesetz*)), and *limited* tax liability, which is *extended* by section 4 in conjunction with section 2 of the Foreign Transactions Tax Act.[184] Unlimited tax liability is imposed whenever either the testator/donor or the beneficiary is a *national resident.* For the testator/donor, this results in tax liability on his or her total domestic and foreign net worth. On the other hand, if only the beneficiary is a national resident the scope of unlimited tax liability include all acquired domestic and foreign wealth, regardless of whether the testator/donor is a national resident or not. National resident (either testator/donor or beneficiary) within the meaning of section 2(1) no. 1 of the Inheritance and Gift Tax Act include individuals whose *domicile or place of habitual abode*[185] is in German domestic territory (section 2(1) no. 1a). Furthermore, *German citizens* who have lived abroad for five years or less also qualify as national residents. Finally, *employees of the German civil service who are resident abroad* are also defined as national residents pursuant to section 2(1) no. 1c of the Inheritance Tax Act.[186] Corporations are subject to unlimited tax liability if they have either their *place of management or seat* in Germany.[187] Limited tax liability is imposed when neither the testator/donor nor the beneficiary is a national resident (section 2(1) no. 3 of the Inheritance Tax Act), and covers, as does limited liability for net worth tax,[188] domestic wealth as defined in section 121(2) of the Valuation Act. The Federal Republic of Germany has concluded *inheritance tax treaties* with Greece, Sweden, Austria and the United States.

VI) Special Transaction, Excise and Luxury Taxes (Verkehrs-, Verbrauch- und Aufwandsteuern)

Within the scheme of German tax law,[189] a distinction is drawn between general and special transaction and excise taxes, whereby value-added tax constitutes a general excise tax.[190] *Transaction taxes* are tied primarily to transactions, that is, to contractual or statutory relations. *Excise taxes* are

excise taxes on commodities. *Luxury taxes* are connected to the use of economic goods or services.

1) *Special Transaction Taxes*

Special transaction taxes are: the *real property transfer tax* on the transfer of title on or ownership of domestic real property; the *insurance tax* on the payment of insurance premiums; the *fire protection tax* on the acceptance of fire insurance premiums; and the *race and lottery tax.*

2) *Special Excise Taxes*

Special excise taxes are the *tax on distilled spirits*, the *beer tax*, the *coffee tax*, the *mineral oil* tax, and the *tobacco tax.*

3) *Luxury Taxes*

Except for the *motor vehicle tax*, luxury taxes are primarily municipal taxes: the *amusement tax*, the *tourism tax*, the *second dwelling tax*, the *dog tax*, and the *hunting tax.*

VII) Value-Added Tax (Umsatzsteuer)

The present state of German law governing value-added tax is the result of the Common Market efforts to harmonize indirect taxation within the Common Market Member States. Initial developments[191] began with the implementation of the first and second value-added tax directives,[192] which led to the replacement of a cumulative cascade type of sales tax payable on gross receipts as provided for in the Turnover Tax Act (*Umsatzsteuergesetz*) of 1951 by a *net value-added tax with deductions for tax previously paid* pursuant to the Value-Added Tax Act (*Umsatzsteuergesetz*) of 1967.[193] In addition, the sixth value-added tax dirctive,[194] implemented by the Value-Added Tax Act (*Umsatzsteuergesetz*) of 1980,[195] was also of great significance in that it achieved a uniform basis of charge. For the time being, the *Value-Added Tax - Internal Market Act* (*Binnenmarktsteuergesetz*) of

January 1, 1993[196] concludes the developments relating to value-added tax within the Internal Market. While the Act maintains the *country-of-destination principle* for intra-Community transactions, it has removed border clearance and control through a system of identification numbers.[197]

1) *Taxable Subject Matter*

Value-added tax is imposed on transactions, e.g. the delivery of goods or the performances of services, but the burden is ultimately carried by the end consumer on to whom the tax, through its inclusion in the price of the good, is shifted. Pursuant to section 1(1) of the Value-Added Tax Act (section 4 also provides for many exceptions that may be taxed), taxable subject matter consists of: *deliveries* (especially that of goods) and *other performances* (in particular, services) carried out in Germany by the entrepreneur; the private *personal consumption* of the entrepreneur and that of the *company*; and the *importation* of goods from non-EC countries (import turnover tax) as well as *intra-Community acquisitions* in Germany.

2) *Taxable Persons*

The only person subject to turnover tax is the *entrepreneur.* Although the entrepreneur does not ultimately carry the tax burden, he or she is the only person who has to calculate and pay the tax. The term »entrepreneur« is defined pursuant to section 2 of the Value-Added Tax Act on a *functional* basis and hinges on whether the activity carried on is a *business or profession activity* exercised in the entrepreneur's own name.

3) *Basis and Rate of Taxation*

The *tax base* for the calculation of value-added tax is essentially the payment for the delivery or other performance, excluding any value-added tax which may have been included in the payment (section 10(1) of the Value-Added Tax Act). The *general tax rate* of 15 percent is normally applied (section 12(1)). A reduced rate of 7 percent (section 12(2) no. 1), however, applies to food and certain beverages, printed materials, and art objects.

References

1 For discussion of this distinction and the exceptions to this distinction, see Parts II to VI below.
2 Income tax, corporation tax, trade tax, inheritance and gift tax, net worth tax and real property tax.
3 Value-added tax and special transaction, excise and luxury taxes; for discussion, see Parts VI and VII below.
4 For an overview on the tax laws of the most important industrialized nations, see *Michael Engelschalk*, in: Engelschalk/Flick et al, Steuern auf ausländische Einkünfte (Münchener Schriftum zum Internationalen Steuerrecht, Volume 7), München 1985, pp. 1ff.; see also *Ramón Valdés Costa*, in: Engelschalk/Flick et al, *supra*, pp. 43ff. for the tax laws of Latin American states.
5 Unlike the tax laws of the USA, which impose tax liability on the basis of *citizenship*, German tax laws, as a rule, do not make tax liability hinge on a mere *legal* relationship to the state (but see Part II)1)b) below for exceptions in the case of extended unlimited tax liability pursuant to sections 1(2) and 1(3) of the Income Tax Act (*Einkommensteuergesetz*); Part III for extended limited tax liability according to section 2 of the Foreign Transactions Tax Act (*Außensteuergesetz*); and Part V)3) for the exception pursuant to section 2(1) no. 1 of the Inheritance and Gift Tax Act (*Erbschaftsteuer- und Schenkungsteuergesetz*)).
6 Sections 8 and 9 of the German Fiscal Code (*Abgabenordnung*); for details, see Part II)1) a) below.
7 Sections 10 and 11 of the German Fiscal Code (Abgabenordnung); for details, see Part IV)1)a)bb),cc) below.
8 For systematization, see *Georg Ruppe/Arndt Raupach*, in: Herrmann/Heuer/Raupach, Kommentar zur Einkommensteuer und Körperschaftsteuer, Köln, February 1990, Einführung zum Einkommensteuergesetz, n. 98.
9 For a discussion on this distinction, see *Jörg M. Mössner*, in: Klaus Vogel (ed.), Grundfragen des Internationalen Steuerrechts (Veröffentlichung der Deutschen Steuerjuristischen Gesellschaft e.V., Volume 8), Köln 1985, p. 122.
10 For a seminal discussion, see *Ottmar Bühler*, Prinzipien des Internationalen Steuerrechts, Amsterdam 1964, pp. 161ff.
11 See *Ramón Valdés Costa*, in: Engelschalk/Flick et al, *supra*, note 3; *Enrique Piedrabuena*, in: Engelschalk/Flick et al, *supra*, pp. 86ff.; *Michael Engelschalk*, Die Besteuerung von Steuerausländern auf Bruttobasis, Heidelberg 1988, pp. 1, 34ff., 79, 88 and 145.
12 For a seminal discussion, see *Ottmar Bühler*, *supra*, note 10; *Klaus Vogel*, Grundfragen des deutschen Außensteuerrechts, in: Klaus Vogel, *supra*, note 9, pp. 17ff.
13 For differences, see Part II)2)a) below.
14 See *Klaus Tipke/Joachim Lang*, Steuerrecht, 13th ed., Köln 1991, pp. 203ff.
15 Exceptions to the principle of taxation on a gross basis arise in particular in the case of employees who are subject to limited tax liability (see Part II)2)a) below).
16 See Part III below.
17 See Part IV)2)c) below.
18 See Part II)1)b) below.
19 For a discussion of circumstances giving rise to double taxation, see *Klaus Vogel*, Double Taxation Conventions, Deventer 1991, Introduction, m. no. 2.
20 The treaty network of the Federal Republic of Germany as of January 1, 1993 included sixty-one treaties on taxes on income and capital, five inheritance tax treaties, and seven special treaties relating to income and capital of shipping and aviation enterprises. For discussion on these treaties and their binding force, see Bundessteuerblatt (BStBl.) I 1993, pp. 6ff.
21 See *Klaus Vogel*, *supra*, note 19, passim.
22 *Ibid.*, Article 23, m. nos. 41, 43 and 76.
23 *Ibid.*
24 For discussion on the effects of the credit method, see *ibid.*, Article 23 m. nos. 148ff.

25 See Part II)2)b) below.
26 See Part VII below.
27 For discussion on the effects of Community law on domestic law from a German perspective, see *Brigitte Knobbe-Keuk*, Intertax 1992, pp. 485ff.
28 Seminal: *Thomas Müller*, Steuer und Wirtschaft (StuW) 1992, pp., 157ff.
29 See Part II)2) below.
30 Official Journal of the European Community (OJ), No. L 225 (20 August 1990), p. 6.
31 OJ, No. L 225 (20 August 1990), p. 1.
32 For a more comprehensive discussion on this Directive, see *Brigitte Knobbe-Keuk*, Intertax 1992, pp. 485ff.
33 For further discussion on all of these effects, see *Gert Sass*, Der Betrieb (DB) 1990, p. 2340; for discussion on the effects of harmonization of tax treaty provisions through directives, see *Moris Lehner*, Europarechtliche Perspektiven für das Internationale Steuerrecht einschließlich der Doppelbesteuerungsabkommen, in: Lehner, Moris and Thömmes, Otmar and others, Europarecht und Internationales Steuerrecht, München 1994.
34 See *Klaus Vogel, supra,* note 19, Article 26, m. nos. 57ff.
35 See *Beatrix Kerwat*, Deutsche Steuerzeitung (DStZ) 1992, pp. 729ff. for discussion on the Directive and on the European Community Administrative Assistance and Co-operation Act (*EG-Amtshilfegesetz*).
36 See *Moris Lehner*, Möglichkeiten zur Verbesserung des Verständigungsverfahrens auf der Grundlage des EWG-Vertrages (Münchener Schriftum zum Internationalen Steuerrecht, Volume 4), München 1982, passim.
37 For an overview on this basic distinction, see Part I)1) above.
38 See *Klaus Tipke/Joachim Lang, supra,* note 14, pp. 194ff and pp. 314ff.
39 Included are the general partnership (*Offene Handelsgesellschaft*), the limited partnership (*Kommanditgesellschaft*), and the civil-law partnership (*Gesellschaft bürgerlichen Rechts*).
40 Section 15(1) sentence 1 no. 2 of the Income Tax Act (*Einkommensteuergesetz*); see *Brigitte Knobbe-Keuk*, Bilanz- und Unternehmenssteuerrecht, 8th ed. 1991, p. 321.
41 For concretization, see Bundesgesetzblatt (BGBl.) 1964 II, p. 104 and sections 2(3) and 132-137 of the Bundesberggesetz (BGBl. 1980 I, p. 1310).
42 *Bundesfinanzhof* (*BFH*), (BStBl.) II 1974, p. 361; 1978, p. 50.
43 For a comprehensive discussion on section 8 of the German Fiscal Code (*Abgabenordnung*) and the definition of the term »domicile«, see *Heinrich Wilhelm Kruse*, in: Tipke/Kruse, Kommentar zur Abgabenordnung und Finanzgerichtsordnung, 14th ed. Köln, April 1993; *Peter Hellwig*, in: Hübschmann/Hepp/Spitaler, Kommentar zur Abgabenordnung und Finanzgerichtsordnung, 9th ed. Köln, July 1993; see also *Jörg Manfred Mössner*, Steuerrecht international tätiger Unternehmen, Köln 1992, pp. 42ff.
44 *BFH*, BStBl. II 1970, p. 153; 1989, p. 182.
45 For the consequences under treaty law of having both a domestic domicile and a domicile abroad, see Part II)1)a)ee) below.
46 *BFH*, BStBl. II 1989, p. 182.
47 *BFH*, BStBl. II 1970, p. 153; 1986, p. 182.
48 *BFH*, BStBl. II 1970, p. 153.
49 *BFH*, BStBl. II 1989, p. 956.
50 *BFH*, BStBl. II 1964, p. 535.
51 *Finanzgericht* (*FG*) Hamburg, Entscheidungen der Finanzgerichte (EFG) 1974, p. 66; Niedersächsisches *FG*, EFG 1987, p. 170.
52 *BFH*, BStBl. II 1968, p. 439; 1989, p. 182.
53 *BFH*, BStBl. II 1989, p. 182; p. 956.
54 *BFH*, BStBl. II 1964, p. 535; 1970, p. 153, 155; 1989, p. 182.
55 *BFH*, BStBl. II 1972, p. 949.
56 Their spouses and children are also considered to be domiciled in Germany as long as they themselves are not employed (Article 14 of the Protokoll über die Vorrechte und Befreiungen der Europäischen Gemeinschaften vom 8.4.1965, BGBl. 1965 II, p. 1482).
57 *BFH*, BStBl. II 1984, p. 11; 1985, p. 331; 1990, p. 701; for details, see *Heinrich Wilhelm Kruse, Peter Hellwig* and *Jörg Manfred Mössner, supra,* note 43.
58 *Heinrich Wilhelm Kruse, ibid.,* m. no. 9.

59 *Bundesminister der Finanzen* (*BdF*), BStBl. I 1990, p. 51.
60 *BFH*, BStBl. II 1989, p. 956.
61 For further discussion on issues relating to frontier worker, see *Rainer Prokisch*, Recht der Internationalen Wirtschaft (RIW) 1991, pp. 396ff.
62 *BFH*, BStBl. II 1990, p. 701; see also *BFH*, BStBl. II 1990, p. 687; 1985, p. 331.
63 See Part II)1)a)cc) above.
64 See section 9 of the German Fiscal Code (*Abgabenordnung*).
65 *BFH*, BStBl. II 1982, p. 452; for particulars on the calculation of the six-month period, see *Heinrich Wilhelm Kruse*, *supra*, note 43, m. no. 5.
66 Amtliche Sammlung der Entscheidungen des Bundesfinanzhofs (BFHE), Volume 161, pp. 482 and 484.
67 *BFH*, BStBl. III 1962, p. 429.
68 *Klaus Vogel*, *supra*, note 19, Article 4, m. no. 9.
69 See table in *ibid.*, Article 4, m. no. 34.
70 See table in *ibid.*, Article 4, m. no. 83.
71 See also Part I)2)a) above and Part II)2) below.
72 For a more detailed discussion on the conditions under which non-residents are subject to unlimited tax liability, see *Thorsten Ehmcke*, in: Blümich, Einkommensteuer, Körperschaftsteuer, Gewerbesteuer, Kommentar, München, June 1987, section 1, m. nos. 60ff.; *Michael S. App*, in: Dankmeyer/Giloy, Einkommensteuer, Kommentar, Neuwied, May 1989, section 1, m. nos. 44ff.
73 The essential characteristic of public funds is that the funds are subject to public supervision and audit (*BFH*), BStBl. II 1971, pp. 519-520.
74 Section 1(2) sentence 2 of the Income Tax Act (*Einkommensteuergesetz*); see the *Vienna Convention on Diplomatic Relations* of 18 April 1961 (BGBl. II 1964, p.957; 1965, p. 147) and the *Vienna Convention on Consular Relations* of 24 April 1963 (BGBl. II 1969, p. 1585; 1971, p. 1285).
75 According to section 1(3) sentence 1 of the Income Tax Act (*Einkommensteuergesetz*), the income of the foreign service employee's spouse must also be included in this amount if the income is subject to taxation abroad and if the employee and his or her spouse do not live separately on a permanent basis.
76 See Part II)1)a)cc) above.
77 See Part II)1)a)dd) above.
78 See Part II)1)b) above.
79 For the features of limited tax liability, see Part I)1) above, and for extended limited tax liability under the Foreign Transactions Tax Act (*Außensteuergesetz*), see Part III below.
80 See Part II)1)c)bb) below.
81 See Part II)2)a) below.
82 See Part II)1)c)cc) and Part II)2)b) below.
83 See Part II)2)c) below.
84 *Helmut Krabbe*, in: Blümich, *supra*, note 73, section 49, m. no. 24; *Jürgen Lüdicke*, in: Lademann/Söffing/Brockhoff, Kommentar zum Einkommensteuergesetz, München, Hannover, September 1991, section 49, n. 1.
85 Income from agricultural and forestry activities, business enterprises, independent personal services and employment, capital assets, rental and leasing of property, and other income.
86 See *Jürgen Lüdicke*, *supra*, note 84, n. 829ff.
87 See *Franz Wassermeyer*, in Klaus Vogel, *supra*, note 9, pp. 49ff. and 56ff.; for details, see *Helmut Krabbe* and *Jürgen Lüdicke*, *supra*, note 84; for a discussion on business income subject to limited taxation, see *Jörg Manfred Mössner*, *supra*, note 43, pp. 73ff.
88 See *Jürgen Lüdicke*, *supra*, note 84, n. 250ff.
89 *Ibid.*, n. 739ff.
90 See *Klaus Vogel*, *supra*, note 19, Art. 6, m. nos. 1ff.
91 See *Wolfgang Kumpf*, in: W. Haarmann (ed.), Die beschränkte Steuerpflicht, Forum der Internationalen Besteuerung, Volume 2, Köln 1993, pp. 27ff. and 29ff.
92 See *Jürgen Lüdicke*, *supra*, note 84, n. 260ff.; *Jörg Manfred Mössner*, *supra*, note 43, pp. 73ff.

93 See *Wolfgang Kumpf, supra,* note 91.
94 See *Jürgen Lüdicke, supra,* note 84, n. 409ff.
95 *Ibid.,* n. 459ff.
96 *Ibid.,* n. 499ff.
97 *Ibid.,* n. 539ff and 589ff.
98 *Ibid.,* n. 649ff.
99 *Ibid.,* n. 790ff.
100 *Ibid.,* n. 805ff.
101 See text directly below.
102 See Part II)2)b) below.
103 See table by *Klaus Vogel, supra,* note 19, Article 5, m. no. 87.
104 See table in *ibid.,* Article 15, m. no. 122.
105 See wording of section 49(1) no. 3 of the Income Tax Act (*Einkommensteuergesetz*) and Part II)1)c)bb) above.
106 See *Klaus Vogel, supra,* note 19, Article 14, m. no. 22ff. and table at m. no. 31.
107 See table in *ibid.,* Article 15, m. no. 34.
108 See summary and table in *ibid.,* Article 15, m. nos. 88 and 95.
109 *Ibid.,* Article 10, m. nos. 18ff.
110 See Part II)2)b) below.
111 See summary by *Klaus Vogel, supra,* note 19, Article 10, m. nos. 249ff and 267.
112 See table in *ibid.,* Article 11, m. no. 99.
113 See discussion in *ibid.,* Article 11, m. nos. 88ff.
114 *Ibid.,* Article 6, m. nos. 22ff., 27, 43ff and 48.
115 *Ibid.,* Article 12, m. nos. 5ff.
116 See Part I)1) above.
117 See Part II)2)a) below.
118 See Part II)2)b) below.
119 See Part II)2)c) below.
120 For distinction, see Part I)1) above.
121 See *Helmut Krabbe, supra,* note 84, section 50, m. no. 14.
122 For further discussion, see *ibid.,* section 50, m. no. 29
123 Section 39d(1) sentence 1 of the Income Tax Act (*Einkommensteuergesetz*).
124 Section 50(5) sentence 1 of the Income Tax Act (*Einkommensteuergesetz*); see *BFH,* BStBl. II 1984, pp. 11 and 13.
125 This income is not included under section 50a(4) sentence 1 no. 3 nor sentence 2 of the Income Tax Act (*Einkommensteuergesetz*).
126 For further discussion, see *Helmut Krabbe, supra,* note 84, section 50, m. no. 29.
127 For a discussion on the effects of the distributive rules, see *Klaus Vogel, supra,* note 19, Introduction, m. no. 45ff.
128 See Part II)1)c)cc) above.
129 See *Klaus Vogel, supra,* note 19, Article 7, m. nos. 56ff., 73ff., 91ff., and 107ff.
130 *Ibid.,* Article 9, m. nos. 7ff.
131 *Ibid.,* Article 23, m. nos. 205ff.
132 *Ibid.,* Article 23, m. nos. 162ff.
133 *Ibid.,* Article 23, m. nos. 190ff.
134 See table in *ibid.,* Article 10, m. no. 88.
135 See table in *ibid.,* Article 11, m. no. 46.
136 See table in *ibid.,* Article 12, m. no. 25.
137 See Part II)2)a) above.
138 See *Thomas Müller,* Steuer und Wirtschaft (StuW) 1992, pp. 157ff.; *Gerd Saß,* DB 1992, pp. 857ff.
139 *BFH,* BStBl. II 1988, pp. 944ff.; 1990, pp. 701ff.; see also *Bundesverfassungsgericht,* Entscheidungen des Bundesverfassungsgerichts, amtliche Entscheidungssammlung (BVerfGE) 43, pp. 1ff.
140 *Ibid.,* however, equitable measures have been rejected by the finance administration (Fin. Min. Niedersachsen, order of 20 August 1990, DB 1990, p. 1483; Oberfinanzdirektion Münster, order of 16 August 1990, Deutsches Steuerrecht (DStR) 1990, p. 538.

141 The cases, however, did not deal with German law: *European Court of Justice* (*ECJ*), Neue Juristische Wochenschrift (NJW) 1987, pp. 569ff. of 28 January 1986 (»avoir fiscal«); NJW 1991, pp. 1406ff. of 8 May 1990 (»Biehl«); EuZW of 28 January 1992 (»Bachmann«).
142 *BFH*, BStBl. II 1992, pp. 618ff.
143 *FG* Köln, DStR 1991, p. 739, of 10 January 1991.
144 *ECJ*, NJW 1993, pp. 995ff. of 26 January 1993 (»Werner«); for critique of this decision, see *Otmar Thömmes*, Internationale Wirtschaftsbriefe (IWB) Fach 11, Gruppe 2, p. 129; *Wolfgang Kaefer*, Internationales Steuerrecht (IStR) 1993, pp. 145ff.
145 *FG* Köln, *supra*, note 143.
146 *BFH*, DB 1993, pp. 1170ff.; see *Wolfgang Kaefer*, IStR 1993, pp. 255ff.
147 For discussion on these consequences of limited tax liability, see Part II)2)a) above.
148 See Report of the Finance Committee of the German Bundestag, BT-Drucks. VI/3537.
149 See Part II)1)a) above.
150 See Part II)1)c)bb) above.
151 See Part IV) 2)c) below.
152 See Part II)1)c) above.
153 For a discussion on the basic distinction, see Part I)1) above.
154 See Part IV)1)c) below.
155 See *Wolfgang Freericks*, in: Blümich, *supra*, note 72, May 1988, section 1, m. nos. 45ff.; *Dieterlen*, in: Lademann, Kommentar zum Körperschaftsteuergesetz, München, May 1991, section 1, n. 16ff.; *Ingo Graffe*, in: Dötsch/Eversberg/Jost/Witt, Die Körperschaftsteuer, Stuttgart, June 1992, section 1, m. nos. 27ff.
156 *BFH*, BStBl. II 1973, pp. 695ff.
157 For further discussion, see *Wolfgang Freericks*, *Dieterlen*, and *Ingo Graffe*, *supra*, note 155.
158 *BFH*, BStBl. II 1968, pp. 695ff.
159 *Reichsfinanzhof* (*RFH*), Reichsteuerblatt (RStBl.) 1938, p. 949.
160 *BFH*, BStBl. II, 1977, p. 857.
161 For discussion of this and of the following, see *Wolfgang Freericks*, *Dieterlen*, and *Ingo Graffe*, *supra*, note 155.
162 Compare *Harald Schaumburg*, Internationales Steuerrecht, Köln 1993, pp. 178ff.; *Jörg Manfred Mössner*, *supra*, note 43, pp. 58ff.; and *Ingo Graffe*, *supra*, note 155, m. nos. 68ff.
163 *BFH*, BStBl. II 1968, pp. 695ff.; 1988, pp. 588ff.; DB 1992, pp. 2067ff.
164 *BFH*, DB 1992, pp. 2607ff.
165 In particular, the Federal Government (*Bund*), the German states (*Länder*), the local authorities, but also professional associations, craft guilds, and institutions; for further discussion, see *Wolfgang Freericks*, *supra*, note 72, m. no. 32ff.
166 See Part II)1)c)bb) above.
167 For further discussion, see *Wolfgang Freericks*, *supra*, note 155, section 2; *Dieterlen* and *Ingo Graffe*, *supra*, note 155, section 2.
168 For discussion on this and the following, see *Ewald Dötsch*, in: Dötsch et al, *supra*, note 155, section 12, Tz. 8ff.; *Günter Sondergeld*, in: Blümich, *supra*, note 72, section 12, m. nos. 9ff.
169 See Part IV)1)a)cc) above.
170 See Part IV)1)b) above.
171 OJ, No. L 225 (20 August 1990), p. 1.
172 OJ, No. L 225 (20 August 1990), p. 5.
173 See table by *Klaus Vogel*, *supra*, note 19, Article 23, m. no. 98.
174 Greece, Portugal and Spain.
175 See *Flick/Wassermeyer*, in: Flick/Wassermeyer/Becker, Kommentar zum Außensteuergesetz, Köln, 1989.
176 *Eugen Bogenschütz*, Recht der Internatinalen Wirtschaft (RIW) 1992, pp. 818ff.; *Günter Gundel*, Internationales Steuerrecht (IStR) 1993, pp. 49ff.

177 Section 2(1) of the Trade Tax Act (*Gewerbesteuergesetz*) uses the term »*Inland*« which is, pursuant to section 2(7), defined in the same way as under section 1(1) of the Income Tax Act (*Einkommensteuergesetz*); see Part II)1)a)bb) above.
178 For further discussion, see *Viktor Sarrazin*, in: Lenski/Steinberg, Kommentar zum Gewerbesteuergesetz, 8th ed., Köln, April 1985/June 1992.
179 For definition of permanent establishment (»*Betriebstätte*«), see section 12 of the German Fiscal Code (*Abgabenordnung*).
180 For discussion on the application of double taxation conventions to trade tax, see *Klaus Vogel, supra*, note 19, Article 2, m. nos. 59ff.
181 See *Max Rid*, in: Gürsching/Stenger, Kommentar zum Bewertungsgesetz und Vermögensteuergesetz, 9th ed., Köln, June 1991.
182 See Part II)1)b) above.
183 See commentaries by: *Max Troll*, Erbschaftsteuer- und Schenkungsteuergesetz, München, September 1991; *Reinhard Kapp*, Kommentar zum Erbschaftsteuer- und Schenkungsteuergesetz, 10th ed., Köln 1974/1989.
184 For discussion on extended limited tax liability, see Part III above.
185 For discussion on these linkages, see Parts II)1)a)cc)-dd) above.
186 For discussion on extended unlimited tax liability, see Part II)1)b) above.
187 For discussion of these linkages, see Parts IV)1)a)bb)-cc).
188 See Part V)2) above.
189 See *Klaus Tipke/Joachim Lang, supra*, note 14, pp. 150ff., 163ff. and 583ff.
190 See Part VII below.
191 For discussion on these developments and the following, see *Wolfram Birkenfeld*, Das große Umsatzsteuerhandbuch, Köln, August 1992, Einführung III.
192 OJ, No. L 71 (14 April 1967), pp. 1301 and 1303.
193 BGBl. I 1967, p. 545.
194 OJ, No. L 145 (13 July 1977), p. 1.
195 BGBl. I 1979, p. 1953.
196 BGBl. I 1993, p. 565.
197 For discussion on the Value-Added Tax - Internal Market Act (*Binnenmarktsteuergesetz*), see *Albert J. Rädler*, IStR 1992, pp. 2ff.