YPOG Article:
New rules on exit taxation

Cologne, August 12, 2022 | Dr. Friedrich Wöhlecke

Lawmakers have recently reformed exit taxation for capital gains from shares in corporations that are held as private assets. The new rules apply as of 2022 and, therefore, companies must take them into account for each departure abroad and include them in the tax planning for any future departures.

The exit taxation applies to individual tax residents who have lived in Germany for at least seven years during the past twelve years and hold at least 1% of shares in a corporation. The place of the corporation's registered office or its place of management is irrelevant. It is also not relevant whether Germany has a right to tax the build in gains or not (eg, due to a tax treaty).

If such individual gives up its domicile or permanent residence in Germany, transfers the shares to a non-German tax resident by way of gift or donatio mortis causa, or if Germany's right to tax the capital gains of these shares is excluded or limited in any other way (an "exit event"), the shares are deemed to be sold at fair value. Sixty percent of the difference between the shares' acquisition costs and the fair value, the deemed capital gain, are taxed at the personal tax rate of the shareholder. Thus, the effective tax burden can be up to 28.5%.

However, if such shareholders move back to Germany within seven years after their departure and, therefore, become subject to German taxation again, the tax on the capital gains is waived under certain conditions. The waiver of the tax comes into consideration when:

- the shares have not been sold, transferred or included in the shareholder's business assets;
- no profit distributions or return of contributions have been made amounting to more than one quarter of the shares' fair value (at the time of the exit event); and
- Germany's taxation right is fully restored.

It should be noted that the heritage of these shares does not qualify as a "transfer" according to the above definition.

In general, the exit tax can be paid without interest in seven annual instalments. To this end, the shareholders need to submit an application to the tax authority and provide a security. However, if shareholders sell or transfer the shares, for example, the tax becomes due immediately. Shareholders applying for a waiver or payments in instalments must fulfil various reporting obligations. For example, shareholders need to communicate their addresses abroad to the competent tax authority, confirm annually that they or their legal successors still own the shares and inform the tax authority if an event occurred that triggered an immediate taxation of the deemed capital gains.

There are several strategies to mitigate the exit taxation – for example, transforming the corporation into a partnership. Alternatively, shareholders could transfer their shares into a partnership engaged in trade or business from a German tax perspective or into a family foundation. However, these strategies normally incur other taxes or the need for fundamentally different corporate governance. Therefore, the individual situation needs to be assessed closely in order to find the best structure before departing abroad.

We are happy to support you and open for further exchange.

Your contact at YPOG:

Dr. Friedrich Wöhlecke
Associate, Cologne

+49 30 7675975 164

+49 151 40228524

friedrich.woehlecke@ypog.law