

The United States-Germany Income Tax Treaty
The Basics

The income tax treaty between the United States and Germany took effect on January 1, 1990. The main point of the tax treaty is to eliminate double taxation on income earned by residents of the United States or Germany when conducting business in the other country. In addition the treaty also is used to prevent avoidance or evasion of taxes. It promotes economic cooperation between the United States and Germany regarding cross-border transactions. This article highlights a few areas that are covered by the treaty and often come into play when structuring cross-border transactions for our clients.

Business Profits

Under the treaty, the business profits of an enterprise of a contracting state are taxable only in that state unless the business carries on business in the other contracting state through a permanent establishment situated therein. In this case only so much of the business profits as are attributable to the permanent establishment will be taxed in the other state. In addition deductions are allowed for research and development expenses, interest and other similar expenses. These deductions are allowed regardless of whether they are incurred in the State of the permanent establishment or elsewhere.

Dividends

The treaty provides that dividends that are paid by a company that is a resident of a contracting state to a resident of the other contracting state may be taxed in that other state. However, these dividends may also be taxed in the state where the company is a resident. This will produce double taxation. As a result the treaty provides that the tax shall not exceed 5% of the gross amount of the dividends as long as the owner holds directly 10% of the voting shares of the company paying the dividends. If the owner does not meet the criteria above the owner will pay 15% of the gross amount of the dividends.

HAUSWIESNER KING LLP

Gains

The treaty provides that gains derived by a resident of a contracting state from real property situated in the other contracting state may be taxed in that other state.

Income for Personal Services

Under the treaty any income that German residents receive for performing personal services as independent contractors or self-employed individuals (independent personal services in the United States) is exempt from U.S. income tax as long as the income is not attributable to a fixed base regularly available in the United States.

Labor and Personal Services

According to the treaty any labor or personal services performed in the United States as employees (dependent personal services) is exempt from U.S. tax as long as the residents meet the following criteria:

- 1) they are in the United States for no more than 183 days during the calendar year
- 2) the income is paid by or on behalf of, an employer who is not a resident of the United States
- 3) the income is not borne by a permanent establishment or a fixed base the employer has in the United States.

If a German resident receives pay for services performed as an employee and member of the regular complement of a ship or aircraft operated in international traffic the pay is exempt for U.S. tax purposes.

The exemptions will not apply if the payment is a director's fee or other similar payments received by a resident of Germany for services performed in the United States as a member of the board of directors of a company resident in the United States.

HAUSWIESNER KING LLP

The exemptions also do not apply to income German residents receive as public entertainers (such as theater, motion picture, radio or television artists or musicians) or athletes if their gross receipts, including reimbursed expenses, are more than \$20,000 during the calendar year. Regardless of these limits, income of German entertainers or athletes is exempt from U.S. tax if their visit to the United States is substantially supported by public funds of Germany, its political subdivisions, or local authorities.

Professors, Researchers, Teachers

A professor or teacher who is a German resident and does not stay in the United States for more than two years to engage in advanced study or research or teaching at an accredited educational institution or institution engaged in research for the public benefit is exempt from U.S. tax on income received for such study, research, or teaching. However, if the individual's visit to the United States exceeds two years, the exemption is lost for the entire visit unless the competent authorities of Germany and the United States agree otherwise.

The exemption does not apply to income from research carried on mainly for the private benefit of any person rather than in the public interest.

Students

Students or business apprentices (including Volontaere and Praktikanten) who are or were immediately before visiting the United States a resident of Germany and who are present in the United States for full-time education or training are exempt from U.S. income tax on amounts from sources outside the United States for maintenance, education or training.

An individual who is or was immediately before visiting the United States a resident of Germany is exempt from U.S. tax on amounts received as a grant, allowance

HAUSWIESNER KING LLP

or award from a nonprofit religious, charitable, scientific, literary or educational organization.

Individuals described in the previous two paragraphs are also exempt from U.S. tax on compensation for dependent personal services of up to \$5,000 per year if: they are present in the United States for not more than 4 years, and the services are performed for the purpose of supplementing funds available otherwise for maintenance, education, or training.

If the individual's visit exceeds 4 years, the exemption is lost for the entire visit unless the competent authorities of Germany and the United States agree otherwise.

An individual who is a German resident and who is employed by a German enterprise or by a nonprofit religious, charitable, scientific, literary, or educational organization is exempt from U.S. tax on compensation paid by the employer from outside the United States if: the individual is temporarily in the United States for not more than 1 year to acquire technical, professional or business experience from any person other than his or her employer, and the compensation is not more than \$10,000. If the compensation is more than \$10,000, none of the income is exempt.

Wages and Pensions Paid by a Foreign Government

Wages, salaries, and similar income and pensions paid by Germany, its Laender, or municipalities, or their public pension funds are exempt from U.S. income tax if paid to individuals other than U.S. citizens and other than individuals admitted to the United States for permanent resident.