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Financing of German Subsidiary

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Naturally there are different ways of supplying the financial funds required to a foreign subsidiary in Germany.

Taking the most popular legal form of a company, the German limited liability company (GmbH) as an example, we would like to highlight a few aspects of these different ways.

A German GmbH requires a minimum share capital of € 25.000. The expenses of the notary public for the drafting and the notarization of the articles of association and the fees for the registering the company in the commercial register, up to approx € 1.500 can be taken from the share capital. The relations show that the minimum capital will not take the company very far in its business activities.

It is certainly possible and to a certain extent essential to start the company with a higher, more adequate share capital. Looking at the share capital from the position of a managing director a higher share capital is more comfortable and secure than a lower capital. Yet the parent company is less flexible in the use of its overall financing of activities within the group since the increase or decrease of share capital is always related to a higher level of formalities.

Alternatively, the financial funds required by a German subsidiary can be provided by effecting payments to the capital reserves/additional paid-in capital instead of paying these amounts to the share capital. The parent company can at any time transfer additional amounts to the subsidiary on the grounds of a simple shareholders' resolution in writing. No notarization and / or registration of this resolution are required. By means of a further shareholders' resolution, payments to the capital reserves can basically be withdrawn without any tax implications.

A further, rather common alternative to supply financial funds to a German subsidiary is granting loans to the subsidiary. The formalities can be reduced to a loan agreement in writing between parent company and subsidiary. The conditions of the loan contract – within a frame of conditions acceptable to the tax office – leave a great flexibility to the parties. The logic behind granting loans is to make interest expenses tax deductible so that the taxable result can be influenced under the aspect of tax optimization.

Since 2008, Germany has introduced a so-called interest barrier rule (Zinsschranke) and replaced the original thin capitalization rules. The concept of the interest barrier rule is that the interest expenses are deductible in a first step to the extent of the interest revenue earned by the subsidiary (e.g. from banks etc.) within the same fiscal year. The remaining interest expenses exceeding the interest revenue, are deductible only up to 30% of the taxable EBITDA (taxable income minus interest earnings plus interest expenses and plus depreciation on fixed assets). In order to keep this rule manageable for small and medium sized companies, the barrier rule does not apply if the interest expenses less interest earnings do not exceed an amount of € 3 million.

It is worthwhile to discuss the aforementioned financing instruments with your tax consultant and your CPA in order to find a sound finance structure of a foreign subsidiary.

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