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Taxation of Charities

National Report Germany

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I. Charity and donation law: systematic overview

German tax law includes numerous rules which provide for preferential treatment of not-for-profit activities. These are partly based on the idea that not-for-profit organisations and their donors support the state by realising public-benefit or charitable purposes and therefore reducing the burden of the state. However, tax privileges are not limited to purposes which are also pursued by the state; indeed, these privileges are also granted to other purposes, for example, religious purposes.[1] With respect to preferential treatment, one has to distinguish between provisions which grant privileges to not-for-profit corporations (e.g. exemption from corporation tax)[2] and provisions that provide for preferential treatment of donations (which are at least partly deductible from the donor's assessment base) and inheritance.[3] However, these rules, which are part of the respective tax acts (e.g. Corporate Income Tax Act, (Local) Business Tax Act, Personal Income Tax Act, Inheritance and Gift Tax Act), neither include a definition of tax-privileged purposes nor do they contain further requirements which ensure that only the altruistic (selfless) promotion of matters of public interest is tax-privileged nor do they include any requirements which consider the management and the statutes of tax-privileged corporations. Indeed, these purposes and requirements are laid down in the third chapter of the Fiscal Code (Abgabenordnung). This chapter clarifies that German tax law provides for a two-tiered concept: While sec. 51 et seq. Fiscal Code provide for general preconditions, concrete tax benefits result from the application of single Tax Acts as mentioned above which, in turn, refer to sec. 51 to 68 Fiscal Code. Therefore, the following considerations will firstly focus on the requirements laid down in sec. 51 et seq. Fiscal Code. Following this, the tax-privileges which are stated in special tax provisions will be explained.

[1] Cf. *R. Hüttemann*, Gemeinnützigkeits- und Spendenrecht, Otto Schmitt, Cologne 2003, § 1 MNs. 8, 80 et seq.
[2] See below III 1 a.
[3] See below III 2.

II. General requirements of tax privileges according to sec. 51 et seq. Fiscal Code

1. Corporations

According to sec. 51(1)(1) Fiscal Code, the named provisions of the Fiscal Code shall apply where a Tax Act grants tax privileges to a *corporation* on account of its serving directly and exclusively public-benefit, charitable or religious purposes (tax-privileged purposes). Sec. 51(1)(2) Fiscal Code states that the term "corporation" as used in sec. 51(1)(2) Fiscal Code encompasses corporations, associations and estate in terms of the corporation tax law and therefore must be interpreted in a broader sense. This includes capital companies (esp. limited liability companies), legal persons established under private law (e.g. associations and foundations) and legal persons established under public law with their economic activities.[4] The common term "Non-Profit-Organisation" (NPO) does not describe a certain legal entity; it must be interpreted as a generic term which describes tax-privileged corporations (in a broader sense) which occur in different legal company forms.[5] Moreover, one has to consider that the term "tax-privileged purposes" which can be found in the Fiscal Code, as well as in special Tax Acts, is not identical with the term "charitable"; indeed, tax-privileged purposes can be public-interest, charitable and religious purposes. However, the widely spread usage of the term "charity law" does not only refer to charitable purposes but also to other tax-privileged purposes and therefore encompasses sec. 51 to 68 Fiscal Code. The tax-privileged status is granted to neither partnerships nor individuals.[6]

2. Tax-privileged purposes

a) Public-benefit purposes

According to sec. 52(1) Fiscal Code a corporation shall serve public-benefit purposes if its activity is dedicated to the altruistic advancement of the general public in material, spiritual or moral respects. According to this rule, it shall not be deemed an advancement of the general public if the group of persons benefiting from such an advancement is circumscribed, for instance by membership of a family or the workforce of an enterprise, or can it never be anything other than small as a result of its definition, especially in terms of geographical or professional attributes.

This definition, as laid down in sec. 52(1) Fiscal Code, is clarified by a non-exhaustive list in sec. 52(2) Fiscal Code which includes the 25 most important public-benefit purposes. Sec. 52 Fiscal Code, on the one hand, refers to non-market activities, e.g. the advancement of religion, of the protection and preservation of historical monuments, of nature, of internationalism, of tolerance in all areas of culture and of the concept of international understanding. However, the list also encompasses

[4] *Hüttemann*, Gemeinnützigkeits- und Spendenrecht, § 2 MN. 1.
[5] *R. Hüttemann*, Wirtschaftliche Betätigung und steuerliche Gemeinnützigkeit, Otto Schmitt, Cologne 2001, p. 30.
[6] *S. Schauhoff*, in: Schauhoff (ed.) , Handbuch der Gemeinnützigkeit, 3rd edition, C. H. Beck, Munich 2010, § 6 MN. 1.

activities which may also be conducted as business activities like the advancement of public health, of science and research, of arts and culture, of education and of sport.

b) Charitable purposes

According to sec. 53 Fiscal Code, a corporation shall serve charitable purposes if its activity is dedicated to the altruistic support of persons (1) who on account of their physical, mental or emotional state are dependent upon the help of others, or (2) whose means do not exceed a certain threshold compared to the standard rate of social welfare assistance.

c) Religious purposes

According to sec. 54 Fiscal Code, a corporation shall serve religious purposes if its activity is dedicated to the altruistic advancement of a religious community which is a public-law entity.[7]

3. Further objective and subjective requirements of a tax-privileged status

To avoid an abuse of the tax-privileges granted in the special tax laws (e.g. sec. 5(1)(9) Corporate Income Tax Act and sec. 3(6) (Local) Business Tax Act), the "charity law" as stipulated in sec. 51 et seq. Fiscal Code provides for several requirements which ensure that only the altruistic (selfless) promotion of matters of public interest is tax-privileged. Essentially, there are four basic principles: From a subjective point of view, sec. 55(1) Fiscal Code demands that advancement or support shall be provided altruistically. From an objective point of view, sec. 51(1)(1) Fiscal Code requires that charitable aims must be tracked exclusively and directly; moreover, according to sec. 55(1)(5) Fiscal Code, charitable aims must be pursued promptly.[8]

a) Directness

According to sec. 57(1)(1) Fiscal Code, corporations pursue their statutory aims directly if they achieve these purposes by themselves. In this sense, corporations are represented by the authorised organs of the corporation (cf. sec. 26(2) German Civil Code; Bürgerliches Gesetzbuch). Moreover, sec. 57(1)(2) Fiscal Code states that this may also be achieved by aides if, in terms of the circumstances of the case, in particular in terms of the legal and actual relationship between the corporation and the aide, the activity of the aide is to be regarded as activity by the corporation itself. Therefore, the activity of an appointee or a freelancer cannot be attributed to the corporation if the person acts by his own volition in his sphere of liability.[9]

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[7] According to sec. 54(2) Fiscal Code these purposes shall include, in particular, building, decorating and maintaining houses of worship and religious community centres, conducting religious services, training priests, providing religious teaching, conducting burials and safeguarding the remembrance of the dead, also administering church assets, remunerating members of the clergy, church officials and servants of the church, and providing old-age and disability pensions for these persons and their dependents.

[8] *M. Droege*, Gemeinnützigkeit im offenen Steuerstaat, Mohr Siebeck, Tübingen 2010, p. 180 et seq.

[9] *J. Uterhark* in: Schwarz, Abgabenordnung, loose-leaf as updated per July 2011, § 57 MN. 1.

b) Exclusivity

Sec. 51(1) Fiscal Code claims the exclusivity of tracking of public interest aims. According to sec. 56 Fiscal Code, exclusivity shall be deemed to exist if the sole pursuit of a corporation is a tax-privileged purpose as set out in the statutes. As distinguishing between tax-exempt activities and activities which are subject to corporate income tax/local business tax within the same corporation is not allowed,[10] a corporation must be regarded as being charitable either as a whole or not at all.[11] However, the concept of exclusivity is constrained in some respects. For example, activities which enable the corporation to promote matters of public interest do not contradict the principle of exclusivity (e.g. asset management, administrative activities, public relation).[12] What is more, sec. 56 Fiscal Code must not be interpreted in a way which suggests that economic activities are per se harmful; sec. 55(1) and sec. 64 Fiscal Code in particular state that economic activities do not automatically trigger a denial of the charitable status.[13] Moreover, sec. 58 Fiscal Code also includes a number of activities which are in line with the principle of exclusivity.[14]

c) Altruistic activity (Selflessness) – extent of permitted economic purposes

aa) Preliminary remarks

Sec. 52, 53 and 54 Fiscal Code require that the advancement or support shall be provided altruistically. According to sec. 55(1) Fiscal Code, this is the case if the activity does not primarily serve the corporation's *own economic purposes*, for instance commercial or other profitable purposes. The aim and the interpretation of this term are highly disputed. On first sight, this requirement seems to be superfluous: The principle of exclusivity (sec. 56 Fiscal Code) shall assure that the fund is only used to pursue tax-privileged purposes set out in the statutes; moreover, sec. 55(1)(1 to 5) Fiscal Code aims at preventing funds from being used inappropriately.[15] One of the most crucial points in applying sec. 55(1) Fiscal Code is whether or not this provision can hinder charitable organisations from carrying out economic activities even if the profits generated through this activity are used to pursue tax-privileged purposes.

[10] *Hüttemann*, Gemeinnützigkeits- und Spendenrecht, § 4 MN. 6.
[11] *Droege*, Gemeinnützigkeit im offenen Steuerstaat, p. 181.
[12] *Hüttemann*, Gemeinnützigkeits- und Spendenrecht, § 4 MN. 10 with further references.
[13] With respect to sec. 55(1) Fiscal Code cf. *K. Tipke* in Tipke/Kruse (ed.), Abgabenordnung/Finanzgerichtsordnung, loose-leaf as updated per 07/2011, § 55 AO MN 3.
[14] For example, foundations are allowed to use a part not exceeding one third of its income for the appropriate upkeep of the donor and his or her near relatives, to maintain their graves and to honour their memory (sec. 58(5) Fiscal Code). Moreover, corporations are allowed to hold social events which are of secondary significance in comparison with its tax-privileged activity (sec. 58(8) Fiscal Code).
[15] Cf. *Hüttemann*, Gemeinnützigkeits- und Spendenrecht, § 4 MN. 69.

bb) Interpretation of the term "own economic purposes" and the "Four-spheres-model"

When interpreting the term "own economic purposes" one firstly has to mention that the fiscal administration,[16] as well as the Federal Tax Court, holds the opinion that the term "economic purposes" is related to the term economic activities within the meaning of sec. 14 Fiscal Code.[17] According to this provision, economic activity means an independent sustainable activity from which revenue or other economic benefits are derived and which comprises more than mere asset management; an activity constitutes asset management if assets are utilised, e.g. by investing capital assets to earn interest or by renting or leasing immovable property. An economic activity does not require the intention to realise a profit.

With respect to other relevant provisions of the Fiscal Code (esp. sec. 68 Fiscal Code), economic activities must be distinguished from other activities of charitable organisations. In this respect, one has to differentiate between four spheres[18]:

The core activity of NPOs is the *ideal sphere* which is characterised by the disbursement of resources to achieve the statutory aims. An accrual of funds in the ideal sphere provides that there is exchange of goods and services. Basically, an accrual of funds includes membership fees, donations, public funding and beneficences, inheritances and legacies. Therefore no own economic interests are pursued if a corporation acts in the ideal sphere.[19]

In the *asset management sphere* charitable corporations use their assets to generate income, which is used for tax-privileged activities.[20] According to sec. 14(3) Fiscal Code, an activity shall be deemed to constitute asset management where assets are utilised, e.g. by investing capital assets to earn interest or by renting or leasing immovable property. Indeed, asset management generally fulfills the requirements of an economic activity;[21] however, this activity is explicitly excluded from the scope of sec. 14(1) Fiscal Code and therefore not regarded as economic activity.[22]

As is the case with asset management, *dedicated activities* ("Zweckbetriebe") as defined in sec. 65 to 68 Fiscal Code, generally fulfill the requirements of an economic activity if revenue is generated. However, as these activities are carried out in order to directly achieve the statuary purposes of the corporation (e.g. operating hospitals, old people's homes, old people's residential and nursing homes,

[16] *Bundesministerium der Finanzen* (Federal Ministry of Finance; BMF), 15 February 2002, Bundessteuerblatt II 2002, p. 267 (p. 267); OFD Kiel, Der Betrieb 2003, 2360 (2360).
[17] Bundesfinanzhof, 15 July 1998, I R 156/94, BFH/NV 1999, p. 244 (p. 245); *ibid.*, 26. April 1989, I R 209/85, Bundessteuerblatt II 1989, p. 670 (p. 672).
[18] *Hüttemann*, Gemeinnützigkeits- und Spendenrecht, § 6 MN. 2 et seq.; *K. Heger* in: Gosch (ed.), Körperschaftsteuergesetz, C. H. Beck, Munich 2005, § 5 MN 231 et seq.
[19] As altruistic activity is solely defined under economic aspects, intangible advantages like social recognition or the perpetuation of the donor do not affect the selflessness; cf. *U. Koenig* in: Koenig/Pahlke (ed.), Abgabenordnung §§ 1 – 368, 2nd edition, Munich 2009, § 55 MN. 4.
[20] Cf. *Hüttemann*, Gemeinnützigkeits- und Spendenrecht, § 6 MN. 4.
[21] *Hüttemann*, Gemeinnützigkeits- und Spendenrecht, § 6 MN. 2.
[22] Cf. *Heger* in: Gosch (ed.), Körperschaftsteuergesetz, § 5 MN. 234.

kindergartens) these activities are similarly not regarded as economic activity (sec. 64(1) in conjunction with sec. 65 to 68 Fiscal Code).[23] Therefore, no own economic interests are pursued. Remarkably, an activity is not regarded as "dedicated" if the income alone derived by economic activities is spent on tax-privileged purposes. In contrast, there must be a direct link between the (dedicated) activity and the tax-privileged purpose.

Consequently, all activities within the meaning established in sec. 14(1) Fiscal Code which qualify neither as asset management nor as dedicated activity are *economic activities*.

cc) Permitted extent of "own economic purposes"

The *fiscal administration* maintains the opinion that a corporation cannot be regarded as selfless if it is *characterised* by economic activities as determined in sec. 14 Fiscal Code (so-called "imprint theory"). This defines a corporation as not tax-exempt if an overall view identifies the economic activity as characteristic. However, it is still not fully clear which criteria must be taken into account to judge whether an economic activity must be regarded as characteristic. However, it seems to be clear that the relation of income generated through economic activities to income generated through non-economic activities is not the only decisive factor. Other factors include the time spent by the members of the corporation on economic/non-economic activities.[24]

A strong scholarly opinion rejects the view of the fiscal administration. According to this opinion, the deciding factor is not how the organisation generates income but if it spends income on tax-privileged purposes;[25] therefore selflessness does not depend on the extent of the economic activity.[26] Moreover, according to that opinion, an equal treatment of any source of funds requires that activities which pursue profits are not per se harmful. According to some scholars, sec. 55(1)(1) Fiscal Code shall avoid a corporation promoting matters of public interest in order to promote their member´s economic interests.[27] The principle of selflessness therefore serves as a complement element to the principle of exclusivity on the level of the subjective intentions of the members of the corporation.[28]

The jurisdiction takes an approach which could be regarded as an intermediate view. In essence, it holds the opinion that a corporation does not serve charitable purposes selflessly if it predominantly (and therefore not additionally) pursues its own economic interests or the economic interests of its

[23] *Hüttemann*, Gemeinnützigkeits- und Spendenrecht, § 6 MN. 2.
[24] BMF, BStBl I 2002, p. 267 (p. 267); cf. OFD Kiel, Der Betrieb 2003, p. 2360; Circular on Application of sec. 55 Fiscal Code.
[25] *Tipke* in: in Tipke/Kruse (ed.), Abgabenordnung/Finanzgerichtsordnung, § 55 AO MN. 5; cf. *Hüttemann*, Gemeinnützigkeits- und Spendenrecht, § 6 MN. 7; *J. Uterhark* in: Schwarz, Abgabenordnung, loose-leaf as updated per July 2011, § 55 MN. 3.
[26] *Uterhark* in: Schwarz, Abgabenordnung, § 55 MN 3 with further references.
[27] Cf. *Hüttemann*, Gemeinnützigkeits- und Spendenrecht, § 4 MN. 69 et seq.; see also *Droege*, Gemeinnützigkeit im offenen Steuerstaat, p. 202 et seq.
[28] *Hüttemann*, Gemeinnützigkeits- und Spendenrecht, § 4 MN. 72.

members.[29] However, the Federal Tax Court is less strict than the fiscal administration when it states that a corporation does not pursue its own economic activities solely on the ground that it carries out economic activities which outweigh its non-profit activities if there are compelling economic reasons and there is no other sufficient funding.[30] Moreover, according to the local tax court of Cologne, it is not harmful to generate profits in single fiscal years if the corporation, at least in the long-term, generates balanced results.[31] Therefore, it seems that, by and large, the jurisdiction interprets even major economic activities as not being harmful if these activities aim at generating profits to fund charitable activities. However, it must be taken into consideration that single decisions can be interpreted in a stricter fashion.

dd) Losses resulting from economic activities

As economic activities always harbour the risk of suffering losses, one has to consider the possibility of offsetting losses within a tax-privileged corporation. If a corporation operates several economic activities, the losses and profits of different activities can be set off because several economic activities are treated as one for tax purposes, cf. sec. 64(2) Fiscal Code.[32] In cases in which there are no profits to set off losses, the legal situation becomes more difficult. According to the Federal Tax Court, the fiscal administration and, to a certain extent, scholarly opinion, offsetting a loss from an economic activity with resources of the ideal sphere (e.g. membership fees, donations) or with resources generated through dedicated activities must generally be regarded as misappropriated use of resources which is not compatible with sec. 55(1) Fiscal Code.[33] However, there are several exceptions. The fiscal administration, for example, maintains the opinion that an offset of losses between the economic and ideal sphere is possible to the extent that means were transferred from the economic sphere to the ideal sphere within the past six years.[34] Moreover, in cases in which such a transfer does not effectively take place (e.g. because the loss only results from depreciation of assets), the tax-privileged status is not affected by the loss.[35] Pursuant to the fiscal administration, a new business activity must break even within three years of its initiation.[36]

[29] Bundesfinanzhof, 23 October 1991, I R 19/91, Bundessteuerblatt II 1992, p. 62 (p. 64).
[30] Bundesfinanzhof, 15 July 1998, I R 156/94, Bundessteuerblatt II 2002, p. 162 (p. 163).
[31] Finanzgericht Köln, Entscheidungen der Finanzgerichte (EFG) 1986, p. 144 (p. 145).
[32] *Heger* in: Gosch (ed.), Körperschaftsteuergesetz, § 5 MN 236; *Uterhark* in: Schwarz, Abgabenordnung § 64 MN. 22.
[33] Bundesfinanzhof, 13 November 1996, I R 152/93, Bundessteuerblatt II 1998, p. 711 (p. 713 et seq.); *Tipke* in: Tipke/Kruse, Abgabenordnung/Finanzgerichtsordnung, § 64 AO MN. 13; dissenting *Hüttemann*, Gemeinnützigkeits- und Spendenrecht, § 6 MN. 21 et seq.
[34] No. 4 Circular on Application of § 55 Fiscal Code; cf. No. 5 to 8 Circular on Application of § 55 Fiscal Code for further exceptions.
[35] *Uterhark* in: Schwarz, Abgabenordnung § 55, MN. 21.
[36] No. 8 Circular on Application of § 55 Fiscal Code.

d) Prompt use of funds

aa) Use of funds in general

According to sec. 55(1)(1) Fiscal Code, the funds of a corporation may only be used for the purposes set out in the statutes. Moreover, members or partners may receive neither profit shares nor, in their capacity as members, any other allocation of funds of the corporation. Therefore, members are not allowed to receive declared or hidden profit distributions or any other bonuses. The correct allocation of resources is a central requirement of its tax-privileged nature.[37] Infringements of the precept of the allocation of resources do not only endanger the status of being tax-privileged and trigger the liability of the corporation,[38] but they can also lead to personal liability of associates. Resources can be defined as receipts from the ideal sphere (e.g. membership fees, donations), surpluses of the administration of assets and, from the business supporting the purpose of the corporation, profits of economic activities and property value which have already been taxed.[39] The resources of the charitable sphere are not allowed to be transferred to the asset management or the economic activities.[40]

However, one has to point out that sec. 58 Fiscal Code contains a list of activities with no detrimental effect on tax privileges. Each of these activities maintains a close link to tax-privileged purposes: for example, a transfer of funds to another tax-privileged corporation; making its workforce or premises available to other persons, enterprises, organisations or a legal person under public law for tax-privileged purposes; the transfer of funds to a reserve, provided that this is necessary to enable it to carry out the sustained pursuit of the tax-privileged purposes as set out in the statutes.

It is worth mentioning that the corporation may use its funds neither for the direct nor for the indirect advancement or support of political parties (sec. 55(1)(1)(3) Fiscal Code). Sec. 55(1)(1)(3) Fiscal Code aims to prevent tax-privileged organisations from being interfered with for purposes of financing political parties and must be regarded as a consequence of matters of party donations.[41] Besides the direct allocation of cash or goods, indirect favoritism in the form of allocations towards third persons, absorption of expenditures and the lending of employees for free is also forbidden.[42] In turn, sec. 25(1)(2)(2) Political Parties Act (Parteiengesetz) states that political parties are not allowed to accept donations from charitable corporations. Political parties are only privileged indirectly as

[37] *R. Wallenhorst* in: Troll/Wallenhorst/Halaczinsky (ed.), Die Besteuerung gemeinnütziger Vereine, Stiftungen und der juristischen Personen des öffentlichen Rechts, 6th edition, Munich 2009, chapter C MN. 72.
[38] *J. Buchna/A. Seeger/W. Brox*, Gemeinnützigkeit im Steuerrecht – die steuerliche Begünstigungen für Vereine, Stiftungen und andere Körperschaften, 10th edition, Achim 2010, p. 131 et seq.
[39] *Koenig* in: Koenig/Pahlke (ed.), Abgabenordnung, § 55 MN. 15.
[40] *Buchna/Seeger/Brox*, Gemeinnützigkeit im Steuerrecht – die steuerliche Begünstigungen für Vereine, Stiftungen und andere Körperschaften, p. 132.
[41] *Tipke* in: in Tipke/Kruse (ed.), Abgabenordnung/Finanzgerichtsordnung, § 55 AO MN. 11.
[42] *Koenig* in: Koenig/Pahlke (ed.), Abgabenordnung, § 55 MN. 20.

sec. 10b(2) and 34g Personal Income Tax Act (Einkommensteuergesetz) grant tax benefits to donators.[43]

bb) Prompt use

Sec. 55(1)(5)(1) Fiscal Code states that the corporation shall, in principle, use its funds promptly for the tax-privileged purposes set out in its statutes. This requires the corporation to make arrangements to assure that liquid and available assets are used to achieve the statutory aims as quickly as possible with simultaneous regard to a reasonable economic action.[44] According to sec. 55(1)(5(2) Fiscal Code, the use of funds for the acquisition or manufacture of assets serving the purposes set out in the statutes shall also constitute an appropriate use. With respect to the time period, sec. 55(1)(5)(2) Fiscal Code states that funds shall be deemed to have been used promptly where they are used for the tax-privileged purposes set out in the statutes no later than during the calendar or financial year following their accrual.

e) Further requirements

On termination of their membership or on dissolution or liquidation of the corporation, members may not receive more than their paid-up capital shares and the fair market value of their contributions in kind (sec. 55(1)(2) Fiscal Code). Moreover, sec. 55(1)(3) Fiscal Code states, that the corporation may not provide a benefit for any person by means of expenditure unrelated to the purpose of the corporation or disproportionately high remuneration.

4. Formal requirements and proceedings

a) Material requirements to be met by the statute

According to sec. 59 Fiscal Code tax privileges shall be granted if it is stated in the statutes, the act of foundation or other articles of association the purpose the corporation pursues, that this purpose fulfills the requirements of sec. 52 to 55 Fiscal Code and that it is pursued exclusively and directly; actual management activity must conform to these statute provisions. If these statute provisions do not meet the requirements set in sec. 59 Fiscal Code tax benefits can be denied just because for this reason.[45]

b) Formal requirements to be met by the statute

Sec. 60(1) Fiscal Code states that the purposes set out in the statutes and the means by which they are to be achieved shall be so precisely defined as to ensure that it can be ascertained on the basis of the statutes whether the preconditions for tax privileges have been fulfilled. Para. 2 of this provision

[43] Donations to political parties can be credited against the personal income tax at an amount of up to 825 Euros, cf. sec. 34g Personal Income Tax Act. Donations which exceed this limit can be deducted from the assessment base at an amount of up to 1650 Euros, cf. sec. 10b(2) Personal Income Tax Act.
[44] *Koenig*, in: Pahlke/Koenig, § 55 AO MN. 29.
[45] *E. Gersch* in: Klein (ed.) Abgabenordnung, 10th edition, C.H. Beck, Munich 2010, § 59 MN. 1.

requires that the statutes must be conform to the prescribed requirements, in respect of corporation tax and trade tax, during the entire assessment period, and, in respect of other taxes, at the time the tax liability arises.

c) No qualification procedure required

German law does not provide for a separate qualification or recognition procedure. Instead, the tax administration checks whether the requirements mentioned above are met within the assessment procedure and for every assessment period.[46] If the fiscal administration comes to the conclusion that a corporation shall be tax-exempt, it will regularly apply this decision to all types of taxes.[47] As corporations are subject to an assessment period of one year a denial of the charitable status in a given year consequently will affect only that particular year. The corporation is entitled to challenge this decision at the tax courts. Not-for-profit organisations are allowed to request a preliminary statement from the tax authorities attesting their tax-privileged character. This document entitles them to distribute contribution receipts to donors, according to which donors are allowed to deduct the donation from their assessment base.[48]

5. Excursus: Transfer of assets by domestic non-profit organisations to domestic or foreign beneficiaries

According to sec. 58(1, 2) Fiscal Code, the privileged status of a corporation shall not be precluded if it procures funds for the achievement of the tax-privileged purposes of another corporation[49] or if it assigns part of its funds to another tax-privileged purpose. The tax-privilege of non-profit organisations resident abroad is rejected by parts of the regional tax authorities;[50] however, according to the grounds of the legislator, the allocation of funds used in pursuing charitable purposes abroad is considered tax-privileged if it is suitable for upholding Germany´s international reputation.[51]

[46] *Gersch* in: Klein (ed.), Abgabenordnung, § 59 MN. 3.
[47] *Buchna/Seeger/Brox*, Gemeinnützigkeit im Steuerrecht – die steuerliche Begünstigungen für Vereine, Stiftungen und andere Körperschaften, p. 510.
[48] *Hüttemann*, Gemeinnützigkeits- und Spendenrecht, § 7 MN. 9; cf. *Buchna/Seeger/Brox*, Gemeinnützigkeit im Steuerrecht – die steuerliche Begünstigungen für Vereine, Stiftungen und andere Körperschaften, p. 516; see also below III 2 b.
[49] In this respect, sec. 58(1) Fiscal Code must be regarded as an exception of the principle of directness; cf. *Gersch* in: Klein (ed.), Abgabenordnung, § 58 MN 1.
[50] Oberfinanzdirektion (Regional tax office) Magdeburg, DStR 2005, p. 1732.
[51] Cf. sec. 58(2) Fiscal Code; BR-Drucks. 545/08, p. 126.

III. Tax privileges stated in special tax provisions

1. Current taxation of corporations

a) Corporate Income Tax and Local Business Tax

Sec. 5(1)(9)(1) Corporate Income Tax Act (Körperschaftsteuergesetz) and sec. 3(6)(1) Local Business Tax[52] Act (also called "(Local) Trade Tax Act"; Gewerbesteuergesetz) both provide that corporations, associations and estate which, according to their statute and their effective management, exclusively and directly serve public-benefit, charitable or religious purposes are personally exempt from corporate income tax. However, both sec. 5(1)(9)(2) Corporate Income Tax Act and sec. 3(6)(2) Local Business Tax Act state that tax exemption is not granted with regard to the extent to which an economic activity is pursued.[53] The term "economic activity" must be interpreted in accordance with sec. 14 and in compliance with sec. 68 Fiscal Code. According to the "Four-spheres-model", mere asset management (cf. sec. 14(2) Fiscal Code), activities of the ideal sphere and dedicated activities (cf. sec. 64(1) in conjunction with sec. 64 to 68) are not regarded as economic activities.[54] The reason for this exception to the general tax exemption is that charity law shall not prefer charitable organisations to other competitors if they participate in the market.[55]

When applying sec. 5(1)(9)(1) Corporate Income Tax Act (as well as other provisions of tax law which preclude tax privileges with regard to the extent to which an economic activity is carried out), one must bear in mind that, according to the fiscal administration in particular, but under certain circumstances also according to the Federal Tax Court, an economic activity which outweighs the charitable activities of a corporation can lead to a complete denial of the charitable status and therefore of any tax privileges.[56]

Sec. 64 Fiscal Code, which corresponds to provisions which preclude tax privileges with regard to the extent to which an economic activity is carried out (and therefore also to sec. 5(1)(9)(1) Corporate Income Tax Act), clarifies the consequences of economic activities. First and foremost, sec. 64(1) Fiscal Code provides that the corporation shall forfeit the tax privilege for the bases of taxation (income, turnover, assets) attributable to such economic activity. According to the Federal Tax Court, revenue and expenditure are attributable to an economic activity if they have been generated by this activity.[57] Sec. 64(2) Fiscal Code provides that several economic activities are treated as a single

[52] Local business tax is levied on every business (independent of whether it is carried out by a corporation, individual or partnership) and essentially depends on the profits of the enterprise. The effective tax rate depends on the municipality in which the business is carried out (i.e. the location of the permanent establishment) and varies between a minimum rate of 7 % and a maximum rate of almost 17 %. Corporations are not entitled to credit the local business tax against the corporate income tax.

[53] According to sec. 5(1)(9)(3) Corporate Income Tax Act sec. 5(1)(9)(2) of this tax act does not apply on forestry enterprises. The same is true for the local business tax according to sec. 3(6)(2) Local Business Tax Act.

[54] See above II c bb.

[55] *Hüttemann*, Gemeinnützigkeits- und Spendenrecht, § 1 MN. 28.

[56] Cf. *Gersch* in: Klein (ed.), Abgabenordnung, § 64 MN. 2.

[57] Bundesfinanzhof, Bundessteuerblatt II 1992, p. 103 (p. 104); *ibid.*, BFH/NV 1992, p. 412 (p. 413).

economic activity. As a consequence, losses and profits of several economic activities can be offset against each other. This is of prime importance as it is forbidden to offset losses incurred through economic activities either against revenue from the ideal sphere or against profits generated through dedicated activities.[58] Sec. 64(3) Fiscal Code provides that the bases of taxation attributable to economic activities shall not be subject to corporation tax and local business tax if the total annual *income* (i.e. not profits)[59], including turnover tax from these economic activities, does not exceed 35,000 Euros. In case this threshold is exceeded, all profits resulting from economic activities are taxed. To avoid the demerging of a tax-privileged corporation into several tax-privileged corporations in order to make use of the 35,000 Euro-threshold several times, sec. 64(4) Fiscal Code states that the subdivision of a corporation into several independent corporations for the purpose of benefiting more than once from the tax privilege pursuant to sec. 64(3) Fiscal Code shall constitute an abuse of legal options for tax planning schemes within the meaning of sec. 42 Fiscal Code.[60]

Therefore, income of not-for-profit corporations is tax-exempt with regard to the extent to which the corporation does not carry out economic activities.

b) Value Added Tax

Corporations are subject to value added tax if they, as an entrepreneur within the meaning of sec. 2 Value Added Tax Act (Umsatzsteuergesetz), render goods and services (sec. 3(3) and (3)(9) VAT Act) for money domestically or carry out other activities within the meaning of sec. 1 VAT Act. The precondition for being an entrepreneur is crucial for the application of the VAT Act.[61] According to sec. 2(1)(1) VAT Act, an entrepreneur independently administrates a commercial or occupational activity. Pursuant to sec. 2(1)(3) VAT Act, an activity has to be regarded as commercial or occupational if it is an enduring activity with the aim of generating income. As there is neither a personal nor a partial personal tax exemption for charitable corporations, they also can be regarded as entrepreneurial if they meet the preconditions of sec. 2 VAT Act.[62] In this case, the "regular" provisions of the VAT Act apply.

However, according to sec. 12(2)(8a) VAT Act, goods and services rendered by corporations which exclusively and directly serve public-benefit, charitable or religious purposes (sec. 51 to 68 Fiscal Code) are subject to the reduced VAT rate of 7 % (instead of the regular rate of 19 %). Of course this preferential treatment does not apply to goods and services which are rendered in connection with economic activities (sec. 12(2)(8a)(2) VAT Act). If goods and services are provided in connection

[58] See above II c cc.
[59] *Gersch* in: Klein (ed.), Abgabenordnung, § 64 MN 7.
[60] Moreover, sec. 64(5) Fiscal Code provides for a special treatment of surpluses resulting from the alienation of used materials obtained free of charge.
[61] *R. Rasche* in: Schauhoff (ed.), Handbuch der Gemeinnützigkeit, § 12 MN. 10.
[62] *Buchna/Seeger/Brox*, Gemeinnützigkeit im Steuerrecht – die steuerliche Begünstigungen für Vereine, Stiftungen und andere Körperschaften, p. 577 et seq.

with dedicated activities, the application of the reduced tax rate depends on the factual circumstances. If these activities are primarily carried out to generate additional income and, in this respect, the corporation enters into direct competition with other enterprises, the reduced rate does not apply.[63]

Sec. 4a(1) VAT Act provides that, under certain circumstances, a tax refund is granted upon request to corporations which exclusively and directly serve public-benefit, charitable or religious purposes (sec. 51 to 68 Fiscal Code). If a corporation acquires goods in order to send them abroad for charitable purposes at no charge, the corporation is not generally entitled to claim a refund of VAT which was paid on the acquisition of the named goods. According to sec. 4a(1) VAT Act, not-for-profit organisations are entitled to apply for a refund of paid VAT to balance this tax disadvantage.[64]

Moreover, sec 23a VAT Act provides that, for purposes of the calculation of the amount of VAT on acquisitions of capital goods which may be deducted (sec. 15 VAT act), an average rate of 7 % of the taxable turnover applies to corporations, associations and assets within the meaning of sec. 5(1)(9) Corporate Income which are not obliged to account for and compile financial statements based on annual stock inventories. This provision aims at simplifying accounting obligations for charitable associations if their annual turnover does not exceed 35,000 Euros.[65]

c) Real Estate Tax

Real estate tax is levied annually on immovable property by the municipalities,[66] independent of whether real estate is held as a private or a business asset. However, according to sec. 3(3)(b) Real Estate Tax Act (Grundsteuergesetz), real estate which is used for public-benefit or charitable purposes by a domestic corporation, association or estate which, according to its statute and their effective management, exclusively and directly serve public-benefit or charitable purposes is exempt from taxation.[67]

d) Wealth tax

Currently, there is no wealth tax imposed in Germany. Indeed, sec. 1(1)(4) Inheritance and Gift Tax Act provides that assets of foundations are subject to inheritance and gift tax once in any 30-year period. However, this provision only applies to foundations and associations which are not charitable (e.g. family foundations). There is no other tax in place of the tax-privileges of donations under the Inheritance and Gift Tax Act (see below 2a).

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[63] However, the reduced rate does apply if, in that case, the corporation directly accomplishes purposes which are mentioned in sec. 66 to 68 Fiscal Code.

[64] *H.-H. Heidner* in: Bunjes/Geist (ed.), Umsatzsteuergesetz, 10th edition, C. H. Beck, Munich 2011, § 4a MN. 2.

[65] *Heidner* in: Bunjes/Geist (ed.), Umsatzsteuergesetz, § 23a MN. 3.

[66] The average tax rate is approximately 1.8 % with respect to real estate used for agricultural or forestry businesses. Otherwise, it is in the region of 1.4 %.

[67] Real estate used by hospitals is, according to sec. 4(6) Real Estate Tax Act, also exempt from taxation if the hospital is regarded as a dedicated activity within the meaning of sec. 67 Fiscal Code.

2. Treatment of donations

a) Inheritance and Gift Tax

Donations (i.e. lifetime gifts and inheritance on account of death) made to a domestic corporation, association, and estate which are, according to their statues and effective management, exclusively and directly serve public-benefit, charitable or religious purposes are exempt from inheritance and gift tax due to sec. 13(1)(16b) Inheritance and Gift Tax Act (Erbschaft- und Schenkungsteuergesetz). The same is true for donations to foreign corporations if their state of residence retroactively exempts donations to German charitable corporations from taxation (sec. 13(1)(16c) Inheritance and Gift Tax Act). In case that assets received as a lifetime gift or by inheritances on account of death are transferred within two years to a foundation which, according to her statues and effective management, exclusively and directly serves public-benefit, charitable or religious purposes, the receipt is exempt from inheritance and gift tax with retroactive effect (sec. 29(1)(4) Inheritance and Gift Tax Act). These tax exemptions are of significant relevance for NPOs as donations would otherwise be taxed with a rate of up to 50 %.

b) Personal Income Tax/Corporate Income Tax

Donations made by individuals and corporations for the furtherance of tax privileged activities as determined in sec. 52 to 54 Fiscal Code are deductible from the assessment base at an amount of up to 20% of total income (sec. 10b(1)(1)(1) Personal Income Tax Act). Alternatively, entrepreneurs are allowed to opt for a deduction of max. 0.4% of the total sum of their turnover and salaries (sec. 10b(1)(1)(2) Personal Income Tax Act).

According to sec. 10b(1a) Personal Income Tax Act, donations for the furtherance of tax privileged activities into the asset stock of a foundation are deductible, on request, by an amount of up to 1 million Euros within the assessment period in which the donation takes place and within the following nine-year period. This privilege is granted in addition to the aforementioned amount. This provision seems to have had a significant impact on the development of the sector of not-for-profit foundations in Germany.