KPMG

Film Financing and Television programming

A Taxation Guide

Now in its eighth edition, KPMG LLP's ("KPMG") Film Financing and Television Programming: A Taxation Guide (the "Guide") is a fundamental resource for film and television producers, attorneys, tax executives, and finance executives involved with the commercial side of film and television production. The guide is recognized as a valued reference tool for motion picture and television industry professionals.

Doing business across borders can pose major challenges and may lead to potentially significant tax implications, and a detailed understanding of the full range of potential tax implications can be as essential as the actual financing of a project. The Guide helps producers and other industry executives assess the many issues surrounding cross-border business conditions, financing structures, and issues associated with them, including film and television development costs and rules around foreign investment. Recognizing the role that tax credits, subsidies, and other government incentives play in the financing of film and television productions, the Guide includes a robust discussion of relevant tax incentive programs in each country.

The primary focus of the Guide is on the tax and business needs of the film and television industry with information drawn from the knowledge of KPMG International's global network of member firm media and entertainment Tax professionals.

Each chapter focuses on a single country and provides a description of commonly used financing structures in film and television, as well as their potential commercial and tax implications for the parties involved. Key sections in each chapter include:

Introduction

A thumbnail description of the country's film and television industry contacts, regulatory bodies, and financing developments and trends.

Key Tax Facts

At-a-glance tables of corporate, personal, and value-added (VAT) tax rates; normal nontreaty withholding tax rates; and tax year-end information for companies and individuals.

Financing Structures

Descriptions of commonly used financing structures in film and television production and distribution in the country and the potential commercial tax implications for the parties involved. The section covers rules surrounding co-productions, partnerships, equity tracking shares, sales and leaseback, subsidiaries, and other tax-efficient structures.

Tax and Financial Incentives
Details regarding the tax and financial incentives available from central and local governments as they apply to investors, producers, distributors, and actors, as well as other types of incentives offered.

Corporate Tax
Explanations of the corporate tax in the country, including definitions, rates, and how they are applied.

Personal Tax
Personal tax rules from the perspective of investors, producers, distributors, artists, and employees.

Digital Media
For the first time, we have included a discussion of digital media tax considerations recognizing its growing role in the distribution of film and television content.

KPMG and Member Firm Contacts
References to KPMG and other KPMG International member firms' contacts at the end of each chapter are provided as a resource for additional detailed information.

Please note: While every effort has been made to provide up-to-date information, tax laws around the world are constantly changing. Accordingly, the material contained in this publication should be viewed as a general guide only and should not be relied upon without consulting your KPMG or KPMG International member firm Tax advisor.

Production opportunities are not limited to the countries contained in this Guide. KPMG and the other KPMG International member firms are in the business identifying early-stage emerging trends to assist clients in navigating new business opportunities. We encourage you to consult a KPMG or KPMG International member firm Tax professional to continue the conversation about potential approaches to critical tax and business issues facing the media and entertainment industry.

Thank you and we look forward to helping you with any questions you may have.

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Germany

Introduction

Germany offers various incentives for the film industry and is considered to be a favorable location in this regard. Germany has three funding institutions at the federal level and various institutions at the state level for film funding. The German film funding is widely spread around the world and in this way affected Germany as a location for film business. Germany has already hosted a number of well-known international film productions. Thus, film funding and suitable backdrops of German history contributed to the site selection. With respect to the film production and film financing business, irrespective of the tax amendments in the past years, the "media decree" is still important for the film business. The media decree was issued by the German Federal Ministry of Finance on February 23, 2001 and amended on August 5, 2003. Besides some provisions that are (due to their nature) only applicable to the taxation of film funds and their investors, the vast majority of provisions deals with general taxation principles in connection with the production, distribution, and financing of films. Their interpretation may affect every person engaged in this business, whether a film fund or not. The qualification of new media transactions from a tax point of view, especially provided digitally, can be challenging, considering that existing tax laws were initially not developed in a digital world. The main aspects of qualification are the treatment of licenses, which may be considered as royalties, rentals, or sales, depending on the extent of limitation of the rights granted. Furthermore, the determination of the place of performance, the source of income, the kind of income, e.g., royalty, service, or sale with regard to holding tax issues, are important questions to be answered when determining the tax treatment of new media. To a certain extent, the VAT law changes affecting the media business are a result of practical challenges. The regulations in German VAT law, which are applicable since January 1, 2015, might influence the film industry especially in respect to the place of supplies of telecommunication, broadcasting, and electronic services to final (moss) consumers (B2C), as well as several accompanying regulations.

Key Tax Facts

Distributed/undistributed profits	15%* (for corporations) For partnerships: Personal income tax rate of the partner
Branch profits of nonresidents	15%* (if maintained by a corporation) Personal income tax rate (if maintained by an individual) or of the partner (if maintained by a partnership)
Trade tax	Between 7% and 17.15%, depending on the municipality
VAT rates	7%, 19%
Normal nontreaty withholding tax rate:	
Dividends	25%*

Interest to residents/nonresidents	Generally 25%*/0%
Royalties	15%*
Tax year-end: Companies	December 31
Tax year-end: Individuals	December 31
Highest personal income tax rate	42%*/45%* ** (with credit system for trade tax)

* Plus 5.5% solidarity surcharge on the tax due

** 45% applicable for income exceeding EUR 256,303 (2017), respectively EUR 260,532 (2018)

Film Financing

Financing Structures

Co-production

It is possible for a German investor to enter into a co-production joint venture with other investors to finance and produce a film wholly or partly in Germany. Each participant in the joint venture is entitled to the film rights and, consequently, to the revenue generated in the respective countries or regions. However, a co-production does not necessarily involve sharing of revenue.

Following the provisions of the media decree, there are two alternative scenarios of how to co-produce a film:

— The co-producers enter into a co-entrepreneurship and, therefore, a partnership relationship for civil law purposes (accordingly, see comments under Partnership).

— The co-producers produce the film within the framework of a co-production community, thus, not entering into a partnership relationship for civil law purposes.

For purposes of the media decree, even the second scenario, i.e., where there is no partnership relationship for civil law purposes, will be treated as a partnership or co-entrepreneurship unless the co-production community merely renders cost-covering services to the participating co-producers, i.e., if the co-production community, upon completion of the production, does not have any exploitation or distribution rights. However, if the co-producers by virtue of supplemental arrangements (in whole or in part) jointly exploit the picture, the transaction will be treated as a partnership for purposes of the media decree.

If the co-production community is deemed not to create a partnership/co-entrepreneurship, it will be disregarded as an entity, but its services will be treated as supporting services of the participating co-producers.

If, on the other hand, the co-production is deemed to create a domestic partnership/co-entrepreneurship, it is treated as transparent for tax purposes in Germany, with the result that tax is imposed at the level of the partners. A non-resident partner would, in principle, be subject to limited taxation in Germany on his income share in the partnership. Special rules might apply on the basis of a Double Tax Treaty (DTT).

In certain cases, a co-production is deemed to be a foreign partnership. However, if such partnership maintains a permanent establishment in Germany, all the partners would be considered to have a permanent establishment in Germany.

A permanent establishment is defined as a fixed place of business or facility that serves the business of an enterprise and over which the entrepreneur (here: the co-production) exercises control.

If a film production site exists for longer than the applicable "de minimis" period (which is likely if several consecutive film productions are carried out in Germany), it is probable that it would be regarded as a permanent establishment of the foreign participants in the co-production. Moreover, if a permanent production office exists in Germany, it will automatically be regarded as a permanent establishment. Additionally, the tax authorities may assert a permanent establishment by virtue of the place of the management or a dependent agency relationship.

If the foreign participants are treated as having a permanent establishment in Germany, they will be taxable in Germany on the income attributable to the permanent establishment. If the film rights are deemed to be created through a permanent establishment in Germany, there is the risk that worldwide revenue derived from the exploitation will be taxable in Germany.

In the past, consideration was made to carrying out film productions through a German special purpose company, e.g., a "camera-for-hire" company, set up in Germany by the parties to the agreement ("participating parties"). Such production company would produce the film (or the German part of the film) on a "work-made-for-hire" basis (see comments under Amortization of Expenditures). For example, a production contract with the participating parties confers on the production company an appropriate production fee, e.g., on a cost-plus basis, but does not give the production company ownership of any rights in and to the film (including, without limitation, the copyright in the film). In such a case, the film rights would then be exploited by the participating parties from their respective locations. Because there would be no permanent establishment of the participating parties in Germany in this case, the resulting revenue should be taxable only in the country of residence of the participating parties. However, following the provisions of the media decree (see above), such an arrangement could be deemed to create a partnership/co-entrepreneurship, and be treated as having a place of business in Germany (and therefore being subject to German tax).

Partnership

In principle, a partnership is a more formal arrangement than a co-production described above. German law provides for several kinds of partnerships, all of which are treated as "transparent" for income tax purposes, i.e., the partnership is not treated as a taxable entity and partners are taxed on their respective shares of the partnership profits. This transparent tax treatment applies not only to partnerships created under German law but also to comparable entities created under foreign law.

German Company

If a foreign film production company intends to maintain an ongoing film production activity in Germany in which German resident investors receive a return, it may be advisable to establish a German subsidiary in order to avoid any foreign withholding taxes on what would otherwise be a cross-border income stream. German investors generally prefer to receive dividends directly from a German company rather than through a foreign parent. In appropriate cases, it is, therefore, worth considering some form of income access arrangement whereby German investors receive dividends directly from a German subsidiary of the foreign parent. If the German investor is a company subject to German corporate tax owning at least 10% in the company's share capital, such dividends would be tax-exempt, but 5% of such dividend income would be treated as non-deductible expenditures for corporate tax purposes, and fully creditable and reimbursable German withholding tax would fall due. For trade tax purposes, more specific rules apply, which vary depending on the German investor's relative interest in the company's share capital. If the German investor is an individual, such dividends distributed are subject to:

(i) The "part-income" rule (60% of the dividend income would be taxed) and to fully creditable and reimbursable withholding tax (under the condition that they constitute "business-related" dividends, e.g., upon application for individuals with a participation of more than 25% or participation held as business assets); or

(ii) In all other cases, a flat tax at a rate of 25% (plus 5.5% solidarity surcharge on the tax due).

Sale and Leaseback

The sale of a film by the production company to another company is unattractive in Germany since a production company (i) is able to immediately write off the expenses it incurs in producing a film as ordinary expenses (see Amortization of Expenditures section below), and (ii) is not required (or allowed) to carry them forward as an asset in the balance sheet. A sale and leaseback would therefore generally give rise to a tax disadvantage. Instead of deducting the production expenses immediately against income generated by the film, the production company would have to set them off against the proceeds of disposal, leaving the income generated by the film to be sheltered only by the periodic lease payments.

Tax and Financial Incentives

Investors

There are no specific incentives for investors.

Producers

Federal Incentives

The main incentive at the federal level is the "*Filmförderungsgesetz,*" which is intended to promote the production and marketing of German films. The incentives are funded by a film levy ("*Filmabgabe*"), which is payable by theatres, the video industry, and broadcasting companies. The *"Deutscher Filmförderfonds"* funds German film productions. In 2016, a further fund, the "German Motion Pictures Fund" was introduced. It concentrates on international co-productions (films and series).

Regional Incentives

Furthermore, there are a number of incentives provided at the state and municipal level. All German states offer different kinds of programs to promote the cinematographic infrastructure of the respective region. Examples of incentives are interest-free loans, non-repayable grants or loans at reduced rates of interest, or partly repayable loans.

Other Incentives

A production company may be able to benefit from the general incentives for investments in Germany.

Actors and Artists

No particular incentives are available for actors and artists engaged in a film production in Germany.

Cinemas and Film Supporting Industry

There are also incentives for cinemas and the film supporting industry in Germany.

Other Financing Considerations

Tax Costs of Shares or Bond Issues

Generally, no form of stamp duty or capital duty is charged on the issue or the transfer of shares, partnership interests, or debt instruments.

Exchange Controls and Regulatory Rules

There are no exchange controls or other regulations preventing foreign investors from repatriating profits to their home territory.

Corporate Taxation

Taxation in General

Corporations are taxable entities subject to corporation tax plus solidarity surcharge and trade tax. The tax burden for corporations amounts to 29.825%, assuming an average trade tax multiplier of 400% (resulting in a trade tax rate of 14%). The effective overall tax rate depends to a great extent on the trade tax, which varies among the municipalities.

Partnerships are not taxable entities for corporate or income tax purposes. The income determined at the level of the partnership is allocated to the partners and subject to tax at the level of the partners on the basis of the distinct tax rate (individual or corporation). The partnership itself is subject merely to trade tax.

Corporation tax, income tax, and trade tax are non-deductible expenses when calculating the taxable income. Expenses for gifts and entertainment expenses are only partly deductible.

Recognition of Income

Film Production Company – Production Fee Income

German-resident Company

If a special purpose company related to other foreign group companies is set up in Germany to produce a film without acquiring rights in that film, i.e., a "camera-for-hire" company, in return for a production fee, the tax authorities might wish to consider whether the production fee is an adequate return for the company's work. Such evaluation might normally take place during a routine tax audit.

It is not possible to provide general guidance as to what might be regarded as an adequate return. This might depend entirely on the facts, i.e., functions performed and risks assumed by the special purpose company.

Foreign Company

A foreign company that enters into a co-production is subject to the same rules set forth above, if its only presence in Germany is a production site.

However, if the foreign company is treated as having a permanent establishment in Germany, the German tax authorities might seek to attribute to it a share of the total profits of the company by establishing an arm's length consideration for the activities performed by the German branch for the benefit of the home office or, more likely, by assessing the value of the activities performed in Germany compared to the company's overall business activities.

Film Production Company – Sale of Distribution Rights

If a German resident company transfers exploitation rights in a film to an unrelated distribution company in consideration for a lump-sum payment and subsequent periodic payments based on gross revenue, such a transaction can be classified either as a sale or a license, depending on the facts and circumstances. This might depend on whether or not the transfer is restricted (i) with respect to the scope of the exploitation right granted, e.g., only theatrical but not video and other distribution rights or (ii) in terms of time or geographic coverage. In the absence of any restriction, the transaction will likely be classified as a sale. On the contrary, a transaction with substantial restrictions will likely be classified as a license, unless the retained exploitation rights of the transferor are economically irrelevant. A sales transaction generates an immediate capital gain for the production company, which will equal the total sales proceeds if the production company has already expensed its total production costs. This presumes that the sale is effected after production (as opposed to a commission production, discussed below). In the case of a license, the production company will only realize income when earned. Lump-sum advances, therefore, must be regularly treated as deferred income to be realized over the period to which such payment relates, i.e., over the term of the license. Likewise, fixed back-end payments would be accrued periodically as income on the same basis.

If the transaction takes place between related parties, the German tax authorities may attribute an arm's length price, i.e., the lump-sum payment and revenue share should reflect the future earning capacity of the film.

Film Distribution Company

If a German resident company "acquires" rights in a film from an unrelated production company, the transaction may be deemed to be a purchase acquisition or a license transaction (see above Film Production Company – Sale of Distribution Rights), depending on the facts and circumstances. In the case of a rental transaction, no acquisition costs have to be capitalized, but all payments to the producer/licensor or accruals made for such payments would constitute tax-deductible expenses in the appropriate period. In this respect, payments made as advances for future periods have to be treated as prepaid expenses, i.e., they may only be expensed over the agreed exploitation term.

Rental payments to a licensor in a treaty country can in most cases be paid without deduction of the German domestic withholding tax rate of 15% (plus 5.5% solidarity surcharge on the tax) applicable to royalties if the recipient's entitlement to treaty benefits is certified by the Federal Tax Office ("*Bundeszentralamt für Steuern*"). Treaty shopping rules might be applied if the recipient is not deemed to be the beneficial owner of the royalties. This would be the case, for example, if an entity interposed in the legal structure is only entitled to a marginal share in the royalties received and has to remit the surplus to a tax haven jurisdiction or if there are no economic reasons for the interposition of such company and it does not pursue its own active business.

Transfer of Film Rights between Related Persons

If a foreign holder of rights in films or videos grants a sublicense for the exploitation of those rights to a German-resident company, the transactions are likely to be of interest to a German tax auditor, particularly if the transfer is between related parties, and if the other party is not taxable in Germany. In such a case, German tax authorities may apply the arm's length test to determine whether the contractually agreed price is acceptable. It is, therefore, necessary to document and defend the intragroup transfer pricing policy under the applicable German tax law.

Under the German intercompany pricing guidelines, prices are not considered to be arm's length if a related film distribution entity incurs losses over several consecutive years. Therefore, if no comparable third party transaction is available, the German distributor must render evidence that it has analyzed its potential earnings and expenses in connection with film distribution prior to entering into the terms and conditions of the royalty agreement with the related licensor. This evidence must prove that a reasonable profit can be expected when engaging in the distribution business.

In principle, it is possible to negotiate acceptable operating margins in so-called advance pricing agreements. However, in practice, such procedures may take years until final agreements are reached.

Expenditures

Amortization

Where a company produces a film in order to exploit the film itself for tax purposes, production costs are a deductible expense for the company incurring them. In principle, they are deductible immediately when expensed rather than being capitalized and then amortized. These expenses may, in general, be deducted against income the taxpayer receives from other sources.

However, where a company acquires rights to a film from another person, the acquisition cost must be capitalized and amortized. The normal depreciation method is on a straight-line basis. According to the opinion of the tax authorities, the useful life of film rights in principle is 50 years, but the specifically applicable useful life will depend on whether all or only one specific exploitation right has been granted. For example, if only the theatrical distribution has been acquired, the useful life may not exceed two years. In practice, parties often choose a shorter useful life, and the issue is often resolved in a later tax audit.

In case a company produces a film without the intention to exploit the film itself, it has to be determined whether the contractual relationship between the two parties involved has the nature of a genuine commission production ("*echte Auftragsproduktion*") or a modified commission production ("*unechte Auftragsproduktion*"). Under a genuine commission production relationship, where a production company produces a film at its own risk for a third party and is obliged to assign all rights in the produced film to such a third party, the production costs incurred, as well as intangible rights created, have to be capitalized as current assets, without the possibility of being amortized over their useful period of life at the level of the production company. On the other hand, in case the parties have entered into a modified commission production relationship according to which the production company solely renders services to the third party in connection with the film production and the full risk of such third party, costs incurred at the level of the production (service) company are fully deductible as business expenses at the level of the third party. The media decree provides for specific prerequisites that have to be met in order to have a commissioned production qualify as a modified commission production.

Earnings Stripping Rules

Due to the earnings stripping rules that apply in general to all types of debt financing of sole proprietorships, partnerships, and corporations, interest expense is completely deductible from the tax base to the extent the taxpayer earns positive interest income in the same financial year. Interest expense in excess of interest income is deductible only up to 30% of tax EBITDA (interest deduction ceiling).Tax EBITDA is defined as taxable profit before application of the interest deduction ceiling, increased by interest expenses and by fiscal depreciation, and reduced by interest earnings. The interest deduction ceiling does not apply where one of the following exceptions is met:

- Interest expense exceeds positive interest income by less than EUR 3 million (de minimis threshold).
- The businesses are not part of a controlled group (non-group businesses). An enterprise is regarded as part of a controlled group if it is or could be included in consolidated financial statements in accordance with IFRS, German GAAP, or U.S. GAAP.
- The exemption for non-controlled corporations applies only if the corporation establishes that the remuneration on shareholder debt financing accounts for not more than 10% of net interest expense. Shareholder debt financing is defined as debt capital received from a substantial shareholder (more than 25%), an affiliated person, or a third party having recourse against a substantial shareholder or an affiliated person.
- The business forms part of a controlled group, but the so-called escape clause applies. If the equity ratio of the entity in question is equal to or greater than the equity ratio of the controlled group, the interest deduction ceiling will not apply. There is a 2% safety cushion for the equity ratio of the business in question. The escape clause applies only if the corporation establishes that the remuneration on shareholder debt financing accounts for not more than 10% of net interest expense. Shareholder debt is defined as mentioned above (see non-group businesses).

Interest expense that is not deductible in the period in which it arose may be carried forward. It increases interest expense in the following year, but is not taken into account to determine tax EBITDA.

As far as the tax EBITDA exceeds the interest income reduced by the interest expenses of the business, it is carried forward into the following five financial years. Tax EBITDA and interest expense carried forward will be erased in reorganizations. The change-of-control rules, however, apply only to the interest expense carryforward.

For tax groups ("*Organschaft*"), the controlling and the controlled companies are treated as one single entity. The interest expense and interest income of the controlled company are considered at the level of the controlling company for purposes of the interest deduction ceiling.

Anti-Patent-Box-Law

For license and royalty expenses accruing after December 31, 2017, the tax deductibility will be restricted in case of the income earned by the licensor that is not taxed or only taxed at a low rate on the part due to a preferential regime to be considered as harmful (so-called "IP-boxes," "patent boxes" or "license boxes").

The ruling refers to Action 5 of the OECD BEPS project, which defines harmful preferential regimes for the licensing of rights as follows: preferential regimes are considered as harmful if they do not tie in with the substantial activity of the taxpayer receiving benefits. Regimes, however, that are consistent with the so-called "nexus approach" are harmless. Under this approach, taxpayers are granted benefits for the licensing of rights only to the extent that they incurred research and development expenditures in this country for the creation of the licensed right or patent.

According to the explanatory memorandum of the law, within the context of the OECD project, the Forum on Harmful Tax Practices undertakes an evaluation of existing and future preferential regimes in view of their consistency with the nexus approach. The OECD's final report on Action 5 already includes a tabular overview of OECD countries with preferential regimes that are, in their present form, inconsistent with the nexus approach. This overview can also be a point of reference for the qualification of the preferential provisions for the purposes of the new ruling.

The revision is designed to cover expenditures for the licensing of use or the right to use rights, in particular copyrights and industrial property rights, commercial, technical, scientific and similar experiences, knowledge, and skills. The scope of application is limited to payments between related persons. Debtors or creditors may also be permanent establishments. Moreover, the creditor’s license income must be subject to a low tax rate (preferential taxation). An income tax burden of less than 25% constitutes a low tax rate. At the same time, the low taxation must be based on a privilege for the income from the licensing of rights that deviates from standard taxation.

A full deduction is also admissible insofar as the foreign creditor's income resulting from the expenses is amenable to the CFC rules and, therefore is, as part of the imputed income amount, already subject to taxation in Germany. In the absence of this exception, double taxation could occur (non-deductibility of business expenses for the licensing costs and taxation of the imputed income amount).

If the requirements for a restricted deduction of business expenses are met, the percentage of the non-deductible part is to be determined by way of a ratio calculation:

$$\frac{25\% - \text{income tax burden in } \%}{25\%}$$

Therefore, the amount of business expenses to be deducted is based on the income tax burden on the part of the creditor of the payment. The higher the tax rate imposed on the royalty income on the part of the creditor, the higher the deductible share of the business expenses on the part of the German debtor.

The deduction restriction also applies to so-called "cases of interposition" or sublicensing. According to the explanatory memorandum of the law, this refers particularly to cases where royalties do not directly flow into a harmful license box regime but are first paid to an interposed related person, who in turn pays royalties to "another" creditor related to the debtor who is subject to a harmful license box regime. This is not applicable, however, if the deduction on the part of the creditor is already subject to the new deduction restriction, e.g., because a domestic company is interposed. This is to prevent so-called cascade effects resulting from a multiple non-deductibility. If, however, in cases of interposition several harmful preferential regimes are applied, the lowest tax burden shall be relevant.

Losses

General Rule

Losses of the current year may only be carried back to the preceding year at a maximum amount of EUR 1 million, which is only possible for corporation income tax. Losses that are neither offset in the year in which they occur nor carried back to the preceding year qualify for a loss carry forward. Up to an amount of EUR 1 million losses carried forward may compensate current taxable income without limitation. Only 60% of the positive income exceeding EUR 1 million can be compensated by further tax losses carried forward. The regulations for the loss carry forward apply to both the corporation income tax and the trade tax.

The tax law permits the losses arising in European Union (EU) or European Economic Area (EEA) countries to be netted against German-source income where the applicable tax treaty avoids double taxation under the credit method. Foreign losses are disregarded in Germany where the exemption method applies. According to jurisdiction, but currently not acknowledged by the German tax authorities, exceptions apply in cases where losses may definitely not be made use of in the foreign country. This could be given in case of a foreign branch as well as a foreign subsidiary company.

Change-in-Ownership Rules

Changes in the ownership of corporations can cause forfeiture of losses for tax purposes—so-called change-in-ownership rules (§ 8c KStG, Corporate Income Tax Act). The restriction proceeds in two steps. Acquisitions of more than 25% and less than 50% of a corporation's shares or voting rights within a five-year period by a person or parties related thereto trigger pro rata forfeiture of losses. Losses fully forfeit where more than 50% of the shares or voting rights are transferred. The statute covers both direct and indirect transfers. The rules also operate where shares are transferred to a group of purchasers with convergent interests. The same applies to trade tax losses and interest carryforwards within the meaning of the earnings stripping rules.

In contrast to the above-mentioned rules, the utilization of tax losses and tax loss carry forwards remains nonetheless possible in the amount of the hidden reserves of the company acquired.

Tax losses and tax loss carry forwards will not be forfeited provided that, in the event of a harmful acquisition of more than 25% but less than 50% of the shares, they do not exceed the hidden reserves on a pro rata basis, or in the event of a harmful acquisition of more than 50% of the shares, the entire hidden reserves of the company are not exceeded. Tax losses and tax loss carry forwards that exceed the hidden reserves will be forfeited. However, this applies only for those hidden reserves that are included in operation assets and are taxable in Germany. This also applies for foreign business assets that are subject to German taxation.

In general, the amount of hidden reserves corresponds to the difference between the fair market value of the acquired shares and the taxable equity capital that relates to the acquired share. In the case of a purchase, the fair market value of the shares corresponds to the remuneration.

If the taxable equity is negative, the amount of hidden reserves corresponds to the difference between the fair market value of the business assets and the (negative) taxable equity capital that relates to the acquired shares.

Another exception to the forfeiture of loss carry forwards is the so-called reorganization clause. Thereafter, any transfer of shares that serves the purpose of a financial restructuring of the corporation does not trigger a forfeiture of loss carry forwards. In this context, a transfer serves a financial restructuring if the restructuring aims to prevent or eliminate a situation of imminent illiquidity or over-indebtedness, and the main structural characteristics of the business remain unchanged. However, the application of the reorganization clause is excluded if the corporate body has fundamentally ceased its business operations at the time of the harmful acquisition, or the corporate body alters its line of business within a period of five years from the acquisition.

Furthermore, according to a provision introduced as from January 1, 2016, certain transfers within groups, e.g., where one entity directly or indirectly owns 100% of the shares in the buyer and the seller, are not qualified as harmful transfers in the sense of the Change-in-Ownership Rules (applicable for transfers following December 31, 2009).

In addition, for harmful transfers following December 31, 2015, subject to certain conditions (e.g., maintaining the same business for a certain period of time before and after the harmful transfer, no dormant business, not being part of a tax group), the Change-in-Ownership Rules do not apply upon application.

Dividends and Capital Gains

Corporation

Dividend income received by a corporation generally is tax-exempt, whereas 5% of the dividend income is treated as a nondeductible business expense. Costs actually incurred are deductible without limit. This rule applies to dividends that are paid by both domestic and foreign corporations. The tax exemption is only granted if the investment at the beginning of the calendar year amounts to at least 10% of the share capital.

Capital gains arising on the sale of shares held by a corporation are also exempt from corporation tax. Similar to the treatment of dividends, 5% of the capital gain is a non-deductible business expense (this also refers to write-ups even if the write-downs have not been tax deductible in former years). Costs incurred in connection with the sale reduce the net amount of the capital gain and lower the base on which the 5% nondeductible business expenses are calculated. Losses on the sale of shares and write-downs due to impaired value are not tax-deductible.

Partnership

If the shareholder of a corporation is a partnership, the dividends and capital gains are taxed at the level of the partners and not at the level of the partnership (unless for trade tax purposes).

If the partner is not a corporation and the partnership is earning business income, the partial-income system applies to the respective dividends allocated to that partner; 40% of the received dividend income or capital gain is tax-exempt, and 60% of the related expenses are deductible as business expenses.

Taxation of Non-Resident Taxpayers

Only income derived from German-source income as provided for in the income tax law (§ 49 EStG) is subject to limited taxation in Germany—irrespective of whether the non-resident is an individual or a legal entity.

Under specific assumptions, according to § 49 EStG, income from licensing of rights to licensees in Germany constitutes German-source income even in the absence of a domestic permanent establishment. Royalty payments are taxed at a withholding tax rate of 15%. Under the provisions of an applicable DTT, the tax rate might be reduced to zero provided that the recipient meets the respective requirements.

A permanent establishment is defined as a fixed place of business or facility that serves the business of an enterprise and over which the entrepreneur (non-resident) exercises control. A permanent representative is defined as an individual that transacts business for an enterprise on an ongoing basis, subject to the instructions of the enterprise. Both a permanent establishment and a permanent representative expose the non-resident to German taxation (subject to the general taxation rules) unless a DTT provides for an exception. If a corporation maintains the taxable presence, a corporation tax rate of 15% (plus solidarity surcharge of 5.5% on the tax) applies and the respective income generated by the German permanent establishment is subject to trade tax. In case of an individual, the personal income tax rate plus solidarity surcharge and trade tax apply. Trade tax does not fall due in case of a German permanent representative.

Indirect Taxation

Value Added Tax (VAT)

VAT is levied at each stage of the production and distribution chain. In general, the German VAT regime covers taxable supplies of goods or services within the German territory that are carried out by a VAT entrepreneur, as well as intracommunity acquisitions and imports of goods.

With regard to the supply of goods and services, VAT generally arises when the supply is carried out. Businesses with less than EUR 500,000 turnover in the previous calendar year may pay VAT on the basis of cash receipts.

The standard VAT rate for supplies is 19%, with a reduced rate of 7% applying to certain services and goods e.g., newspapers, books (in hard copy), and transfer of rights, which arise from the copyright law.

Certain goods and services are zero-rated and entitled to input VAT deduction if corresponding formal documentation is provided. The most common examples are intra-Community supplies of goods and export supplies of goods to a non-EU destination. Additionally, German VAT law foresees a tax exemption for some turnovers, which however, do not entitle the supplier to deduct input VAT in relation to this turnover.

VAT entrepreneurs that are registered for VAT purposes in Germany must calculate their VAT liability and file preliminary VAT returns with the German tax authorities on a quarterly basis (on a monthly basis for VAT entrepreneurs with a total annual VAT payable to the tax authorities of more than EUR 7,500 in the previous calendar year). VAT returns must be filed electronically. In addition to the preliminary VAT return filing procedure, VAT entrepreneurs must file an annual VAT return. In case of cross-border transactions, further reporting obligations may apply for VAT entrepreneurs, e.g., EC Sales Lists and Intrastate declarations.

Microbusinesses that fulfill certain criteria (essentially an annual turnover not exceeding a certain threshold) are not liable for VAT in Germany pursuant to the so-called

"*Kleinunternehmerregelung*", however, these provisions are generally only applicable to businesses established in Germany.

For certain services or supplies that are carried out by a non-resident VAT entrepreneur to a business, and are taxable in Germany as well as for certain other services or supplies that are taxable in Germany, the "reverse charge mechanism" applies, meaning that the recipient of the service (rather than the supplier) will be liable for VAT.

If a foreign entrepreneur is not registered for VAT purposes in Germany, the Federal Tax Office will reimburse any input VAT paid in Germany upon application (if the respective formal requirements are fulfilled and reciprocity is given).

With regard to the special VAT regulations please see the section Digital Media below.

Other Indirect Taxes

Aside from VAT, there are other taxes in Germany designated as "indirect taxes." Such taxes comprise any other excise duties and transactions taxes. They are levied, for example, on the following products: mineral oil, coal, natural gas, gasoline and certain biofuels, alcohol, tobacco, coffee, beer, and electricity.

Personal Taxation

Taxation of Resident Individuals

Resident individuals are subject to income tax on their aggregated worldwide income. The tax year for income tax purposes is the calendar year. An individual's income is subject to income tax plus solidarity surcharge. Church tax is collected if the individual belongs to one of the recognized churches.

Net income from employment is determined by deducting any expenses incurred to produce, maintain, and safeguard that income from gross receipts. Tax on employment income is withheld at source.

In the case of income from self-employment, the taxpayer can choose between the equity comparison method and the cash basis accounting method. Under the equity comparison method, the relevant gross income is the difference between the net worth of the assets pertaining to each category of income at the end of the preceding assessment period compared to the current assessment period. Under the cash basis accounting method, taxable income is computed by reducing gross income by income-related expenses in accordance with cash receipts and disbursements. Business-related expenses are generally deductible under both methods. In addition, special expenses and extraordinary expenses are deductible.

In most cases, individuals have to file a tax return. On the basis of the tax return, the individual income tax is calculated according to progressive tax rates. The zero-bracket amount is EUR 8,820 (2017) and EUR 9,000 (2018). For married taxpayers, the zero-bracket amount is doubled. The tax rate increases with the income amount from 11% to 42% (marginal tax rate). The rate of 42% is applied, starting with an income of EUR 54,058 (EUR 108,116 in case of joint assessment) and EUR 54,950 (EUR 109,900 in case of joint assessment) for 2017 and 2018, respectively. The highest personal income tax rate is 45% for income of EUR 256,304 or more (resp. EUR 512,608 in case of joint assessment) and EUR 260,533 or more (resp. EUR 521,066 in case of joint assessment) for 2017 and 2018, respectively.

Taxation of Non-Resident Individuals in General

Non-resident individuals are subject to income tax on certain categories of income from German sources (§ 49 EStG, see above). To trigger German income tax, the income of the non-resident must have specific connection with Germany. Depending on the type of income, the German-source income of nonresidents may be subject to tax either through withholding at source or by assessment upon filing of a tax return.

Taxation of Artists

Foreign artists, who are neither resident nor ordinarily resident in Germany, are liable to limited tax liability with their income from their German-source artistic activities. Business income, income from self-employment, or income from employment could be given.

Film authors, film composers, and expert advisers, are in general not integrated into the company/body they are working for and are therefore generally self-employed. Actors, directors, cameramen, assistant directors, and other staff are normally integrated into the production organism, and are therefore not self-employed. Dubbing actors and dubbing directors are self-employed in general.

For self-employed artists (or artists with business income), who are subject to limited tax liability, the income tax is levied by withholding tax at source. The withholding tax rate amounts 15% plus 5.5% solidarity surcharge if the receipts exceed EUR 250. Receipts of less than EUR 250 are tax-free and can be paid without withholding tax. It may only be refrained from withholding tax if a tax exemption certificate issued by the Federal Tax Office is presented (subject to the regulations of the respective DTT).

In case of EU/EEA residents, expenses caused by the taxable activity may reduce the receipt if the expenses are proved. Under these circumstances, the tax is calculated on the basis of the receipt minus expenses but subject to a tax rate of 30%.

For non-resident artists who are integrated in the production organism and therefore not self-employed, the German employer has to withhold wage tax at source unless the applicable DTT provides for an exemption. The respective exemption certificate is issued by the competent tax office of the employer upon application. Subject to certain conditions and employee category, wage tax may be withheld on a lump-sum basis.

Foreign Tax Relief

A German film production or distribution company that receives income from abroad may, in many cases, be able to avoid deduction of foreign withholding taxes, or to obtain a refund of such taxes, under a DTT between Germany and the country concerned.

Where a foreign withholding tax is suffered and is not refundable, it is, in principle, creditable against German tax on the same income. If such tax relates to an earlier period, e.g., if royalty income of the German company is earned in a given year, but actual receipt and deduction of withholding tax are in a later year, or a later period, e.g., if a foreign licensee pays a down payment under deduction of withholding tax that is deemed to be deferred income in Germany to be realized by the German company in later years, credit can be obtained against the tax of the year in which the income is effectively realized in Germany. However, the German creditable tax is calculated based on the income after deducting an appropriate allowable proportion of expenses. This is particularly relevant if a production company has incurred substantial financing expenses, or if a distribution company has to pay substantial royalties to its licensor. The German tax computed in this way is often less than the withholding tax actually paid. The limitation is applied on a country-by-country basis, and unrelieved foreign tax credits cannot be utilized by being carried back or forward.

A further difficulty arises if there is no German tax liability because of losses being brought forward. In all such cases, as an alternative, the foreign tax may be deducted as a business expense, in which case relief amounting to the percentage of the German statutory corporation tax and trade tax rate can be achieved.

For these reasons, foreign withholding taxes suffered by a German company may be a real tax cost.

Digital Media

At all stages, the production and exploitation of film works becomes more and more digital, especially the area of VFX (visual effects realized in postproduction) is innovative in this regard.

However, the current law and tax law were not developed in a digital world and, thus, current law does—in most cases—not yet reflect the world of digital media. Whereas the existing German tax laws, to a great extent, refer to a certain physical presence in Germany or a connection to Germany, the entertainment content that is digitally transmitted increases the ambiguity under the current law. Accordingly, the qualification of digital transactions from a tax point of view is still demanding.

Income Taxation

To what extent income is subject to taxation depends on the kind of business transaction. Thus, when providing digital content or online transactions in general, it has to be differentiated whether a royalty, a rental, a sale, or even a service is given. The qualification of a license in this regard is mainly influenced by whether limitations in time (or place) apply. In case of a royalty earned by a non-resident, generally, withholding taxes are provided for, whereas in the case of a sale or service by a non-resident, no withholding taxes apply.

Furthermore, the source of income and place of performance are decisive when assessing a potential tax liability in Germany. As the current definition of a permanent establishment comes up against limiting factors, the question arises which factors are critical, e.g., in the case of the "cloud," as these are deemed to be different from those that were developed in the past years in the case of servers.

Also, revenue streams become increasingly complex as more entities in different jurisdictions sharing the revenue may be involved. Further, withholding tax (see above) and indirect tax aspects (see below) become more important, especially in cases of big volumes of transactions with small margins or small amounts per transaction.

Indirect Taxation

Background

In order to ensure that the VAT receipts correspond to the EU member states, where telecommunication, broadcasting, and electronically supplied services are "consumed," and in order to prevent competitive advantages of businesses established in EU member states applying lower VAT rates (or established outside the EU) in comparison to businesses in EU member states applying higher VAT rates, the respective regulations will be modified in all EU member states.

Suppliers of telecommunication, broadcasting, and electronically supplied services made by EU suppliers to private individuals (B2C) are taxable in the EU member state where the customer is established, and has his permanent address or usually resides (contrary to the past rules, which provided that the place of such services were where the supplier had been located). With respect to supplies of telecommunication, broadcasting, and electronically supplied services made by EU and non-EU suppliers to business customers and by non-EU suppliers to private individuals, applicable rules already ensure taxation in the country where the customer belongs to, and there will be no change as of 2015 in this respect.

These regulations are based on changes in the EU legislation and were implemented into German VAT law as of January 1, 2015.

Consequences

Suppliers of the above-mentioned services need to identify where each customer is established, has his permanent address, or usually resides as this will determine the place of taxation (and inter alia the applicable VAT rate). In order to facilitate such determination, a Council Implementing Regulation contains a number of regulations and presumptions, which have legal effect in all 28 EU member states. In explanatory notes regarding this, the Council Implementing Regulation of the European Commission commented in detail on the regulations and presumptions. These regulations entail considerable challenges for the affected suppliers.

Mini One-Stop Shop

To avoid having businesses register for VAT purposes in each EU member state in which they render the above-mentioned services and to minimize administrative burden, the so-called MOSS is introduced. EU and non-EU businesses in general can opt to use a Web portal in the EU member state in which they are identified for MOSS purposes to declare the abovementioned services supplied to nontaxable persons established within the EU instead of filing VAT returns in all affected EU member states.

Services Made through Telecommunications Networks, via an Interface, or a Portal

Many digital services supplied through a telecommunications network, via an interface, or a portal can be delivered to the final consumer by an intermediary. In such situations, it is necessary to identify who the supplier of the service is in order to determine who is liable to account for VAT. The regulations stipulate that in case certain preconditions are fulfilled, a taxable person taking part in the supply of digital services is acting in his own name but on behalf of the provider of these services, i.e., the taxable person is treated as having received and supplied these services himself, meaning that the last entrepreneur fulfilling the respective preconditions in such a row renders the services to the final consumer.

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