



# GERMANY

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International Comparison of Insurance Taxation

October 2007



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## International Comparison of Insurance Taxation

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### Germany – General Insurance

1 Definition	Accounting	Taxation
Definition of 'property and casualty insurance company'	A company carrying on any kind of direct insurance business other than life insurance (including annuities), health insurance, legal expenses insurance and social security.	No separate definition.
2 Commercial accounts/ Tax and Regulatory returns	Accounting	Taxation
Basis for the company's commercial accounts	Generally accepted accounting principles (GAAP) and special accounting principles for insurance companies, both embodied in the Commercial Code (HGB). Specific regulations on technical reserves and the valuation of investments must be observed.	Taxation is based on the commercial accounts, as adjusted according to tax legislation and fiscal court decisions.
Regulatory returns	Separate detailed returns must be filed with the German regulator ( <i>Bundesanstalt für Finanzdienstleistungsaufsicht</i> or BaFin).	N/A.
Tax returns	N/A.	Annual returns are to be submitted as required by tax law, based on the (adjusted) commercial accounts.



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### Germany – General Insurance (continued)

3 Technical reserves/ Equalisation reserves	Accounting	Taxation
Unearned premium reserves (UPR)	The 1/360th or 1/24th method in principle as a discretionary regulatory minimum, generally net of 85% of commission (92.5% for reinsurance).	As per accounts.
Unpaid claims reported (outstanding loss reserves)	Item-by-item valuation. The full amount of an estimated claim has to be added to the reserves, whereas certain claims due are to be deducted. Reasonability of the reserves will be disputed if the estimates exceed 10% (motor liability) or 20% (general liability) of the amounts later paid. The statistical method (group valuation) – especially in certain lines of insurance (i.e. transport) – is accepted for small claims.	Reserves for the same type of obligations must be set up according to statistical experience (as defined by tax law and guidelines from the tax authorities) with respect to the probability of the reduced final obligations in total. In principle, liabilities with a remaining lifetime of at least 12 months must be discounted at a rate of 5.5% p.a. Blanket deductions are to be made for certain types of insurance (e.g. general liability and motor liability).
Claims incurred but not reported (IBNR)	Blanket valuation based on experience or statistical methods. The full estimated claims must be reserved.	As for unpaid claims reported.
Unexpired risks	Not separately shown in the balance sheet.	N/A.



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### Germany – General Insurance (continued)

General contingency/solvency reserves

To guarantee solvency, a minimum capital is required, depending on the scope of the (envisaged) business.

The contingent loss reserve is not recognised for tax purposes.

A contingent loss reserve may be set up for insurance contracts taken out in that business year, valued as the collective risk for each type of insurance. The collective risk is calculated as the difference between the expected premiums received and expected benefits paid out for each type of insurance. No other contingency/solvency reserves (apart from below).

Equalisation/catastrophe reserves

An equalisation reserve must be established and calculated if significant fluctuations in the annual requirement may be expected and these fluctuations are neither offset by premiums nor covered by reinsurance. A formula is to be used reflecting the standard deviation of net losses for the past 15 years (30 years in some specified cases). Equalisation reserves must be increased by 3.5% per annum up to a maximum limit. Additional reserves for certain large risk insurance categories are deductible according to specific regulations. Catastrophe reserves are only allowable for pharmaceutical business liability insurance, nuclear plants insurance and insurance for large-scale terrorist acts.

As per accounts.



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### Germany – General Insurance (continued)

#### 4 Expenses/Refunds

Acquisition expenses

#### Accounting

Direct and indirect costs arising from the conclusion of insurance contracts (e.g. commission, advertising costs, administrative expenses for processing applications) must be deducted immediately.

#### Taxation

As per accounts.

Loss adjustment expenses on unsettled claims (claims handling expenses)

Fully deductible for individual cases; flat-rate deduction under certain circumstances.

In principle as per accounts.

Experience-rated refunds

Deductions for refund of excess premiums permitted.

As per accounts.

#### 5 Investments

Gains and losses on investments

#### Accounting

All realised gains and losses resulting from capital investments must be shown in the profit and loss (P&L) account. However, qualifying realised gains from real estate, may be set up as an untaxed reserve for up to six years.

#### Taxation

For business years through 2003, capital gains from direct share investments are tax-exempt and corresponding losses are not deductible. For the business year 2004 onwards, capital gains from direct share investments are only 95% tax-exempt and corresponding losses are not deductible. Capital gains realised on the disposal of fund units are generally taxable. Due to the transparency of fund investments, the proportional part of any tax-free equity income gained by the fund (dividends and capital gains from its direct share investments, see above) is deductible. Corresponding losses from the fund's direct share investments are not taken into account.



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### Germany – General Insurance (continued)

Assessment of investments	As a basic rule, investments are valued at acquisition costs, (depreciated by any reduction in the market value). Long-term investments are valued at acquisition costs, which may be depreciated if any value decrease is likely to be temporary. If the value decrease is likely to be permanent, depreciation is mandatory.	Depreciation is restricted. The lower going concern market value may only be used if a decrease in value is likely to be permanent. Depreciations of shareholdings are not deductible.
Investment income	Interest and dividends must be included in the P&L account, (with credit for taxes withheld).	As per accounts. For business years through 2003, dividend income is tax-exempt. For subsequent business years, dividend income is only 95% tax-exempt.
<b>6 Reinsurance</b> Reinsurance premiums and claims	<b>Accounting</b> Premiums are deductible immediately. Reinsurance claims reduce reserves. Note: an actual transfer of risk is required.	<b>Taxation</b> As per accounts.
<b>7 Mutual companies</b> Mutual companies (all 'profits' – in principle – returned to members/policyholders)	<b>Accounting</b> Premium refunds to members are expenses. Profit distributions to members (rare) are appropriations and therefore not expenses.	<b>Taxation</b> Premium refunds are deductible to a certain extent.



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### Germany – Other Tax Features

#### 8 Further corporate tax features

Loss carry-overs

#### Taxation

Mandatory one-year carry-back up to EUR 511,500.

Carry-forward of loss remaining after carry-back:

- for business years through 2003 without limitation in respect to amount and duration and can be offset in full;
- for the business year 2004 onwards the amount of loss carried forward that can be offset in full in one business year is restricted to EUR 1 million. Any amount over and above this can be offset at 60% (i.e. minimum taxation of 40% for remaining income after EUR 1 million off-set).

The remaining loss can be carried forward indefinitely.

Foreign branch income

Taxation depends on the double-taxation treaty applicable: either fully taxable with credit for foreign tax or tax-exempt.

According to the German tax authorities, a foreign insurance branch must be allocated income as if it were a fully operational insurance company; therefore, the actual function of the branch is not taken into account.

Capitalisation will generally be recognised if required by the host state's insurance regulations.

Domestic branch income

Calculated according to German tax rules (including transfer pricing rules).

According to the German tax authorities, a domestic insurance branch must be capitalised and allocated income as if it were a fully operational insurance company, therefore, the actual function of the branch is not taken into account.



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## International Comparison of Insurance Taxation

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### Germany – Other Tax Features (continued)

Corporate tax rate

Corporate tax:

1. for business years before 2003: 25%;
2. for business year 2003: 26.5%;
3. for business years 2004 onwards: 25%;

Solidarity surcharge: 5.5% of corporate tax payable.

Trade tax: rate depends on the individual municipality in which the company is situated (average 18%). Trade tax is a deductible expense for corporate tax purposes.

Average effective tax rate is currently between 39% and 42%.

A reform of corporate taxation is expected in 2008, with a reduction of effective tax rates.

#### 9 Other tax features

Premium taxes

#### Taxation

In general, 19% (16% before 2007) insurance tax on all gross premiums for direct business.

In certain specified cases, a rate of 3% to 18% (2% to 15% before 2007) applies. No premium taxes on health insurance, statutory social security insurance and reinsurance.

Fire brigade tax is also payable on the gross premium for fire insurance (8%), property insurance (effective rate 2%) and contents insurance (effective rate 1.6%). Generally, if fire brigade tax is payable, the premium tax rate is reduced.

Premium taxes are owed by the policyholder, whereas fire brigade tax is owed by the insurer and may not be on-charged to the policyholder.

Capital taxes/VAT

No (general) capital taxes for the policyholder or insurer.

Insurer may be liable for real estate (property) tax on the sale or transfer of domestic property (deductible).

No VAT on insurance premiums; correspondingly, no refund of input VAT.



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### Germany – Other Tax Features *(continued)*

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Captive insurance companies

The only German fiscal guidelines regarding captives were developed as case law from the 1930s and one specific circular issued in the 1970s. More guidance was provided on the CFC aspects of captives in a 2004 circular, but the status is still not fully clear. Companies only underwriting risks in the group are not allowed to set up technical reserves if the business is not carried out according to technical principles. In this case, premiums paid are not deductible for the policyholder. Captives may also be covered under German legislation concerning controlled foreign companies.



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### Germany – Life Insurance

#### 1 Definition

Definition of life insurance companies

#### Accounting

A company that carries on any kind of direct life insurance. The licence for life insurance does not include any related insurance classification, but the general (limited) permission to do supplemental business.

#### Taxation

No separate definition.

#### 2 Commercial accounts/ Tax and Regulatory returns

Basis for the company's commercial accounts

#### Accounting

GAAP and special accounting principles for insurance companies, both embodied in the Commercial Code (HGB).  
Specific regulations on technical reserves and on the valuation of investments must be observed.

#### Taxation

Taxation is based on the commercial accounts, as adjusted according to tax legislation and fiscal court decisions. In addition, special regulations regarding surplus payments to policyholders must be observed.

Regulatory returns

Separate detailed returns must be filed with the German regulator (*Bundesanstalt für Finanzdienstleistungsaufsicht* or BaFin).

N/A.

Tax returns

N/A.

Annual returns are to be submitted as required by tax law, based on the (adjusted) commercial accounts.



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### Germany – Life Insurance (continued)

#### **3 General approach to calculation of income**

Allocation of the total results between shareholders (dividend) and policyholders (premium refund)

#### **Accounting**

As a general principle, for profit participation life insurance at least 90% of an insurer's investment income must be allocated to a special reserve for premium refunds. In practice, this percentage is higher (on average between 95% and 98% of the insurance company's gross profits). These policyholder bonuses are expenses. For unit-linked life insurance, there is no reserve for premium refunds, rather, any fluctuations in the value of the funds in which the insurer has invested must be correspondingly reflected in the reserve for future claims.

#### **Taxation**

The reserve for premium refunds is deductible to a certain extent; as a basic rule, it is deductible as far as an insurer's overall annual profit is higher than the net investment income from its trading capital and other investments.



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### Germany – Life Insurance (continued)

#### 4 Calculation of investment return

Calculation of investment income and capital gains

#### Accounting

Total income approach.  
Interest and dividends must be included in the P&L account, with credit for taxes withheld.

#### Taxation

Capital gains realised on the disposal of fund units are generally taxable. Between 01.01.2002 and 31.12.2003 dividend income and capital gains from shareholdings were tax-exempt and corresponding losses were not deductible. Due to the transparency of fund investments, this also applied to shares held indirectly via an investment fund (i.e. the proportional part of any tax-free equity income gained by the fund was deductible and corresponding proportional losses from the fund's direct investments were not taken into account).

Effective 01.01.2004, all dividend income and capital gains from holdings in corporate companies are fully taxable for life insurance companies, whereas write-offs on holdings in corporate companies and losses on the disposal of those assets are tax-deductible.

The respective life insurance company could apply to use this rule, retrospectively, for all business years from 2001 onwards (deadline was 30.06.2004). However, such income, gains and losses can only be used at 80% (i.e. minimum 20% taxation for the years 2001 to 2003 inclusive).

The German Ministry of Finance (BMF) has indicated that the new rule will apply to both directly held investments and shares held indirectly via investment funds.



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### Germany – Life Insurance (continued)

5 Calculation of underwriting profits or total income	Accounting	Taxation
Actuarial reserves	<p>Actuarial reserves covering the company's obligations from the life policies must be established according to standard recognised actuarial methods (prospective method). If this is not possible, then figures from the last business year, with an interest mark-up, are to be used (retrospective method). When calculating the reserves, a maximum interest rate of 2.25% is to be used (2.75% between 01.01.2004 and 31.12.2006, 3.25% before 01.01.2004).</p>	<p>As actuarial reserves are interest-bearing, they are not to be discounted for tax purposes.</p>
Commission expenses	<p>Deductible. On-charge to policyholders possible (<i>Zillmerung</i> or 'zillmerisation').</p>	As per accounts.
Gains and losses on investments	<p>All realised gains and losses resulting from capital investments must be shown in the P&amp;L account. However, qualifying realised gains from real estate may be set up as an untaxed reserve for up to six years.</p>	<p>See calculation of investment income and capital gains above (Section 4).</p>



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### Germany – Life Insurance (continued)

<p>Assessment of investments</p>	<p>As a basic rule, investments are valued at acquisition costs, depreciated by any reduction in the market value. Long-term investments are valued at acquisition costs, which may be depreciated if any value decrease is likely to be temporary. If the value decrease is likely to be permanent, depreciation is mandatory.</p> <p>For capital investments made on behalf of holders of unit-linked policies, any fluctuations in the value of the funds must be reflected in the reserve for future claims.</p>	<p>Depreciation is restricted. The lower going concern market value may only be used, if the value reduction is likely to be permanent. Depreciation of shareholdings is deductible.</p> <p>As per accounts for capital investments made on behalf of holders of unit-linked policies.</p>
<p>Dividend income</p>	<p>To be included in the P&amp;L account, with credit for taxes withheld.</p>	<p>See calculation of investment income and capital gains above (Section 4).</p>
<p>Premium refunds to policyholders</p>	<p>As a general principle, for profit participation life insurance at least 90% of an insurer's investment income must be allocated to a special reserve for premium refunds (policyholder bonus). These policyholder bonuses are expenses.</p> <p>In principle, there are no premium refunds for unit-linked life insurance, as any income from the underlying funds is reinvested.</p>	<p>The reserve for premium refunds is deductible to a certain extent; as a basic rule, it is deductible as far as an insurer's overall annual profit is higher than the net investment income from its business assets.</p>
<p>Other special deductions</p>	<p>None.</p>	<p>N/A.</p>



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### Germany – Life Insurance (continued)

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**8 Reinsurance**

Reinsurance

**Accounting**

Premiums are deductible immediately.  
Reinsurance claims reduce reserves.

**Taxation**

As per accounts.

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**7 Mutual companies/Stock companies**

Mutual companies.

**Accounting**

Profit distributions to members (rare)  
are appropriations and not expenses.

**Taxation**

As per accounts.



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Foreign branch income

Taxation depends on the double-taxation treaty applicable: income is either fully taxable with credit for foreign tax or tax-exempt. According to the German tax authorities, a foreign insurance branch must be allocated income as if it were a fully operational insurance company. Therefore, the actual function of the branch is not taken into account. Capitalisation will generally be recognised if required by the host state's insurance regulations.

Domestic branch income

Calculated according to German tax rules (including transfer pricing rules). According to the German tax authorities, a domestic insurance branch must be capitalised and allocated income as if it were a fully operational insurance company. Therefore, the actual function of the branch is not taken into account.



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### Germany – Other Tax Features (continued)

Corporate tax rate

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Solidarity surcharge: 5.5% of corporate tax.

Trade tax: rate depends on the individual region in which the company is situated (average 18%). Trade tax is a deductible expense for corporate tax purposes.

The average effective tax rate is currently between 39% and 42%.

A reform of corporate taxation is expected in 2008, with a reduction of effective tax rates.

#### 9 Policyholder taxation

Deductibility of premiums

#### Taxation

For policies issued before 01.01.2005:

Subject to certain criteria, premiums into an endowment insurance or annuity insurance are tax-deductible up to specific amounts.

Unit-linked policies are excluded.

For policies taken out on or after 01.01.2005:

Only premiums into certain annuity insurance policies are tax-deductible up to EUR 20,000 p.a. in principle. Strict criteria apply. In 2005, only 60% of the maximum deductible amount applies, and increases by 2% annually until 2025, when the full EUR 20,000 can be used. Premiums into endowment insurance policies are not tax-deductible.



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### Germany – Other Tax Features (continued)

Profits generated

For policies taken out before 01.01.2005:

- Profits paid out as 'one-off' payments are taxable in principle.

The profits are tax-free if certain criteria are fulfilled;

- For regular annuity payments the deemed profit is taxable, which is calculated according to a statutory table;

For policies taken out on 01.01.2005 or after;

- Profits paid out as 'one-off' payments are fully taxable in principle.

Profits are only 50% taxable if certain criteria are fulfilled;

- For annuity insurance policies with tax-deductible premiums, the annuity payment is taxable in full in principle. A transition phase applies until 2040, during which the annuity payments are only partially taxable according to an increasing scale;

- For all other annuity payments the deemed profit is taxable, calculated according to a statutory table.

Certain policy amendments will affect the taxation of 'one-off' payments.

If the profits are not paid to the policyholder, these are subject to gift tax in principle on the side of the beneficiary. However, certain tax-free allowances apply, depending on the proximity of the beneficiary's relationship to the policyholder (e.g. spouse, child, grandchild, etc).

Moreover, under certain circumstances, the payment to a beneficiary will not be subject to inheritance tax if the beneficiary paid the premiums for the policy.

Proceeds during lifetime

As per profits generated (see above).



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### Germany – Other Tax Features *(continued)*

Proceeds on death

Not subject to income taxes, but depending on the circumstances, the death benefit may be subject to inheritance tax on the side of the beneficiary. However, the aforementioned tax-free allowances apply, depending on the proximity of the beneficiary's relationship to the policyholder (e.g. spouse, child, grandchild, etc.). Moreover, under certain circumstances, the payment to a beneficiary will not be subject to inheritance tax if the beneficiary paid the premiums for the policy.

#### **10 Other tax features**

Premium taxes

#### **Taxation**

No premium tax or sales tax.

Capital taxes

No (general) capital taxes for the policyholder or insurer. Insurer may be liable for real estate (property) tax on the sale or transfer of domestic property (deductible).



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