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Preface

KPMG LLP’s (KPMG) Film Financing and Television Programming: A Taxation Guide, now in its sixth edition, is a fundamental resource for film and television producers, attorneys, tax, 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. Its primary focus 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 media and entertainment Tax professionals.

KPMG published the first guide more than 15 years ago as a resource for global coverage of incentives and tax updates as they apply to the film and television industry. Subsequent editions expanded into coverage of financing techniques, credits/incentives, and a thorough appendix of withholding tax rates—a valuable reference tool for all finance and tax professionals.

Each chapter of the sixth edition 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. Additionally, the United States chapter focuses on both federal and state incentives, highlighting the states that offer the more popular and generous tax and financial incentives. 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 VAT tax rates; normal non-treaty withholding tax rates; and tax year-end information for companies and individuals.

Financing Structures
Descriptions of commonly used financing structures in film and television 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-effective 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.

Appendices
Additionally, withholding tax tables setting forth the non-treaty and treaty-based dividend, interest, and film royalty withholding tax rates for the countries surveyed are included as an appendix and can be used as a preliminary source for locating the applicable withholding rates between countries.

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

The sixth edition of KPMG’s Film and Television Tax Guide is available in an online PDF format at www.kpmg.com/filmtax and on CD. The guide is searchable by country.

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 book 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.

Finally, we would sincerely like to thank all of the KPMG International member firm Tax professionals from around the world who contributed their time and effort in compiling the information contained in this book and assisting with its publication. Production opportunities are not limited to the 35 countries contained in this guide. KPMG and the other KPMG International member firms are in the business of 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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January 2012
Introduction

The past years have been significantly influenced by a number of changes in tax rules. The 2008 Business Tax Reform Act was followed by the 2009 and 2010 Tax Act which altered the tax landscape.

With respect to the film production and film financing business, irrespective of the tax amendments in the past years, two issues are still very important for the film business: the “media decree” and the “tax deferral schemes” as provided for in § 15b German Income Tax Act (EStG).

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.

§ 15b EStG provides that losses arising out of “tax deferral schemes” may neither be used to offset income nor deducted pursuant to the general loss carry back and carryforward rules. Instead, pursuant to § 15b EStG, such losses can only be used to offset income of the taxpayer arising from the same source as such losses. Pursuant to § 15b EStG, the use of such losses is only restricted in cases where projected losses were expected to exceed 10% of invested capital (exemption amount). According to this legislation, if a scheme or structure gives rise to tax benefits in the form of losses, then it is a “tax deferral scheme.” This legislation was made especially to apply to media investment funds and has more or less eliminated the private investor market for film funds.

The central feature of the 2008 Business Tax Reform Act was the reduction of the tax burden for corporations to less than 30% (combined rate of corporation tax and trade tax). However, the 2008 Business Tax Reform Act made changes that also broadened the tax base, such as a limitation on the deductibility of interest, rental, lease, and license payments. This legislation therefore significantly changed financing structures that have been used in the past. The 2009 and 2010 Tax Acts clarified the provisions introduced in 2008, addressed the issue of evasion, and conformed German law to various EU developments.
### Key Tax Facts

<table>
<thead>
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<th>Tax Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Distributed/undistributed profits</td>
<td>15%* (for corporations) For partnerships: personal income tax rate of the partner</td>
</tr>
<tr>
<td>Branch profits of non-residents</td>
<td>15%* (if maintained by a corporation) Personal income tax rate (if maintained by an individual) or of the partner (if maintained by a partnership)</td>
</tr>
<tr>
<td>Trade tax</td>
<td>Between 7% and 17.15% depending on the municipality</td>
</tr>
<tr>
<td>VAT rates</td>
<td>7%, 19%</td>
</tr>
<tr>
<td>Normal non-treaty withholding tax rate: Dividends</td>
<td>25%*</td>
</tr>
<tr>
<td>Interest to residents/non residents</td>
<td>Generally 25%*/0%</td>
</tr>
<tr>
<td>Royalties</td>
<td>15%*</td>
</tr>
<tr>
<td>Tax year-end: Companies</td>
<td>December 31</td>
</tr>
<tr>
<td>Tax year-end: Individuals</td>
<td>December 31</td>
</tr>
<tr>
<td>Highest personal income tax rate</td>
<td>42/45%*, ** (with credit system for trade tax)</td>
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* Plus 5.5% solidarity surcharge on tax due  
** 45% for income above EUR 250,730

### 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 revenues generated in the respective countries or regions. However, a co-production does not necessarily involve sharing of revenues.
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 an independent 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 revenues 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 confer on the production company to 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 revenues 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 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, 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 from 2009 onwards are, if they constitute “business-related” dividends (e.g. upon application for individuals with a participation of more than 25% or participation held as business assets), subject to (i) the “part-income” rule (60% of the dividend income would be taxed) and to fully creditable and reimbursable withholding tax, 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” (FFG), 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, by the video industry and by broadcasting companies. In addition, the “Deutscher Filmförderfonds” (DFFF) funds German film productions.

**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.

**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%. 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. In contrast, 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 their 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 revenues, such a transaction can 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 of economic irrelevance.
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 connected parties, the German 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 unconnected 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% 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 is interposed in the legal structure and 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 are like 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 intra-group 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 the entering into of 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 (APAs). However, in practice, such procedures may take years until final agreements are reached.

**Expenditures**

**Amortization**

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 2 years. In practice, parties often choose a shorter useful life, and the issue is often resolved in a later tax audit.

Where 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, where the parties have entered into a modified commission production relationship where 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 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
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 5 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 carry forward.

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.

**Losses**

**General Rule**

Losses of the current year may only be carried back to the preceding year at a maximum amount of EUR 511,500. Losses that are neither offset in the year in which they occur nor carried back to the preceding year qualify for a loss carryforward. 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 tax law permits the losses arising in EU (European Union) or EEA (European Economic Area) 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. 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 daughter 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 triggers 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 change-in-ownership rules apply to transfers of shares on or after January 1, 2008. The same applies to trade tax losses and interest carry forwards 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 which 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

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of the harmful acquisition or the corporate body alters its line of business within a period of 5 years from the acquisition.

Different loss limitation rules existed in the past (§ 8 (4) KStG): no use could be made of existing loss carry forwards if a corporation's economic identity had changed. A change of economic identity was assumed if more than 50% of the shares in the corporation were transferred and the corporation recommenced or continued its trade or business with predominantly new assets. The old loss limitation provisions are last applicable where more than 50% of the shares in a corporation are transferred within a five-year period beginning prior to January 1, 2008 and predominantly new business assets are injected prior to January 1, 2013. There is thus a period during which the old and new rules overlap and apply cumulatively.

Dividends and Capital Gains

Corporation

Ninety five percent of the dividend income received by a corporation is tax-exempt, whereas 5% of the dividend income is treated as a non-deductible business expense. Costs actually incurred are deductible without limit. This rule applies to dividends which are paid by both domestic and foreign corporations.

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. Costs incurred in connection with the sale reduce the net amount of the capital gain and lower the base on which the 5% non-deductible 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%) 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 is levied at each stage of the production and distribution chain. In general, 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 intra-community 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 and self-employed individuals 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 and transfer of rights, which arise from the copyright law.

Certain goods and services are exempt from VAT if corresponding formal documentation is provided. The most common examples are intra-EC deliveries of goods and exports of goods to a non-EU destination and services related to these deliveries.

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 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 the case of cross-border transactions, further reporting obligations may apply for taxpayers.

Micro businesses that fulfill certain criteria are not liable for VAT in Germany pursuant to the so-called “Kleinunternehmerregelung”, but these provisions are generally only applicable to businesses established in Germany.

For certain services or supplies which are carried out by a non-resident VAT entrepreneur and 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 apply).

**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 on the following products: mineral oil, coal, natural gas, gasoline and certain bio-fuels, 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. Therefore, 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. As from 2010 onwards the zero-bracket amount is EUR 8,004. For married taxpayers the zero-bracket amount is doubled. The tax rate increases with the income amount from 14% to 42% (marginal tax rate). The rate of 42% is applied starting with an income of EUR 52,882 (EUR 105,763 in case of joint assessment). The highest personal income tax rate is 45% for income of EUR 250,730 or more (resp. EUR 501,462 in case of joint assessment).

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 non-residents 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 adviser, are in general not integrated into the company/body they are working for and, therefore, generally self-employed. Actors, directors, cameramen, assistant directors and other staff are normally integrated into the production organism and 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 which 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 is in a later year) or a later period (e.g., if a foreign licensee pays a down payment under deduction of withholding tax which 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.
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