

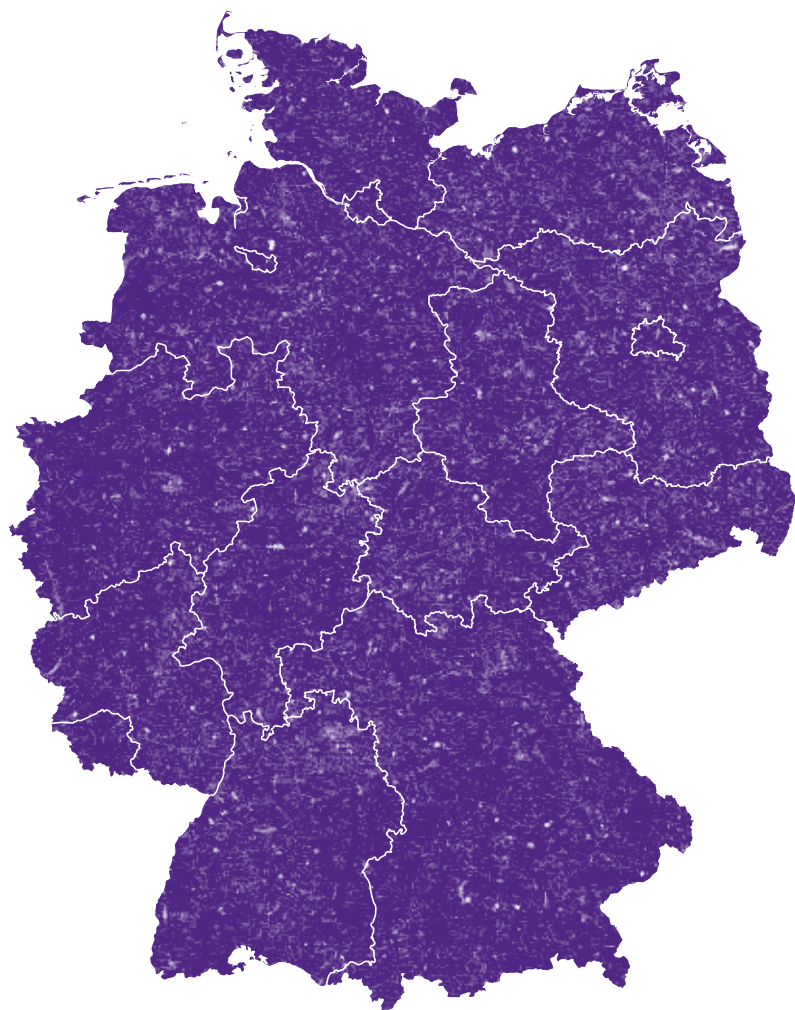


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Doing business in Germany

If you are planning on [doing business in Germany](#) knowledge of the investment environment and information on the legal, accounting and taxation framework are essential to keep you on the right track...



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Foreword

Germany is the fourth largest economy in the world after the USA, China and Japan. For years the country has enjoyed a premier standing among the leading export nations of the world and the third largest exporter in 2014. In 2016, several renowned studies identified Germany as the most attractive investment location in the EU – as for example in the latest American Chamber of Commerce opinion survey conducted among US companies. Despite the Euro crisis and uncertainties in international markets, Germany continues to earn strong trust and high confidence as a location for doing business. International rankings especially cite the quality of Germany's infrastructure and the excellence of its research and development landscape when explaining the appeal of the Federal Republic in international competition.

Foreign companies wishing to gain a successful foothold in Germany should plan their commitment carefully. Whether it be labour law, finance, taxes, financial statements or founding an enterprise – the following pages will provide you with the most important rules and regulations that you should observe as a foreign investor when entering the German market.

This guide has been prepared to provide businesses with an overview of Germany dealing with some of the factors that may affect the decision to do business in the country. However, the information contained in this document is generic in nature and should not be acted or relied on without obtaining specific professional advice. This guide includes legislation in force as of January 2017.



Country profile

Summary

Germany is a relatively large and highly developed country in the heart of Europe. Many factors make investing in Germany worthwhile. Stability of the political and legal system, influenced by the country's membership in the European Communities and the Euro-zone, good infrastructure, well trained staff, and a good standard of living are only some of the aspects worth mentioning.

Geography and population

Germany is a densely populated country in central Europe. It borders Denmark, the Netherlands, Belgium, Luxemburg, France, Switzerland, Austria, the Czech Republic and Poland. Approximately 82.8 million inhabitants live in an area of around 360,000 square kilometres. In 2016 the increase of population was about 0.8%. About 8.6 million inhabitants were not German citizens, most of them from Turkey, former Yugoslavia, Italy, Greece and Poland and Russia as well as from other European countries.

Political and legal system

Germany is a democratic, federal, multiparty republic with representatives chosen directly by the people. The federal system means that the federal government (Bund) shares power with sixteen states (Bundesländer).

The dual executive is made up of the Chancellor, who is head of government and the President, who is head of state. The President's function is merely representative, despite being head of state. He is elected for a five-year term. The Chancellor is elected by the Lower house for a four year period and may also be re-elected. In 2005, Angela Merkel, the first woman Chancellor of Germany was elected and re-elected in 2009 and 2013.

The parliament is divided into an Upper House (Bundesrat) and a Lower House (Bundestag). The Lower House is elected by popular mandate. The Upper house consists of members of the sixteen state governments that are not directly elected by the people of the country, but appointed by the state governments. The Upper House is empowered to initiate new legislation, to veto new legislation passed by the Lower House and in certain cases must approve such legislation.

Germany has an independent judiciary using a "civil law" system that goes back to Roman law and partly to other legal sources from German regions. The origins of Germany's legal system have been shaped by constitutional law but are also influenced by the law of the European Communities and

international law. German law is a predominantly statute law. Statutes apply to virtually all aspects of life. The statutes are passed by the federal legislative as well as by that of the states. The states are responsible for matters such as the police, local government and education.

Germany's courts are largely specialised and provide comprehensive legal protection. Alongside the constitutional jurisdiction with the Federal Constitutional Court as the highest court there are five mayor jurisdictions. The "ordinary jurisdiction" forms the largest part and includes the civil and criminal jurisdiction. The other categories are administrative, employment, social and fiscal jurisdiction.

Language

German is the business language in Germany. Traditional regional languages are not relevant in terms of business communication. Some international companies in the economic centres also deal completely or partly in English or, rarely, in other languages.

German dates are written DDMMYY, the number 1,000,000 is a German "Million". The American billion, the number 1,000,000,000 is a German "Milliarde". German digits of thousands are separated by a dot, not a comma.

Currency

Since 2001 Germany has been using the EURO as its official currency.

Business hours/time zone

The working week of about 40 hours begins daily between 7 and 9 am.

In 2006, former federal restrictions on opening hours for retail outlets were repealed. The regulation of shop closing hours is now up to the states (Bundesländer). Therefore, the opening hours vary from state to state. Most states now allow five to six days shop opening for 24 hours plus additional exceptions for Sunday shopping. However, this is generally speaking not fully taken advantage of by the shop owners. Extended opening hours are implemented mostly in retail centres or by certain supermarkets.

German standard time is + 1 hour GMT. Like in other countries, German standard time is set forward for one hour during the summer (so-called summertime).

Public holidays

There are nine public holidays per year and up to an additional three extra days in certain regions.

Economy

The major sector of the economy is services (68.9%) followed by industry (25.7%), construction (4.8%) and agriculture (0.6%).

Important business centres are Frankfurt, Hamburg, Munich and the conurbations of the Rhine/Ruhr area (Essen/Cologne/Düsseldorf). Since German reunification in 1990, there have been substantial infrastructure improvements in the Eastern German areas, attracting high levels of government funding.

With the expansion of the European Economic Area to include Central and Eastern European States the proximity to these States has placed Germany in a prime position to profit from new trading partnerships with the expanded European Community.

In 2016 the Gross National Income was € 3,133.9 billion.

Economic growth

After the global financial crisis in 2008 German economy shrank in 2009 by 5.6%; since then it is growing steadily with an average of 1.4% per annum during the last ten years. In 2016 growth has improved to 1.9%.

Employment levels

In 2016, unemployment was on the level of 3.9 %. The unemployment level is generally higher in the new states in Eastern Germany than in Western German areas.

Living standards

Germans enjoy a comparatively high standard of living with good wages and a high proportion of middle class earners. Levels of tax and social security payments are comparatively high within Western Europe.

The average life expectancy is 78.2 years for men and 83.1 years for women for individuals born between 2013 and 2015.

Cost of living

Lately, costs of living have increased, especially for food, rent, energy and fuel. Inflation in 2016 was 0.5% compared to the previous year.

Regulatory Environment

Summary

As Germany is a highly developed country and a member of the European Communities a detailed legal framework for business exists. Thus, doing business in Germany entails observing and complying with a relatively complex regulatory environment. Apart from lawyers and consultancy firms, legal and other advice can be obtained from the State Ministries of Economics or regional Chambers of Commerce.

Restrictions on foreign ownership

There is no foreign ownership restriction in Germany regarding property or land. The telecommunication/media section is also not restricted.

Government approvals and registration

Any new trade or business operation must be reported to the local Office of Business and Standards (Gewerbe-/Ordnungsamt), which will issue a certificate of registration (so-called Gewerbeschein) and simultaneously inform the tax authorities. Government permission is required for special types of business.

The local authority and the Chamber of Commerce must be notified of the business and trade. The local tax office must be notified for the taxation of business and employees. The Health insurance office must be notified regarding social security contributions related to employees.

The membership of an occupational collective society (Berufsgenossenschaft) may be required. These bodies are responsible for obligatory personal accident insurance/worker's compensation.

Firm names

The name of the company must be suitable to identify the company and distinguish it from other companies and must not include details that may be misleading concerning the business. German law is rather strict regarding the usage of terms that imply a certain regional standing, size or type of company or business. Examples are certain geographical terms ("German", "European"), words that describe the market place, such as "factory", "wholesale", "centre", or terms that imply that a company consists of separate legal entities, such as "association", "pool". Furthermore, the legal form of company must be clearly indicated in its name. It may be useful and time saving to check the planned company name with the Chamber of Industry and Commerce in advance.

Business letters

Business letters, such as invoices, receipts, list of prices, faxes and emails of companies must conform to certain standards. Internal communication and advertisements directed to an indefinite group of people for example, are not regarded as business letters. All business letters and order forms which are directed to a specified addressee must generally contain:

- the legal form (commonly known abbreviations are allowed)
- the registered office of the company
- the local court at which the office of the company is registered
- the number under which the company has been entered into the Commercial Register and
- if the company is a:

GmbH:

The family name and at least one fully written first name of every Managing Director and

of the Chairman of the Supervisory Board, if the company has formed a Supervisory Board with a chairman.

AG:

The surname and at least one fully written first name of every member of the Board of Management and of the Chairman of the Supervisory Board. The Chairman of the Board of Management must be named explicitly.

GmbH & Co KG:

In addition to the company name of the GmbH & Co. KG, the company name of the GmbH as general partner as well as the information for the GmbH mentioned above.

Unless foreign law has additional requirements, all business letters and order forms used by a German branch of a Limited Liability Company or of a Public Limited Company domiciled in a foreign country must contain details of the Commercial Register in which the branch has been registered, the number under which the branch has been registered and the name, the legal form and the registered office of the foreign company.

As these rules represent administrative regulations, the court of register may impose fines on the Managing Directors (each fine up to € 5,000), if the business letters do not disclose the required information in the correct form.

Competition rules

Restrictive trade practices legislation

Apart from the European competition regime that applies to German companies, national law provides for the prohibition of:

- certain enumerated horizontal agreements and concerted practices between undertakings (with specific exemptions)
- vertical price or condition agreements (with a specific exception for items of publication and licensing agreements)
- abuse of dominant position
- discrimination
- boycott
- recommendations (with a specific exception for non-binding price recommendations for branded products)

Merger control

Basically, companies are free to merge. Apart from the European Merger Regulation that is applicable to mergers of significance within the Community, national legislation exists for internal mergers and acquisitions, which must be notified to the German Cartel Office before their execution. If they lead to or increase market dominance, they can be prohibited by the Cartel Office. Special procedural rules apply.

Fair trading legislation

Detailed and strict rules on fair trading, consumer credit and general terms of trade exist. Specific sections of industry and banking are regulated by special legislation and self-regulatory codes.

Consumer protection

Basically, consumers are protected in two ways: on the one hand companies producing goods or

offering services that affect consumers are controlled (pharmaceutical and food industry, insurances, banks) by the state/public law, on the other hand (partially) obligatory civil law regulates contracts with consumers. The public law side of consumer protection usually operates with permissions and/or authorisations that are required for certain business activities or products. Civil consumer protection legislation is mostly regulated in the Civil Code (Bürgerliches Gesetzbuch). Detailed provisions exist for what may be regulated in pre-formulated terms and conditions. The standard is stricter, if a consumer is recipient of these contract terms.

Furthermore, for various reasons a (time limited) right to withdraw from the contract is granted to consumers, for example if the contract was made using direct selling (e.g. at the home of the consumer) or distance selling (e.g. electronic communication methods via internet or mail order business). A consumer's right to withdraw from a contract also exists for consumer financing agreements. Apart from the right to withdraw, consumer contracts are strictly regulated in the Civil Code, i.e. the content of consumer financing contracts.

Companies that sell via the internet have to comply with certain regulations. Another aspect of consumer protection may be seen in the detailed regulation of warranties for products and of general product liability.

Import and export controls

German import and export control is mostly governed by European Law, which regulates the import and export of goods in and out of the Common Market. Only the few aspects of import and export control not regulated by EU law are subject to German legislation, and only under the condition that this does not contravene European law. However, the control mechanisms are based at national public authorities (e.g. Bundesamt für Wirtschaft und Ausfuhrkontrolle). Import and export is controlled in different ways (see below import restrictions). Within the European Community and the EFTA there is generally free trade.

Price controls

In general, there are no controls over prices or income. In July 2014, the German parliament approved the country's first national minimum wage of € 8.50 per hour. The law entered into force on 1 January 2015. The minimum wage has been raised to € 8.84 as of January 1, 2017.

Use of land

Most of the land in Germany is divided into separate real estates which are registered in the Land Register (Grundbuch). The Land Register is maintained by the local courts (Amtsgerichte). Each real estate is registered in a separate file, disclosing the ownership, liens on real property and other encumbrances. The Land Register is very important, as any transfer of property or the granting of rights/ encumbrances in relation to the property of land requires registration. The Land Register enjoys so called "public record status", meaning that, generally speaking, the content is regarded as representing the true situation as regards the piece of land (although certain methods of correction exist if the content of the Land Register is in fact incorrect).

Exchange control

Some information for government statistics must be provided regularly when a company is under foreign ownership or does business with foreign companies. Notification of transactions in EURO that exceed certain limits must also be made by natural persons. Pursuant the German Money Laundering Law (so called Geldwäschegesetz) banks, lawyers, auditors, financial institutions, casinos, trustees, any retail or wholesale business and other parties have in addition to other obligations the obligation to identify the contracting party regardless of whether the party is a foreigner.

Finance

Summary

Germany has a traditionally bank-based system of financing. However, over the last decade, the importance of bank loans has declined, being increasingly substituted by alternative financing sources.

Available sources of external financing in Germany are among others:

- Bank loans and loans from other creditors
- Public issuance of shares and bonds via capital markets
- Private Equity
- Germany-specific funding sources like Schuldscheindarlehen, Genussscheine and funds provided under the KfW development programmes

The German financing market has traditionally been bank-based. The presence of the so-called “house bank principle” – a strong and long-term business relationship between an enterprise and one specific bank – as well as the favoured treatment of debt capital with regard to tax and insolvency laws, made it relatively more attractive for German enterprises to be financed by bank loans than via capital markets.

However, the way in which enterprises in Germany finance themselves underwent considerable changes over the last years. Among the various financing instruments, bank loans are still the most important source of external funding in Germany. But the importance of bank loans in the German financing market has declined, being substituted partly by the growing share of loans from other creditors, including insurers, other financial institutions and other enterprises. Overall, tightening credit standards in the financial crisis and rising regulatory requirements under the Basel Agreement have induced enterprises to turn to alternative forms of financing.

While – by international standards – financing through capital markets via issuance of shares or bonds generally continues to be a funding method of relatively less importance in Germany, issuance of corporate bonds has recently attracted increased attention among non-public medium-sized German companies.

Other Germany-specific forms of funding are, for instance, Schuldscheindarlehen (bonded loans), Genussscheine (participation certificates) and – in particular – loans granted by German development banks like the KfW-Mittelstandsbank.

Although more than 1,250 – mostly small and medium-sized – German enterprises are financed by private equity capital, the share of private equity investments out of the total amount of financing in Germany stays relatively small in size.

The following provides a brief overview of main sources of external financing in Germany:

Banking System

The structure of the German banking system is generally characterised by three different types of credit institutions: credit banks, savings banks and cooperative banks. While credit banks and cooperative banks are organised under private law, savings banks have a legal structure under public law. All three banks are universal banks and are highly competitive among themselves as well as within their category.

Typical of the German finance and banking system is the still existing house bank principle which is of high importance for the development especially of small and medium-sized companies. House

banks do not only act as creditors but also as central agents for subsidies that are granted by German development banks, e.g. the KfW-Mittelstandsbank.

Banks are still the main lenders within the German credit market. However, over the last decade, they have increasingly been substituted in favour of other creditors, including affiliated enterprises. This may partly be due to growing economic integration and the associated internationalisation of corporations. However, it is probably also related to bank supply-side factors which, in the form of stricter credit standards during recent economic downturns and rising regulatory requirements helped enhance the relevance of alternative sources of funding. The global regulatory initiative, Basel III, which was developed in response to the deficiencies in financial regulation revealed by the latest financial crisis, was widely assumed to increase the costs of bank lending, at the same time fuel demand for alternative forms of financing. Due to the current low-interest phase the impact on the financing costs has not been dramatic so far.

Banks provide financing arrangements, particularly, but not limited to the following:

Overdraft – intended to finance working capital. The borrower can operate his current account in debit up to an agreed limit. Overdrafts are formally repayable on demand, although in practice they are agreed for a period of up to twelve months with a mutual option for subsequent renewal.

Term Loans – for a period of several years. The repayment terms are negotiated and the rate of interest may be fixed or variable. Banks will normally require security either in the form of a guarantee by the proprietors or a charge over the assets of the business or the proprietors.

Mortgages – are available with certain property and buildings being held as security for the loan. Mortgages are normally cheaper than normal loans due to the effective security supplied to the loan institution.

Loans from the KfW-Mittelstandsbank – a German government-owned development bank for small and medium enterprises – still play a crucial role in the financing mix of German start-up businesses as well as of many established small and medium-sized companies. The KfW-Mittelstandsbank also provides equity and mezzanine financing. In 2016 the KfW Mittelstandsbank has granted financial support to small and medium sized enterprises amounting to € 21.4 billion.

The following is a list of the main programmes promoted by the KfW-Mittelstandsbank:

- ERP Start-Up Loan – Startgeld (ERP Gründerkredit – Startgeld)
- ERP Start-Up Loan – Universal (ERP Gründerkredit – Universell)
- ERP Capital for Start-Ups (ERP-Kapital für Gründung)
- KfW Entrepreneur Loan – Debt Capital (Unternehmerkredit Fremdkapital)
- ERP Regional Promotion Programme (ERP-Regionalförderprogramm)
- ERP Participation Programme (ERP-Beteiligungsprogramm)
- ERP Innovation Programme (ERP-Innovationsprogramm)

Further information on these and other development programmes offered by the KfW-Mittelstandsbank is provided on www.kfw.de.

Capital Markets

Compared to other developed countries and also by European standards, market-based external financing (issuance of shares, corporate bonds) continues to play a minor role in Germany. In recent years, however, issuance of corporate bonds has gained increased popularity within non-public medium-sized companies, enabling them to reduce dependence from bank credits and to establish a more diversified financing structure.

Raising finance through the Stock Exchange is suitable for established companies and will usually require the support of a merchant bank and the publication of detailed information in support of the proposed issue. Consequently, the costs of such an issue can be considerable.

Share purchases that result in the holding of certain amounts of shares or - if the company is listed on the stock exchange - of voting rights, must be notified to the company. In case of attainment of voting rights in a company listed on the stock exchange in a member state of the European Union or in another country of the European Economic Area, notification to the Federal Supervisory Office may also be necessary.

Schuldscheindarlehen (Bonded Loans)

A Germany-specific form of debt is the Schuldscheindarlehen (usually translated as “bonded loan” or “certificate of indebtedness”). Being originally a funding source of the public sector, a considerable number of private companies has recently discovered the Schuldscheindarlehen as an alternative to classic financing instruments like bank loans or bonds.

Schuldscheindarlehen are bilateral loans with maturities ranging from usually 2 to 10 years, privately placed, unlisted, unregistered, usually governed by German law and embedded in the legal framework of the German civil code. They are offered mainly by insurance companies and pension funds with banks operating as intermediary.

Schuldscheindarlehen contribute to a diversified financing structure and help reducing the companies’ dependence from bank loans. At the same time they are often less expensive than issuances of bonds due to lower issuance and administrative costs. Moreover, a credit rating is not required. Another advantage of Schuldscheindarlehen over corporate bonds is that – thanks to pooling programmes of the intermediary banks – they are usually available in very small quantities from about EUR 500k onwards.

Private Equity

Private equity is equity capital not quoted on a public exchange. Private equity consists of investors and funds that make investments directly into private – mainly small and medium-sized – enterprises or conduct buyouts of public companies that result in a delisting of public equity. The majority of private equity is provided by institutional investors and accredited investors who can commit large sums of money for long periods of time. However, compared to the relevance of the Anglo-Saxon private equity market, private equity stays a minor source of external financing in Germany.

The most common types of private equity investments are:

Buyout – Purchase of a company’s shares in which the acquiring party gains controlling interest of the targeted firm. Most common form is the leveraged buyout (LBO) where a significant percentage of the purchase price is financed through borrowed money.

Mezzanine Capital – Hybrid product that contains characteristics of both debt and equity. Mezzanine financings can be structured either as a subordinated note (debt mezzanine) or as preferred stock (equity mezzanine). It is positioned between senior bank debt and equity in the capital structure of a company and is usually a more expensive source of financing than senior debt. It is often used by smaller companies that are unable to access the bond market. An example of Mezzanine Capital is the below-described Genussschein.

Venture Capital – Equity investments in early-stage companies, usually associated with high earnings potential but high risk.

Growth Capital – Equity investments in mature companies

Further information on private equity funding in Germany is provided, for example, by the Bundesverband deutscher Kapitalbeteiligungsgesellschaften (BVK), the association of private equity and venture capital companies operating in Germany.

Genussscheine (Participation Certificates)

Another typically German type of investment are Genussscheine (participation certificates) that guarantee a share in the profit generated by the issuer, but do not come with voting rights. The profit entitlement is securitised by means of a certificate.

Genussscheine cannot explicitly be classified as debt or equity. As they are a subordinated type of investment, usually serviced after other third-party creditors in case of bankruptcy, Genussscheine exhibit features of equity. On the other hand, they are debt-like in that they are typically structured like a corporate bond with periodic payments and repayment of the invested money at some maturity date. For participation certificates, no general standards apply, neither stipulated by law nor by the rules of the stock exchanges themselves. Each feature can be adapted to the individual financing needs of the issuer. Participation certificates are negotiable, but are not considered as shares.

Over the last few years Genussscheine have enjoyed increasing popularity as a financing source, in particular to companies that are not publically quoted but are willing to generate funds via the stock exchange.

Imports

Import restrictions

The restriction or the prohibition of import of certain goods may be due to economical or non-economic reasons. The basis for such restrictions are regulations of the United Nations or the European Communities as well as national legislation regarding foreign trade (Außenwirtschaftsgesetz) or other special national legislation (e.g. regarding the import of food, pharmaceuticals, weapons, or rare animals).

UN or EU-Resolutions may impose (total/partial) embargos on certain countries, meaning that no transactions may be made with this country. Total restrictions also exist for some dangerous goods (e.g. infected animals). In addition, the import of certain goods may be restricted in quantity. If a restriction in quantity is applicable, an application for import permission may be made at the Bundesausfuhramt.

Which goods or respectively goods from which countries are restricted may be traced from publication in the Federal Gazette (Bundesanzeiger). Further information may be obtained from the Bundesausfuhramt.

Customs duties

Germany is a member of the EU, and thus participates in the common customs system of the EU. No customs duty is levied on goods imported from within the EU. For intra community acquisitions of goods, Value Added Tax (VAT) is to be accounted for by the purchaser. Customs duty and import VAT is levied on most goods imported from outside the EU. Most German businesses can reclaim import VAT, but they cannot reclaim import customs duty.

Summary

- Import restrictions may apply in specific circumstances
- Germany participates in the common customs system of the EU
- Customs duties are not levied between EU member states
- Import VAT is charged on goods imported from outside the EU

Business entities

Summary

In practice, foreign investors in Germany generally speaking operate through a subsidiary or a branch. While branches are no separate legal entity, subsidiaries are German companies of any legal form with all rights and obligations applicable to the legal form chosen. German companies may be divided into corporations and partnerships.

A corporation commences to exist when the Articles of Association are drawn up in notarial form. It legally exists with its registration in the German Commercial Register. The law regarding corporations is rather strict and formal. A partnership starts to exist if two or more persons, legal entities or corporations enter into a business relationship with a common business purpose. The structure of a partnership is often less complicated and more flexible than of a corporation and its incorporation less formal. As opposed to corporations the partnership itself is not a legal entity but partly dealt with as if it was.

Business entities

The different types of enterprises are:

1. Aktiengesellschaft – AG / Public limited company
2. Gesellschaft mit beschränkter Haftung – GmbH / Limited liability company
3. Kommanditgesellschaft auf Aktien – KGaA / Partnership partly limited by shares
4. Gesellschaft bürgerlichen Rechts – GbR / Civil law partnership
5. Offene Handelsgesellschaft – OHG / General trading partnership
6. Kommanditgesellschaft – KG / Limited partnership
7. Partnerschaftsgesellschaft – PartG / Partnership association
8. GmbH & Co KG – GmbH & Co KG / Limited partnership with a limited liability company as a general partner
9. Societas Europaea – SE / European company
10. Niederlassung / Branch
11. Einzelunternehmen / Sole trader
12. Stille Gesellschaft / Silent partnership

Corporations/Stock Companies

Limited liability companies (GmbH)

A GmbH is a private limited company, governed by the German Limited Liability Companies Act (GmbHG) and its respective Articles of Association. The GmbH is more flexible and less formal than the AG. Since the shareholders of a GmbH can control and instruct the management directly (which the shareholders of an AG cannot), foreign investors generally prefer to establish a subsidiary or joint venture in the form of a GmbH. Because of the limited liability of the GmbH, this type of company is a risk for its creditors. For this reason banks usually demand personal credit assurances of shareholders (e.g. guarantee) or other securities for credits.

Establishing a Limited liability company

The Articles of Association must first be signed by the shareholders and notarised by a public notary. Then, they must be filed electronically with the Commercial Register and made available for public inspection.

The law concerning the Limited Liability Company has been revised and modernized (Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Mißbräuchen, so-called MoMiG). The changes took effect on November 2008. The MoMiG simplifies the regulations for the foundation of a GmbH. It offers the possibility to found a GmbH by using a pre-formulated “foundation set” made up of model Articles of Association, registration with the Commercial Register, first shareholders’ meeting and a list of shareholders. If this option was used the notary public would only be consulted for the attestation of signatures of the shareholders. This would mean that all necessary steps up to registration could be taken without legal support. However, these simplifications may only be taken advantage of if certain restrictions as regards the foundation and the content of the Articles of Association are followed. This option therefore is only of interest to some (not complex) foundations. If this option is not chosen the current procedure will remain basically unmodified.

The Articles of Association must include provisions with respect to the name, registered office and object of the company, the amount of share capital and the portion thereof subscribed by each shareholder.

Application for registration is made by filing the Articles of Incorporation and certain other documents with the local Commercial Register (Handelsregister). In practice, this will be the work of the public notary in charge (unless the option of foundation by using the “foundation set” according to MoMiG is taken). As a general rule, the documents may only be filed electronically.

The Commercial Register records the name, registered office, business address, share capital, object of the company, date of the conclusion of the Articles of Association, and its legal representatives etc. and will publish the contents of the registration. The registered office cannot be located outside Germany.

Incorporation and registration lead to notary fees and Commercial Register fees of about € 1,000, depending on the size of the company and other circumstances (e.g. necessity of translation).

The usage of the “foundation set” according to the MoMiG leads to a reduction of these costs, at least if legal advice is not taken.

So far, duration of formation was to be expected to take generally from a few days up to twelve weeks, depending on circumstances and region. The registration with the Commercial Register does not depend on the issuance of state permits that then may be filed subsequently. However, if this subsequent filing of state permits does not happen within certain time limits the entry of the company may be cancelled.

Pre-incorporation trading is permitted. Since the GmbH only comes into existence with the registration in the Commercial Register, the managing directors and other persons acting on behalf of the company are personally liable without limitation for any liabilities incurred before registration.

Capital stock and shareholders

The minimum share capital is:

Authorised € 25,000

Paid up 25% of each capital contribution, however at least € 12,500 and/or 100% of the contributions in kind, special rules apply to single shareholder companies.

The minimum share capital may upon foundation and under certain circumstances be reduced to € 1. If the share capital of a GmbH is reduced to anything between € 1 and € 24,999, the company name must include the indication “Unternehmergeellschaft” (entrepreneurs company) or as an abbreviation thereof “UG”. This company would then still represent a GmbH regardless of the reduced minimum share capital. However, this particular type of GmbH will be restricted as regards the distribution of its profits. The model of the “Unternehmergeellschaft” requires the subsequent saving up of the minimum share capital up until the amount of € 25,000 is reached. The saved

profits have to be appropriated to legal reserves. Later on, these reserves may be allocated to the share capital. Once the minimum share capital of € 25,000 of a GmbH is reached, the indication “Unternehmergeellschaft” may be deleted.

In general, stricter requirements exist for contributions in kind than for cash contributions. Contributions in kind must be stated in the Articles of Association. The value of such contributions in a GmbH must be proven by the shareholders by production of documentary evidence. Proof of value of the contribution in kind is a prerequisite for registration in the Commercial Register.

The shares in a GmbH may be held by one or more persons. In a GmbH the minimum nominal value of each share is € 1. It is permissible to issue shares at a price exceeding this minimum value.

Company Name

Apart from the general regulations concerning the firm name (see above), the name of a GmbH must always include the legal form of the company, i.e. “Gesellschaft mit beschränkter Haftung”, or a commonly known abbreviation thereof (e.g. GmbH). The company must indicate its status as “Unternehmergeellschaft” (see above). The name does not need to be in German.

Management and officers

Representation

In a GmbH, the Board of Directors is elected by and responsible to the shareholders. A GmbH can choose to have one or more director(s). A Managing Director can only be a natural person with full legal powers. Persons convicted of criminal bankruptcy offences are not eligible for the position for five years from the date of their conviction. Persons banned from certain professions or trades are not eligible for a directorship with a GmbH, dealing with this kind of profession or trade. Managing Directors need not be Germans nor even be resident in Germany, but they must be able to enter the country legally at any time without further restrictions. For tax purposes, a Managing Director located in a country other than Germany could lead to a dual residency of the company and negative tax consequences. If several Managing Directors are appointed, they represent the GmbH jointly. The shareholders may pass a resolution granting each Managing Director or one of several Managing Directors the right

- to represent the company alone
- to represent the company jointly
- with one or several Managing Directors
- to represent the company jointly with one or several holders of a so-called Prokura (full commercial power of attorney)

The Managing Directors are appointed by the shareholders in the Articles of Incorporation (or in a separate resolution) before the registration of the GmbH, as the Managing Directors have to perform certain formalities: They must confirm the receipt of the required share capital contributions from the shareholders, file the application for registration, and deposit their signature at the Commercial Register.

Responsibilities and Liability of a Managing Director of a GmbH

As regards the internal relationship between the Managing Director and the GmbH, the rights of the Managing Director can be restricted in the Articles of Association. Such a restriction is not valid in respect to third parties.

Specific responsibilities of a Managing Director are for instance, but not limited to, proper bookkeeping and the preparation of

- the annual financial statements
- preservation of company assets which are needed for the maintenance of the share capital

- effecting the required notifications to the commercial register
- notifying the shareholders in case the company has a loss which exhausts more than 50% of the share capital
- filing of an application for insolvency without undue delay (3 weeks maximum) in case of the company being unable to meet its debts or over-indebtedness of the company

The Managing Director may be personally liable because of personal negligence or a violation of law.

Supervisory Board

A Supervisory Board with employee representation is only required by law for companies with more than 500 employees. However, the shareholders are free to implement an optional Supervisory Board and transfer some of their rights/duties to it.

Dissolution

A GmbH may be dissolved for various reasons that are regulated by statute and/or in the Articles of Association. Statutory reasons for dissolution are, for instance, a shareholders' resolution, a court or other official decision, the expiry of the period for which the company was set up and insolvency. The dissolution must be registered with the Commercial Register. Following this registration, the company does not cease to exist, but remains in force as a GmbH under liquidation. Liquidation is managed by liquidators, usually the former Managing Directors of the company. Liquidation procedures are mainly enshrined in law. After the conclusion of the liquidation any remaining assets may be distributed to the shareholders but not before one year after the public notice to creditors of the liquidation was made. Following this, the company is removed from the Commercial Register.

Short Facts GmbH

- Private limited company
- Minimum share capital € 25,000.00
- May hold rights and bear obligations
- Formalized incorporation
- Moderate flexibility as regards its constitution
- Liability with corporate capital and assets
- Generally no personal liability of its shareholders
- Transfer of shares requires notarial form

Public Limited Company (AG)

Establishing a Public Limited Company

The formation of a Public Limited Company (AG) requires one or more individuals or corporate bodies as founders. There are no restrictions on nationality or country of residence of the founding members. Formation begins when the member(s) have the Articles of Incorporation and Articles of Association notarised by a public notary.

The Articles of Incorporation must include

- names of the founding members
- concerning nominal value shares the nominal value and value of the shares and concerning individual shares the amount of individual shares issued to each founding member
- paid up amount of the share capital

By statute, the Articles of Association have to include

- name of the company and its registered office (which must be in Germany)
- the object of the company

- amount of the share capital
- composition of the share capital including nominal value of the nominal value shares and number of individual shares
- statement as to whether the shares are bearer shares or registered shares
- number of members of the board of management
- regulations as to the form in which official notices of the company are to be made

In addition to statutory requirements, the Articles of Association may contain other provisions as deemed necessary (provided these do not conflict with the German Public Corporation Act). Following the signing, application for registration is made by filing the Articles of Incorporation and certain other documents with the local Commercial Register (Handelsregister). In practice this will be the work of the public notary in charge.

The notary will determine which documents are required, especially if the company should request a government permit. The Commercial Register records the name, registered office, business address, share capital, object of the company, date of the determination of the Articles of Association, and its legal representatives etc. and will publish the contents of the registration.

Incorporation and registration lead to various costs, e.g. notary fees, legal fees and commercial register fees, translation costs etc.

The formation of the company will generally take two to twelve weeks, depending on circumstances.

Pre-incorporation trading is permitted. Managing Directors and other persons acting on behalf of the company and founders who agree to pre-incorporation trading are personally liable without limitation for any liabilities incurred.

Company Name

Please see the general explanations as to the company name above. The name must include the word "Aktiengesellschaft" or an abbreviation thereof (e.g. AG).

Capital stock and shareholders

The minimum share capital is:

Authorised € 50,000

Paid up 25% in cash and/or 100% in kind of the nominal value of each share plus all of any share premium.

In general, there are stricter requirements for contributions in kind than for cash contributions. Contributions in kind must be stated in the Articles of Association. The value of such contributions in kind is subject to a special audit. Proof of value of the contribution in kind is a prerequisite for registration in the Commercial Register. In September 2009 the law was amended so that under certain conditions specified in the law the special audit may exceptionally be omitted. In these cases the proof of value is provided by other documents (e.g. business valuation).

The amounts of minimum share capital for AGs also apply to so-called small AGs that are not listed on the stock exchange. The small AG represents a popular option to a GmbH, as it entails the advantages of an AG, while some of the stricter requirements for public companies do not apply to it.

The shares are registered by name or are issued in bearer form. In December 2015 the law has changed. Now in principle, registered shares are issued. The issue of bearer shares is only possible if it is a publicly listed company or under strict requirements by law.

Shares in an AG may be issued either as nominal value shares or as individual shares. A combina-

tion of these types is not permitted. The nominal value shares are a division of the nominal share capital, the value of the individual shares depends on the number of individual shares. This means that the holder of nominal value shares participates directly by the amount of financial contribution, whereas the holder of individual shares participates on a pro rata basis. If an AG issues nominal value shares the minimum value per share must be € 1.

Management and officers

Director(s)

An AG may have one or several director(s) who form the Board of Management. If the share capital exceeds € 3 million and the Articles of Incorporation do not make other provisions, two directors are required. The Board of Management is elected and controlled by the Supervisory Board.

There are no German citizenship requirements for Managing Directors, but it may be required that Managing Directors are at least in a position to readily cross the German border (visa, residence permit, citizen of a Member State of the EU etc.) and manage the company not only by phone, email and fax. For tax purposes, a Managing Director in a country other than Germany being the sole Managing Director could lead to a dual residency of the company and negative tax consequences. Under certain circumstances, the authorities responsible may require examination of the financial probity of potential directors (e.g. in banking and financial sectors).

Supervisory Board

Whereas the Board of Management is fully responsible for the day to day running of the company, the role of the Supervisory Board is essentially to ensure that the terms of reference are complied with and to act on behalf of the shareholders in their dealings with the company. Thus, the Supervisory Board elects and controls the Board of Management. The role of the supervisory board has been strengthened by recent legislation without modifying the dualist management system typical to the German Public Corporation Act. For example, the Articles of Association must state that certain kinds of business transaction require the supervisory board's consent. Furthermore, the information flow was regulated in favour of the supervisory board.

The Supervisory Board itself is elected by the shareholders' meeting. In the selection of Board Members is important to note that in principle at a publicly listed company cannot be elected, who was in the last 2 years member of the Board of Management. A member of the Supervisory Board of a capital market oriented public companies pursuant to the definition in the German Commercial Code also must have expertise in the fields of accounting and auditing. Often the Supervisory Board is also elected by the employees because of the German labour law right of co-determination (Mitbestimmung). The composition of the Supervisory Board and employees' representation varies depending on the number of employees and the business branch. In AG's with fewer than 500 employees, the employers generally speaking – depending on the date of incorporation and on certain characteristics of the AG - are not required to have employee representation on the Supervisory Board at all. Supervisory Boards vary in size between 3 and 21 members depending on the amount of share capital issued.

Dissolution

An AG may be dissolved for various reasons that are regulated by statute. Statutory reasons for dissolution are, for instance, a shareholders' resolution, a court or other official decision, expiry of the period for which the AG was set up to run and insolvency. The dissolution must be registered with the Commercial Register. Following this registration, the company does not cease to exist, but remains in force as an AG under liquidation. Liquidation procedures are mainly enshrined in law. After the conclusion of the liquidation any remaining assets may be distributed to the shareholders, but not before one year after the public notice to creditors of the liquidation was made. Following this, the company is removed from the Commercial Register.

Short Facts AG

- Public limited company
- Minimum share capital € 50,000.00
- May hold rights and bear obligations
- Strictly formalized incorporation
- Low flexibility as regards its constitution
- Two tier company: Board of Management and Supervisory Board
- Liability with corporate capital and assets
- Generally no personal liability of its shareholders
- Easier transfer of shares
- May be quoted at the stock exchange

Short Facts GbR

- Partnership
- Treated as a legal entity
- Informal foundation
- Great flexibility as regards its constitution
- Unlimited personal liability of its shareholders

Short Facts OHG

- Partnership
- Operating of a business is business purpose
- May hold rights and bear obligations
- Informal foundation (plus registration at Commercial Register)
- Great flexibility as regards its constitution
- Unlimited personal liability of its shareholders

Partnerships

General partnerships

General partnerships are the non-commercial "Gesellschaft bürgerlichen Rechts"(Civil law partnership) and the „Offene Handelsgesellschaft“(General trading partnership). If Civil law partnerships undertake "trading" activities as defined by the German Commercial Code, such partnerships are then regarded as General trading partnerships. The basic principles of the Civil law partnership generally apply both to the General trading partnership and the Limited partnership (Kommanditgesellschaft).

Civil law partnership (Gesellschaft bürgerlichen Rechts)

The Civil law partnership is the basic form of partnership. The Civil law partnership is treated as a legal entity now, since recent jurisdiction has granted to it (almost) the same rights as to other General partnerships. The names of the partners are decisive. Civil law partnership can sue or be sued in court, is entitled to acquire rights and property and can enter into contracts.

The formation of a Civil law partnership requires two or more persons (individuals, legal entities or corporations) who pursue a lawful non-trading purpose. Basically, there is no mandatory form of partnership agreement (no written contract or notarisation is required), meaning greater flexibility concerning the content and structure of the agreement (exception: the agreement requires notarisation if contributions in kind in form of shares in a GmbH or real estate are provided). The partnership agreement does not have to be filed at the Commercial register. Thus, formation is completed with the conclusion of the agreement.

All partners are subject to joint and several liability. In principle, all partners are authorized to manage the partnership together unless otherwise expressly stipulated.

General trading partnership (Offene Handelsgesellschaft)

The General trading partnership is not a legal entity, but statute partly treats it as if it was. The General trading partnership can sue or be sued in court, is entitled to acquire rights and property, and can enter into contracts. The General trading partnership is regulated by the German Commercial Code (Handelsgesetzbuch). The name of the General trading partnership must designate the type of company by adding “Offene Handelsgesellschaft” or a commonly known abbreviation thereof, e.g. OHG.

To found an OHG, two or more partners (individuals, legal entities or corporations) join with a common purpose to establish a General trading partnership. If the common purpose is the operation of a trade and this trade is actually operated by the partners, the partnership is regarded as a General trading partnership by act of law, meaning that the later registration with the Commercial Register is only declaratory, but not constitutive. This, however, does not apply if partners are operating a minor trade as defined by law. In the latter case the registration forms an indispensable part of formation of the General trading partnership.

Furthermore, statute provides for certain partnerships whose common purpose is not the operation of a trade, but namely the administration of own property or the operation of an agricultural or forestry business, to voluntarily register with the Commercial Register as a General trading partnership. In these cases the registration with the Commercial Register is also constitutive for the formation of the General trading partnership.

Generally the partnership agreement does not need to meet a particular form, except for certain non-cash contributions, e.g. shares in GmbH, real estate. There are few formal requirements with regard to the content and structure of partnership agreements and it is up to the parties involved to stipulate an agreement which suits their own special circumstances. However, at least the following content of the partnership agreement is recommended:

- name, registered office and object of the partnership
- partners and amount of contribution of each partner
- management and representation
- profit and loss distribution
- accounting and reporting requirements
- partners’ meeting and passing of resolutions
- succession
- termination of partnership and termination settlement

Following the drafting of the partnership agreement, an application of formation must be made (jointly) at the Commercial Register, as the “Offene Handelsgesellschaft” generally takes effect as such by this registration, if it has not already commenced trading as a partnership. The partners are obliged to register the name and registered office of the partnership, the names, domiciles and the date of birth of the partners as well as representation of the partnership. The application to the Commercial Register has to be certified by a notary. The partners render contributions in cash or in kind. The contributions of the partners form the assets of the partnership and are held jointly by the partners. All partners assume unlimited liability for debts and obligations incurred in the name of the General trading partnership. The partners are jointly and severally liable. Normally each partner has the authority to act on behalf of the partnership in the ordinary course of business and enter binding agreements in its name. However, the partners may appoint one or more managing partners and invest them with the authority to act on behalf of the partnership as a whole.

Limited partnerships (Kommanditgesellschaft)

In a Limited partnership at least one partner (individual or corporate) qualifies as General Partner (for rights and personal liability, so-called Komplementär) and the other partner(s) as Limited Partner(s) (so-called Kommanditist). The General Partners’ liability extends to their personal assets, i.e. the General Partner is liable for the debts of the company without any limitation. The liability of the General Partner corresponds to that of a partner of a General trading partnership. The Limited Partners are liable up to their capital investment in the partnership (fixed and registered amount). The contributions may be made in cash or in kind. As the General Partner may also be a GmbH, the liability of all partners is effectively limited to the assets of the GmbH as General Partner. This kind of formation is a so-called GmbH & Co. KG which is very popular in Germany. By using this type of company no associated partner assumes unlimited liability.

The business name must designate the type of company by adding “Kommanditgesellschaft” or a commonly known abbreviation thereof, e.g. KG. In the case of a GmbH & Co. KG the name must designate the limited liability of the General Partner, e.g. GmbH & Co. KG.

Short Facts KG

- Partnership
- Operating of a business is business purpose
- One General Partner and one Limited Partner (minimum)
- May hold rights and bear obligations
- Informal foundation (plus registration at Commercial Register)
- Great flexibility as regards its constitution
- Unlimited personal liability of its General Partners (can be limited by using a “GmbH”)
- Liability of Limited Partners with their capital investment paid in

The regulations governing the General trading partnership (OHG) are generally speaking applicable to the Limited partnership, unless special provisions of the Commercial Code take precedent. Hence, concerning formation, partnership agreement and registration, please see the general remarks above concerning the General trading partnership.

Additionally, however, the partnership agreement of a Limited partnership must stipulate the position of the Limited Partners and the Limited Partners’ capital investment. Furthermore, the application to the Commercial Register must additionally name the Limited Partners and the amount of their capital investment.

Generally speaking, the Limited partnership is managed and represented by the General Partners. However, the partners may allocate some internal rights of management to the Limited Partners. Due to their limited liability, the Limited Partners are not entitled to represent the Limited partnership. If a GmbH is the sole personally liable partner (GmbH & Co. KG), the GmbH usually fulfils its management duties using its own Director.

Partnership association (Partnerschaftsgesellschaft)

The Partnership association is only available to individuals of certain professions (e.g. certified public accountants, attorneys, architects, medical practitioners). In legal terms this partnership may be allocated between the Civil law partnership and the General trading partnership. Similarly to the OHG and the KG it is treated by law as if it was a separate legal entity, even though it is not. The name of the partnership association must include at least the surname of one of the partners, the addition “Partner” or “Partnerschaft” and all professions practised in the Partnership association. The partnership agreement must be concluded in written form and contain the name and registered office of the Partnership association, the object of the partnership and - as regards the partners – the names, the residences and the professions practiced.

The Partnership association must be registered in the Partnership Register of the region where it is seated. Before registration the Partnership association is regarded as a Civil law partnership. The application to the Partnership Register in notary certified form must be made by all partners and must contain the obligatory facts of the partnership agreement as described above as well as the date of birth, the power of agency and the profession of the partners.

Towards third parties the partnership as a whole is liable with the assets of the partnership as well as all partners jointly. However, if only one or some of the partners were in charge of an assignment, only this/these partner(s) are personally liable.

Sole traders

For the establishment of sole proprietorships, general applications/notifications must be made as described above (notification to the “Gewerbeamt”, tax authorities, the Chamber of Commerce, health insurance office). For some types of businesses (crafts) a certain certified qualification is required in order to be in charge of the business (registered master of crafts, “Meister”), but exceptions exist, especially for foreign nationals.

A sole proprietor whose business requires a commercial business organisation because of its type or size must be registered in the Commercial Register and carry the name “eingetragener Kaufmann” (registered Salesman) or a commonly known abbreviation thereof (e.g. e.K.). If the business does not require such business organisation (i.e. it is a small/simple business) the registration is not mandatory. However, once registered, the addition to the name must always be made.

Short Facts

Sole traders

- No company
- May hold rights and bear obligations
- Requires certain applications and notifications
- May require registration at Commercial Register
- Unlimited personal liability of its proprietor

German and foreign company branches (registered)

In contrast to a subsidiary, branches are no separate legal entities. This means that they cannot hold rights or bear obligations. Consequently, branches generally speaking are ruled by the company they belong to. A disadvantage of the establishment of branches is the liability of the company for its branches. In contrast, subsidiaries with a registered office in Germany must comply with German law in general as well as with the specific regulations that exist with respect to their legal form. The establishment of German or foreign company branches (registered) is governed by the Commercial Code.

German company branches (registered)

Usually, procedures for the formation of a German branch take less time than for the formation of a company. There are no minimum capital or audit requirements, except for certain types of business.

Branches, generally speaking, may take the same name as the company, but if a branch is located in the same area as the company, German law requires that the name of the branch contains a supplement that clarifies that the branch belongs to the company in order to prevent them being confused. If the name of the branch differs from the company name, the branch name must indicate that the branch is a branch and not a separate legal entity, and to which legal entity it belongs. Other than that, the general rules regarding company names apply (see above).

The company must apply for registration by filing the name and the place of the branch electronically with the Commercial Register at the location of the principal place of business.

Foreign company branches (registered)

Foreign enterprises are permitted to establish branches or subsidiaries in Germany.

The registration of the branch of the foreign company must be made electronically at the Commercial Register at the location of the branch. The content of the application for registration of the foreign branch depends on the legal form of the foreign company.

In general, German law states that the foreign branch is to be treated as if it was a business entity itself in Germany in terms of application, registration, etc. This means that the establishment of a foreign branch is more formal than the establishment of a branch of a German company, as the information relating to the foreign company has to be gathered as well.

As regards branches of foreign corporations (especially public limited company and limited liability company), special rules exist. The registration must, generally speaking, be even more detailed and must include evidence of the existence of the foreign entity (e.g. certified translation of Articles of Association).

Generally speaking, the registration must include:

- approvals by the German state, if required
- the company’s foreign legal registration
- the legal form of the company
- persons with power of agency
- applicable law

Further special requirements exist for AGs, KGaAs and GmbHs originating from laws which specifically relate to these types of entities.

Short Facts

German company branches (registered)

- No separate legal entity
- Cannot hold rights and bear obligations
- Registration at the Commercial Register (few details)
- Compliance with German law
- Liability of company for its branches

Short Facts

Foreign company branches (registered)

- No separate legal entity
- Cannot hold rights and bear obligations
- Registration at the Commercial Register (many details)
- Compliance with German law
- Appointment of branch manager may be appropriate
- Liability of company for its branches

If a foreign company founds more than one branch in Germany, these strict requirements only apply to one branch. The company may select which branch they apply to.

A branch may be managed by the foreign director(s). However, as the head office of the corporation is abroad, it may be useful to appoint a person as branch manager with legal authority to act on behalf of the foreign company. If a branch manager is appointed this fact also needs to be registered.

According to European legislation of the last years, it is now the case that because of the freedom of establishment, the foundation of a company in another EU member state and the subsequent foundation of a branch in Germany, that acts as main office, as well as the relocation of a foreign company's business seat from an EU member state to Germany must be recognized by German authorities and courts if the requirements are fulfilled.

Other entities/legal forms of business organisation

Partnerships partly limited by shares (KGaA)

The Kommanditgesellschaft auf Aktien (KGaA) is rarely encountered and combines elements of an AG and a KG (Limited partnership). The capital stock is divided into shares owned by Limited Partners without personal liability. At least one partner must be personally liable. This partner resembles the General partner of the Limited partnership. Thus, this type of corporation is partly governed by the Commercial Code and partly by the Public Corporation Act (Aktiengesetz). The minimum share capital of the KGaA must be € 50,000.

European Company (Societas Europaea)

On October 8, 2001 the European Council of Ministers formally adopted the Regulation to establish a European Company Statute (ECS) and the related Directive concerning worker involvement in European companies. Both introduce a new European Company (Societas Europaea = SE). These rules came in force on October 8, 2004 and are accompanied by the introductory act of the European Company effective since December 29, 2004.

The SE gives companies operating in more than one member state the option of being established as a single company under Community Law and so be able to operate throughout the EU with one set of rules and a unified management and reporting system rather than having to comply to the different national laws of each member state where subsidiaries are located.

The SE with a minimum share capital of € 120,000 is able to operate on a European-wide basis and is governed by Community law directly applicable in every Member State. The EU Directive on worker involvement regulates that the creation of a European Company requires negotiations regarding the involvement of employees.

Silent Partnership (Stille Gesellschaft)

This kind of partnership is called a Silent partnership, as the partnership is not disclosed. In a Silent partnership a partner contributes a certain amount to the business, in exchange for a participation in the profits of the partnership, but not in the property of the business. The silent partner's participation in losses can be excluded in the partnership agreement. Apart from the silent partner's contribution, the silent partner has no further liability. The silent partner also does not participate in the management of the business. The silent partnership is formed by a partnership agreement and is governed by a special section of the German Commercial Code.

Practice and legal jurisdiction have created the so-called "Atypische Stille Gesellschaft" (non-typical Silent Partnership) where the silent partner participates in the property and the accumulated hidden reserves of the partnership, assists in the management or simultaneously is a limited partner. Certain tax implications have to be considered. All these types of participation are used as a method of financing, but are taxed differently.

Joint Ventures

Joint ventures are most frequently founded in the legal form of a Civil law partnership or a Silent partnership (see above). Usually they are formed for a limited period and allow the investors to participate in a company or a certain project. The participation may be in capital but can also be contributed by production means or know-how. Usually it is agreed that the risk is shared between the parties.

Labour

Summary

German labour law is a modern law that grants many rights to employees. German nationals have a constitutional right of free choice of profession. Discrimination on the grounds of race, sex or religion is prohibited. Furthermore, employees may appeal to the labour court against "socially unjustified" dismissal. There are government regulations covering minimum conditions of labour, minimum holiday entitlements, continued payment of salaries during pregnancy and illness, regulations covering dismissal and special rights for minors (e.g. for adolescents).

Wages

In 2016, the average gross income of employees was approximately € 2,905 per month; for 2017 it is approximately € 2,975 per month. In July 2014, the German parliament approved the country's first national minimum wage of € 8.50 per hour. The law entered into force on 1 January 2015. The minimum wage has been raised to € 8.84 as of January 1, 2017.

Social security

The state provides benefits for employees who are sick, injured, unemployed or disabled. In order to finance these benefits, both employers and employees make monthly social security contributions. These obligations and entitlements do not apply to the self-employed.

The payment of social security contributions for employees is obligatory. Agreements that formally seem to establish self-employment whilst the "apparent self-employed person" has a duty to comply with instructions and is integrated into the work organisation of the instructor, are treated like dependant employment in terms of social security contributions.

Self-employed contractors "similar to employees" may be subject to the public pension scheme. In simplified terms, contractors fall under this category if they work basically for one client/customer only and have no employees.

Pensions

State pensions are paid for by monthly social security contributions. In 2017, the contribution for pensions is 18.7% of gross earnings, half of which is paid for by the employer. The other half is deducted directly from the monthly earnings of the employee. As mentioned above, such contributions are only to be paid by employees (including "apparent self-employees") and contractors "similar to employees".

Furthermore, employers often operate their own pension scheme providing additional benefits. Self-employed people usually take out private cover.

In principle, state retirement pensions in the past was available over 65 (under certain conditions 60 or 62) years of age. Since the year 2000 the previously lower pension age for women is being raised step by step to that of male employees, as the Federal Constitutional Court ruled that a differentiation is unconstitutional on the grounds of sex discrimination. An increase of the pension age to 67 is being introduced on a step by step basis as well.

Fringe benefits

Holiday pay

Generally, the working week is approximately 40 hours. Paid holidays per year may vary from four as statutory minimum leave to six weeks depending on industry and seniority. There are nine public holidays per year and up to an additional three days in certain regions.

Sick pay

If an employee becomes ill, the employer is obliged to pay the employees' salary for a period of six weeks. Further payment is made from the statutory health insurance fund or an equivalent institution.

Profit sharing

Overall, share ownership by employees in the companies they work for is not that common in Germany. Participation in net profit as part of salary ("profit sharing") is more common than participation in capital ("co-partnership"). It tends to be large public limited companies that have staff share schemes. The significance of stock option programs has increased in recent years. Small and medium sized companies only offer share schemes as an exception to the rule, partly because of the legal structure of these entities and the legal or practical tradability of the shares (often GmbH's or partnerships). Even less common in Germany is a share scheme open to all employees. These schemes tend to be restricted to the management of a company.

Accident Insurance

A statutory accident insurance exists for persons employed or in training as well as for certain other working people, children in nurseries, pupils and students. The contributions concerning employees are paid by the employers. Apart from this, the risk of personal accidents can be insured privately.

Healthcare

The German healthcare system differentiates between the self-employed and employees. The general rule is that employees must make obligatory health insurance contributions as part of national insurance and that the self-employed are free of this obligation. In 2017 the contribution for statutory health insurance is 14.6% of the gross earnings up to the social security contribution ceiling (currently € 4,350.00 per month).

Half of the contributions plus an additional average contribution of 1.1 % for the employee are directly deducted from the monthly wages or salaries and transferred to the health insurer. The other half of the contributions are borne by the employer who transfers the contributions to the health insurer. Above a certain income level (in 2017 € 4,800.00 monthly respectively € 57,600 per year), employees are allowed to change over to a private health insurance scheme. This may in certain cases be cheaper and offer better service. But following German law it is only possible to return to the obligatory health insurance if the annual gross salary falls below the yearly income level again. For employees older than 55 years the possibility of return is excluded.

An exception to the general rule that self-employed people do not have to make obligatory health insurance contribution exists for certain professions (farmers, artists, publicists). Self-employed members of other professional groups may take out voluntary health insurance.

Another branch of the national insurance is called care insurance (Pflegeversicherung) which covers the risk of being in need of care because of invalidity/old age. The contribution is 2.55% of the gross earnings. An additional 0.25% is applicable in case of employees with no (dependent) children. The details of this insurance follow a similar pattern to the German health insurance system.

Unemployment Insurance

All employees have to pay contributions to the legal unemployment insurance, which is 3.0% of the salaries and wages half to be paid by the employer and half to be deducted from the employees' salaries.

Employment protection legislation

Minimum standards of working conditions are established by law and controlled by special insurance institutions. Employers must insure against liability for injury or disease sustained by employees in the course of their work (accident insurance).

Compensation is payable for unjustified dismissal, if it cannot reasonably be expected to continue with the employment relationship and the amount depends on earnings and period of employment. It is normal practice for redundancy payments to be made to employees who willingly accept redundancy, if a reduction in employee numbers is planned.

Employees are also protected if a company or an operating unit is sold or changed in its corporate form or in case of outsourcing. The work contract including all collective agreements will remain in force with respect to the new employer. Furthermore, the employees must be informed in a certain way regarding such changes and may object to them within a month of the receipt of the information.

Unions

Trade Unions are well established in the majority of business branches, and are generally organised industry-wide. By law, companies employing more than "five full-employed people must agree to the setting up of a Worker's Council (so-called Betriebsrat). Workers' Councils are elected by the employees of an enterprise and have certain rights of codetermination (Mitbestimmung), e.g. the right to be consulted on issues relating to personnel matters, social welfare and to be informed of certain economic matters.

Personnel limitations - foreigners/nationals

Nationals of many countries (not members of the EU) require a visa either in order to cross the German border or, depending on the nationality, in order to stay in Germany for a longer period of time than three months per half a year. Generally speaking, residence permits (issued by the Aliens Office) and work permits (issued by the Aliens Office) are also required. To realize free movement of workers within the EU, (working) citizens of the EU are issued a residence permit for their residence in Germany. EU-citizens who are out of work are also granted a residence permit if they are able to provide for themselves and are registered with a health insurance company. EU citizens do not need to obtain a work permit. For other nationals, generally speaking, stricter rules apply.

'Privileged Non-EU nationals', citizens of countries such as Australia, Israel, Japan, Canada, Republic of Korea, New Zealand and USA do not require a visa to enter Germany for working purposes. Privileged nationals must apply for work and residence permits during the first three months of their stay in Germany and are not allowed to start any work activities before they have registered their residence and receive the work and residence permit.

Highly qualified persons can receive the EU Blue Card, which provides a right of residence. Furthermore self-employed persons and majority shareholders of an "Aktiengesellschaft" or a "Gesellschaft mit beschränkter Haftung" or partners of an "Offene Handelsgesellschaft" may be granted a temporary residence permit for the purpose of self-employment if there is an overriding economic or specific regional interest.

Financial Reporting and Audit

Summary

Financial statements (balance sheet and profit and loss account) must be prepared once a year by all types of business entities. For corporations (e.g. SE, AG and GmbH) and certain partnerships without a natural person as a fully liable partner (e.g. GmbH & Co. KG) stricter rules apply than for other entities. For these entities the rules for the financial statements, their statutory audit, disclosure and filing are stricter than for partnerships and sole proprietors. Special rules apply for certain industries (banks, insurances) and cooperative societies.

1 Financial Accounting and Reporting for Single Entities

1.1 Legal Form of Companies

The German financial reporting law very generally distinguishes between partnerships and corporations. Partnerships without any natural person as a fully liable partner are treated as a corporation.

1.1.1 Partnerships

Partnerships consist of more than one legal person. For the purpose of this section, the term partnership is used only for such companies which do have at least one natural person as a fully liable partner.

Unless the partnership does not exceed two of the following three criteria in three subsequent years, there is not any obligation for public filing or audit of the financial statements.

Partnership Size Criteria

Sales revenue m€	Total Assets m€	Staff Headcount
130	65	5,000

The obligations become into effect in the third of the subsequent years.

For such companies most rules for large corporations apply.

Forms of partnerships are:

- GbR** Gesellschaft bürgerlichen Rechts (*civil partnership*)
- PartG** Partnerschaftsgesellschaft (*partnership*)
- OHG** offene Handelsgesellschaft (*general partnership*)
- KG** Kommanditgesellschaft (*limited partnership*)

The financial statements must be signed by all fully liable partners.

For partnerships which do not have any natural person as a fully liable partner (e.g. **GmbH & Co. KG**) the rules for incorporated companies apply. Those partnerships are in the following referred to as **KapCo**.

1.1.2 Incorporated Companies (Kapitalgesellschaften)

The equity of incorporated companies is limited by shares. Shareholder can be at least one natural

or legal person. Forms of corporations are:

- GmbH** Gesellschaft mit beschränkter Haftung (*Limited*)
- AG** Aktiengesellschaft (*Corporation*)
- SE** Europäische Gesellschaft (*European Company*)
- KGaA** Kommanditgesellschaft auf Aktien (*partnership limited by shares*)

There are a number of additional rules which have to be followed by listed entities, entities which have issued instruments that are publicly traded and for certain industries (e.g. banks, insurances, and other financial institutions). For the purpose of this publication we will not explain the rules and regulations for such companies.

1.2 Size matters

There are many partial exemptions for very small sole proprietorships (see 1.7), small and medium sized entities (see 1.8). Stricter rules apply for corporations (e.g. SE, AG, KGaA, GmbH) and KapCo.

Criteria determining Company Size

Category	Sales revenue m€	Total Assets m€	Staff Headcount
Small	≤ 12.0	≤ 6.0	> 40.0
Medium	≤ 40.0	≤ 20.0	≤ 250
Large	> 40.0	> 40.0	> 250

The category is met if any two of the three criteria are met in two subsequent years. A company moves into another category if it has met or fallen below the respective criteria in two subsequent years. The change in category becomes effective at the end of the second year.

For a newly incorporated entity the situation on the first reporting date is decisive.

1.3 The Main Elements of Financial Reporting

German companies have to prepare **financial statements** once a year. The financial statements comprise of three parts:

- balance sheet (*Bilanz*)
- profit and loss account (*Gewinn- und Verlustrechnung*)
- notes (*Anhang*).

Micro-entities are dispensed from the obligation to draw up notes, provided that they disclose certain information at the foot of the balance sheet, and have only to prepare an adridged balance sheet and profit and loss account. Micro-entities are small companies according to the above mentioned size criteria that do not exceed the limits of at least two of the three following criteria:

- total assets: € 350,000
- sales revenues: € 700,000
- staff headcount: 10.

For large and medium-sized corporations the financial statements are accompanied by the **management report** (*Lagebericht*) which comments on the course of the business and the overall situation of the company including commenting key performance indicators. It should also include informa-

tion, among others, on:

- the expected development of the company
- research and development
- existing branches of the company
- risk management and hedging policy

Companies being subject to the German legal requirements on equal participation of women and men in management positions have to prepare a corporate governance statement including information on gender quota in the management and supervisory bodies. This statement has to be included in the management report as a specific section or can be published on the company's website, to which reference has to be made in the management report.

The financial statement has to be compiled using **German GAAP** and must be in **German language** and in **Euro**. IFRS financial statements may be used for public filing, but do not exempt from the compilation of a German GAAP financial statement as the latter is decisive for a number of matters, e.g. profit distribution.

The business year is generally the calendar year, however, other business years may be chosen and registered with the consent of the fiscal authorities. Short business years are exceptionally possible, e.g. after an acquisition to align the business year of the target to the parent's financial reporting cycle. A longer reporting period than one year is not permitted.

Excursus: Stocktaking

Every company is required to stock take its assets at the beginning of the business and subsequently at the end of every financial year.

There are several facilitations for the stock takes, i.e. fixed value, group assessment, sampling on the basis of generally accepted mathematical-statistical methods. Permanent inventory is acceptable if certain preconditions are met.

The physical stock-take can be effected in a period of three months before to two months after the balance sheet date if inventory at the financial year end can be reliably assessed by roll forward or roll back calculations.

1.4 Responsibility for the Accounting and the Financial Reporting

The responsibility for the accounting and the financial reporting is with the fully liable partners or the legal representatives of incorporated entities.

The legal representatives of the incorporated company are each and collectively responsible for the compilation and the public filing of the financial statements and the management report. All members of the management board (in the case of the SE and AG: *Vorstand*), all managing directors (in the case of the GmbH: *Geschäftsführer*), or all fully liable partners (in the case of a limited partnership, KGaA: *Komplementäre*) are required to sign the financial statements.

KapCo are represented by the managing directors or the board of the managing corporation which acts as the fully liable partner. Therefore, the managing directors of the managing corporation (typically a GmbH) sign the financial statements of the KapCo and normally present them together with the management report to the partners, however, the partnership agreement may include other provisions.

The managing directors of a **GmbH** present the financial statements and the management report together with an auditor's opinion (if any) to the shareholders. If the GmbH had a supervisory board (by law or voluntarily as of the articles of incorporation) or a similar governance body the documents

are presented to it. Details are to be agreed in the articles of incorporation. The shareholders finally approve the financial statements and the management report. The managing directors are responsible for a timely publication in the German Electronic Federal Gazette (*Elektronischer Bundesanzeiger*, www.bundesanzeiger.de).

The management board of a **SE** or **AG** prepares the financial statements and presents it to the supervisory board. The supervisory board (or its audit committee) reviews and approves it in a joint resolution with the management board unless the articles of the incorporation or a resolution of management and supervisory board move the approval to the shareholders assembly. The chairman of the supervisory board reports in writing on the review and the subsequent approval to the shareholders. The management board is responsible for a timely filing in the German Electronic Federal Gazette.

1.5 Timing

The financial statements and the management report of corporations and KapCo have to be compiled within three months after the financial year end. They have to be published immediately after approval by the shareholders, latest within one year after the business year end.

Small size incorporated companies and KapCo have to compile their financial statements in the ordinary course of the business but latest six months after the financial year end. They have to be published immediately after approval by the shareholders, latest within one year after the business year end.

1.6 Audit requirements

The financial statements and the management report of large and medium sized incorporated companies, KapCo and large partnerships have to be audited. The audit has to be conducted by an independent auditor (*Wirtschaftsprüfer*) or an independent audit firm (*Wirtschaftsprüfungsgesellschaft*).

The auditor is appointed by a shareholders' resolution and the subsequent engagement letter. The appointment should be made before the financial year under audit has ended. In the case of a voluntary audit the shareholders' resolution can be omitted unless the articles of incorporation require the audit. The engagement letter is signed by the managing directors or – in the case of a supervisory board – by the chairman of the supervisory board or its audit committee if any.

After conducting the audit on the basis of German GAAS the auditor issues a long form audit report and an auditor's report. The auditor's report will be attached to the financial statements and the management report. The long form audit report will be presented to the management, the supervisory board or the shareholders' meeting.

1.7 Exemptions from the Obligation of Financial Reporting, Audit and Publication

Sole proprietors achieving less than € 600,000 revenues and less than € 60,000 profit after taxes are exempted from financial reporting, however, they have to follow tax accounting rules.

An **incorporated company** or KapCo which is the subsidiary of a company that is required to compile consolidated group financial statements is exempted from the obligation to compile, audit and publish financial statements and the management report if all of the following conditions are met:

- declaration of all shareholders that they have approved company use of the exemption and publication of the declaration in the German Electronic Federal Gazette
- declaration of the parent company that it guarantees the commitments entered into by the subsidiary in the following financial year and publication of the declaration in the German Electronic Federal Gazette
- the subsidiary is included on a full consolidation basis in the consolidated financial statements of the parent prepared and audited in accordance with EU Accounting and Auditing Directives

- the exemption of the company has been disclosed in the parent consolidated financial statement notes
- the consolidated financial statements and the group management report of the parent company together with the auditor's report have been published in the Electronic Federal Gazette. The exemptions can be used selectively and also apply for large partnerships.

The two conditions mentioned first are only applicable to incorporated companies, not to KapCos.

1.8 Partial Exemptions for Small and Medium Sized Incorporated Companies and KapCo

The German law on financial reporting offers a number of partial exemptions for small and medium sized companies which can – within the boundaries of continuity in presentation – be selectively and discretionary used for compilation and for publication. If a partial exemption has not been used for the compilation it can though be used for publication. You should, however, speak to your auditor if the published financial reporting is not entirely the same as the audited financial statements and management report.

Small and medium sized companies may choose to publish the balance sheet and the profit and loss accounts on a higher level of aggregation. Small sized companies can even omit the profit and loss account and the respective notes for publication in the German Federal Gazette. Furthermore, micro-companies are allowed to submit the balance sheet in electronic form to the permanent deposit with the operator of the Electronic Federal Gazette instead of publishing in the Electronic Federal Gazette.

Small sized companies are exempted from management reports.

There is a number of exemptions related to disclosures in the notes that may be used by small and medium sized companies.

There are no specific requirements for the financial reporting of branches of foreign companies. The tax law, however, requires the maintenance of books and records. In the case of companies registered in a member state of the EU or the EEA financial statements of foreign company have to be filed (along with a German translation) in the German Electronic Federal Gazette.

2 Consolidated Financial Statements and Group Management Report

2.1 Requirement for the Preparation

A parent company seated in Germany is required to compile consolidated financial statements and a group management report within the first five months after business year end if it has control over one or more other entities. An Exemption applies if the German parent was at the same time the subsidiary of a parent incorporated in the EU or the EEA and that parent publishes consolidated financial statements and a group management report together with the group auditors' report in German language in the German Electronic Federal Gazette.

The group financial statements of the parent are exempting if all of the following are being met:

- The German parent and its subsidiaries are included in the group financial statements.
- The group financial statements and those of the ultimate EU/EEA parent are prepared in line with the respective EU regulations.
- The notes of the single entity financial statements of the German parent includes information on the name and the location of the parent which compiles the exempting group financial statements and the group management report, the reference to the exemption from the requirement to compile group financial statements and group management reports, and the explanation of the differences to German GAAP.

A comparable exemption applies if the German parent is a subsidiary of a parent incorporated outside the EU and the EEA if the consolidated financial statements are prepared in accordance with e.g. IFRS or national accounting standards being equivalent to accounting standards within the EU and if the management report is equivalent to a management report required within the EU.

A parent company is exempted from the compilation of group financial statements and the group management report if two of the three following criteria are not exceeded:

Criteria Determining Mandatory Group Financial Statements

	Sales revenues m€	Total Assets m€	Staff Headcount
Pre-elimination figures more than	48.0	24.0	< 250
Consolidated figures more than	40.0	20.0	< 250

2.2 Main Elements of Group Financial Reporting

Group financial statements comprise of

- group balance sheet (*Konzernbilanz*)
- group profit and loss accounts (*Konzerngewinn- und -verlustrechnung*)
- consolidated notes (*Konzernanhang*)
- group cashflow statement (*Konzernkapitalflussrechnung*)
- group equity movement schedule (*Konzerneigenkapitalspiegel*)
- group segment reporting (*Segmentberichterstattung*), voluntary.

In addition the group has to compile a **group management report** which comments on the course of the business and the overall situation of the group. It should also include information on:

- matters of significance that have occurred after the end of the financial year
- the expected development of the company
- risk management and hedging policy
- existing branches of the parent and its subsidiaries
- research and development
- guidelines for the remuneration of the management (listed entities only)
- main features of the internal control system and the risk management (listed entities only)

2.3 Accounting Standards

The Consolidated Financial Statements have to be compiled using German GAAP or EU endorsed IFRS. For publicly traded parent companies the application of the IFRS is compulsory.

2.4 Audit Requirements for Group Financial Statements

Consolidated financial statements and the group management report have to be audited by independent auditors or independent audit firms. We may refer to 1.6 which accordingly applies.

Tax

Summary

- Individual Income Tax Rates between 14 and 45%
- Corporate Income Tax Rate 15%
- Solidarity Surcharge 5,5% on CIT
- Standard VAT Rate 19%, Reduced Rate 7%
- Municipal Trade Tax Rate between 7 and 17%, depending on municipality where the business is located
- Former Thin Capitalisation Rules replaced by a system called “Interest Barrier” generally applicable in case interest expense exceeds € 3 mil.
- Restrictions on use of losses in case of share transfer

Tax reforms

The last essential Tax Reform carried out in Germany has been the 2008 Business Tax reform. The main reason for this Tax Reform was the creation of incentives to do business in Germany. To achieve this, the corporate tax rate has been decreased from 25% to 15%. However, due to financing/budget obligations, this relief is counter-financed by a broadening of the tax base. Some of the changes will be mentioned hereafter.

COMPANIES

German companies are subject to Corporate Income Tax, Solidarity Surcharge and Trade Tax.

Corporate Income Tax

Liability to tax

German resident corporations are subject to corporate income tax (CIT) on their worldwide profits but Double Tax Treaties (DTT) might restrict this local taxation right. Municipal trade tax is also levied with some adjustments. A company is resident in Germany if it is incorporated in Germany or if its central management and control is in Germany, wherever it is incorporated.

Partnerships are only subject to municipal trade tax, but not to income or corporate income tax (transparent entity). The partners are taxed on their share of the partnership profit. There are restrictions as to the loss deductible at the level of the partners for limited liability partners.

Non-resident companies are only taxed on their German source income. A tax liability may arise for example if a permanent establishment is set up in Germany, such as a branch, business office, warehouse etc. or a participation in a partnership. The tax liability of the German branch of a non-resident company is limited to its German source income and capital gains.

Tax rates

The German legislator abolished the former split-rate system of corporation tax (40% for retained profits, 30% for distributed profits) generally from 2001. The current corporate tax system has been implemented with a uniform tax rate. This corporate tax system grants no CIT credit to shareholders. For years prior to 2008, the CIT rate has been 25%. From 2008, it is reduced to 15%. Non-resident corporations are also taxed at the “at rate of 15% from 2008.

Solidarity Surcharge

To support the new Eastern German states, a solidarity surcharge of 5.5% on the CIT is still levied, which raises the tax burden of corporate taxpayers from 15% to 15.825%. The solidarity surcharge on the corporation tax also applies to German branches of a foreign corporation.

Trade Tax

Municipal trade tax is levied on the basis of the company’s income plus or minus certain adjustments. The level of tax rate depends on the municipality in which the business or branch is located. The basic trade tax rate on corporate income for years before 2008 has been 5%, multiplied by factors ranging typically from 300% to 490% (legal minimum rate 200%) depending on the municipality. The trade tax rate on income thus varied between 13% and 20%, since in the past trade tax was deductible for CIT and trade tax purposes.

From 2008, trade tax is no longer deductible for CIT and trade tax purposes. The basic trade tax rate has been decreased from 5% to 3.5%, resulting in (lower) trade tax rates of between 10.5% and 17%. To counter-finance the lower amounts collected by the municipalities, for trade tax, the tax base also has been broadened.

Tax base (differences between book and taxable profits)

The basis for the calculation of taxable income are the statutory accounts. Adjustments must for example be considered for assets (e.g. extraordinary depreciation is only allowed under certain circumstances) and accruals (which may need to be calculated differently and then have to be discounted). Only 70% of entertainment expenses can be deducted.

Both capital gains from the sale of shares in foreign or German corporations and dividends received are exempt from CIT. The same applies for trade tax purposes with restrictions (see below). However, 5% of the dividend or gain is regarded as non-deductible expenses.

While capital gains are exempt from CIT, losses from the sale of shares cannot be deducted from the corporate and trade tax base. The same applies to any extraordinary write-off on shares. The sale of so-called “tainted shares” (see below) is not tax exempt.

From 2008, for corporations, write-offs on receivables against related parties (direct or indirect holding of more than 25%) are no longer deductible, if a third party would not have provided loans under the same conditions.

Group taxation (Organschaft)

Generally, group tax consolidation is allowed under certain circumstances. The shareholder (corporate, individual or partnership) may include profits and losses of subsidiaries (Organschaft), provided a profit and loss sharing agreement (Gewinnabführungsvertrag) is concluded between the two, which is registered in the commercial register of the integrated company within a certain time frame. This means that any profits of the subsidiary will be paid over to the parent, but the parent also has to cover losses of the subsidiary. The agreement must be effective for at least five calendar years. A further condition for a tax group is that financial integration (direct or indirect holding of more than 50% of voting rights) exists from the beginning of the fiscal year of the subsidiary.

As a consequence, losses of the subsidiary may be offset against profits of the parent company or vice versa. It should be noted that this only applies to losses of the same year. Prior years’ losses would not be included for tax purposes but can be used by the integrated company (Organschaft) after the tax group ends.

For trade tax purposes, the same conditions apply for a tax group as for CIT.

Each company in a tax group has to file its own CIT and trade tax return. The tax base will be cal-

culated at each level separately and is then included in the parent's tax return. The parent would be subject to (corporate) income tax and trade tax with the income of all subsidiaries.

Thin capitalisation rules

Until 2003, thin capitalisation rules were only applicable to companies with shareholders which are not subject to unlimited German taxation. This has changed from 2004, as the prior rules have been challenged in the courts as being discriminatory to foreign shareholders. From 2004, the rules also apply to loans provided by German shareholders. Commencing with the fiscal year 2008, the system has been changed completely as explained below.

From 2004, the remuneration paid by a corporation for a shareholder or related party loan was to be considered as a hidden distribution of profits if

- the remuneration is not calculated at a fixed rate of interest or
- the debt /equity ratio at any time of the fiscal year exceeds 1.5:1

Provided, interest due on the shareholder or related party loan did not exceed € 250,000 during the fiscal year, thin capitalisation rules were not applicable (provided loans had not been given to acquire shares in a corporation under certain further conditions; in this case, there was no safe haven and the interest was deemed to be a hidden profit distribution). Provided, interest exceeded € 250k, all interest on loans exceeding the safe haven was at stake.

For fiscal years beginning after May 25, 2007 and not ending before January 1, 2008, completely new rules have been implemented, now affecting all interest (Zinsschranke or interest barrier). The new rules are applicable to corporations and trading partnerships alike, no matter who the shareholder or partner is. It applies not only to loans from shareholders/partners, but also from third parties like banks. The general rule is that the net interest expense (balance of interest income and interest expense) is only deductible for tax purposes if it does not exceed 30% of the taxable EBITDA (only regular depreciation/ amortisation is allowed; extraordinary write-offs will not be added back) at the end of the preceding fiscal year. For corporations, the taxable income before interest, tax, depreciation and amortisation is relevant. Dividends received and capital gains realised will, therefore, not be included when calculating the basis for deductible interest expenses since they are tax exempt.

Non deductible interest will be available for a carry forward. However, in case of a change in ownership exceeding certain percentages, this interest carry forward might be lost partially or entirely.

In line with the Economic Growth Acceleration Act (Gesetz zur Beschleunigung des Wirtschaftswachstums) the possibility of an EBITDA carry forward was introduced. According to this, unused EBITDA can be carried forward to the next 5 years and can be included in the calculation of the interest costs deductibility in these years. An EBITDA forward is possible regarding to business years ending after December 31, 2009 in general.

There are three exemptions to the restriction of interest deduction:

1. The annual net interest is less than € 3 mil.
2. The company is not partially or fully part of a consolidated group.
3. The equity ratio of the financed business at the end of the preceding fiscal year equals or exceeds the equity ratio of the consolidated group (in general to be calculated on the basis of IFRS).

The second exemption will only be valid for corporations in case it can be proven that not more than 10% are financed by a shareholder (with more than 25% direct or indirect ownership) or related party or third party with recourse to the shareholder or related party (e.g. back-to-back-financing).

For corporations which are part of a consolidated group, the third escape clause may only be applied provided none of the consolidated group members is financed not more than 10% by the shareholder or a related party. However, this only applies to net interest expenses which are not mere intragroup financing.

In case that interest deduction is disallowed, the disallowed amount is not deemed as a constructive dividend (as it was in the past with the thin cap rules). For trade tax purposes, there will be no additional add back for disallowed interest (but the general tax base would be increased by the non deductible amount).

Filing of tax returns

Companies generally have to file their tax returns within five months of the end of the tax year, but extensions to file at the end of December may be granted.

Tax is paid in quarterly advance instalments generally based on the prior year's level of tax. The difference between the amount paid and the amount assessed has to be paid or is refunded within one month after the assessment has been issued.

Use of losses

CIT losses may be offset against previous years' profits up to a limit of € 1.0 mil or against future profits at limited amounts. Trade tax losses may be offset only against future profits. From 2004, losses-carried-forward may only be offset up to € 1.0 mil without limitation, the exceeding amount can be offset only up to 60% of the remaining gross income of the current year.

In the past, the set-off of losses against future profits of a corporation was based on the condition that the company maintains its legal and economic identity. Basically, the economic identity of a company was lost if more than 50% of its shares had been transferred to a new shareholder and the company resumed or continued its business with predominantly new assets. The injection of new assets was not harmful if the only intention of the injection was corporate recovery, but the conditions for this were quite strict.

From the fiscal year 2008 and transfer of shares after December 31, 2007, the use of losses carried forward has been significantly changed. In case of a transfer of shares or voting rights of more than 25% to one acquirer (or related party) within a period of five years, the losses not used until then insofar are no longer deductible (25% up to 50% of the loss-carry-forward is lost). In case that, within a period of five years, more than 50% have been transferred, no remaining losses are deductible (complete loss-carry forward is lost). This rule is also applicable if shares are transferred to a group of purchasers that have convergent interests.

Regarding to share transfers after December 31, 2009, the following exemption clauses may apply in case of a harmful transfer of shares:

According to the group clause tax losses are not lost, if the transfer of shares takes place within a group which is held by one shareholder who holds 100% in both sellers and purchaser.

According to the hidden reserve clause tax losses can be used after a harmful transfer of shares to the extent the assets of the company includes in Germany taxable hidden reserves.

Dividends

Dividends received from foreign subsidiaries are tax exempt in Germany (but 5% of the dividend is deemed as being non deductible expenses). The tax exemption also applies to all domestic dividends independent of a minimum participation quota, a minimum holding period or the fulfilment of an activity clause. The tax exemption also affects trade tax, but for trade tax purposes, a minimum participation quota of 10% (from 2008 onward: 15%) has to be fulfilled and the shares have to be

held from the beginning of the fiscal year of the recipient of dividends. With respect to income from dividends, there is no distinction between corporations subject to unlimited or limited tax liability as well as German permanent establishments of foreign companies. Thus, the tax exemption is also granted to profit shares that have to be attributed to the domestic commercial permanent establishment of a non-resident foreign corporation. The same applies to profit shares in partnerships which have received dividends from corporations.

For foreign dividends, 5% of the dividend income is deemed non-deductible. All financing and similar costs exceeding this amount are deductible as general business expenses. This also applies to German dividends from 2004 onward, whereas in the past, all expenses directly related to the exempt dividend received from a German corporation were disallowed as expense up to the amount of exempt dividend received.

Special depreciation on the value of shares is non deductible. The same applies to e.g. write-offs on receivables (see above under the heading “tax base”).

Withholding taxes

Effect of treaties

Credit is available for foreign taxes on income against the German corporation tax charge on that income. Foreign tax may instead be deducted from taxable income. This implies that the income is not tax exempt in Germany. Unused foreign tax credits cannot be carried back and forth in the tax accounts.

A considerable number of Double Tax Treaties exists which provide relief from double taxation of certain categories of income. Business income, achieved by a branch in a “treaty” country, is usually exempt from German taxation. Treaties also entitle non-German shareholders of German resident companies to a partial refund of German withholding tax.

Foreign income

Resident corporations are subject to unlimited CIT liability with their worldwide income. Foreign income is taxable at ordinary tax rates, with a credit for foreign tax payable on the same income. Part of foreign income might be exempt from German taxes if a Double Tax Treaty applies. Provided a German corporation receives a dividend from a foreign subsidiary, the dividend is tax exempt except 5% of the dividend which are deemed to be non-deductible expenses. Foreign withholding tax on tax exempt dividends cannot be credited against German CIT.

The corporate tax liability of non resident foreign corporations is limited to German-source income.

Withholding tax/Flat tax on dividends and capital gains

In general, withholding tax has to be deducted on dividends paid by a German company. This also applies to dividends paid to a foreign (also EU) shareholder. Under certain conditions (e.g. no treaty shopping), the foreign shareholder can apply for an exemption from withholding tax under the parent / subsidiary directive or a double tax treaty. This requires that special conditions are fulfilled. If no exemption is granted, the shareholder might apply for a refund if, again, certain conditions are fulfilled.

For dividends after December 31, 2008, a new flat-rate tax of 25% plus solidarity surcharge of 5.5% has been introduced. In case that no exemption has been granted, this applies also to dividends to foreign shareholders. In case of a foreign corporate shareholder who does not fulfil the requirements for a full refund, a refund of 2/5 of the tax withheld can be applied for.

INDIVIDUALS

Tax rates

The individual income tax rates are as follows:

Minimum tax rate since 2009 – 14%
Maximum tax rate since 2008 – 45%

For capital income, a flat rate tax has been introduced with the 2008 Business Tax Reform which applies for example to capital income from interest, dividends, similar distributions, but also to capital gains on shares (effective from 2009). The rate is 25% plus solidarity surcharge and possibly church tax. No income related expenses will be deductible, except expenses in direct connection with the sale of shares. Only in exceptional cases, the individual tax rate applies and expenses are deductible (e.g. in case of the shareholder also being an employee (managing director) of the corporation).

For married couples, a joint assessment is generally applicable. Thus, married couples have to opt to be assessed individually, otherwise they are assessed jointly. For the purpose of calculating the tax rate, the total of both spouses’ income is halved but the resulting amount of tax is doubled (so-called split rate). Also, certain tax allowances are doubled. As a general rule, a joint assessment may be more favourable than an assessment as a single person, if the income of one spouse is much higher than the income of the other spouse.

Residence criteria

German Tax Law considers an individual to be a German resident provided the individual is either present in Germany during the current calendar year for a minimum of 183 days or maintains a home in Germany.

Taxation of Resident Individuals

Resident individuals are subject to unlimited tax liability. Their worldwide income is subject to German income tax. The taxpayer may deduct certain business expenses and personal costs from gross income. Allowances, for instance for expenses for children, household and social security may reduce gross income.

Gross Income

Gross income includes all income from agriculture and forestry, business, self employment, employment, investment (e.g. dividends, interests, royalties), rental, other (including annuities and private short-term capital gains).

Capital Gains and Losses

The sale or exchange of non-business assets may be subject to taxation on capital gains only if it is expressively mentioned in the Income Tax Act (ITA). Until including 2008, according to the German ITA, capital gains are taxable only if they relate to a private “short-term” transaction or sale of a participation or so-called “tainted shares” in a corporation.

A private short-term transaction includes different forms of transactions within a certain time frame. The sale of real estate within a period of ten years since acquisition, for example, qualifies as a taxable capital gain transaction. In the past, for other private assets, a capital gain was only taxable provided the period between acquisition and sale was less than one year. From 2009, if that

income is derived out of private assets at least during one calendar year, the time limit extends to ten years. The sale of articles for daily use is not liable to tax. Losses resulting from private short-term transactions may in general only be offset against capital gains from other short-term transactions within the same year for the purpose of reducing gross income. For losses until December 31, 2008, different rules apply.

Capital gains on shares or similar rights are taxable without any time limit between acquisition and disposal. In case the total shareholding does not exceed 1%, a withholding tax rate (“at tax rate”) of 25% plus solidarity surcharge plus possible church tax is to be withheld. This applies to capital gains which fall under the new regulations from January 1, 2009 (i.e. shares acquired and sold after January 1, 2009). Expenses are allowed if in direct connection with the disposal.

Capital gains from the sale of shares in corporations equalling or exceeding 1% are treated as business income. It is sufficient that a shareholder owns 1% of the share capital at any time during the five years preceding the transfer. In this case, 60% of the gain is subject to German Income tax (no “at tax rate applicable”). On the other hand, 60% of the amount of losses and expenses resulting from the sale transaction are tax deductible.

In addition to short-term capital gains and capital gains deriving from the sale of participations exceeding 1%, private capital gains are taxable if so-called “tainted shares” are sold. Tainted shares might result for example from a contribution of a qualifying participation in exchange for shares (if not short term) as to the regulations under the Reorganisation Tax Act prior to December 12, 2006. Reorganisations after December 12, 2007 no longer result in tainted shares.

Taxation of non-resident individuals

A non-resident is not subject to unlimited tax liability. Only German source income is subject to tax in Germany. In general, German source income is derived for example from a permanent establishment, a German employer or real estate situated in Germany. For non-resident foreigners only limited lump sum allowances are deductible.

Under certain conditions, non-residents may apply to being subject to unlimited taxation. This requires that at least 90% of the income derived is taxable in Germany or that the income which is not taxable in Germany generally does not exceed € 8,004.

Special rules for expatriates

Depending on terms of the relevant Double Tax Treaty, some foreign income of expatriates is not taxed in Germany. Income earned in Germany is fully liable to taxation, as the expatriate is a resident of Germany.

Although the foreign income may not be taxed in Germany, it is included in the total income of the expatriate for the purpose of assessing the income tax rate which applies to the taxable income.

Payment dates

Income tax on gross pay is normally deducted from employees' wages monthly by the employer and paid to the tax authorities. Normally this will settle the income tax liability of the employee. Any remaining balance owed or to be refunded becomes due one month after the assessment has been completed (see tax returns below) and a tax assessment has been issued by the tax authorities.

Tax returns

German residents and certain non-residents who have a limited tax liability are generally required

to file an income tax return. They are assessed on a tax year basis which for personal income tax is the calendar year. Tax returns are due by May 31 following the end of the tax year. Extensions might be granted.

Effect of treaties

Germany has a dense network of Double Tax Treaties which can affect the German tax liability of residents and non-residents.

Value Added Tax (VAT)

VAT is charged on the supply of goods and services within Germany.

VAT is charged on an input and output system. A VAT-able business can generally reclaim the input VAT it pays on purchased goods and services (but no input tax deduction is allowed for exempt supplies), and must account for the output VAT charged for the sale of goods or the supply of services.

Rates

Three rates apply to goods and services (from January 1, 2007)

- Standard 19%
- Reduced Rate 7%
- Zero Rate 0%

Returns

Preliminary VAT returns are generally submitted monthly. Provided, the amount of VAT was less than € 7,500 in the prior year, they can be submitted quarterly. The monthly return must be submitted by the 10th of the following month, a quarterly return by the 10th of the month following the quarter end. Extensions of one month might be granted under certain conditions. Annual returns follow the general rules for tax returns (generally May 31st of the following year).

OTHER TAXES

Property taxes

Real estate tax is payable on the assessed value of property at varying rates depending on the municipality where the real estate is situated.

Real estate transfer tax

Transactions in German real estate (normally exempt from VAT) are subject to real estate transfer tax at a rate between 3.5% and 5% on the purchase price of the real estate transferred. In cases where the real estate is just part of a transaction, special rules for calculating the tax basis apply. The basis for the tax is calculated in a special way. Additionally, a transfer of at least 95% of the shares in a corporation or partnership triggers real estate transfer tax on the real estate owned by the entity.

Inheritance tax/gift tax

Inheritance tax is imposed on the transfer of property upon death if the deceased was a German resident at the time of death or the beneficiary is currently a German resident. If neither the deceased nor the beneficiary was German resident at the time of death, then inheritance tax is raised only on certain property located in Germany.

Gift tax is charged on transfers of assets during the giver's lifetime, if either the giver or the recipient is a German resident. Gifts of property by a non resident to a non resident recipient are also liable to tax if the property is located in Germany. Inheritance tax and gift tax are both assessed on the basis of the taxable value of the property transferred.

Beneficiaries are entitled to a tax class based personal exemption for property transferred either upon death or as a gift during the giver's lifetime. The tax classes are as follows:

Class I

Spouse/companion in life, children, stepchildren and grandchildren, and to parents and forebears in the case of transfer on death

Class II

Parents and forebears for gifts, brothers and sisters (also half-brothers and half-sisters), nephews, nieces, stepparents, sons-in-law, daughters-in-law, parents-in-law, and divorced spouses/companion in life of a terminated registered partnership

Class III

All other beneficiaries and transfer of property for specific purposes

The relevant exemptions currently are:

- Spouse and companion in life € 500,000
- Children/stepchildren, children of died children/stepchildren in Class I € 400,000
- Grandchildren/step-grandchildren in Class I € 200,000
- Other persons in Class I € 100,000, in Class II € 20,000 and in Class III € 20,000

The personal exemption is € 2,000 if neither the deceased nor the beneficiary was a German resident at the time of death. Double Tax Treaties may, however, allow for higher exemptions in the case of a surviving spouse.

A surviving spouse/companion in life and children under 27 are granted a special maintenance allowance, which applies only to property transfers on death, less the capital value of tax-exempt pension payments accruing to the surviving spouse or children. For the surviving spouse/companion in life the allowance is € 256,000; for children it varies according to their age.

Allowances are also available to cover the transfer of household and personal effects.

Tax free allowances are as well available for the transfer of businesses including farms and forestry assets.

Rates applicable to transfers on death vary from 7% to 50% depending on the tax class of the beneficiary and the value of property transferred.

Contact Details

For questions please contact Grant Thornton Baltic UAB or Warth & Klein Grant Thornton offices or the Grant Thornton International Business Centers and the Head of Tax. They are located at the following addresses:

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