Germany

Legal overview

Executive Summary

German company law offers a wide range of different forms of company for the individual needs of foreign investors. It is, however, of a relatively formalistic nature compared to some other jurisdictions. Many documents require notarisation and registration by the relevant commercial register kept by the local courts. When finalising the content of articles of association, legal restrictions must be taken into consideration to avoid the risk of ineffective agreements. The German commercial register is recognised internationally as being advantagous since anyone can view it and find up to date information about those companies registered on it.

Registered Companies and Partnerships

Foreign individuals/companies that wish to operate in Germany may do so by either establishing a branch office of the foreign company in Germany, or founding a German subsidiary company. Whether an independent entity is actually required will, however, depend on the 'economic activity' that is intended to be carried out by the foreign company.

Geograophically and organisationally speaking, the branch office is a partly independent unit. Legally speaking, it is merely a dependent 'arm' of the main company and not a legally independent company. Branch offices are established by filing for registration in the relevant local commercial register. This filing for registration must be notarised and must be in German as must any associated documents which are to be submitted. Merely dependent branch offices do not require registration in the commercial register; the registration of the business with the authorities at the branch's place of business is sufficient.

A subsidiary is a legally independent entity with its own company name and accounting arrangements. The requirements for the creation of a subsidiary differ depending on the chosen 'form' of company. A distinction is made between business partnerships (Personenhandelsgesellschaften) and incorporated companies

(Kapitalgesellschaften).

Business partnerships include in particular the general partnership (OHG) or the limited partnership (KG or GmbH & Co. KG).

The limited liability company (GmbH), the public limited company (AG) or the European Company (SE) are all forms of incorporated companies that are available in Germany.

Business partnerships must be registered in the commercial register, as must incorporated companies. This is regarded internationally as an advantage as it means that individuals/companies seeking to enter into business relationships with the partnership/company can be confident that they are dealing with a legitimate entity. Similarly, it makes it clear who comprises the partnership/company and who, for example, has authority to conclude contracts on behalf of a company.

In addition to business partnerships and incorporated companies, there are other 'forms' which companies can take, though these are not generally suited to the operations of a commercial enterprise. These include, in particular, companies constituted under civil law (GbR) and partnership companies (PartG). These type of companies do not need to be entered on the commercial register. In the world of business, however, they play a minor role at best.

Classification of Registered Companies

German company law contains many different provisions relating to the various forms of company. Aside from those mentioned above, other forms of companies cannot be established under German law. Foreign companies can, however, generally operate independently in Germany to a significant extent.

Incorporated companies are registered in the commercial register and third parties can generally trust the entries in the commercial register. So if, for example, an individual is appointed as a director and this has been entered in the commercial register, there will be an assumption that that individual can make declarations on behalf of the company, and has authority to conclude contracts for example, even where this person is no longer actually appointed director of the company.

Incorporated companies generally require a minimum level of capital to be paid in, which is available to the creditors of the company as a recoverable asset. Moreover, recourse to the shareholders of the company is generally no longer possible. The shareholders are

therefore not personally liable for the company's liabilities.

Business partnerships are also separate legal entities. However, in the case of a general partnership (OHG), the shareholders have unlimited liability for all of the company's liabilities. In the case of limited partnerships, and in particular a GmbH & Co. KG, the liability of just one shareholder is unlimited, the liability of the other shareholders being limited to a maximum liability amount specified in the articles of association. In the case of a GmbH & Co. KG, a GmbH can serve as the shareholder with unlimited liability.

Memorandum and Articles of Association

Under German company law, the articles of association are key for regulating the company's relationships and every company is required to have articles of association. Incorporated companies must registered their articles in the commercial register. The content of the articles of association is accessible by the public and may also be reviewed by the registry authorities. If the articles of association violate compulsory provisions of law, the company will not be registered, and will not exist.

The articles of association describe the company's relationships both externally and internally, and will refer to any agreements that exist between the shareholders. In addition, the articles of association include details of the name, address, purpose and duration of the company, its shareholders and their capital, shares and liabilities, the management and representatives of the company, thenon-competition obligations of the company, any provisions concerning shareholder resolutions, resulting distributions or withdrawals, provisions relating to the exclusion of shareholders,indemnities, and any provisions relating to the liquidation of the company. In considering the above, the law only provides for minimal information to be given in the articles of association; the shareholders generally being free to agree on everything else.

It is possible, in many areas aside from the actual articles of association, for additional agreements to be entered into between the shareholders. These do not usually need to be registered, making it possible for the shareholders to keep additional agreements confidential and out of the public eye.

Share Capital, General Meetings

The minimum capital required to incorporate a limited liability company (GmbH) amounts to EUR 25,000 and EUR 50,000 for a public limited company (AG). With regard to business partnerships,

the law does not require a minimum capital.

General meetings can be held at any time by the shareholders. The shareholders need not to attend in person and meetings can also be held by telephone conference or by similar means if the articles of association allow this. The legal regulations and the articles of association set out the procedure that must be followed to convenve and hold general meetings. If these are not adhered to, this can lead to the nullity or at the very least contestability of any shareholder resolutions subsequently passed. For certain shareholder resolutions, the simple majority vote of the shareholders is not sufficient, instead qualified majorities are required. This process can also be set out in detail in the articles of association. The law generally provides that ordinary general meetings should be held by incorporated companies at least once a year, during which the respective annual financial statements may be adopted and the result distribution decided upon.

Directors

Every company must have at least one director. The law stipulates that for business partnerships in general, all partners are jointly authorised to represent and manage the company. In limited partnerships, the partner who is personally liable is entitled to manage the partnership solely, however this can be modified in the articles of association.

The directors of incorporated companies are usually appointed by shareholder resolution or by resolution of the supervisory board. Their details will also have to be entered in the commercial register.

Directors can be individuals who are resident outside of Germany, and they do not have to speak the German language.

The appointment of directors may be determined in the general meeting, as may their duties and responsibilities in terms of whether theyare authorised to represent the company together with other directors, or whether they shall have sole power of representation.

Financing of a Company

The shareholders are often free to decide how a company is to be financed. In the case of incorporated companies, as above, there is a minimum level of share capital that must be paid before the

company can be registered. In the case of limited partnerships, the 'limited partners' will assume liability up to a specified amount, but will not necessarily pay that amount into the partnership. So long as that payment is outstanding, they will be directly liable to the creditors up to their specified amount.

Irrespective of this, a company can finance itself in other ways, for example in the form of private loans, shareholder loans or bank loans. 'Silent partnerships' can also be concluded with outside investors. A company could also opt to increase its capital by way of shareholder resolution at a general meeting.

Commencement of Business

Incorporated companies are only formed upon their being entered in the commercial register. The registration may take a few days depending on the working turnaround time of the relevant authorities in each case. The company will also need to open a bank account as part of the registration process and prove payment of the minimum capital. In comparison, business partnerships will commence upon the articles of association being agreed prior to registration in the commercial register.

Mergers and Acquisitions

Shares in incorporated companies and business partnerships can be sold relatively easily by way of a private purchase contract. Both the purchase of company/business shares (share deal) and the acquisition of all of (or the significant) assets of the company (asset deal) are commonly practised in Germany. It should be noted that for certain forms of company, the contract will need to be notarised.

For public limited companies (Aktiengesellschaften) in particular, there is also the option of acquiring publicly traded shares in companies on the free capital market. However, this is usually only applicable to public limited companies. If certain 'investment thresholds' are exceeded, this may trigger further legal obligations which, for example, impose a duty on the company to make a public offer to acquire additional shares.

Corporate Insolvency

In certain circumstances, companies may be required by law to go through insolvency proceedings if, for example, they find themselves in a situation where their liabilities significantly outweigh

their assets, such that the company is unable to pay its debts. In the case of looming insolvency, the company can volunteer to enter into insolvency proceedings itself.

The legal framework of insolvency is such that creditors can generally only recover a certain proportion of their claims; namely where the assets of the company are sufficient to cover this. Claims of creditors will take priority over any shareholder claims against the company.

The insolvency administrator is entitled by law to either reclaim or contest certain payments and/or other benefits provided by the company to outside investors (including shareholders) within a certain period of time prior to the company entering into insolvency.

Winding Up of Companies

The winding up of a company may be brought about by shareholder resolution. Even where the articles of association provide for a specific term of the company, the company will generally be liquidated after the end of this period. The authorities and courts can also, in certain cases (for example in the case of insolvency), force the dissolution of the company.

Where a 'dissolution resolution' is passed, liquidators will be appointed to take steps to wind up the company. The liquidators are often former directors of the company, however the shareholders have the option to pass a resolution if they decide otherwise.

In the context of liquidation, the liquidator is tasked with satisfying the company's liabilities as far as possible by collecting the company's claims, with a view to selling the assets. An invitation must be made to all creditors of the company and this should be published. If, within a year, no further creditors bring a claim and all existing claims have been satisfied, the company will be removed from the commercial register.

Author: Steffen Lorscheider, Spieker & Jaeger
steffen.lorscheider@spieker-jaeger.de

Contact:
Dr. Steffen Lorscheider, LL.M.
LAWYER AND NOTARY PUBLIC
steffen.lorscheider@spieker-jaeger.de
Tel.: +49 (0) 231 95858-75

Tax overview

Company Registration

Every new business, whatever its legal form, must submit an application to register the business with the relevant municipal administration of its place of business. The municipal administration automatically sends an appropriate message to the German tax authorities that the business is aware of its obligations and is keen to ensure compliance with them. Nevertheless, registration for tax purposes has to be done separately with the German tax authorities. If the company intends to employ people, additional registrations will need to be made with the local employment office.

Set-up tax

There are no set-up taxes payable in Germany, except for a small fee for registering the company in the relevant municipal administration (as above).

National current benefit tax

Corporate income tax

The taxable profit is based on the accounting profit, subject to certain adjustments. In addition, there are limited deductions available for certain expenses, and there are extensive rules prohibiting the deduction of interest paid. Generally, net interest expenses in excess of EUR 3 million are non-deductible to the extent that they exceed 30% of earnings before interest, taxes, depreciation and amortisation (EBITDA).There are, however, certain exceptions to these rules, for example, in the case of a lack of group affiliation.

Taxable profits, including capital gains of both corporations and branches doing business in Germany are subject to a corporate income tax rate of 15% plus a supplement of 5.5% of the corporate income tax (known as a 'solidarity surcharge'). The income tax rates of partnerships will depend on the individual tax rates of each partner.

If, at the beginning of the calendar year, a German resident company holds 10% or more of the shares in a domestic and/or foreign company as well, the company will not be subject to tax on dividends received from its shareholding under the 'participation' exemption, subject to certain conditions being met. A flat-

rate amount of 5% of the dividends will, however, be classified as non-deductible expenses.

Trade tax

All industrial and commercial undertakings with an establishment in Germany are subject to trade tax, based on the income generated from the industrial or commercial activity (trade business). The income from the trade business is essentially its profit, subject to certain adjustments.

Partnerships receive a tax-free allowance of EUR 24,500 on the income generated by the industrial or commercial activity exercised by the business.

The trade tax is paid in its entirety to the municipality in which the registered office of the undertaking is located. If the undertaking has several establishments in different municipalities, the total trade tax will be distributed among them in line with a distribution quota. Each municipality may, within certain limits, set the rate of the business tax itself. The average rate of the trade tax is currently between 8% and 22% of the profits of the industrial or commercial undertaking.

Advance payments on trade tax are paid quarterly.

Other taxes (VAT, property taxes)

VAT is levied at the standard rate of 19% for most goods and services. A reduced rate of 7% applies to food, books and certain other necessities and services which are listed in an annex to the Value Added Tax Act. VAT is not applicable in relation to the export of goods. Certain medical services, banking services and school education are also exempt from VAT.

VAT is charged on the transaction value. The tax collected by the business from its customers is paid to the tax authorities by way of a tax return, which is either filed monthly, quarterly or annually. VAT charged to the business (and paid to other businesses) is deductible from the VAT payable to the authorities, any negative balance of these amounts will be refunded. A foreign company may (under certain conditions) reclaim German input VAT.

There is a transfer tax in Germany of 3.5% to 6.5% on real estate. If certain conditions are met in the case of a group restructuring exercise, transfer tax will be exempt.

In addition, annual property tax on real estate will be payable up to a specific rateable value ('Einheitswert') which is essentially below the carrying/market value. However, the amount of annual real estate tax payable is immaterial in practice.

Treaties preventing 'double taxing'

General rules

Germany has concluded a wide range of agreements aimed at preventing 'double taxing'. Examples include withholding tax on interest (25%), royalties (15%) and supervisory board compensation (30%), plus a supplement of 5.5% (solidarity surcharge) under domestic legislation.

Such treaties cover almost all of the industrialised countries as well as many others. The rates negotiated for withholding tax rates are often lower than the local rates.

Benefit distribution (national withholding taxes, international tax exemptions)

Germany levies a dividend withholding tax on profit distributions by resident companies. The German dividend withholding tax rate is 25%, plus a supplement of 5.5% (solidarity surcharge). This rate may be reduced, often to 5% or nil under German legislation, double tax treaties (as above) or the EU Parent-Subsidiary Directive.

Tax treatment of losses

Losses may be carried back for a year and carried forward for an indefinite period. Restrictions apply to annual losses in excess of EUR 1 million, which can only be offset against profits up to 60% per year. The remaining amount may be carried forward.

In the event of a major change in the ultimate shareholder of a company, losses that have been incurred before the change cannot be offset against future profits unless certain tests are met.

Employer obligations (salary taxes, social security)

Generally, an employer is obliged to deduct tax and social security contributions from their employees' wages before paying this to the relevant tax authorities/social insurance institutes. The employer will be responsible for ensuring that the correct amounts of

tax and social security contributions are paid.

Tax on wages and social security contributions are normally paid on a monthly basis in arrears.

In Germany, social security contributions include:

- Statutory pension (including disability) insurance;
- Unemployment insurance;
- Health insurance;
- Nursing care insurance; and
- Occupational accident insurance.

With the exception of occupational accident insurance, which is entirely paid by the employer, the contributions to social insurance funds are split more or less equally between the employee and their employer. As above, the employee`s share of the social security contributions are withheld by their employer, who will pay these to the relevant institutes on behalf of the employee.

Author: Werner Schmid,Treuhand Union GmbH

Contact:

Essen

OECOTAX Revisions-und Treuhandgesellschaft mbH Wirtschaftsprüfungsgesellschaft Steuerberatungsgesellschaft Pelmanstrasse 46
45131 ESSEN
Tél. +49 201 78 20 61
Fax +49 201 78 12 57
E-mail : info@oecotax.de Site web : www.oecotax.de
Klaus KUCHENBUCH

München

TREUHAND UNION GmbH
Sonnenstrasse 20
80331 MUNCHEN
Tél. : +49 89 59 90 86 0
Fax : +49 89 59 90 86 66
E-mail : info@treuhand-union.de
Site web : www.treuhand-union.de
Ingrid MAYERHANSER-MARX, Werner SCHMID

Saarlouis

WHS Steuerberatungsgesellschaft GmbH Prälat-Subtil-Ring 3
66740 SAARLOUIS
Tél. +49 6831-45020
Fax +49 6831-450240
E-mail : hp@whs-steuerberatung.de
Site web : www.whs-steuerberatung.de
Helmut PORN