



DOING  
BUSINESS IN  
GERMANY

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RECHTSANWÄLTE STEUERBERATER WIRTSCHAFTSPRÜFER • PARTNERSCHAFT

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# Doing Business in Germany

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# I. The Country at a Glance

## **Language**

German is the predominant and only official language spoken in Germany.

## **Exchange Rates**

On January 1<sup>st</sup> 2002, the Euro became the legal tender in the twelve states participating in the monetary union. In Germany, it replaced the Deutsche Mark (DM) as the official currency unit. Nevertheless, the DM could be used as a currency until February 28<sup>th</sup> 2002. All the values expressed in DM for periods before January 1<sup>st</sup> 2002 have been converted on the basis of the fixed rate 1 Euro = DM 1.95583.

In 2004, the exchange rate for the U.S. dollar to the Euro ranged between 1.18 and 1.34 U.S. dollars. For current exchange rates, please refer to the European Central Bank ([www.ecb.de](http://www.ecb.de)).

## **Geography and Climate**

Covering an area of 357,021.54 square kilometres, Germany is one of the largest countries in Central Europe. The German territory reaches from the 6<sup>th</sup> to the 15<sup>th</sup> degree of latitude and from the 47<sup>th</sup> to the 52<sup>nd</sup> degree of longitude. Due to its central location in Europe, Germany has borders with nine European countries. Denmark is the only Scandinavian neighbour to the north. To the west, Germany is adjacent to the Netherlands, Belgium, Luxembourg and France. The southern neighbours of Germany are Switzerland and Austria. To the east, Germany borders the Czech Republic and Poland.

Since October 3<sup>rd</sup> 1990, i.e. after the five states of the former German Democratic Republic acceded to the Federal Republic of Germany, the Federation is composed of 16 states ("Länder"). Berlin, which is also a state of its own, is the capital of Germany.

The German climate is semi-continental, with cold winters, warm summers and rain in every season.

Germany's local time is one hour ahead of Greenwich Mean Time between the last Sunday in March and the last Sunday in October. During the rest of the year, it is two hours ahead of Greenwich Mean Time.

In 2003, Germany had a population of approximately 82.5 million with a population density of 231 inhabitants per square kilometre.

## **Cultural Influence on Business Conduct**

Freedom of business enterprise is a principle of the German Constitution (Grundgesetz) and there are no limitations on business activities based on cultural reasons. Nonetheless, especially after the strong immigration flows of the 1960s, people from many different cultures now live in Germany. This may partially influence the way business is conducted, but it does not influence the law.

## **Religious Influence on Business Conduct**

On the one hand, the German constitution (Grundgesetz) protects the free exercise of religion, but on the other hand it also guarantees the right to conduct business freely. Therefore there are no religious prohibitions on the way business is conducted. There are some influences of foreign religions, which are mostly practised by the immigrated population, but again they play no role in the law.

## **Infrastructure**

Germany offers highly developed infrastructures, comprising road, air and water transport.

The most important part of the infrastructure is the well developed road system. Every large town is reached by motorways. In Germany, most goods are transported by road.

Air transport is also highly developed. International airports are located in Berlin, Bremen, Cologne, Dresden, Düsseldorf, Frankfurt am Main, Hamburg, Hannover, Leipzig, Munich, Nuremberg and Stuttgart.

The railway system is also very efficient, with nearly every town having direct access to the railways. The railway network is often used for international traffic.

Transport by the waterways is also possible. Germany has access to the North Sea as well as to the Baltic. On the one hand, the big ports in Bremen and Hamburg offer the possibility for transatlantic navigation. On the other hand, waterway harbours like Bremen render inland navigation feasible through fifteen ship canals and several navigable rivers. Apart from these ports, it should be mentioned that the important international port of Rotterdam is not very far away and is linked to Germany by the Rhine.

The public transportation system is also well developed. Suburban railways and buses connect suburbs to the large cities such as Munich, Berlin, Hamburg and Frankfurt. Public transportation includes busses, underground trains and trams. It is always possible to use taxis.

### **Communication System**

As far as the communication system is concerned, Germany offers extensive and modern services. A number of private and competing providers offer good telephone services for both land and mobile networks, which cover the whole country. Digital telephone connections are also available. Written messages can be sent by internet, post or fax.

### **Public Services**

The supply of water is guaranteed by the individual municipalities and the network is publicly owned. The municipalities can found private companies to carry out this service. Until recently, electricity and gas supply companies were state-owned. Now there are still public companies offering gas and electricity, but there are also various competing providers selling their own services (for example, the joint-stock companies *e.on* and *Ruhrgas*). As a consequence, the state no longer has a monopoly on these services. Natural gas is not available in every region, but the network is being expanded so that even smaller villages will be gradually connected.

## 2. General Considerations

### Investment Policies

The German government and industry actively encourage foreign investment in Germany, and German law treats foreign firms in the same way as it treats German firms. There are no special nationality requirements on directors or share-holders, nor do investors need to register their investment intent with any government entity.

The 1956 U.S.-FRG Treaty of Friendship, Commerce and Navigation affords U.S. investors national treatment and provides for the free movement of capital between the U.S. and Germany. Germany signed the National Treatment Instrument of the OECD Committee on Investment and Multinational Enterprises (CIME) and the OECD Code on Capital Movements and Invisible Transactions (CMIT). Although Germany's foreign economic law contains a provision permitting restrictions on private direct investment flows in either direction for reasons of foreign policy, foreign exchange, or national security, no such restrictions have been imposed.

Germany lags somewhat behind in developing any kind of centralized inward investment promotion/assistance structure. For historical reasons, it runs most public business within a very decentralized, federalist system. However, as a centralized governmental agency which is devoted to foreign investment, Germany's current government set up the Federal Commissioner for Foreign Investment in Germany. The offices of the Federal Commissioner for Foreign Investment in Berlin, New York and Chicago are a primary source of contact and information for foreign investment in Germany supplying practical assistance to companies considering the setting up of a new business in Germany or the expansion of their already existing businesses there. The team of the Federal Commissioner for Foreign Investment supports potential investors with its far-reaching network of contacts in the public and private sectors of the German corporate world, assisting them in locating suitable sites for manufacturing, R&D, headquarters and back-office operations, providing information about markets and market segments, and connecting investors with the economic development authorities throughout Germany.

One bold step taken in investment promotion thus far is the New German Länder Industrial Investment Council GmbH (IIC), which was activated in early 1997 to represent eastern Germany. The IIC's team was the first official German agency to actively promote the interests of not just a state but an entire region.

The IIC has the mandate as well as the resources to professionally develop a worldwide network (other offices are located in London, New York and San Francisco) to help potential investors recognise and take advantage of the investment opportunities available, as well as to provide fullservice project support throughout the decision and execution processes.

### Rate of Inflation

The current rate (December 2004) of inflation in Germany is 2% and thus comparatively moderate. Due to the political process of reunification and the parallel economic development of the German New Länder there have been considerable shifts in the inflation rate for the last decade (from 2.8% in 1989 to 5% in 1992 and 0.6% in 1999). However, over the last six years the average German inflation rate has been below 2%, thus complying with the criteria put forth by the ECB for a stable European economic development.

## Investment Incentives and Restrictions

### General Situation

The expansion of the EU to Eastern Europe will necessarily result in a restructuring of the EU-based structural funding of certain Western European regions which are now considered underdeveloped. However, for the foreseeable future (at least until a new structural funds budget is implemented in 2007), investment incentives and support from the EU will continue relatively unchanged in Germany. This is good news for direct foreign investors in Germany, who are treated in the same manner as domestic investors when it comes to government financial support. Many advantages can still be found in the five new eastern German Federal States (Länder). The New German Länder will require another decade or more of state aid before they become self-sufficient. The German Chancellor Gerhard Schröder therefore pledged that the solidarity pact, which currently provides for the average annual transfer of € 25 billion (including provisions for investment incentives) to the former East Germany, should be renewed when the existing agreement expires in 2004.

A progressive development for the investor can also be found on the private side of financing an investment project. The banking system is restructuring and the venture capital market is growing faster than anywhere else on the continent. Furthermore, the much heralded tax reform which began to take effect at the start of 2001 significantly slashed corporate rates and eliminated capital gains taxes on the sale of shares by corporations.

### Special Investment Incentives

#### **Financial assistance for starting, expanding or re-equipping business**

The European Recovery Program provides for a wide range of investment financing, partly depending on the development stage of the enterprise, the industry sector and the investment purpose. Relevant for foreign investors are in particular:

- **ERP program “Equity for start-ups”**

This program offers long-term loans to start-ups of up to € 500,000.

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- **ERP program “Equity for growth”**

This program offers loans of up to € 500,000 for investments into an existing SME (established between two and five years before the investment).

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- **ERP program “Equity for employment and investment”**

This program offers investment loans of up to € 2 million for enterprises which are at least five years in operation, are financially sound and can be expected to perform well in the future.

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### ■ ERP Regional Assistance Program

This program offers long-term loans of up to € 500,000 for investments of SMEs both newly established and operating for some time either in the New Federal States, Berlin or the qualified areas in the old States.

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### ■ ERP Innovation Program

This program is designed to support the long-term financing of research and development projects in Germany and their subsequent market entrance. Although no technology is excluded, information and communications technology, material technology and biotechnology are focussed.

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### ■ ERP Environment and Energy Saving Program

This program offers low interest rate loans to private enterprises investing into environmental or energy saving measures. The maximum loan is € 500,000 in the old and € 1,000,000 in the new Federal States.

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In May 2004, the German Ministry for Economy and Employment (BMWA) published a brochure detailing the information on the different programs available. It can be ordered or downloaded from the website of the Ministry [www.bmwa.de](http://www.bmwa.de). More information on the above mentioned programs can also be found at [www.kfw-mittelstandsbank.de](http://www.kfw-mittelstandsbank.de).

### Loan Guarantees

Guarantee banks operate in all states and are prepared to provide guarantees for loans for investments to SMEs and start-ups which do not possess the typical collateral to guarantee their loans. Guarantees cover up to 80% of the defaulted loan. The maximum amount of the guarantee cannot exceed € 1 million.

### Investment Restrictions

Foreign and domestic entities have the right to establish and own business enterprises, engage in all forms of remunerative activity, and to acquire and dispose of interests in business enterprises. From a legal point of view, there are no exceptions to this basic principle. De facto restrictions (and also few exceptions to private activities) exist in the former public sectors concerning the supply of water, natural gas and electricity, as well as some aspects of the post, telecommunication and railway services.

The privatization of state-owned utilities has promoted competition and led to price reductions in some sectors. In 1998, Germany began to deregulate its telecommunications sector. Scores of foreign and domestic companies have invested in that sector, although the government continues to hold a 43% stake in the former monopolist Deutsche Telekom (DT). Since then, DT has lost more than one third of the long-distance market to competitors, but still maintains a 98.7% hold over the "local loop". The electricity market was opened to competition in April 1998. Foreign firms have invested in it, though with some difficulty, due to the high network fees. The natural gas market was liberalised in August 2000, but competitors have had enormous difficulties gaining access to the incumbents' networks.

Lufthansa Airlines has also been privatized, but the European Union (EU) requirement that the airline remains majority-owned by EU entities limits the extent of foreign investment. The German government also partially privatised Deutsche Post (DP) in November 2000, but the government decided to extend the DP's monopoly in letter delivery until 2007. The Cartel Office, as well as other regulatory agencies, address problems and settle complaints brought forward by foreign market entrants and bidders.

Bureaucratic discretion is strictly limited in Germany and decisions by administrative agencies can be subject to judicial review by the German Administrative Courts, which decide impartially and independently from governmental or executive influence.

According to Transparency International, the Berlin-based international "corruption watch agency", Germany is among the least corruption-plagued countries of the industrialised world. However, the construction sector, the privatisation of former East German enterprises, and the awarding of public contracts represent areas of some continued concern.

## Market

### Industry

The mainstay of the German economy is industry. In 2004, the roughly 48,000 industrial corporations with a turnover of approximately € 125 billion, employed about 6 million people. The great majority of industrial enterprises in Germany are of small or medium size. Only about 1.9% of industrial enterprises have more than 1,000 employees and nearly three quarters of all firms have fewer than 100 employees.

However, about 40% (2.6 million) of the total work force in the industrial sector is employed by large firms with more than 1,000 employees. These large companies are also very important customers for a multitude of small and medium-sized suppliers. Large companies generate about 51% of the total industrial turnover. (For more information see [www.facts-about-germany.de](http://www.facts-about-germany.de)).

With 775,000 employees (2004) and an annual turnover of € 209 billion, the automotive industry has a share of 18% in the German GDP, making it one of the most important branches of the German economy. With 5,506,629 cars in 2003, Germany is the world's third largest producer of automobiles (after the United States and Japan).

The engineering sector, producer of goods requiring capital investment, is made up to a large extent of medium-sized companies. Approx. 70% of the almost 6,000 companies in this sector have less than 100 employees (average throughout the sector is approx. 150). Engineering and machinery manufacturing are the largest industrial employers in Germany, and, with an export quota of 68%, extremely export oriented. 61% of all exports of the sector goes to Europe, the largest market for German engineering products.

In December 2003, 83% of capacity was absorbed. In 2003, the sector had an annual average of 885,000 employees, and a turnover of 132.4 billion Euro. 4.4 billion Euro was allotted to research and development and 4.2 billion Euro to investment.

The chemical industry is an important supplier of primary, intermediate and finished products for sectors such as health care, the automotive industry and construction, as well as for private consumption in Germany. With a total workforce of about 464,000, the chemical industry generated a turnover of approximately € 136.4 billion in 2003. Roughly 64% of its output was exported.

Branch of Industry	Employees	Turnover
Automotive industry	775,000	€ 208,6 billion (2004)
Chemical industry	464,000	€ 136.4 billion (2003)
Electrical engineering and electronics industry	814,000	€ 154 billion (2003)
Engineering	885,000	€ 132.4 billion (2003)
Food industry	550,000	€ 127 billion (2003)
Textile and clothing industry	150,500	€ 22.8 billion (2003)
Metal industry	3,500,000	€ 181 billion (2004 Q1)
Precision engineering and optical industry, process-control technology, electro medical equipment	253,000	€ 35 billion (2003)
Aerospace industry	70,200	€ 15,7 billion

With a turnover of € 154 billion in 2003 and about 814,000 employees in 2003, the electrical engineering and electronics industry is an equally important industrial branch in Germany. A turnover of about € 128 billion was produced in 2003 by the food industry, which has a workforce of about 550,000. The textile and clothing industry still plays a significant role, employing 150,500 people and generating a turnover of € 22.8 billion in 2003. With a workforce of roughly 3.5 million, the metal industry reached a turnover of approximately € 181 billion in Q1 2004. About 2,900 enterprises (mostly SMEs) operate in the precision-engineering and optical industry, process-control technology and the manufacturing of electro-medical equipment and timepieces, employing more than 253,000 employees with a turnover of more than € 35 billion in 2003. The aerospace industry, which employed about 70,000 people and generated a turnover of about € 15.7 billion in 2003, has pioneered the introduction of modern technology in many fields. Through its major European co-operation projects (such as Airbus and Ariane), it functions as a motor for co-operation between European industrial companies.

### Services

While the mainstay of the German economy is still the industrial sector, its relative importance has declined markedly in recent years as a result of structural change. Its share of the gross value of all economic sectors fell from 51.7% in 1970 (old states) to roughly 30% (Germany as a whole). In the same period, the public and private service sector considerably increased its share up to 70% in 2004. The definition of service sector includes distribution services (retail, transport, news), business services (financial and legal consulting, leasing), personal services (catering, culture, sports, household) and social services (state, health, education).

## Diplomatic Relations

### General Situation

After the end of World War II, German politicians saw their main goals in the coming decades as restoring their country's reputation, regaining its sovereignty, and becoming once again a member of good standing in the community of nations. Germany is, therefore, a party to many international agreements, coalitions and alliances. Two main developments have marked German history after 1945. The first was the reintegration of the FRG into western Europe, the second was the establishment of close diplomatic ties between the FRG and the U.S.A.

The first step towards the reintegration of the FRG into western Europe was the creation of the European Coal and Steel Community (ECSC), which was proposed in the spring of 1950 by the French foreign minister Robert Schuman in order to revive European economic cooperation and prevent future conflicts between France and Germany. The negotiations with France, Italy, Belgium, the Netherlands and Luxembourg on the ECSC were successfully concluded in June 1952. The establishment of the ECSC laid the foundations of the future European Community. Adenauer's conciliatory but resolute foreign policy also secured the admission in 1951 of the FRG into the Council of Europe, a body established in 1949 to promote European ideals and principles. The outbreak of the Korean War in 1950 convinced western leaders of the growing threat of international communism. The United States began to encourage European countries, in particular the FRG, to contribute to their own defence. After plans for a European defence community (EDC) had failed because of the French veto, negotiations were successfully concluded with the signing of the Treaties of Paris in May 1954, which ended the occupation statute and made the FRG a member of the Western European Union and of NATO.

The German-French Friendship Treaty (*Elysee Treaty*) came into effect in January 1963, calling for regular consultations between the two governments, semi-annual meetings of the heads of state, and a youth exchange programme.

The most important international agreements and partnerships in which Germany participates are: NATO (*the North Atlantic Treaty Organization*), the UN (*United Nations*), the EU (*European Union*), the OECD (*Organization for Economic Cooperation and Development*), the G-10, the OSCE (*Organization for Security and Cooperation in Europe*), the WTO (*World Trade Organization*), and the WHO (*World Health Organization*).

For further information on German membership of international organisations, follow the link [www.factbook.wn.com/Germany](http://www.factbook.wn.com/Germany).

A list of the addresses of all embassies in Germany can be found at [www.accracer.de/botschaften.html](http://www.accracer.de/botschaften.html).

### Restrictions on Business Dealings

There are no formal prohibitions or restrictions on certain business dealings with the country. However, with regard to the privatisation of the former public sector, specifically the telecommunications sector and the sectors of supply of gas, electricity and water, foreign enterprises have met with certain factual impediments and sometimes have found it very difficult to gain access to these sectors.

### Travel Restrictions

There are no travel restrictions within Germany.

### 3. Investment Incentives

Investment incentives in Germany are provided by the Federal Government and by the European Union. They are available to all investors and companies who qualify for each program, with, in principle, no discrimination on the basis of nationality, as long as the investment is beneficial for the German economy as a whole. In order to be eligible for the incentive, if the applicant is a company, it needs to have its registered seat or management in the Federal Republic. The nationality of its actual shareholder(s) is unimportant, i.e. subsidiaries of foreign companies and companies owned by foreign individuals or legal entities are not discriminated against as long as they are registered or incorporated in Germany. If the investor is a private individual, he or she is automatically eligible if he/she is a citizen of a member state of the European Union. Applicants from other countries should have either a right of unlimited residence or an unlimited residence permit for Germany.

#### Export Guarantees

German exporters may benefit from export guarantees provided by the Federal Government for the promotion of German exports. The management of the official export guarantee scheme is delegated to Hermes, a consortium consisting of *Hermes Kreditversicherung AG* and *PwC Deutsche Revision AG*.

The export guarantee is available as a guarantee for private buyers and as a guarantee for public buyers. The former is issued when the importer is a private enterprise, and therefore potentially subject to insolvency proceedings. The latter is issued when the importer is a government, a public authority or similar body. Besides credit risks (supplier credit cover), the Hermes guarantee can also cover the manufacturing risk (before-shipment cover), i.e. the costs up to the premature ending of manufacture as a result of a covered event which makes the completion or delivery of the goods impossible or unacceptable for the exporter.

The **Hermes guarantee** is available in the following forms:

- specific policy: cover for a single export contract with a foreign buyer;
- revolving policy: if the same foreign buyer is supplied repeatedly on conditions of short-term payment, the exporter may benefit from cover for all transactions with such buyer rather than a specific policy that would require a separate application for each transaction.
- whole turnover policy: this is a simplified procedure with lower premiums, available if an exporter regularly supplies a number of buyers in various countries on conditions of short-term payment.

Risks covered:

- Political risks: non-conversion and non-transfer of local currency deposits made by the debtor due to restrictions placed on international money transfers, as well as legislative or administrative measures, war or revolution abroad, which prevent payment of the covered debt. In case of supplier credit cover and whole turnover policies, the loss of entitlement to payment due to inability to fulfil contractual obligations for political reasons and the loss of goods due to events caused by political circumstances before the risk passes to the buyer are also covered.
- Commercial risks: inability to collect the debt due to insolvency of the foreign buyer; as well as failure to pay within six months of the due date (protracted default).

In case of the manufacturing risk guarantee, the insured may be indemnified for his own costs in case of:

- the insolvency of the foreign customer
- renunciation of the contract or serious breaches of contract
- sovereign actions and war
- embargoes applicable in Germany or to third countries participating in the export
- non-payment of cancellation costs or rights to part payment following justified cancellation by the customer.

The guarantee scheme does not cover 100% of the contract(s) value, and the insured must bear a share of the loss himself. As a rule, the percentage of cover is 95% for political risks and 85% for insolvency or protracted default. In case of the buyer credit guarantee and the manufacturing risk guarantee the cover is always 95%. It is important to note that the uninsured portion of the risk must not be insured elsewhere.

In order to apply for cover, an application must be submitted to Hermes, which will then present it to an Interministerial Committee for Export Guarantees for decision. Applications must conform to the generally accepted terms and conditions of international trade as laid down in the "Arrangement on Guidelines for Officially Supported Export Credits" and the recommendations of the "International Union of Credit and Investment Insurers". Application, issuing and prolongation fees are charged for handling applications. Premiums charged depend on the country risk group, the status of the buyer (public/private or private with a bank as guarantor), type of cover, amount of covered debt and terms of payment.

## Export Incentives

As a way of promoting the export of German goods, the Federal Government offers medium and long-term financing to exporters. Such financing is provided through the *Kreditanstalt für Wiederaufbau* (KfW) and the *Ausfuhrkredit-Gesellschaft mbH* (AKA). The only eligible transactions are the export of German capital goods and services to developing countries (according to the list of the OECD Development Assistance Committee). The so-called "countries in transition" are excluded. Another requirement is the granting of Hermes cover (as described above) by the Federal Government over a loan term of at least four years. As a rule, loans are tied to deliveries and granted directly to the buyer or to a bank in the buyer's country, but usually disbursed directly to the exporter.

### Kreditanstalt für Wiederaufbau (KfW) Loans

The maximum loan amount, depending on the available funds, is fixed as follows:

- 85% of the actual order value for contracts worth up to € 25 million.
- € 21.25 million (i.e. 85% of € 25 million) for contracts worth between € 25 million and 50 million.
- 85% of 50% of the actual order value, for contracts worth over € 50 million, usually not more than € 85 million.

The loans, granted in U.S. dollars or Euro, are subject to the Commercial Interest Reference Rate valid for the relevant currency at the time of signing the loan agreement. The interest rate is fixed according to the minimum interest regulation of the OECD Arrangement on Officially Supported Export Credits. In addition, a commitment fee of 0.375% p.a. is charged on the undisbursed loan amount from the conclusion of the loan agreement to the time of full disbursement. Repayment is performed in equal consecutive semi-annual instalments, with the first repayment instalment due six months after the starting point.

- Application for a loan should be submitted to the KfW as early as possible prior to conclusion of an export contract.

## Grants, Subsidies and Funds

### Further export financing by Kreditanstalt für Wiederaufbau (KfW)

In addition to the financing program described above, KfW also offers export credits refinanced exclusively from capital markets funds and therefore not subject to the OECD Arrangement minimum interest regulations. These funds may be granted as an alternative/complement to the above-described export financing program, or to finance export transactions to Central and Eastern European countries, former Soviet Union countries or industrialised countries.

### Ausfuhrkredit-Gesellschaft mbH (AKA) Loans

AKA provides export financing to small and medium-sized exporters. The requirements for eligibility are the same as for KfW loans (but no funds raised from the capital markets), and Hermes cover is also required. AKA grants loans up to 85% of the value of the export contract, but the total contract value per individual transaction may not exceed € 5 million. Applications should be submitted to AKA through the exporter's own bank.

Investment incentives, in the form of cash grants, subsidies or loans are made available to investors in Germany by both the Federal Government and the European Union. The amount of such incentives and the terms on which they are granted depend on two main factors: the geographical area in which the investor plans to operate (former West or East Germany) and the size of the enterprise applying for incentives (small/medium-sized enterprises or large enterprises). Small and medium-sized enterprises (SME) are enterprises with less than 250 employees with a maximum annual turnover of € 40 million or a maximum balance sheet sum of € 25 million. To a lesser extent, the type of activity also plays a role, and some activities are excluded. All funds are distributed through the *Kreditanstalt für Wiederaufbau* (KfW).

Any state aid package offered within the European Union is subject to approval by the European Commission if either the state aid is worth € 50 million or more, or if all three of the following conditions are fulfilled: the project investment amount is € 50 million or more, the state aid represents 50% or more of the maximum subsidy level, and the state aid per job amounts to € 40,000 or more. The Commission reviews the project and determines the maximum allowable incentive package. Three factors are taken into account: the effect on the market structures and on competition (market distortion); the capital-to-labour ratio of the investment project (capital intensity); the indirect-to-direct job creation ratio (regional impact). The Commission must reply to each application within two months.

The investor can receive help in crafting the appropriate incentive package, as well as support throughout the whole project finance process, from the Industrial Investment Council (IIC).

## European Recovery Program (ERP)

The European Recovery Program provides for a wide range of investment financing, partly depending on the development stage of the enterprise, the industry sector and the investment purpose. Of particular relevance for foreign investors are:

### ■ ERP program “Equity for start-ups”

This program offers long-term loans to start-ups of up to € 500,000. The repayment period may be up to 15 years. Interest rates vary from 0% in the first year to 5% in the fifth year; after the fifth year the then current interest rate for investment loans has to be paid.

### ■ ERP program “Equity for growth”

This program offers loans of up to € 500,000 for investments into an existing SME (established between two and five years before the investment). The repayment period may be up to 15 years. The interest varies according to the risk qualification and the financial situation of the borrower.

### ■ ERP program “Equity for employment and investment”

This program offers investment loans of up to € 2 million for enterprises which are at least five years in operation, are financially sound and can be expected to perform well in the future. The repayment period is ten years. Interest rates vary according to the general situation on the capital markets as well as to the financial situation of the borrower.

### ■ ERP Regional Assistance Program

This program offers long-term loans of up to € 500,000 for investments of SMEs both newly established and operating for some time either in the New Federal States, Berlin or the qualified areas in the old States. The repayment period may be up to 15 years. Interest rates are 4.25% in the New German States and Berlin and 4.5% in other areas of the Federal Republic.

### ■ ERP Innovation Program

This program is designed to support the long-term financing of research and development projects in Germany and their subsequent market entrance. Although no technology is excluded, information and communications technology, material technology and biotechnology are focussed. Depending on region and program part, the maximum loan varies from € 1 million up to € 5 million. The financing of several individual projects within the same enterprise is possible. The repayment period may be up to 10 years. Interest rates are 4.1% in the new German States and Berlin and 4.35% in other areas of the Federal Republic.

### ■ ERP Environment and Energy Saving Program

This program offers low interest rate loans to private enterprises investing into environmental or energy saving measures. The maximum loan is € 500,000 in the old and € 1,000,000 in the new Federal States. The repayment period is up to 15 years in the new German States and Berlin and up to 10 years in other areas of the Federal Republic. Interest rates are 4.25% in the new German States and Berlin and 4.5% in other areas of the Federal Republic.

In May 2004, the German Ministry for Economy and Employment (BMWA) published a brochure detailing the information on the different programs available. It can be ordered or downloaded from their website [www.bmwa.de](http://www.bmwa.de). More information on the above mentioned programs can also be found at [www.kfw-mittelstands-bank.de](http://www.kfw-mittelstands-bank.de).

### Incentives in Eastern Germany

The new states of Eastern Germany offer some of the most lucrative investment support packages available in Europe. Both large enterprises and SMEs making a greenfield, brownfield or start up investment can receive subsidies. The total incentive package can cover up to 50% (35% for non-SMEs) of the investment costs. These subsidies take the form of non-repayable grants, below-market rate loans and employment support programs. Most manufacturing firms, as well as industry-related services (e.g. research and development, technical design) are eligible. Some of these incentives (e.g. R&D venture capital support) are also available in Western Germany.

#### Cash bonus (*Investitionszulagengesetz*)

Investors are legally entitled to a cash bonus which is paid by the local tax authority. It is a tax-free cash payment or tax credit if there are profits reported during the year following the eligible expenditures. For SMEs, the bonus covers up to 27% (in Berlin 20%) of the purchase or production cost of new, depreciable equipment. For non-SMEs, it covers up to 15% (in Berlin 10%) of such costs. The bonus also covers 15% (in Berlin 10%) of the purchase or construction cost of new buildings for both SMEs and non-SMEs. The equipment must remain in Eastern Germany, and the building must be used commercially by the incentive recipient for a period of at least five years after the date of purchase or after construction is completed. Vehicles and used assets are not subsidisable. Application for the bonus must be submitted to the local tax authority at the time of the tax declaration, and the money is received around the middle of the following year.

While the relevant law (*Investitionszulagengesetz*) expired at the end of 2004, the government of the Federal Republic committed itself to an extension of investment support along similar lines.

#### Cash grants (*Investitionszuschuss aus Mitteln der Gemeinschaftsaufgabe*)

To be eligible for a cash grant, the investment must create long-term jobs, i.e. for at least a five-year period after completion of the investment, and at least 50% of the expected turnover must be generated outside a 50 km radius. Construction, farming, mining, shipbuilding, steel and transportation industries are ineligible. The cash grant will be calculated on either capital expenditure or labour costs, at the investor's choice. In any case, the maximum subsidisable investment amount is € 500,000 per job created and € 250,000 per job saved. Eligible capital expenditure includes: purchase or production of tangible assets such as buildings or equipment; purchase or production of intangible goods such as patents or software (for non-SMEs, only up to 25% of the total subsidisable investment); purchase of land and leased or rented assets. Eligible labour costs include all wage and non-wage costs for a two-year period, but the job position must be creating high value-added and must stay in existence for at least five years. Application for the cash grant must be submitted to the State development bank before the start of the investment, and the payment is received after submission of proof of expenditure.

#### Loans

- *ERP Regional Program*: applies to SMEs only. Long-term loans at favourable fixed interest rates which can cover up to 75% of the investment cost, with a maximum amount of € 3 million. The subsidised value of these loans reduces the maximum level of cash grants.
- *KfW Program*: applies to SMEs and non-SMEs with a maximum turnover of € 500 million. Long terms loans at favourable fixed interest rates which can cover up to 75% of the investment cost, with a maximum amount of € 5 million. These loans do not reduce the maximum level of cash grants.

Application for both kinds of loans must be submitted to the investor's own private bank before the start of the investment. The money is received after approval (about one to two months).

## Labour-related incentives

Labour-related incentives may apply to both SMEs and non-SMEs. They are:

- *Employment subsidy for start-ups (§§ 225-228 SGB III)*: subsidy of up to 50% of the wages per employee for up to twelve months in the case of hiring of unemployed or handicapped persons. Limited to 2 employees. Application at the local job agency (*Arbeitsagentur*).
- *Employment assistance (§§ 217-224 SGB III)*: subsidy of up to 50% of the wages for up to 12 months for the hiring of long-term unemployed persons. For employees older than 50 years, assistance for up to 36 months is possible. Application for these incentives can be submitted at any time to the local job agency (*Arbeitsagentur*).
- *Structural Adjustment Measures for Enterprises in East Germany (§ 415 Abs. 3 SGB III)*: This incentive can be granted for additional jobs for unemployed persons or who fulfil the conditions for receiving unemployment benefit, limited, however, to long-term unemployed, under 25 years, over 50s or handicapped. The amount is € 691 per month for a maximum of one year. The number of assisted jobs may not be greater than 10% of the workforce or 10 jobs.

## Research and development incentives

Research and development incentives can be provided as:

- *Cash grants from the economic ministries of the relevant new German States*: Available to SMEs only, it is granted for the development of new products, technologies or services. The maximum amount is € 200,000. Applications via the investment bank of the relevant state.
- *ERP innovation program/research and development loan*: Available to SMEs and non-SMEs with a maximum turnover of € 125 million. Maximum volume is € 5 million, the repayment period may be up to 10 years.

## Tax Incentives

Tax incentives in Germany are very limited, and there is no differentiation between the old and the new Federal States. The available incentives are:

**Depreciation allowance**: this is a special accelerated depreciation rate of 20%, which can be used in combination with the traditional depreciation method. It applies to the cost of purchase or production of all new movable capital assets.

**Capital reserves allowance**: this permits the creation of a reserve of up to 50% of the future production or acquisition costs for movable goods that are depreciable. The maximum amount of the reserve is € 150,000 (€ 300,000 for start-ups) and can be held for two years (five years for start-ups).

## 4. Financial Facilities

### The German Banking System

#### Banking

Unlike, for example, in the U.S.A. where a system of separate banks prevails, the German banking system is based on a universal principle. In Germany, banks are permitted to offer all usual financial and advisory transactions (e.g. investment, loan and securities transactions, investment advice, building society savings, leases and insurances).

In the German banking system, there are four major banking groups; private banks, public banks, cooperative banks and special banks.

While all banks, in principle, are universal banks, in the case of some special banks (building societies or investment houses) the range of business is usually limited to special functions. Even some public institutions such as the KfW Bank group (which arose in January 2003 by the merger of the Kreditanstalt für Wiederaufbau and Deutsche Ausgleichsbank) belong to this segment. The special role of the special banks is shown less by the number of branches or employees than by the market share of almost 23 % of balance sheet assets.

#### Central Bank

The German monetary system is, since 01.08.1957, the responsibility of the Central Bank. The characteristics of such a system is that one central bank monitors the flow of currency and has the exclusive right to issue currency. In Germany, the following banks are involved:

#### *The European Central Bank*

With the beginning of the European Currency Union on 1 January 1999, monetary jurisdiction in the Euro States transferred from the national central banks to the European Central Bank (ECB). The ECB is based in Frankfurt am Main and is conceived on the model of the German Federal Central Bank. Its most important task is the monitoring of the Euro and ensuring its stability.

Money policy measures are decided on by the highest committee of the ECB, the council of the ECB, which consists of the directors of the ECB and the central bank presidents of the Euro States. The council decides whether and which instruments of money policy are to be employed in order to guarantee the stability of the Euro (e.g. changing the basic interest rate).

### **The German Federal Central Bank**

The central bank of the German banking system is the *Deutsche Bundesbank*, which is located in Frankfurt am Main and which has nine regional head offices, called Bundesbank-Hauptverwaltungen. The Bundesbank is an integral part of the European System of Central banks (ESCB) and participates in the fulfilment of the ESCB's tasks with the primary objective of maintaining the stability of the Euro and ensuring the orderly execution of domestic and foreign payments.

Although the German Federal Central Bank, on the introduction of the Euro, transferred its competence as central money issuing bank to the European Central Bank, it remains the most important financial institution in Germany and exercises many functions.

- Bank of issue: together with the European Central Bank, the Deutsche Bundesbank is authorised to issue banknotes.
- The bankers' bank: the banks have to maintain balances known as minimum reserves at the Bundesbank. As a part of the ESCB, the Bundesbank is thus the banking system's ultimate source of refinancing.
- The state's bank: the Bundesbank is the principal bank of the federal government and, to a lesser extent, of the Länder governments. It carries accounts for public authorities, executes payments and assists the governments in their borrowings in the capital market. However, the Bundesbank is not allowed to lend money to public authorities.
- In addition, the Bundesbank provides the banks with banking services for settling cashless payments.
- Besides, it participates in the supervision of credit institutions and financial services institutions.
- Finally, it is the guardian of the monetary reserves of the Federal Republic of Germany, and invests them at interest.

### **Bank accounts**

Practically all bank transactions operate through or are reflected in one or more bank accounts. The establishment of any relationship with a bank, therefore, begins with the opening of an account.

The requirements for opening a bank account are:

- The bank must examine either a passport or an official identity card.
- If the person opening an account is opening it in the name of another, the bank must examine his/her authorisation to do so as well as proof of the existence of such other person.
- If the other person is a corporate entity, the bank must obtain extracts of the entity's registration.

### **Bank loan**

All German banks usually offer a variety of loan facilities. When applying for a bank loan, some specific regulations set up by the banks have to be considered. In most cases the bank will request security and information about the intended use of the proceeds of the loan.

## The German Stock Market

In addition to the Frankfurt Stock Exchange, there are seven regional stock exchanges in Germany (in Berlin, Stuttgart, Munich, Bremen, Hanover, Hamburg and Düsseldorf), which are mainly specialized in particular market segments. For example, on the Stuttgart Exchange approx. 70% of all warrants are traded.

### **Trading Segments under the Stock Exchange Act**

Because of the fact that the Frankfurt Stock Exchange, with more than 95% of the turnover in shares, is the most important stock exchange in Germany, the following comments, while referring to the Frankfurt Stock Exchange as an example, can mostly be extended to the seven regional stock exchanges.

At the present time, the Frankfurt Stock exchange has three market segments, the official market, the regulated market and free trading.

#### [1] Official Market

On the official market of the Frankfurt Exchange in March 2003 approx. 4,300 bonds and 4,072 shares were listed.

The conditions for admission to the official market are comprehensively determined by statute or by the rules of admission to the stock exchange. For example, the issuer must complete a certain admission process. In this process, the issuer must, together with at least one financial institution, a financial services provider and a company which is active according to Section 53 ss. 1 sent. 1 Banking Act or Section 53 b ss. 1 sent. 1 Banking Act, make an application to the stock exchange admissions office, which ultimately makes the decision as to admission onto the official market. In addition, the Stock Exchange Act and the Stock Exchange Admission Regulation provide certain obligations for issuers of admitted securities, focussing, in particular, on the preparation of interim reports.

Due to the amendment of the EU Prospectus Directive, the admission jurisdiction will, at the latest in five years, be transferred to a state authority, in the process of harmonization of the prospectus requirements Europe-wide.

#### [2] Regulated Market

On the regulated market of the Frankfurt Stock Exchange, there are at present 428 shares and approx. 1,200 bonds in trading (as of March 2003).

The regulated market is largely compatible with the official market because of references in the stock exchange rules of the Frankfurt Stock Exchange. Differences concern only the length of the period of existence of issuers, the partial admission of securities of a class and the minimum distribution of securities. Overall, this market segment is suitable for medium-sized companies for the acquisition of capital through the market.

### [3] General Standard and Prime Standard

The German legislature has authorized the stock exchanges to provide further requirements in their rules for the partial areas of the official market and the regulated market for the admission of shares or certificates representing shares. For example, the rules of the Frankfurt Stock Exchange, as amended with effect from 01.01.2003, provide for a division of the official market and the regulated market into a general standard and a prime standard.

The decision on admission to the prime standard is made by the admissions office of the Frankfurt Stock Exchange – as in the case of the general standard of the official market and the regulated market.

### [4] Free Trading

Free trading is, from the point of view of the companies listed thereon (in Frankfurt in March 2003 almost 4,800 companies were listed in this sector), the major market segment. In free trading, mostly foreign shares and options are traded.

Free trading does not require any formal admission and therefore no obligations connection therewith. An issuer can be listed – depending on the free trading directive – even without the knowledge or agreement of the affected company.

### **German Stock Exchange Index**

The stock exchange index is the price index reflecting the price changes on the stock market overall and/or individual groups of shares. The index is intended to serve as orientation for investors as to the tendency of the market.

The DAX, introduced in 1988, has become the acknowledged standard as representing the 30 largest German shares. It remains the only index exclusively of the German market. The major criterion for the inclusion of a company in the DAX is the 35/35 rule, according to which a share can only be included in the index if it belongs to the 35 largest companies according to the free float and stock exchange turnover criteria. Vice versa, a company can be removed from the index if this 35/35 rule is no longer fulfilled. A further criterion is the listing in the prime segment of the Frankfurt Stock Exchange.

## 5. Exchange Controls

### Business Transactions with Nationals, Residents or Non-Residents

#### Nationals

Natural persons can be German citizenship by:

- birth
- acceptance as a child
- grant of citizenship to a foreigner.

Further details are provided by the Citizenship Act. There are special provisions for *Aussiedler* and residents of the former German eastern territories.

#### Residents

Under the German Foreign Trade Act *residents* are:

- natural persons whose place of residence or usual place of abode is on the German economic territory (this includes the Austrian areas of Jungholz and Mittelberg),
- legal persons and partnerships having their registered offices or management in the German economic territory,
- permanent establishments of foreigners in the German economic territory, if they have their administration there, and
- branches of foreign subjects in the German economic territory if they have their management there, and for which separate book-keeping is maintained.

#### Non-residents

The following are *non-residents* under German foreign trade law:

- natural persons whose place of residence or usual place of abode is abroad,
- legal persons and partnerships having their registered offices or management abroad,
- permanent establishments of German residents abroad, if they have their administration there, and
- branches of German residents abroad if they have their management there, and for which separate bookkeeping is maintained.

#### Restrictions on conducting business

In principle, foreign enterprises can conduct business in the German economic territory under the same conditions as German enterprises.

Exports and imports of certain types of goods, such as weapons of war, nuclear technology and dual-use goods, are subject to prohibitions, restrictions or license in accordance with international agreements. Detailed provisions are contained in Regulation (EC) No. 1334/2000 of the Council of 22.06.2000 and in the Foreign Trade Act. In addition, the export of goods to certain states or certain recipients be restricted by regulation of the European Communities or resolutions of the security council of the United Nations (embargo).

## Money Transfer

### Reporting requirements

There are many notification obligations especially in the area of movement of capital and payments which affect German direct investment abroad and foreign investment in Germany, inter alia.

### Loans

There are no restrictions on granting or taking of loans.

## Investment Controls

There are no regulations discriminating against foreign direct or indirect investments in Germany.

### Exchange Rate

As Germany belongs to the European Monetary Union, the official currency in Germany is the Euro. The exchange rate to the dollar is determined freely by the market, and no pre-determined fluctuation margin applies.

### Import and export of Currency

No restrictions apply either to the import or export of currency. At the present time no states are subject to embargos extending to the import or export of currency.

### Notification obligations in the area of movement of capital and payments

There are many notification obligations in the area of movement of capital and payments, mainly applying to the general information of the offices responsible for economic and monetary policy in Germany. Notifications are to be made on the prescribed forms to the main administration of the Bundesbank in the area in which the obliged party is based.

Notification obligations apply in the area of the movement of capital to German direct investment abroad and foreign investment in Germany. For example, the formation of companies, the acquisition of participations and the granting of loans as operating capital, are subject to notification. Assets abroad and assets of foreigners in Germany, above certain limits, are subject to notification.

However, residents are, under certain conditions, obliged to report incoming and outgoing payments and claims of and debts to foreigners. Special notification obligations apply to payments between financial institutions, and for payments in transit trade and shipping.

## 6. Import/Export Regulations

### General Remarks

Germany is a member of the EEC. Most rules on customs, exports, imports, manufacturing requirements and trade regulations are, therefore, harmonised by European law.

Germany is a member of the WTO and GATT and acts in the framework of these rules.

On a regional basis, Germany is a party to numerous bilateral agreements. Under the General Preference System, the EU granted unilateral customs exemptions to the Central and Eastern European Countries. These countries enjoy preferential treatment when selling goods in the EU market, as the import of industrial goods is largely duty-free. Through the EU, Germany is linked to Iceland, Norway, Liechtenstein and Switzerland by a free trade agreement (European Economic Area), and makes use of the customs union with Andorra, San Marino and Turkey. Additionally, a wide range of EU preferential and other trade agreements with important economic partners have promoted European trade with non-member countries. Unilateral agreements on regional customs preferences exist with the countries of the Mediterranean region, as well as with the ACP states (countries in the African, Caribbean and Pacific regions) and the OCT states (Overseas Countries and Territories).

### Customs Regulations

Customs treatment is regulated by the Community Customs Code. Goods traded for free circulation within the Community are not subject to any customs process.

Goods imported from non-EU countries into the customs area of the Community are subject to the customs process. They must be presented as dutiable goods to the appropriate customs office, thereby initiating the customs process. This follows as soon as customs clearance is applied for, the purpose of the import being the decisive category. The application is usually filed by the carrier on the applicant's (German importer's) behalf.

Customs tariffs for member states are set down annually in the European Common Customs Tariff.

### Foreign Trade Regulations

As a rule, the principle of freedom of trade and payment transactions is the basis for all foreign trade regulations in Germany. Any restrictions are laid down in the German Foreign Trade Act (*Außenwirtschaftsgesetz*), and the Foreign Trade and Payments Regulation (*Außenwirtschaftsverordnung*).

The basic freedom of transactions in foreign trade is restricted by national, European, and international rules. However, the control lists of international control regime (MTCR, Austria Group, NSG, Wassenaar Agreement) have been reflected both at the national and European level. To sum up, the EU List of Goods and the German Export List serve as a legal guideline for any restriction on foreign trade.

## Imports

The import of goods is almost completely liberalised in the area of industrial products. Import licences are required only for precisely defined goods within strict legal limits. This is the case for some individual products and some countries of origin, especially in the textiles and clothing sector.

## Exports

As already mentioned, any restriction on foreign trade must fall within set legal limits. The legal regime for exports is based on the Foreign Trade Act, as implemented by the Foreign Trade and Payments Regulations. The provisions of these two pieces of legislation are supplemented by the export restrictions contained in the Military Weapons Control Act (*Kriegswaffenkontrollgesetz*). Apart from the national regime, the restrictions on foreign trade may arise from additional legal measures which could be adopted by the United Nations and the EU, such as embargoes, prohibitions on exports, or other special regulations.

A list of goods requiring export licences is laid down in the German Export List (Sections 5 and 7 of the Foreign Trade and Payments Regulations), reflecting the List of Goods of the EU Regulations. Basically, the national regime corresponds with the control lists of the international export control systems (MTCR, Australia Group, NSG, Wassenaar Agreement). Further, export licenses are required for dual-use goods as provided by Council Regulation (EC) No. 3381/94.

In addition to restrictions such as authorisation requirements, attention should be paid to other duties already mentioned in the customs treatment (see above), especially with regard to the accompanying documents or the country of origin rules.

## Manufacturing Requirements

Assuming that the customs clearance for free circulation is granted to imported goods, and no other restrictions apply, it does not automatically follow that the goods may be offered or sold on the market of the Federal Republic of Germany. As a rule, imported goods must comply with the same requirements as domestic products. Apart from this, a number of other laws provide norms and regulations with which specific products must comply. Among them: Poison Act (*Giftgesetz*); Feed Act (*Futtermittelgesetz*), Wine Act (*Weingesetz*), Quality Class Act (*Qualitätsklassengesetz*), Meatcontrol Act (*Fleischbeschau-Übergangsgesetz, Lebensmittel- und Bedarfsgegenständegesetz*). Generally, products do not have to contain ingredients or components being found or produced in Germany.

For technical working tools and machines, industrial safety and accident prevention standards must be observed. These take the form of so-called technical guidelines (*technische Anleitungen*), or other technical rules and quality standards.

## 7. Structures for Doing Business

### Governmental Participation

The Federal Republic of Germany operates a free market economy, in which the government does not seek to retain an active role in the conduct and financing of commercial or industrial enterprises, but rather to regulate the market in order to provide for good investment, production and competition opportunities.

Nonetheless, the government still owns a substantial share in some large enterprises that provide important services for the whole population, such as the German Railways. These are mostly stock corporations, in which the government acts like a normal shareholder, without particular privileges to the detriment of the private investor.

### Joint Ventures

There are two kinds of joint ventures allowed in Germany, the so-called equity joint venture, and the contractual joint venture. The equity joint venture is set up through a two-step process. Firstly, the joint venture partners set up and control a civil undisclosed partnership, by which they regulate their relationship with each other. This partnership is the actual joint venture. Secondly, another company is set up (the *Gemeinschaftsunternehmen*), completely controlled by the partnership, and the objectives of the joint venture are actually carried out by this company. This company can be any form of business association, limited or unlimited, corporate or non corporate. For all practical purposes, in Germany the most advantageous legal form for the *Gemeinschaftsunternehmen* is the GmbH. In fact it offers wide autonomy as far as the Articles of Association are concerned, and being controlled by only one shareholder (the partnership), the joint venture partners have complete control over it.

The contractual joint venture has a simpler structure compared to the equity joint venture. In fact it is only formed by a civil partnership, without the establishment of a second company.

Both forms of joint venture have advantages and disadvantages, and choosing the right one depends on the investors' needs and objectives. The contractual joint venture's main advantage lies in its simplicity. It is very simple, quick and cheap to set up, for it does not need registration (other than declaring its name and seat) and does not have a minimum capital requirement. It can be brought to an end without undergoing liquidation procedures. It also offers the advantage of secrecy: there is no requirement to publish the partnership agreement in the commercial register. All these advantages are unknown to the equity joint venture, because establishing a GmbH (or another corporation) requires more time, expenses and carries disclosure in the commercial register or publishing accounting records. The most significant difference for the investor between the two forms is that in the contractual joint venture the partners are subject to unlimited personal liability for the partnership's debts, as soon as the civil partnership engages in external transactions. On the other hand, the equity joint venture (having a limited company as the *Gemeinschaftsunternehmen*) offers limited liability to the joint venture partners. They are also taxed in different ways: the contractual joint venture, being a partnership, is not subject to corporate tax, while the equity joint venture is, since the *Gemeinschaftsunternehmen* is usually a corporation.

## Limited Liability Companies

### Gesellschaft mit beschränkter Haftung (GmbH)

The German limited liability company (*Gesellschaft mit beschränkter Haftung – GmbH*) is a corporate body with legal personality separate from that of its shareholders. Consequently, after registration, the shareholders are not liable for the corporation's liabilities and the corporation is subject to corporate tax. It is statutorily regulated by the GmbH Act (GmbHG) and by the Commercial Code (HGB). Its shareholders can be individuals, partnerships or corporations, and it is possible for a GmbH to have only one shareholder. A GmbH needs to have a minimum capital of € 25,000.

To be incorporated, and thus come into existence as a legal entity, it has to be registered in the commercial register maintained by the local courts. If the activity of a GmbH requires a licence (e.g. manufacturing/trading in pharmaceuticals, real estate agency), such licence has to be obtained before registration. Before applying for registration it is necessary that the shareholders pay in the capital, which may be contributed in cash or in kind, and at least one quarter of each capital share must be paid up. Added together, these payments must amount to at least half of the statutory minimum capital (i.e. € 12,500). Shareholders also have to provide the Articles (statutes) of Association, which must at least contain the name (which has to include the expression "*Gesellschaft mit beschränkter Haftung*" or "*GmbH*") and registered seat of the company, an objects clause, the amount of the stated capital and the amount subscribed by each shareholder. The capital must be fully subscribed. The Articles of Association must be signed by all managing directors in notarised form, and must include a statement as to whether the managing directors are authorised to represent the company alone or jointly. The application is submitted to the court competent for the place where the company will have its registered seat, and if the court is satisfied that all requirements for incorporation are met, it will enter the company (and its Articles of Association) in the register. The register is public.

The establishment of a GmbH takes place before a notary. Satisfactory evidence must be provided that the subscribing shareholders actually exist, and that the persons representing them are duly authorised. The incorporation of a GmbH will usually take between four to six weeks, and the costs of registration include the court fees and the notarial fees, which will be a percentage of the share capital. There is no requirement that any of the shareholders or managers be German or European, but laws relating to residence or work permits for non-EU citizens have to be complied with.

Every shareholder must possess at least € 100 worth of shares, and the shares need to be divisible by € 50. The shares are not freely negotiable, and their assignment requires a notarised deed, both the transfer agreement and the transfer itself. All changes in the Articles of Association, as well as capital increases or decreases, require notarial form. The notarial fees are a fixed percentage of the actual (not stated) value of the shares, and these fees can be enormous in case of large transfers. One way to avoid these fees is to notarise such deeds with Swiss Notaries, for they are recognised in Germany and their fees are much lower. The Articles of Association can provide all sorts of restrictions on the assignment of shares, such as pre-emption rights or requirements to obtain the other shareholders' consent. There is no shareholder register; but the managing director must submit an annual correct list of shareholders to the Commercial Register, together with the financial statements. Normally shares carry a right to vote in the shareholders' meeting, but it is possible to provide for non-voting shares in the Articles of Association.

### Stock Corporation (Aktiengesellschaft, AG)

The Aktiengesellschaft (AG) is regulated by the Aktiengesetz (AktG), the provisions of which are mandatory to a much greater extent than those of the GmbH Act. This means that an AG is much less flexible than a GmbH in its organisation. To be incorporated, an AG must have a minimum share capital of € 50,000. Shareholders can be individuals or any sort of company or corporation, and all shares may also be held by one single shareholder. The AG, in compliance with the HGB, has full accounting and disclosure requirements. The incorporation of an AG involves a three-step process, and in the case of the formation of a bank, insurance and investment company, it is necessary to obtain a licence. Firstly, it is necessary to set up the Articles of Association in full notarial form. The Articles must specify the founders, the par value, the issue price, the different kinds of shares and who subscribes for each kind (if applicable) and the amount of capital paid in. Secondly, the incorporators must subscribe the shares. Thirdly, the local court processes the application and enters the company in the commercial register, and at this point the company comes into existence as an AG. The incorporators also appoint the first board of managers and supervisory board, and these appointments must be registered in notarised form. It is possible for an incorporator to become a member of either board. Since 1994, it is possible for an AG to be incorporated by one single person (even a juridical person).

The governance of the AG is structured as a mandatory three-tier system, consisting of the board of managers (*Vorstand*), the supervisory board (*Aufsichtsrat*) and the shareholders' meeting (*Aktionärsversammlung*). The board of managers is composed of one or more persons (plus a mandatory employee director if the AG employs more than 2,000 people) and is appointed by the supervisory board. Directors can be removed from office only by the supervisory board and only for good cause (gross breach of duties, incapacity, vote of no confidence by the shareholders' meeting). Appointment and removal are to be registered in the commercial register. There are no restrictions on who can be appointed (the appointee has to be a natural person), but members are subject to very strict competition and conflict of interests rules. The supervisory board is composed of representatives of the shareholders and of the employees. One third of the board, or half of it if the AG has more than 2,000 employees, must be employees' representatives. It is composed of a minimum of three and a maximum of 21 members. The supervisory board appoints, supervises and removes the board of directors, but cannot be given any managing functions or representation powers. It represents the AG vis-à-vis the board of managers. It is not possible to be a member of both boards. The supervisory board has to give approval for certain kinds of transactions, as required by law or by the Articles. The legal liability of the members of the supervisory board is similar to that of the managers, but they are not subject to competition restrictions.

The shareholders' meeting is the assembly of all shareholders and is competent for the appropriation of retained earnings and the appointment of the annual auditor. It has to meet at least once a year. It has exclusive competence on all questions related to the economic and legal organisation of the AG, e.g. amendments to the Articles, mergers and transformation, dissolution and liquidation of the corporation. These decisions require either simple or qualified (2/3) majority. All resolutions have to be recorded in notarial form.

## Partnerships, General or Limited

There is a difference between civil and commercial partnerships. A commercial partnership may only be established for the purpose of running a business within the meaning of s. 1 and 2 of the Commercial Code. Artists, scientists and the liberal professions cannot form a commercial partnership. Instead, they can associate into a *Partnerschaft*, which is a form of partnership virtually identical to the OHG, but specifically reserved for such professions. The nature and size of the business must be such as to require a commercial organisation, including book-keeping and accounting. Commercial partnerships have to register their business name and domicile; name, domicile and status (general or limited) of all partners in the commercial register, but only the partners' signatures require notarised form. Therefore the cost of registration is very low and not linked to the size of the partnership. In the case of a limited partnership, the amount of the contribution of the limited partners has to be specified.

Partnerships are non-corporate bodies and have no legal entity of their own, so they are not subject to corporate tax. Nonetheless they can sue or be sued in their own name and acquire rights and real property. They can also delegate management functions to a third party.

### General Partnerships

#### **Offene Handelsgesellschaft (OHG)**

The OHG consists of at least two persons, which may also be legal entities, jointly running a business. There is no limitation on the number of partners. It is governed by the Commercial and the Civil Code. A written partnership agreement is not required but its trade name, domicile and name of partners have to be registered in the commercial register. The registration has only a declaratory effect, since the partnership can come into existence regardless of registration.

All partners are personally, jointly and fully liable for all debts incurred by the partnership. The structure of the OHG is not subject to many mandatory legal rules. In theory, each partner is entitled to represent and manage the OHG, and issues of basic interest for the partnership have to be decided by the partners' meeting. Nonetheless, the partnership agreement can provide differently. There is no minimum capital required.

#### **Gesellschaft bürgerlichen Rechts (GbR)**

The GbR is not subject to the Commercial Code, but only to the Civil Code, most relevant provisions of which can be disregarded if the partners so agree. A civil partnership can sue and be sued in its own name. The liability of the partner is the same as for partners of an OHG. If the partnership owns assets, title is held by all partners jointly and not shared severally. This means that a partner cannot dispose of his own asset share.

The partnership in theory should be managed by all partners acting together, but in the partnership agreement it can be stated who is responsible for the management and has power of representation. However, full management powers cannot be delegated to a third party.

A civil partnership can also take the form of an undisclosed partnership, the particular characteristic of which is that it does not itself engage in legal relations with third parties. The partners take all actions that go beyond their relations with one another in their own name and not in the partnership's name. Therefore there is no partner who has power of representation and who can bind the partnership vis-à-vis third parties. This kind of partnership is especially used for the setting up of joint ventures and silent partnerships.

## Limited Partnerships

### **Kommanditgesellschaft (KG)**

The KG is a company in which some partners are fully liable while others (*Kommanditisten*) enjoy limited liability. There must be at least one general, fully liable partner (*Komplementär*). There is no legal minimum on the amount to be paid in by the limited partners, but their names and the amount of their liability must be registered in the commercial register. If not registered, their liability is unlimited. All general partners are subject to direct and unlimited liability. Each general partner is entitled to represent the partnership vis-à-vis third parties, and the only way to limit this is to register that one (or more) particular general partners do not have power of representation, or that the partnership is represented only by two general partners signing together. The partnership agreement can provide internal limitations, such as the need for approval by all partners (or majority) for transactions which exceed a certain amount. Limited partners usually only participate in the management in issues that require a vote, but, if the agreement so provides, they can also be, for instance, appointed managing director and have power of representation.

### **GmbH & Co. KG**

It is a limited partnership where the general partner is a limited liability company. This means that the GmbH is fully liable for all debts of the partnership but, of course, being a limited company, only the company's assets are at risk, not the private assets of the company's shareholders. It is taxed as a partnership (only once, escapes corporate two-tier taxation) but in practice excludes unlimited liability for individuals.

The representation and management of the partnership rest on the GmbH, in practice on its managing director(s). Foreign limited companies are allowed to form a "Ltd&Co.KG" as long as they offer a similar creditor protection as a GmbH (e.g. minimum capital).

## Silent Partnership

A silent partnership (*Stille Gesellschaft*) can be set up by agreement between any company (which will be the principal), and a commercial company or a merchant (the silent partner). The silent partner does not own a share in the company's assets, but he does have a pre-determinate share in the profits and losses. Such share is not necessarily proportionate to his contribution. It is possible to agree that the silent partner should not bear a share in the losses, but his right to a share in the profits cannot be excluded. His liability is limited to the amount invested. In case of the principal's bankruptcy, the silent partner's position is that of an outside creditor, so that he can claim repayment of his contribution, minus the amount of his share in the losses. There is no requirement to disclose the existence of a silent partnership to third parties. This partnership is treated like a loan for tax purposes, so the silent partner's profits will be taxed as income from capital and not as business income. In order for his income to be qualified as business income, the silent partner should participate in losses, in any increase or decrease in the value of the assets or even in the management (atypical silent partnership).

## Sole Proprietorship

### Partnership Limited by Shares

The Partnership Limited by Shares (*Kommanditgesellschaft auf Aktien – KGaA*) is a corporate body, with legal personality of its own, consisting of regular stockholders (*Kommanditaktionäre*) and one or more general partners with unlimited liability (*Komplementär*). It can be conceptualised as a hybrid between a limited partnership and a stock corporation, as it contains elements of both and is statutorily regulated by the Stock Corporation Act (AktG) and the Commercial Code (HGB). Unlike partnerships, the KGaA is subject to corporate tax.

To be incorporated, the Articles of the KGaA need to be recorded by a notary and the company needs to be registered in the commercial register. The requirements and the procedure for registration follow that of a stock corporation: it must have a minimum capital of € 50,000, but in addition it needs to have at least five incorporators. After registration, the partners' liability for the company's debts is as follows: the general partners (*Komplementäre*) bear unlimited personal liability, while the *Kommanditaktionäre*'s legal position is that of a stock corporation's shareholder, i.e. limited liability and free negotiability of their shares. The Partnership Limited by Shares must have at least one general partner who may own all shares (so-called One-Man-Partnership Limited by Shares).

The KGaA has a three-tier governance structure: the unlimited partners (who take the place of the Board of Directors), the shareholders' meeting and the supervisory board. The general partners have full power of management and representation, although it is possible to provide in the Articles for the exclusion of some of them from such powers. The stockholders sit in the shareholders' meeting, which has a right to reserve approval for certain retained transactions (i.e. that go beyond the corporation's ordinary business), as regulated in the Articles. The supervisory board represents the shareholders against the general partners and enforces the decisions of the shareholders' meeting. The KGaA's supervisory board is much weaker than the AG's, for it does not have the power to appoint and dismiss the management, but merely to supervise their actions. This is the advantage of the KGaA as the mandatory codetermination of the employees, who delegate representatives to the supervisory board, has no effect on the management.

A sole proprietor (*Einzelkaufmann/Freiberufler*) is a natural person doing business or exercising a profession. He bears all losses and takes all profits and personally bears all risks. He is personally liable to his creditors without limitation, and there is no distinction between his private and business capital. Both his private and business creditors can satisfy their debts against the sole proprietor's entire assets. If he is a merchant, he might be subject to the German Commercial Code (HGB), and must apply for registration in the commercial register where his business is registered under his trade name. He has to keep books and draw up a balance sheet once a year. He is subject to personal income tax only.

## Branches/Subsidiaries/Representative Offices

A foreign investor may undertake business activities in Germany by establishing a branch or a pure representative office of the foreign head office, or by creating a subsidiary in the form of a partnership or corporation. The representative office is the only form of establishment which does not create a taxable presence in Germany, but in order to qualify as such it must be very carefully set up: it has to perform auxiliary functions only and cannot involve a dependent agent who has the power to enter into contracts on behalf of the foreign investor.

On the contrary, a subsidiary involves the setting up of a company controlled by the foreign corporation, and can take the form of any German partnership or corporation, with the relevant registration procedures, tax consequences and potential liability for the investor (see above). Most foreign investors structure their German subsidiaries in the form of a GmbH, for it offers a high degree of flexibility and limited liability for the foreign head office.

Finally, a branch is considered as the German representation of the foreign corporation, not as a separate legal entity distinct from the parent company, and it is therefore not incorporated in Germany. The major consequence of this is that the head office is directly liable for all obligations and claims relating to the branch. On the other hand, since the branch has a certain degree of independence in carrying out its business, it is subject to taxes and to German law. Even though a branch is not incorporated in Germany, it needs to be registered in the commercial register. To register the branch, the court will request evidence of the legal existence of the head office, copies of the Articles of Association, names of all managing directors, the amount of the share capital, the location of the principal place of business of the corporation and the names of the persons acting in Germany. All this information will be published in the Federal Gazette (*Bundesanzeiger*). Since January 2001, branches are subject to the same corporate tax rate on retained earnings as subsidiaries, and no withholding tax is charged on profits remitted by the branch to the foreign head office.

## Trusts and Other Fiduciary Entities

Trusts (*Treuhandverhältnisse*) under German law are subject to the same legal principles as trusts in Anglo-Saxon jurisdictions. Nonetheless, a trust in Germany is not a typical legal form, it is not regulated by the Civil Code (BGB) or the Commercial Code (HGB) or any act, and is not at all as common as in Common Law countries. It is established and regulated by contract, and it finds its most common practical application in companies and corporations, i.e. in the administration of shares or interests in companies. This means that it is possible for a partner or a shareholder to administer as trustee the share of another partner or shareholder. In this case the trustee is in fact the shareholder vis-à-vis the other shareholders and third parties. He carries on business in his own name and not as a representative of the beneficiary, but he owes a fiduciary duty to the beneficiary as far as the administration of the beneficiary's shares is concerned. Breach of such duty makes the trustee liable for damages to the beneficiary. A trust can take the form of an *eigennützige* or *fremdnützige* trust. The former is established to pursue the trustee's interests (e.g. the trustee holds the trust assets as security), while the latter serves the beneficiary's interests (the trustee holds the trust assets solely for the beneficiary's benefit). A trust is not itself subject to taxes. Rather, all profits made through it are to be taxed as those of the beneficiary himself.

## 8. Operation of the Business

### Advertising

Advertising in Germany is mainly dealt with in the amendment of 08.07.2004 to the Act against Unfair Competition, which further liberalised the German unfair competition law – the Discount Act and Free Gifts Regulation having been repealed in 2001.

The amended Act against Unfair Competition Act contains a general clause (Section 3) which is referred to in the further provisions. The Act has particular significance for advertising (nuisance, camouflaged advertising, value advertising, competitions and games of chance, comparative advertising, misleading of the market etc.). The Act, however, also covers other competitive actions, for example, intentional hindrance of competitors, interference with the sales systems of others, disparaging comments etc. Infringements against provisions other than those of the Act are also regarded as unfair actions if they are intended to influence the market in the interests of the participant (Section 4 no. 1 I Act against Unfair Competition). This covers, for example, the provisions on protection of health (the Act on Advertising Non-medical Health Products, Medical Preparations Act, Act on Food and Goods in Daily Use) but also price regulations and professional regulations (for doctors, lawyers etc.).

According to the general clause of Section 3 Act against Unfair Competition, unfair competitive acts intended to influence, in a not insignificant way, competition to the disadvantage of competitors, the consumer or other market participants, are inadmissible. Examples are (Section 4 Act against Unfair Competition) interference with the free decision of the consumer, for example by the exercise of pressure or other unreasonable improper influence, exploitation of the business inexperience, in particular, of children or young persons, concealment of the advertising character of acts of advertising, unclear presentation of the conditions for participation in competitions or games of chance or making participation of consumers in competitions or games of chance subject to the purchase of goods or a service (unless the game of chance is naturally associated with the goods or service, for example, as is the case with competitions in periodicals), demeaning or defaming competitors, alleging matters to be true which are not true and which are appropriate to damage the operations of another or the creditworthiness of a business, copying of goods or services of a competitor if, inter alia, an avoidable confusion of the consumer as to the origin of the goods would be caused.

Misleading advertising is also forbidden (Section 5 Act against Unfair Competition) and in this case even true, but misleading, statements can be subject to this prohibition, as can concealment of relevant data prior to the conclusion of contract. So-called inducement advertising, i.e. if goods are not maintained in reasonable quantity for the satisfaction of anticipated demand, can also be misleading advertising. Reasonable in this sense usually means a period of two days.

Comparative advertising (Section 6 Act against Unfair Competition) is only unfair under certain conditions, e.g. when it does not refer to goods or services for the same demand or the same purpose or does not refer objectively to significant, relevant, verifiable and typical characteristics or the price of such goods/services or the evaluation of a description used by a competitor is exploited or interfered with in an unfair manner.

## Attorneys

The new Section 7 deals with unreasonable nuisance. The prohibition of unreasonable nuisance refers to acts which in their nature and kind, independently of their content, are seen as nuisance. Section 7 ss.2 refers – not exclusively – to some examples such as telephone marketing without prior approval of the consumer. Furthermore, inadmissible postal – or e-mail and SMS – advertising is dealt with. Even advertising mail and letterbox advertising individually addressed can be unfair. With regard to telephone advertising the legislator decided for the so-called opt-in solution, according to which a telephone call to the consumer for advertising purposes is only admissible if the person telephoned has previously expressed his approval. In the case of other market participants, at least their implicit approval is required. In the case of e-mail advertising, the electronic postal address (e-mail, telephone number for SMS advertising) can be used under narrow conditions by a business which has received this information from the consumer in the course of a sale of goods or services, including for direct advertising for similar goods or services (unless this has been forbidden by the consumer). However, the customer when his address is recorded and in case of each use thereof, must be clearly and unmistakably advised of the right to refuse.

The Act contains two penal provisions, namely Section 16 in which intentional misleading advertisement and the conduct of so-called snowball systems are dealt with. In addition, the disclosure of business or operational secrets is an offence under Section 17 of the Act.

In principle, any competitor and even consumer protection associations under certain circumstances, can claim cease and desist orders and compensation for breach of Section 3. In the case of an intentional breach there is, in principle, a claim for the return of the profit made. Not, however, to the competitor affected but to the Federal Budget (Section 10).

The requirement to have local counsel (so-called “*Anwaltszwang*”) is limited to the cases explicitly stated by the law. This is only the case of pleading in court, and only in higher courts. Four levels of courts are distinguished: *Amtsgerichte* (Local Courts), *Landgerichte* (Regional Courts), *Oberlandesgerichte* (Higher Regional Courts) and the *Bundesgerichtshof* (Federal Supreme Court). As a general rule, only in the higher courts is there a requirement of legal representation by an attorney, while in the *Amtsgericht*, there is no such requirement. There are, however, a few exceptions, e.g. some family law issues require representation by a lawyer in any court, but for investors such exceptions are of little importance.

There are a number of ways of finding an appropriate local counsel. The Internet and/or legal directories may be consulted.

The fees to be paid to an attorney are regulated in a comprehensive *Bundesrechtsanwaltsvergütungsgesetz*. However, it is possible to agree fees on another basis, e.g. hourly rates. Legal fees may be considerable.

## Bookkeeping Requirements

As a rule, German companies adopt national accounting standards as prescribed in the Commercial Code (*Handelsgesetzbuch – HGB*). These accounting standards have to comply with the principles of proper accounting (*Grundsätze ordnungsmäßiger Buchführung* (GoB)). Nonetheless, the GoB are not incorporated in any special act or directly referred to. Rather, they are involved in a number of acts, EU norms, judgements, non-legal statements of bodies such as the German Industrial Trade Association or German Institute of Auditors.

The accounting system is transparent and consistent with international banking norms, and financial statements prepared in accordance with International Accounting Standards like US-GAAP and IAS are recognised under German Law. A body corresponding to the Financial Accounting Standard Board has also been suggested.

By now, listed companies are obliged to prepare their consolidated financial statements in accordance with US-GAAP or IAS. Furthermore, banks have increasingly gone over to publishing their financial statements in the IAS. This has led to a steady increase in the number of German companies reporting under US-GAAP and IAS. The US-GAAP might be referred to as “*Bilanzierungspraxis ordentlicher Kaufleute*” (Bookkeeping practice of prudent businessmen) and thus slowly becoming part of the German principles of proper accounting.

## Business Ethics/Codes

In 2002, the German Federal Government published a German Corporate Governance Code. The Code has been drafted in cooperation with the business community and aims at promoting the trust of national and international investors, customers, employees and the general public in the management and supervision of listed German stock corporations. Although it is a body of non-binding recommendations, compliance with it is viewed as a sign of commitment to make Germany a more attractive place in which to invest. The code contains nationally and internationally recognised principles for correct and responsible corporate governance, and adherence is desirable for all investors.

The Corporate Governance Code has to be seen in connection with the Transparency and Disclosure Act (*Transparenz- und Publizitätsgesetz*), which requires management boards in Germany to disclose annually, in the electronic Federal Gazette, any deviations from the Corporate Governance Code, as well as an explanation for such non-compliance. The reason for the publication requirement is to ensure that information is permanently available to shareholders. The requirement is not toothless, as it may have a considerable influence on the share price.

The code is primarily addressed to listed corporations, but serves as a guideline of corporate governance for non-listed companies as well.

## Consumer Protection Laws

Effective consumer protection law aims at ensuring that the consumer is placed in an equivalent bargaining position as the non-consumer contracting party. Thus each investor has to consider that the consumer, as a “weaker” party, may be protected under special circumstances. These circumstances are the object of concern of the general regulations in the Civil Code (*Bürgerliches Gesetzbuch* – BGB) as well as of the special provisions contained in specific laws.

In Germany, the general protection is provided in the Civil Code. As a basis, the consumer is defined as a natural person entering into contracts for purposes that are not ascribed to his/her commercial activity. Consumers entering into agreements regulated by the other party’s so-called general terms and conditions of contract (developed as a model for an indefinite number of contracts), deserve special protection. These contracts, for instance, cannot include clauses which are unreasonably detrimental to the consumer, such as exclusion of liability clauses.

In general, these legal provisions must always be referred to when possible restrictions for an investor are examined.

## Construction

Very detailed building permit requirements are provided for in the Federal Building Code (*Baugesetzbuch, BauGB*) and in state law. On the one hand, federal law is concerned with *Bauplanungsrecht*, i.e. urban building and rules for zoning maps and urban renewal measures. On the other hand, state law deals with the *Bauordnungsrecht*, i.e. regulations for the construction, modification or demolition of buildings. In principle, the construction or modification of any building requires a permit, with a number of specific exceptions. For example, there is no need for permission for the construction of buildings in the urban area which do not exceed a volume of 75 m<sup>3</sup> and do not have a heating system. Some modifications to buildings are also free from permit requirements, such as repair works to the heating systems. Also freed from permit requirements, as long as they comply with the local building plan, are the construction or modification of homes, small warehouses or buildings for commercial or industrial use (maximum one floor and 500 m<sup>2</sup>). In these cases, a fast-track procedure is available to apply for certification by the competent agency that the project complies with the local building plan. The agency has to process the application within one month.

If a permit is required, it has to be applied for with the administration agencies of the municipality (*Kreisverwaltungsbehörden*) where the building is or will be located. The ultimate responsible body for building supervision is the State Home Office, which delegates decision-making powers for building permits to the municipalities. Application for permission has to be submitted in writing to the municipal agency, together with all relevant documents and building plans. The application and the project must be signed by the person ordering the building and by the engineer or architect responsible for the project.

## Contracts

The application is then processed by the competent municipal agency, which is required to handle it without undue delay. Usually, if an application only needs approval from the municipal agency, it will take about one month to reach a decision, provided the application was filed correctly and included all relevant documents. This time frame may be longer if the approval of other agencies at higher level (e.g. state level) or any other *body representing a public interest* is required. The competent authority will grant the permit if it is satisfied that the building project is compatible with the area's building plan and that the buildings will comply with all health and safety regulations (e.g. fire-protection) and with any public laws applicable. Of course, the municipal agency has the power to verify compliance on site, both during and after completion of the building.

There are application fees, but their amount varies from agency to agency and on the size of the project.

German law upholds the principle of freedom of contract. Everyone can enter into contracts with anyone, and the parties can govern their relations freely. For the vast majority of contracts there are no particular requirements of form, and in principle oral agreements are also legally binding and enforceable.

The other question is, which law is applicable to a specific contract between parties of different nationality. In principle, the parties are free to state in the contract which law is to be applied (freedom to choose the legal regime to which the contract will be subject). This rule is subject to exceptions, as stated in the Introductory Act to the German Civil Code (EGBGB) in the section concerning Conflict of Laws. The choice of law in a contract will be disregarded by the courts under certain circumstances, such as when it would be clearly unjust or contrary to public order to enforce it. If the parties did not include such a clause in the contract, the question of the applicable law will be decided according to the German provisions on conflict of laws, as stated in the EGBGB.

Moreover, it is possible to agree on the use of UNCITRAL law on the international sale of goods, as a specific law designed to govern sales beyond national borders. Especially the so-called "Insotermis" may serve the purpose of providing a uniform interpretation of certain delivery clauses used in foreign trade, such as exact supply and other purchase obligations of the contracting parties, the allocation of risk, distribution of costs, transport and insurance matters, as well as the procurement of documents and certificates of origin.

The question of the court jurisdiction is to be distinguished from the question of applicable law. As an alternative to litigation in the ordinary courts, it is of course possible to adjudicate disputes by way of arbitration. An arbitration clause, if properly incorporated in the contract, will be normally enforced by the courts, and it is possible to obtain an order of stay of proceedings. Nonetheless, German courts will verify the validity of the arbitration clause in every specific case, and the right of a party to appeal to an ordinary court cannot be excluded.

### Price Controls

Usually, there are no applicable price controls. Under special circumstances some price regulations may be imposed. This is the case of the Renewable Energy Act (*Gesetz über den Vorrang erneuerbarer Energien – Erneuerbare-Energien-Gesetz*). Accordingly, the electricity network-operating authority has a duty to take the stored electricity and provide the corresponding compensation. The amount of compensation to be paid is stated in the Act and depends upon several criteria.

### Product Registration

Product registration requirements apply especially to sensitive products, such as software. At the European level, there are provisions for a standard procedure for registering a product name. Firstly, the product must be defined according to precise specifications. Secondly, the application, including the specifications, must be sent to the national competent authority. After being examined at national level, the results are transmitted to the European Commission. In this phase, the product undergoes control procedures, at the end of which it will be ascertained whether there are any objections or if the requirements are met. In any case, there follows a publication in the Official Journal of the European Community.

### Reductions or Return on Capital

If a foreign investor establishes a company or a corporation in Germany, there is no requirement that all or part of the profits made remain in Germany. Therefore the investor is allowed to take profits out of Germany, and these profits will be taxed according to the applicable German taxation rules. Whether the investor will be subject to double taxation depends on his/her home country's own rules or any bilateral or multilateral treaty which may exist between Germany and the foreign country in question.

As far as capital is concerned, it is likewise possible to transfer capital gains made in Germany into another country, without restrictions as to the amount. It is also possible to reduce a corporation's capital while the corporation is still ongoing, but only as long as the remaining capital amount is not less than the statutory minimum.

## Sale of Goods

There are only technical restrictions to the sale of goods in Germany, concerning shops' business hours or licenses. For instance, there is a requirement that shops stay closed on Sundays and public holidays and observe the business hours provided for by law.

As a rule, any person planning to engage in the sale of goods, in a shop or otherwise, needs to obtain a licence. Such licences are obtained very easily for the vast majority of goods, while special regulations apply to certain kinds of goods such as pharmaceutical products, chemicals or firearms. For these kinds of goods, the seller may need to have special personal qualifications (e.g. the seller of pharmaceuticals must have a degree in pharmaceutical studies), or the buyer must have a licence himself (e.g. firearms). Other general restrictions on the sale of goods arise from antitrust and unfair competition laws which, for example, limit the possibility and regulate the manner of door-to-door sales. Rules on product guarantees and standards of quality should also be taken into consideration.

## Trade Associations

For nearly all aspects of business enterprise, there is an industry or trade association which is active in a particular field. When trying to establish a partnership, these may serve as a suitable point of contact.

This is only a very small sample of the most important associations in Germany which are open to everyone:

- Bundesverband der Deutschen Industrie e.V. (Federation of German Industries) in Cologne
- Deutscher Industrie- und Handelstag (Federation of German Chambers of Industry and Commerce) in Bonn
- Bundesverband des Deutschen Groß- und Außenhandels e.V. (Federation of German Wholesale and Foreign Trade) in Bonn
- Zentralverband Elektrotechnik- und Elektronikindustrie e.V. (German Electrical and Electronic Manufacturers Association)
- Verband Deutscher Maschinen- und Anlagenbau e.V. (German Association of Machinery and Plant Manufacturers)
- Centralvereinigung Deutscher Handelsvertreter- und Handelsmakler-Verbände (General Association of Commercial Agents and Brokers)

## 9. Termination of Business (GmbH)

A GmbH may be wound-up (i.e. liquidated) voluntarily by a shareholder resolution on the liquidation of the company and the appointment of a liquidator (usually the current managing directors). Subsequently, the liquidation and the name of the liquidator must be filed for registration with the competent commercial register. After announcement of the liquidation a one-year suspension period begins. Creditor claims must be satisfied and a final balance sheet be presented. The current business operations must be ended, claims liquidated, liabilities satisfied and the company assets be liquidated. After the approval of the annual report and, later, of the final liquidation balance sheet by shareholders, a final account will identify, inter alia, what is then distributed to shareholders. Finally, at the end of the liquidation period the dissolution of the company is filed for registration with the commercial register and, thereafter, is announced accordingly.

Until the end of the liquidation period agreements between the GmbH and its employees, in general, remain in effect. The fate of the individual employment relationships, however, is guided by German labour law.

Due to the suspension period required by law, the winding-up of a GmbH will always take more than one year. The actual time scale depends on the scope of the company's business before liquidation and the level of distribution etc. connected to existing claims, liabilities and the like.

Notary costs are based on the value of the business. The company must also take into account any accountants' fees etc. regarding the preparation of balance sheets etc.

During the liquidation period, the GmbH remains liable to taxes. The liquidator thus has to pay the current taxes of the GmbH and to fulfill any fiscal obligations.

## 10. Labour Legislation, Relation and Supply

### Employer/Employee Relations

Labour law in the Federal Republic of Germany is codified and almost entirely consists of federal law. There is no consolidated labour law code, but many hundreds of separate statutes and regulations containing provisions relevant to labour law. Relations between employers and employees are also governed by collective bargaining agreements, works agreements and individual employment contracts.

The Occupational Training Act obliges employers who have employed persons as trainees, to train them. The employment of trainees, however, is discretionary. The employer is also obliged, based on the principles of care for employees developed in court judgments, to provide further training for its employees. In practice, this has very little significance.

### Employment Regulations

#### Hiring of Nationals

There is no obligation to hire German nationals.

#### Minimum Wage

There is no statutory minimum wage. However, in some cases, collective bargaining agreements provide for minimum wages. Payment of less than 80% of the normal wages under a collective agreement by employers not party to the agreement, can lead to the invalidity of the employment contract due to wage dumping (Section 138 ss. 1 Civil Code). Payment of only 66% of the normal collective bargaining agreement wages can constitute a crime due to wage dumping (Section 302 a Criminal Code).

#### Maximum Number of Working Hours

On working days (which include Saturdays), employees may not work longer than eight hours per day or 48 hours per week. Extension to maximum 10 or 60 hours is possible if this is balanced out by free time within a certain period (Sections 3 ff. Working Times Act). In principle, working on Sundays and holidays is prohibited although there are exceptions for certain types of work and persons, e.g. in the catering industry, leisure, recreation and entertainment centres, the media and the energy industry. The employer is obliged to record the employee's working time in excess of the daily working hours, and to maintain these records for at least two years.

#### Minimum Number of Vacation and Sick Days

The employee has a right to paid vacation of at least 24 working days (including Saturdays) in a calendar year. In principle, this vacation must be taken by the end of any year. A carry-over to 31.03. of the following year is possible in certain circumstances. In Germany, it is normal that up to six weeks vacation be agreed.

The employer is obliged to continue paying an employee who is incapacitated from work due to illness and cannot therefore perform his duties for a period of up to six weeks at the rate of the remuneration contractually agreed. After six weeks illness this duty ceases. From that point the employee's health insurer will pay sickness benefit. If an employee is repeatedly sick he again has the right to payment for six weeks if he has not been incapacitated by the same illness for at least six months or the illness is then due to another cause. If an employee becomes ill during vacation, the days of illness will not be counted as vacation.

## Hiring and Firing Requirements

There is no obligation to employ.

### Hiring

The employer usually conducts an interview with applicants for a job. The applicant is obliged to answer admissible questions correctly. Questions as to the membership of a party or referring to pregnancy are not admissible.

The employment contract between employer and employee provides the rights and duties of the parties and is usually concluded in writing. If no written contract is concluded, the onus of proof lies with the employer. The minimum content of the employment contract consists of the name and address of the parties, the commencement of the employment, the place of employment, the remuneration, the working hours, the duration of vacation, the periods of notice and a short description of the work (cf. Section 2 Evidence Act).

### Dismissing

The employment can be ended by the conclusion of a written termination agreement between employer and employee. In this case, the employee waives all protection against dismissal.

The employment can be ended unilaterally by either the employer or the employee by written ordinary or extraordinary termination. The employer is, however, unable to dismiss certain groups of persons (e.g. trainees, pregnant employees and mothers, severely handicapped persons, members of works councils). If there is a works council in the employing company, a dismissal is only possible after it has been heard or – in certain cases – with its approval. The procedure for hearing/approval is very strictly formalised.

### Extraordinary Dismissal

Extraordinary dismissal arises only in the presence of good cause (Section 636 Civil Code). Good cause is present in exceptional circumstances only, e.g. by serious breach of working duties or sustained refusal to work or gross insult to a superior. Extraordinary termination does not usually require a period of notice.

### Ordinary Termination

The statutory or contractual period of notice has to be observed in the case of ordinary termination. The statutory notice period is four weeks expiring on the 15th or at the end of a calendar month. With a period of service of two years, the statutory notice period is gradually extended according to the length of service. If less than 20 persons are employed, it can be contractually agreed that the four weeks period of notice continues to apply. A longer period of notice can be agreed, although the period of notice for the employer may not be shorter than that for the employee. In the case of temporary employment, dismissal is only possible if this is agreed contractually in writing, otherwise the temporary employment ends on the expiry of the intended term, prior notice of the expiry is required.

## Labour Permits

The employer must always base a dismissal on one of the permissible grounds therefor. If more than five persons are employed (for employment concluded after 01.01.2004, the number is ten or more), ordinary dismissal is subject to the limitations of the Dismissals Protection Act. According to this Act, a specific ground for dismissal is required. Such a ground may be personal, e.g. repeated illness of the employee, unsuitability, behaviour, e.g. bad work performance or disturbance of the work place. Prior to dismissal on the grounds of conduct, the employee must already have received a warning. Redundancy is also a ground for dismissal. In addition, the employees to be dismissed on grounds of redundancy must be chosen on the basis of certain social considerations such as the length of service, age, maintenance obligations and possibly severe handicap. The employee can, however, file a claim with the Labour Court within three weeks of receipt of the dismissal notice for a declaration that the employment has not been dissolved by the termination. If the claim succeeds, e.g. due to the absence of an admissible ground for dismissal, the employee is entitled to continued employment on the same conditions.

In the case of mass dismissals, advance notice to the competent employment agency is required in order that the dismissals be valid.

In the case of the dismissal of older employees (from the age of 55), the employer may be obliged to reimburse the federal employment agency for the unemployment benefit for up to a period of 32 months.

## Labour Availability

Both qualified and unqualified workers are available on the German employment market. The number of those seeking work in February 2005 was approx. 5 million. Those seeking work and those seeking employees advertise both in the daily newspapers and in specialist periodicals and often on the internet. Placing of workers is conducted through the local job centres, personnel agencies/headhunters (in particular for highly qualified employees) or personnel service agencies.

Every foreign employee intending to take up work in Germany requires a labour permit. Citizens of member states of the European Union, foreigners with an unrestricted residency permit, and foreigners with whose originating states agreements to that fact have been concluded, do not require work permits – with some exceptions.

For certain groups of persons no labour permit is required in Germany. These include, for example, leading employees, to whom general power of attorney has been granted, leading employees of international groups or companies working in the German division at the level of board member, director or manager, or delegated to Germany for a certain task.

It is recommended that the work permit and the relevant residency permit be obtained at the German Consulate or German Embassy in the home state of the employee prior to entering Germany. This applies even if no Visa is required to enter Germany (e.g. for American or Australian citizens). Taking up work in Germany without a valid labour permit is an offence.

The process may take up to three months, because the residence permit must be applied for at the same time. When the new Immigration Act of 30.07.2004 comes into force, the processing period should be considerably shorter.

The fees depend on the nature and duration of the permit. They can be ascertained when making application. The documents required also vary from state to state. The highest fee for a residence permit is 80 Euro.

## Safety Standards

The employer is statutorily obliged to provide a safe place of work (Sections 618, 619 Civil Code) and to inform the employee as to the nature of the work, its place in the overall operation and the health and accident risks involved (Section 81 Shop Constitution Act). Technical and medical work protection is provided for in many statutes and regulations. The Work Safety Act obliges the employer to appoint members of the works council and experts for work safety to support the employer in providing work safety and prevention of accidents. The Work Protection Act provides for protection measures for the avoidance of working accident and occupational health risks including measures for designing work processes appropriately to human dignity. The employer is statutorily obliged to insure his employees against occupational accidents and illnesses (statutory accident insurance obligation). The accident insurer (trade association) provides safety rules which must be observed by the employer.

## Unions

Approx. 7 million employees in Germany are members of a trade union. The most important trade unions are *ver.di* and *IG Metall*, the trade unions are organized in an umbrella association, the German Trade Union Association.

The trade unions have many opportunities of influencing the company. Primarily, they conclude the collective bargaining agreements either regionally for an entire industry or also with each employer.

The works council represents the employees at works level. A works council may be elected in a plant usually with at least five permanent employees. The employer must accept the works council, which has considerable rights to information, to supervision, hearing and co-determination, based on the Shop Constitution Act in relation to financial, personnel and social matters within the company.

Works agreements are concluded between the works council and the employer determining the working conditions and the operating and constitutive matters of the plant for all employees.

In addition, under the One Third Participation Act, the supervisory board of companies (corporations, limited liability companies with more than 500 employees) must include one third employees' representatives, who then have the possibility of influencing business decisions at the highest level.

The trade unions are traditionally close to the German Social Democratic Party (SPD), which arose out of the labour movement at the end of the 19th and beginning of the 20th century. The employer is not obliged to organise trade unions or a works council. The employer is, however, obliged under the Shop Constitution Act to support an elected works council as well as to observe its rights.

The trade unions conclude collective bargaining agreements with the employer associations, regulating labour law rights duties of the parties as well as issues under the Shop Constitution Act. They have the force of law. On the basis of collective bargaining agreements or parallel to them, works agreements are concluded between the works council and the employer.

If an employer is not a member of an employer's association, he is only obliged to observe the relevant collective bargaining agreement if this has been declared to be generally binding or if the application of a certain collective bargaining agreement is specified in the employment contract. Only 4% of all collective bargaining agreements have been declared to be generally applicable.

## II. Tax on Corporations

The German tax system is highly complicated and, in general, not comparable with the US or UK tax system. Income taxation in Germany differs with respect to corporations, partnerships and individuals, while the latter can achieve seven different categories of income. In addition to profit/income related taxes (income tax, corporate income tax and trade tax), Germany levies VAT, inheritance and gift tax, real estate transfer tax, real estate tax and some other excise taxes.

We would like to point out that the following answers give only a brief overview of some key issues of the German tax system and should not be misunderstood as a complete account.

First of all, a company's tax status depends on its legal form. Corporations are taxable entities and, thus, subject to corporation tax, to trade tax and to solidarity surcharge. Partnerships (non-corporate entities, i.e. Offene Handelsgesellschaft, Kommanditgesellschaft and Gesellschaft bürgerlichen Rechts), on the other hand, are not taxable entities for corporation or income tax purposes. The income determined at the level of the partnership is rather allocated to the individual partners. The partnership itself may only be subject to trade tax.

### Allowances

Basically, depreciation is allowed on tangible or intangible fixed assets which have a useful life of more than one year. Land and participations in other corporations cannot be depreciated. Land may be written down to a lower going-concern value if the reduction in value is presumably permanent. Goodwill resulting from an acquisition via an asset deal may be depreciated on a straight-line basis over 15 years.

Depreciation is, in general, based on the acquisition or production costs of an asset. The straight-line, reducing-balance and output-related methods are allowed. A change from the reducing-balance to the straight-line method is possible. Except for buildings, depreciation rates are not fixed by law. However, the Federal Ministry of Finance publishes guidelines for the useful lives in official recommended tables.

Moveable assets not exceeding € 410 (excluding V.A.T.) may be deducted fully in the year of purchase or production.

In general, a corporation can deduct all business expenses which are connected with its taxable revenues. Trade tax is deductible for corporate income tax purposes.

- Expenses connected with tax-exempt income are not, in principle, deductible.
- Further, remuneration paid on shareholder debt is subject to the German thin capitalization rule. This rule basically applies to loans provided to a corporation having unlimited or limited tax liability by a substantial domestic or foreign shareholder (holding directly or indirectly more than 25% of the share capital) or a person related to the substantial shareholder. Loans provided by a third party entitled to take recourse to the substantial shareholder or a person related to him are also covered by the rule if the corporation is not able to prove that no so-called back-to-back financing is given. Loans provided by a related person of the shareholder are also subject to the thin capitalization rule. Interest paid on detrimental loans are not tax deductible but deemed to be constructive dividends if the safe haven (equity to debt ratio = 1:1.5) is exceeded, unless the arm's length test cannot be made, or if the remuneration agreed on such loan is not determined as a fraction of the principal (hybrid financing). An exemption limit in the amount of € 250,000 for detrimental interest payments is provided. Further, interest paid on intra-group acquisition loans is not tax deductible at all.

- Corporate income tax is not tax deductible.
- Remuneration paid to the shareholder or an affiliate is subject to the arm's length test. If the arm's length test is not fulfilled, the remuneration is not tax deductible but treated as a constructive dividend or constructive capital contribution.

### Calculation of Taxes

In general, the German tax accounting is based on the commercial accounting (*Maßgeblichkeitsprinzip*). Therefore, the determination of taxable income is based on the profits shown in the financial accounts, but subject to compelling tax provisions. Accounting for commercial and tax purposes is required by law, and failure to comply may result in an assessment based on estimates by the tax authorities.

Basically, all assets and liabilities have to be determined in the balance sheet at the end of the fiscal year. Unrealised losses must be recognised, although there are some restrictions for tax purposes, e.g. provisions for anticipated losses on pending transactions. Unrealised profits are not recognized. Assets are determined at cost, less depreciation or at their lower going concern value if this is presumed to be permanent. The going concern value is defined as the amount as a fraction of the total purchase price which a purchaser of the entire business would allocate to a specific asset assuming he intended to continue the business. If the reason for the impairment in value no longer exists, the write down must be reversed.

Provisions have to be recognised for contingent liabilities if it is reasonably expected that the future event will confirm the liability. In particular, provisions have to be fixed for anticipated guaranty and warranty costs, for pensions if the employee's obligation to make pension payments is documented in a written promise, and the employee has a legal right to a once-off or periodic pension benefit.

Long-term provisions and liabilities (to be settled within more than 12 months of the balance sheet day) bearing no interest have to be discounted for tax purposes using an interest rate of 5.5%.

Dividends received from a domestic or foreign corporation are tax exempt for corporate income tax purposes. However, 5% of dividends received are deemed as non-deductible business expenses. For trade tax purposes, the 95% tax exemption is only applicable if the corporation holds at least 10% of the nominal capital of a domestic company at the beginning of the fiscal year. For dividends received from a foreign company, the trade tax exemption requires that the corporation holds at least 10% of the nominal capital of the foreign company without interruption from the beginning of the calendar year and provided the foreign corporation derives its gross income exclusively or almost exclusively from active operations.

### Capital Gains

In general, capital gains are treated as ordinary income. Therefore, capital gains are subject to corporate income tax at a rate of 25%, solidarity surcharge on the corporate income tax at a rate 5.5% and trade tax, the rate of which ranges between 15 and 24.5% depending on the municipality in which the corporation maintains its permanent establishment. Further, the trade tax qualifies as business expenses for corporate income tax purposes.

Capital gains resulting from a sale of shares in domestic or foreign corporations are basically tax exempt for both corporate income tax and trade tax purposes. However, 5% of the capital gain is treated as non-deductible business expenses and, thus, subject to corporate income tax, solidarity surcharge and trade tax at the ordinary rates.

## Filing and Payment Requirements

The corporate income tax return, the trade tax return and the VAT tax return for the previous year have to be filed latest on May 31 of the current year. Under certain circumstances, an extension of time is possible. If the tax returns are not filed in time, the tax authorities may assess the tax on the basis of an estimated amount, and may, in addition, impose a penalty of up to 10%. For VAT purposes, preliminary tax returns have to be filed monthly or quarterly.

In general, corporate income tax, trade tax and VAT have to be paid in instalments. The instalments for corporate income tax and trade tax purposes are generally based on the tax results of the preceding tax assessments. An amendment during the year is possible. The monthly or quarterly prepayments for VAT purposes have to be calculated by the entrepreneur.

The advance payments of corporate income tax have to be made on:

**10 March; 10 June; 10 September and 10 December.**

The advance payment for trade tax purposes has to be made on:

**15 February; 15 May; 15 August and 15 November.**

For VAT purposes, the instalments have to be made either monthly or quarterly. The amount of the instalments depends on the monthly or quarterly VAT liability calculated by the corporation.

The final tax liability has to be paid on the date determined in the tax assessment notice. In general, the payments have to be made one month after receiving the tax assessment notice from the tax authorities.

## Miscellaneous Tax Due

- Germany has no tax on capital.
- There is no business licence tax.
- There is no apprenticeship tax.
- Germany levies real property tax (*Grundsteuer*) and real estate transfer tax.
- Further, Germany levies insurance tax, mineral oil tax, ecology tax and motor vehicle tax.

## Registration Duties

There are no registration duties due upon the incorporation of company, upon an increase in capital, upon the transfer of the company's shares, upon a transfer of corporate assets or any other registration.

### Sales Tax or Other Turnover Tax

As all European countries, Germany follows the value-added tax (VAT) system. Therefore, input tax is creditable against output tax. The credit mechanism basically requires that the input tax is connected with taxable turnovers or with privileged tax exempt turnovers.

Basically, deliveries and other services supplied in Germany by a corporation are subject to VAT. The standard rate is 16%, some deliveries are taxed at a rate of 7% and some supplies are tax exempt (e.g. financial services).

In general, a preliminary VAT return has to be filed monthly in which the corporation has to calculate its VAT liability. The preliminary VAT return has to be made up to the 10<sup>th</sup> of the current month for the previous month. At the same date, the VAT liability has to be paid over to the tax authorities. By May 31 of the current year, the annual VAT return for the previous year has to be filed.

### Social Security and Welfare System Contributions

A corporation is basically not subject to social security contributions, retirement or pension contributions or unemployment insurance contributions. However, the corporation as an employer is obliged to withhold and pay over the contributions to social security (comprising health insurance, pension insurance, unemployment insurance and nursing care insurance) for its employees. Further, the amount of social security contributions is carried jointly by the employer and the employee (equally).

### Tax on Profits

The profit of a corporation is subject to a 25% corporate income tax plus 5.5% solidarity surcharge thereon. Further, the profits of a corporation are subject to municipal trade tax, the rate of which ranges between 15 and 24.5%. Since the trade tax is deductible for corporate tax purposes a rate of, say 22.5% results in an effective tax rate of 18.37%. Further, the trade tax is deductible for corporate income tax purposes.

### Tax Treaties

Germany has double tax treaties with about 100 countries, including the US and all European countries.

There are rules against treaty shopping. In general, a corporation may not benefit from the treaty privilege if its shareholder is not entitled to this privilege if investing directly in Germany. Further, the general abusive provision stated in the fiscal code can apply.

### Territoriality Rules

Corporations resident in Germany are subject to taxation on their worldwide income (unlimited tax liability). A corporation is resident in Germany if it maintains either its registered office (as determined by the articles of incorporation) or its central place of management in Germany. The central place of management is where the key decisions of the business are regularly made.

Corporations not having their registered offices or central place of management in Germany are subject to limited tax liability. Limited tax liability applies to income from sources in Germany, e.g. income derived from a permanent establishment or permanent representative in Germany, gains from the sales of shares or stock in a German corporation if the share- or stockholding is at least 1%, income from agriculture and forestry, rental income and certain categories of income where tax is withheld at source. Capital gains resulting from the sale of real estate located in Germany are also subject to German corporation tax.

## Treatment of Losses

Tax losses which cannot be offset in the current year may be carried back one year up to an amount of € 511,500. If losses exceed the amount of € 511,500 they may be carried forward without limitation as to time. However, since 2004, the loss carry forward is restricted. An amount of € 1 million may be carried forward without limitation. A higher amount may only be carried forward up to an amount of 60% of the corporation's profit.

If a corporation changes its economic identity, losses incurred in prior fiscal years may not be claimed. A change of economic identity is assumed for example if more than 50% of the shares in the corporation are transferred and if the corporation resumes or continues its business with mainly new assets. New assets have to be considered within 5 years after the potentially detrimental share transfer.

For trade tax purposes, a loss carry back is not allowed. Trade tax losses of up to € 1 million may be carried forward without limitation. A higher amount may only be carried forward up to an amount of 60% of the trade tax profit. No time limitation applies to the loss carry forward. A corporation which has changed its economic identity may not claim a loss carry forward (see the principles for corporate income tax purposes above).

## Wealth Tax

Wealth tax is not levied since 1997.

## Withholding Tax

Dividends paid to the shareholder are subject to a 20% withholding tax plus 5.5% solidarity surcharge thereon. For domestic shareholders, a relief at source is provided under certain preconditions. A relief at source for a European corporate shareholder is provided if the preconditions of the EU parent-subsidiary directive are fulfilled. Otherwise, subject to an applicable treaty, a full or partial refund of the withholding tax is possible.

Subject to an applicable treaty or the EU interest royalty directive, royalties paid to a foreign shareholder are subject to a 25% withholding tax plus 5.5% solidarity surcharge thereon.

The rate of withholding tax on interest depends on the character of the loan granted. Further, interest payments on loans provided by a substantial shareholder or a related person thereto are subject to the German thin capitalization rule. If the interest payments on such loans are classified as constructive dividends, the withholding tax rate complies with the above mentioned rate on dividends paid to the shareholders.

There is no withholding tax on profits realised by a foreign corporation. If the foreign corporation is subject to limited tax liability on its domestic income in Germany, it is taxed in the same way as a domestic corporation.

## 12. Tax on Individuals

Income received by an individual is subject to income tax plus solidarity surcharge thereon and church tax if the individual belongs to one of the “recognised” churches. Income achieved by an individual from trade or business is also subject to trade tax.

### Allowances

For depreciation, see above. In general, the same principles as for corporations apply, i.e. assets with a useful life of more than one year used to achieve taxable income may be depreciated.

- For income from employment: € 920
- For income from capital: € 51
- For income from annuities: € 102

Further, in the case of income from capital, a “saver tax allowance” (“*Sparerfreibetrag*”) in the amount of € 1,370 (in case of joint assessment of husband and wife, € 2,740) is provided.

Special expenses (*Sonderausgaben*), which are rather private than income-related expenses, may be deducted under certain circumstances, partly within limited amounts. Special expenses are, for example, certain alimony and maintenance payments, premiums for life and accident insurances and compulsory social security payments, expenses for vocational education, expenses for professional tax advice and church tax paid.

Further, extraordinary expenses (*außergewöhnliche Belastungen*) may be deducted if some preconditions are fulfilled. If a taxpayer incurs unusually high, unavoidable expenses due to extraordinary circumstances or hardship, relief may be granted by allowing a deduction if the expenses exceed a “reasonable burden”.

Finally, for purposes of tax assessment, a tax-free allowance (*Grundfreibetrag*) in the amount of € 7,664 for each individual is provided.

### Calculation of Taxes

An individual can achieve seven different categories of income, and the determination of the taxable base depends on the category of income achieved.

The categories of income are:

- [1] Income from agriculture and forestry
- [2] Income from a trade or business
- [3] Income from self-employment
- [4] Income from employment
- [5] Income from capital
- [6] Income from real estate and certain other tangible property and royalties
- [7] Specific other income (including annuities, certain capital gains and certain non-recurring income)

For the categories 1 to 3 (so-called “profit income”), the tax base has to be determined by “deduction of business expenses from the gross receipts (“profit determination”). In these categories, increases in the value of assets as well as capital gains are generally subject to income tax (for trade and business income also subject to trade tax). Decreases in the value of assets as well as losses on a sale of assets are tax deductible, if some further preconditions are fulfilled. In case of category 1, the tax accounting is normally based on the German GAAP accounting. For income from agriculture and forestry some special provisions are foreseen. In the case of income from self-employment, the determination of the tax base follows basically the “inflow-outflow-principle”; i.e., revenues have to be considered when they are received and expenses have to be considered when they are paid. However, assets with a useful life of more than one year may be deducted only by way of depreciation.

For the categories 4 to 7 (so-called “non-profit-income”), the tax base has to be determined by deduction of expenses connected with taxable income from the gross receipts (“excess of receipts over expenses determination”). Depreciation of assets used to achieve income has to be considered. In these categories increases in the value of assets as well as capital gains are generally not subject to tax (but see below for taxation of capital gains). Correspondingly, decreases in value and losses resulting on a sale of assets are not tax relevant. The determination of the tax base principally follows the “inflow-outflow-principle” (see above).

### Capital Gains Tax

Capital gains realised on a sale of business assets are generally subject to tax at the ordinary rates.

Capital gains realised on a sale of shares or stock in a corporation held as private assets are subject to tax if the individual holds at least 1% of the nominal capital. Further, capital gains realised on a sale of shares or stock in a corporation held as private assets are subject to tax if the holding period does not exceed one year. The half-income-privilege applies basically to these capital gains, i.e. only 50% of the capital gains are subject to income tax. Correspondingly, expenses and losses cannot be deducted for the amount of capital gain which is tax-exempt.

Capital gains realised on a sale of real estate are subject to tax if the holding period is not more than ten years. Capital gains realised by a sale of other assets are fully subject to tax if the holding period is not more than one year.

Losses realised on selling assets within the holding period of one or ten years can only be set-off against capital gains from such transactions within the same calendar year. Excess losses can be carried back and forward within the general rules but, again, may only be offset against gains from such transactions in the previous year or in the future years.

### Filing and Payments Requirements

Income tax returns have to be filed annually. German resident individuals are required to file an income tax return if the income for the assessment period exceeds € 7,664 and the income has not been subject to withholding tax at source. The income tax return has to be filed by May 31, for the preceding calendar year. Under certain circumstances, an extension of time may be granted.

If the individual is an entrepreneur for VAT purposes, he also has to file preliminary VAT returns monthly or quarterly. Further, an annual VAT return has to be filed by May 31, for the preceding calendar year.

The tax authorities issue a tax assessment notice after receiving the tax return. In this notice, the final tax liability, which is payable within one month after the receipt of the assessment notice, is shown.

For income not subject to withholding tax, the tax authorities will assess quarterly prepayments of income tax and solidarity surcharge based on the preceding year's tax or on estimates. The prepayments dates are 10 March, 10 June, 10 September and 10 December.

## Inheritance and Gift Tax

An individual having his place of residence (*Wohnsitz*) or his customary place of abode (*gewöhnlicher Aufenthalt*) in Germany is subject to German inheritance or gift tax. Inheritance or gift tax is levied if either the testator/donor or the heir/donee is resident in Germany.

In general, all assets left or given away are subject to tax. For some assets, tax exemptions are provided.

The tax rate depends on the relationship between the testator/donor and the heir/donee and the amount received. The tax rates vary between 7% in the tax bracket I up to an amount of € 52,000 and 50% in the tax bracket III for amounts exceeding € 25,565,000.

### Allowances

Provided some preconditions are fulfilled, for business property, agriculture and forestry property and participations in domestic corporations of more than 25%, a tax-free amount of € 225,000 is granted. Further, after deducting the tax-free amount, only 65% of the remaining value is subject to tax.

In general, tax allowances are available for:

- Spouses, in the amount of € 307,000
- For children and stepchildren and the children of deceased children and stepchildren, an amount of € 205,000
- For children of the children and stepchildren, for parents and grandparents in cases of inheritance, an amount of € 51,200
- For parents and grandparents in the case of gifts, for brothers and sisters and their children, for step-parents, for parents and children in law and for the divorced spouse, an amount of € 10,300
- For all remaining recipients, an amount of € 5,200

## Repayment and Filing

The heir or donee is obliged to inform the tax authorities about the occurrence of a case of inheritance or gift. The tax authorities may demand an inheritance or gift tax return from the heir or donee. In cases of gift, the tax return may also be demanded from the donor.

The inheritance or gift tax has to be paid in general one month after having received the inheritance or gift tax assessment notice from the tax authorities.

## Real Estate/Habitation Tax

An individual owning real estate is subject to real estate tax (*Grundsteuer*). The real estate tax is levied annually by the German municipalities. The amount of real estate tax is the product of a tax multiplier (*Steuermesszahl*), the assessed value (*Einheitswert*) and the rate of assessment (*Hebesatz*). The tax multiplier depends on the kind of real estate and ranges between 2.6‰ and 3.5‰. The rate of assessment differs according to the municipality entitled to levy the real estate tax and may be different for industrial or agricultural property.

## Sales Tax

An individual not qualifying as an entrepreneur for VAT purposes is not subject to VAT (sales tax). VAT has to be paid to the tax authorities only by entrepreneurs within the meaning of the VAT Act.

### Social Security and Welfare System Contributions

In general, all employees are insured under the German social security which comprises health insurance, pension insurance, unemployment insurance and nursing care insurance. Social security is funded by the contributions of both employees and employers. The amount of the contribution depends on the gross income of the employee. Currently, the social insurance contribution carried jointly amounts approx. to 40% of the gross salary, i.e. 20% for the employer and 20% for the employee. The contribution has to be withheld and paid over by the employer for the account of both by the 10th of each month.

Self-employed individuals may also be subject to German social security excluding, however, unemployment insurance. Self-employed individuals are obliged to pay the entire amount of insurance contributions themselves.

### Stock Options, Profit Sharing and Savings Plans

Stock options are in general taxed at the time the option is exercised. The difference between the stock market price and the agreed option price is taxed as a benefit-in-kind and, thus, subject to income tax. The employer is obliged to withhold wage and salary tax.

The German tax law does not know profit sharing plans.

Since the calendar year 2002, the German Income Tax Act provides tax benefits for additional private pension savings granted by payment to the individual of an old-age-savings subsidy. In order to qualify for this subsidy, the taxpayer has to conclude a certified old-age pension contract and contribute a minimum amount. The content of the contracts is specified in detailed regulations.

### Taxation of Benefits-in-kind

Benefits-in-kind granted by the employer to an employee are, in general, subject to income tax at the ordinary rate. The assessment base is the monetary value of the benefit-in-kind, although, for purposes of simplification, some special calculation methods are applicable. For some benefits-in-kind a tax allowance is granted.

### Taxes on Dividends

An individual holding shares or stock in a corporation receives dividends if the participation in the corporation qualifies as an equity instrument. Regardless of whether the dividend is paid in cash or in kind, the dividend payments are subject to tax at the level of the shareholder/stockholder. The half-income-privilege is applicable to dividend income, thus only 50% of the dividend payments are subject to income tax. Correspondingly, only 50% of the expenses related to the dividend income is tax deductible.

If the individual holds the participation in the corporation as a trading or business asset, the half-income-privilege is only applicable for trade tax purposes if the individual holds at least 10% of the nominal capital of a domestic company at the beginning of the fiscal year. For dividends received from a foreign company, the trade tax exemption requires that the individual holds at least 10% of the nominal capital of the foreign company without interruption from the beginning of the calendar year and provided the foreign corporation derives its gross income exclusively or almost exclusively from active operations.

## Tax on Income

The national tax rate on income of resident individuals depends on the amount of the taxable income. Germany has a progressive tax scale which starts with a rate of 15% on a taxable income of € 7,665, and ends with a rate of 42% for taxable income over € 52,152.

A solidarity surcharge in the amount of 5.5% of the income tax is also levied.

Income of non-residents is generally taxed by way of withholding tax. The withholding tax rates depend on the kind of income and range between 20% and 30%. If the taxation of a non-resident individual is carried out by way of tax assessment, the same rates as for resident individuals apply.

Trade tax is levied by municipalities only on income from trade and business. The trade tax rates range between 15 and 24.5%. Further, the trade tax can be credited against the income tax liability of the individual within a special mechanism.

For non-residents the same rules apply as for residents.

## Tax Treaties

Germany has double tax treaties with about 100 countries including the US and all European countries.

## Territoriality Rules

Individuals resident in Germany are subject to unlimited tax liability there. An individual is resident in Germany if he has his place of residence (*Wohnsitz*) or his customary place of abode (*gewöhnlicher Aufenthalt*) in Germany. A physical residence of more than six months results in a customary place of abode.

An individual not resident in Germany is subject to limited tax liability.

An individual resident in Germany is subject to tax on his worldwide income provided it is covered by one of the following seven categories of income:

- Income from agriculture and forestry
- Income from a trade or business
- Income from self-employment
- Income from employment
- Income from capital
- Income from real estate and certain other tangible property and royalties
- Specific other income (including annuities, certain capital gains and certain non-recurring income)

A non-resident individual is only subject to tax on income from German sources. This includes, in particular, income from agriculture and forestry, business income achieved via a permanent establishment or permanent representative in Germany, capital gains resulting from a sale of shares or stock in a resident corporation provided the participation is at least 1%, income from self-employment or employment services performed or used in Germany, dividend income from a resident corporation, interest on mortgages and bonds issued by a German borrower, rental income from real estate located in Germany, gains resulting from a sale of German real estate.

## Wealth Tax

Wealth tax is not levied since 1997.

## Withholding Tax

Salary is subject to a withholding tax at source. The employer is obliged to withhold and pay over the withholding tax (wages and salary tax) to the tax authorities for the account of the employee. Further, solidarity surcharge in the amount of 5.5% of the wages and salary tax has to be withheld.

Employees not having their permanent or ordinary residence in Germany are subject to limited tax liability on their wages and salary income resulting from employment in Germany. The income tax is withheld at source.

Most of the German treaties determine that the employee's state of residence has the taxation right, if the employment in Germany does not exceed 183 days per each calendar year and the remuneration is paid by an employer or for an employer not resident in Germany and the remuneration is not borne by a German permanent establishment of the employer. The 183 days are not determined by the duration of work but by the duration of presence in Germany.

## 13. Tax on Other Legal Bodies

The German taxation system distinguishes between taxation of corporations, individuals and partnerships. Other legal bodies are taxed either as fully transparent entities (the income achieved by the legal body is deemed to be achieved directly by the investor, e.g. capital investment companies regulated by the German investment code), as corporations or as partnerships (transparent for corporate income and income tax purposes, but non-transparent for trade tax purposes and for determination of income). The questions are answered below with respect to the taxation of partnerships. A separate item at the end of the statement will give a brief overview of the taxation of associations and foundations.

Partnerships (*Offene Handelsgesellschaft*, *Kommanditgesellschaft* and *Gesellschaft bürgerlichen Rechts*) are only subject to trade tax provided the activity of the partnership qualifies as trade or business activity. For income tax and corporate income tax purposes, the profits achieved by the partnership are attributed to its corporate or/and individual partners. Although the partnership is not subject to income tax as well as corporate income tax, the category of income as well as the amount of the taxable income is determined at the level of the partnership (uniform and separate profit determination).

If the partnership achieves business or trade income, remuneration paid to its partners for services, for hiring out assets or real estate or for granting loans is classified as business or trade income at the level of the partnership, but is attributed beforehand to the receiving partner. The remuneration classified as business or trade income (special remuneration) is also subject to trade tax at the level of the partnership. Expenses related to the interest in the partnership (e.g. financing and administration costs) as well as expenses in connection with assets provided for use by the partnership (special business expenses) are deductible for trade tax and (corporate) income tax purposes.

If the acquisition costs of an interest in a partnership exceed the equity attributable to the partner, the excess amount has to be considered in a special supplementary tax balance sheet. In the supplementary balance sheet, the difference has to be allocated to the assets and liabilities of the partnership in proportion of the individual going-concern values. A residual amount has to be shown as goodwill. Amounts allocated to depreciable assets (including goodwill) may be depreciated in the subsequent years in accordance with the depreciation rules applicable to the relevant assets. The result of the supplementary tax balance sheet is only attributed to the partner who has capitalised the acquisition costs.

### Allowances

The allowances are basically the same as for corporations (see above).

### Calculation of Taxes

The determination of the taxable income in general follows the accounting under German GAAP (see above) provided the partnership achieves business or trade income.

If the partnership achieves other income, the taxable base is determined by the principles explained above. If profit income (income from self-employment and income from agriculture and forestry) is achieved, the principles of "profit determination" are applicable. If the partnership achieves capital, rental or other income ("non-profit income"), the taxable base is determined by the excess of receipts over expenses (see above).

## Capital Gains

The taxation of capital gains realised by a partnership depends on whether the partnership achieves profit income or non-profit income. Further, the taxation depends on whether the partners of the partnership are individuals or corporations.

If the partnership achieves profit income, capital gains are, in general, taxable at the level of the corporate or individual partner at the ordinary corporate income tax or income tax rates. For business and trade income, trade tax is levied at the level of the partnership.

Capital gains realised by the partnership from a sale of shares or stock are basically taxed if the partnership achieves profit-income. The capital gain allocated to an individual partner is subject to the half-income privilege and, thus, 50% thereof is subject to income tax at the ordinary rate plus solidarity surcharge of 5.5% thereon. Capital gains attributed to a corporate partner are tax exempt. However, 5% of the capital gain is deemed as non-deductible business expenses and, thus, subject to 25% corporate income tax plus solidarity surcharge of 5.5% thereon and trade tax at a rate depending on the municipality in which the corporation maintains its permanent establishment.

If the partnership achieved business or trade income, the German tax authorities hold the opinion that the capital gain is fully subject to trade tax at the level of the partnership.

If the partnership achieves non-profit income, a capital gain is, if it is allocated to a corporate partner, subject to tax at the ordinary corporate income tax rate plus solidarity surcharge and trade tax. For capital gains resulting from a sale of shares or stock, the 95% tax-exemption (see above) is applicable.

If the capital gain realised by a non-profit income partnership is allocated to an individual partner who holds the interest in the partnership as a business asset the capital gain is, in principle, subject to income tax and solidarity surcharge and trade tax at the ordinary rates. For capital gains resulting from a sale of shares or stock, the half-income-privilege is applicable, in principle.

Capital gains allocated to an individual partner who holds the interest in the partnership as a non-business asset, are subject to tax only if the holding period of the asset sold does not exceed ten years for real estate or one year for other assets or if the individual partner does not hold his interest in the partnership for more than ten years (if the partnership sells real estate) or one year (if the partnership sells other assets). Such taxable capital gains are taxed at the ordinary tax rates plus solidarity surcharge. For capital gains realised on a sale of shares or stock, the half-income-privilege is applicable, in principle, at the level of the individual partner.

Irrespective of the holding period, capital gains resulting from a sale of shares or stock are subject to tax at the level of the individual partner, if the participation in the corporation held indirectly by the partner amounts at least to 1% of nominal capital. Such capital gain is, in principle, subject to the half-income-privilege (50% is taxed) at the ordinary rates plus solidarity surcharge.

## Filing and Payment Requirements

The partnership has to file the tax return (declaration for purposes of the uniform and separate profit determination) by May 31 each year for the preceding year.

A trade or business active partnership has to file its trade tax return by the same date.

If the partnership qualifies as an entrepreneur for VAT purposes, it has to file its annual VAT return by May 31. The preliminary VAT returns have to be filed either monthly or quarterly.

A partnership qualifying as an entrepreneur has to pay the VAT liability resulting from the preliminary VAT returns monthly or quarterly. The final VAT payment has to be made within one month after receiving the tax assessment notice showing a remaining VAT liability.

A partnership achieving business or trade income has to pay the final trade tax liability within one month of receiving the trade tax assessment notice.

Basically, the trade tax has to be paid in instalments, the payment dates being

**15 February, 15 May, 15 August, and 15 November.**

The instalments for VAT tax purposes have to be made monthly or quarterly based on the calculation of the entrepreneur.

## Miscellaneous Taxes

A partnership may be subject to real estate tax, real estate transfer tax and motor vehicle tax.

## Registration Duties Applying to the GmbH

### Incorporation

A GmbH is incorporated based upon a declaration of the shareholder(s) before a notary, which triggers notaries' fees. If the capital is to be contributed in cash, at least half of the minimum share capital (€ 12,500 out of € 25,000) must be paid into an account of the GmbH. If the capital is to be contributed in kind, the total share capital must be contributed (equalling € 25,000). A GmbH must be registered. The application to the competent commercial register must be signed by the managing director(s) of the GmbH and must be certified by a notary (again triggering fees).

### Change in the Capital

Any increase or decrease in the share capital of a GmbH constitutes an amendment to the GmbH's articles of association and must therefore be based on a notarised shareholder resolution. Such notarisation results in notaries' fees. In case of an increase in the share capital, the subscriber must make a certified declaration of assumption. Fees for the certification apply. Any change in the capital of a GmbH must be filed for registration with the competent commercial register; signed by all managing directors and, in each case, certified (with fees for certification).

### Transfer of Shares

The (notarised) transfer of shares in a GmbH is not filed for registration with the competent commercial register. The managing director(s), however, must update the list of shareholders of the GmbH and send such list to the commercial register.

### Transfer of Assets

In general, no registration duties apply upon a transfer of assets of a GmbH, unless specific registration requirements exist with respect to individual assets (e.g., registration of ownership of real property).

### Other Registration Duties

The German Law on Limited Liability Companies (*GmbHG*) in several instances requires registration of corporate facts and changes, e.g., upon the removal and/or appointment of managing directors or persons holding a general power of attorney (*Prokuristen*), amendments to the articles of association or the liquidation of the GmbH.

### Sales Tax or Other Turnover Tax

If the legal body qualifies as an entrepreneur for VAT purposes, it is subject to VAT.

The input tax is creditable if the partnership achieves taxable returns or privileged tax-exempt returns (e.g. exports). The general tax rate for deliveries or other services is 16%. For some deliveries a tax rate of 7% is applicable.

The annual VAT return has to be filed by May, 31 for the preceding year. The remaining VAT has to be paid within one month after receiving the VAT assessment notice.

Preliminary VAT returns have to be filed monthly or quarterly by the 10<sup>th</sup> for the preceding month/quarter. The VAT liability calculated by the entrepreneur has to be paid over to the tax authorities at the same date.

### Social Security and Welfare System Contributions

A partnership itself is not subject to social security and welfare system contributions. If the partnership qualifies as an employer, it may be obliged to make contributions for its employees.

### Special Tax Themes

In general, income taxation in Germany depends on the legal form of the taxpayer. Corporations are subject to corporation tax, individuals are subject to income tax and partnerships are only taxable entities for trade tax purposes if they achieve income from trade or business.

### Tax on Profits

The partnership itself is neither subject to income tax nor to corporate income tax. Profits achieved by the partnership are allocated to its partners and at the level of the partners subject to income tax or corporate income tax at the ordinary rates in each case plus solidarity surcharge.

A partnership achieving business or trade income is subject to trade tax. The trade tax rate depends on the municipality in which the partnership maintains its permanent establishment. The trade tax rates range between 15 and 24.5%. The individual partners of the partnership can credit the trade tax against their individual income tax liability within a special mechanism.

### Tax Treaties

Germany has nearly 100 double tax treaties including the U.S. and all European countries. It has to be noted that not the partnership itself is entitled to benefit from the treaty privileges but its partners. For rules against treaty shopping see above.

### Territoriality Rules

Since a partnership is not a taxable entity for (corporate) income tax purposes, the tax status of its partners is decisive. Thus, the principles for individuals and corporations mentioned above are applicable. For trade tax purposes, only income attributed to the domestic permanent establishment of the partnership is subject to tax.

### Treatment of Tax Losses

Losses of a partnership are allocated to its partners for (corporate) income tax purposes. The partner is basically entitled to deduct the allocated loss from other positive income. The general loss carry forward rule applies.

A limited partner of a partnership may not deduct an allocated loss from other income if his (tax) capital account in the partnership is or will be negative. Further, these losses may neither be carried forward nor carried back. Such losses may only be offset against profits from the same partnership in the following years.

For trade tax purposes, losses of up to € 1 million may basically be carried forward without limitation. Any excess may be carried forward only up to 60% of the relevant trade tax profit of the partnership. A further condition for the loss carry forward is that the partners of the partnership who have suffered the loss are identical with those who want to carry forward the loss.

### Wealth Tax

Wealth tax is not levied since 1997.

### Withholding Tax

Payments of a partnership to its corporate or individual partners do basically not trigger withholding tax, since the profits achieved by the partnership are taxed at the level of the partners.

## 14. General Tax Considerations

### Tax Generally

Within the scope of the German tax provisions, a company or other entity may be structured to achieve the desired tax consequences. There is a general abusive provision in the German fiscal code. Structures which are only established to achieve a tax advantage and which have no economical reasons can be disregarded by the tax authorities.

In general, under further preconditions, binding rulings of the German tax authorities are provided to validate or invalidate the chosen form of doing business. To apply for a binding ruling it is required that the German tax law (including jurisdiction or statements of the tax authorities) does not provide for a clear solution.

### Taxation of Associations and Foundations

In principle, associations and foundations are, as incorporated entities, subject to corporate income tax. Therefore, the above mentioned principles for taxation of corporations apply.

However, associations and foundations could be tax privileged if they carry out charitable activities. To qualify as a tax privileged entity, the statutes of the association or foundation have to be in accordance with a rigid formal framework. The statutes must state the specific purpose of the charitable activity. Tax privileged purposes are:

- Public benefit purposes, i.e. the activities are intended to benefit the public materially, spiritually or morally
- Charitable purposes, i.e. activities to support individuals who are physically or economically distressed
- Support of churches, i.e. the activity is intended to support religious organisations which are recognised under public law

Firstly, the purposes mentioned above have to be pursued exclusively and directly by the charity. The second requirement is that the management must act in accordance with the limits set by the statutes.

The entire funds of the charity have to be utilised exclusively for its statutory purposes. As a general rule, the revenues of a charity (but not the endowment itself) must be utilised on a short-term-basis, i.e. by the end of the year following the year in which the revenues are received. Current expenses connected with the statutory activities, e.g. rents, wage payments or administrative costs are allowed provided they are reasonable. However, the association/foundation should not use its revenues predominately for administration costs.

After the establishment of a charity, the tax authorities will examine whether the statutes are in accordance with the formal requirements and, if this is the case, will issue a preliminary certificate. If the charity has filed a tax return for the preceding fiscal year, the tax authorities will also examine whether the management acted in line with the statutes. In the final tax assessment, tax privileges may ultimately be granted for corporate income tax, trade tax and VAT purposes.

Tax privileged associations and foundations are exempt from corporate income tax and trade tax. The VAT rate is reduced to 7%. Further, inheritance and gift tax is not levied on donations to privileged domestic associations and foundations.

If the tax privileged association or foundation maintains a business, it is partially subject to corporate income tax and trade tax on this business activity. The business income determined by the principles applicable to corporations is taxed at the ordinary trade tax, corporate income tax and solidarity surcharge rate. However, the business is not subject to corporate income tax plus solidarity surcharge and trade tax if its annual revenues (including VAT) do not exceed € 30,678.

## 15. Immigration Requirements

### Immigration Controls

Germany does not apply any fixed immigration quotas. Immigration is, however, *de facto* restricted by the requirement of a residence permit.

To enter Germany, foreigners require a valid passport as well as any residence permit which may be applicable to their circumstances. In principle, no evidence of vaccination or other health documents need be provided, although for the issue of a visa certain health conditions must be fulfilled.

### Immigration Requirements/Formalities

#### Residence Rights of non-EU Citizens

Every foreigner intending to remain on the territory of the Federal Republic, in principle, requires a residence permit.

If a residence permit is granted without being conditional on a certain purpose, an *Aufenthaltsurlaubnis* is referred to. If a foreigner holds such a permit for eight years and if the other conditions of Section 27 Aliens Act are fulfilled, a privileged form residence permit – the *Aufenthaltsberechtigung* – is issued.

A residence permit for a specific purpose is issued as an *Aufenthaltsbewilligung* or *Aufenthaltsbefugnis*. The *Aufenthaltsbewilligung* permits the foreigner to stay only for a specific temporary purpose (e.g. study). An *Aufenthaltsbefugnis* is issued if a foreigner is permitted on grounds of international law or urgent humanitarian grounds or in the political interests of the Federal Republic of Germany to enter and remain, and the issue of an *Aufenthaltsurlaubnis* is not possible.

For citizens of many non-European countries, an *Aufenthaltsgenehmigung* is dispensable. This applies, however, only if the foreigner stays in Germany for a maximum of three months in any period of six months, and does not exercise any gainful occupation in that time. In that case, a valid passport suffices for the entry and the stay. A list of the states affected by this provision can be accessed through the website of the foreign ministry, [www.auswaertiges-amt.de](http://www.auswaertiges-amt.de).

The application for an *Aufenthaltsurlaubnis* is processed in a period of three to four months.

Foreigners must, when they have a fixed place of residence, register with the competent residence office. If a change of residence occurs, a registration at the new residence office is required.

### **The Right of Residence of EU Citizens**

Under the EU Treaty, every citizen of the EU has the right to move and stay in the sovereign territory of Member States, subject to the restrictions in the Treaty and in the implementing regulations.

A directly applicable right of residence is among the basic freedoms of the common market provided in the EU Treaty. The rights of EU citizens are also specified in detail in many regulations and directives as well as in the EU Right of Residence Act.

The issue of an *Aufenthaltsgenehmigung*, therefore, is primarily of declaratory effect. Citizens of EU States, the EFTA and Switzerland can, therefore, obtain their residence permits even after entry into Germany. The EU residence permit is granted without charge.

### **Visa**

Citizens of EU Member States do not require a visa to enter Germany.

### **Visa for Less than Three Months**

Citizens of Non-EU States are obliged, without restriction, to obtain a visa to stay in Germany. For a stay of up to three months each half year; citizens of those states for which the EU has revoked the obligation, do not require a visa. A list of such states can be accessed on the website of the foreign ministry [www.auswaertiges-amt.de](http://www.auswaertiges-amt.de).

### **Visa for a Stay of More than Three Months**

For a stay of more than three months, foreigners require an *Aufenthaltsgenehmigung* in the form of a visa to be obtained prior to entry.

Citizens of the EU Member States, the contracting States of the Schengen Convention and of the following states can apply for their visa even after entry into Germany:

- Switzerland
- Australia
- Israel
- Japan
- Canada
- New Zealand
- United States of America
- Honduras
- Monaco
- San Marino

It is recommended that the appropriate forms for the residence permit are obtained and submitted before leaving an individual's home country. These forms can be obtained from a German Embassy or one of its General Consulates or through downloads from one of the embassy websites. Processing the completed forms may take up to three months.

In Germany it will also be necessary to register with local authorities (*Ortsamt, Bezirksamt, or Einwohnermeldeamt*) within the first week after arrival. Registration can be done at the local police station or at the city hall.

## 16. Expatriate Employees

### Cost of Living and Immigration

For a comparison with several international countries/capitals please see the following table (updated version at [www.finfacts.ie/costofliving](http://www.finfacts.ie/costofliving)):

Mercer Human Resource Consulting COST OF LIVING SURVEY 2004 – INDEX SUMMARY – TOP 50 CITIES									
Rank		City	Index		Rank		City	Index	
2004	2003		2004	2003	2004	2003		2004	2003
1	1	Tokyo, Japan	130.7	126.1	26	52	Amsterdam, Netherlands	88.1	76.8
2	7	London, UK	119.0	101.3	27	22	Los Angeles, USA	86.6	85.6
3	2	Moscow, Russia	117.4	114.5	28	58	Berlin, Germany	85.7	75.3
4	3	Osaka, Japan	116.1	112.2	29	14	Hanoi, Vietnam	85.6	89.5
5	4	Hong Kong	109.5	111.6	30	18	Shenzhen, China	85.6	86.7
6	6	Geneva, Switzerland	106.2	101.8	31	29	Taipei, Taiwan	85.3	83.5
7	8	Seoul, South Korea	104.1	101.0	32	18	Guangzhou, China	84.9	86.7
8	15	Copenhagen, Denmark	102.2	89.4	33	40	Tel Aviv, Israel	84.8	79.1
9	9	Zurich, Switzerland	101.6	100.3	34	37	Budapest, Hungary	84.5	80.2
10	12	St. Petersburg, Russia	101.4	97.3	35	25	Chicago, USA	84.5	83.9
11	5	Beijing, China	101.1	105.1	36	16	Ho Chi Minh City, Vietnam	84.5	88.5
<b>12</b>	<b>10</b>	<b>New York City, USA</b>	<b>100.0</b>	<b>100.0</b>	37	25	Beirut, Lebanon	84.3	83.9
13	17	Milan, Italy	98.7	87.2	38	30	San Francisco, USA	84.3	83.0
14	21	Dublin, Ireland	96.9	86.0	39	66	Luxembourg	84.3	74.0
15	13	Oslo, Norway	96.2	92.7	40	63	Düsseldorf, Germany	84.3	74.2
16	11	Shanghai, China	95.3	98.4	41	74	Glasgow, UK	84.1	72.3
17	23	Paris, France	94.8	84.3	42	65	Frankfurt, Germany	84.0	74.1
18	42	Istanbul, Turkey	93.5	78.8	43	62	Munich, Germany	84.0	74.4
19	34	Vienna, Austria	92.5	82.4	44	56	Bratislava, Slovak Republic	83.9	75.7
20	67	Sydney, Australia	91.8	73.7	45	38	Jakarta, Indonesia	83.9	80.0
21	41	Rome, Italy	90.5	79.0	46	32	Singapore	83.6	82.8
22	48	Stockholm, Sweden	89.5	78.2	47	56	Dakar, Senegal	83.4	75.7
23	36	Helsinki, Finland	88.8	80.9	48	27	Riga, Latvia	83.3	83.7
24	35	Abidjan, Ivory Coast	88.7	81.3	49	49	Prague, Czech Republic	83.3	78.1
25	31	Douala, Cameroon	88.3	82.9	50	71	Athens, Greece	82.9	72.9

The current rate of inflation is approximately 2%.

## Driver's Licenses

The law permits a foreign national to use a foreign or an international driver's license as a valid license within Germany for a period of one year. This period commences on the date of the driver's arrival in Germany.

The holder of a foreign or international driver's license can receive the German license quite easily. He will first have to obtain a translation and classification of his foreign license. This is done by the *Allgemeiner Deutscher Automobil Club (ADAC)*, which has offices in major cities all over Germany and its central office in Munich.

With the exception of EU nationals, the applicant must furnish proof that he has driving experience in Germany. The confirmation of his company or any third person will be sufficient. Further, an eye test made by a licensed optician is required, but, again, not for EU nationals.

The confirmation, the translations of the license, a passport, a passport photo, the eye test certificate, the certificate from the *Einwohnermeldeamt* (see Section XVI. Immigration Requirements) and the required fee must be handed to the *Amt für öffentliche Ordnung, Führerscheinstelle*. This office will process the papers and, after a period of time (generally at least one month), issue the German license. It should be noted that after the year has elapsed, every driver who has not received a German driver's license will be considered as driving without a license.

## Education

There are 3.5 million pupils in primary schools in Germany. From there, pupils go on to a number of different types of secondary schools, such as

- *Hauptschule* (equivalent to a secondary modern school);
- *Gymnasium* (equivalent to a grammar school);
- *Realschule* (in between a secondary modern school and a grammar school);
- Comprehensive school;
- Special school.

The development of standardised course content for individual schools, and the increasing use of academic assessments to determine whether students have covered specific information, make it much more difficult for children in their teens to move from one school to another. There are no fees for attending state schools; fees for private schools vary.

## Housing

There are no restrictions on house ownership of foreigners. The investor does not have to have housing before he enters the country. Unfortunately, inflated housing markets tend to coincide with areas where there are high expatriate populations, such as Munich, Frankfurt, and Hamburg, and to a lesser extent Düsseldorf, Cologne, and Berlin. A one-bedroom apartment in Frankfurt or Munich will typically cost between € 500,- and 900,- per month. Because there is a housing shortage in some cities, it might be useful to hire a home search service.

The investor may give a housing subsidy to his employees and deduct the amount as business expense from tax. However, the employee will have to pay tax on the amount received.

## Importing Personal Possessions

Personal possessions can be imported duty free if the following conditions are met:

- a valid work permit (if it is required) for at least 12 months and residence permit;
- a furnished house or flat in Germany for a period of at least 12 months;
- the normal home was abroad for a period of at least two years prior to the arrival in Germany;
- ownership and use of the personal possessions for a period of at least six months prior to moving.

Personal cars imported duty-free must be kept for three years before disposal. Within three years the car can be sold if the customs debt (customs duty, VAT, consumption tax and other compulsory payments) is paid.

Personal belongings may not be imported before obtaining the residence permit. A formal declaration to the Customs Authorities is necessary. It is recommended that a shipping agent handles all customs documentations.

## Medical Care

Germany today has a comprehensive high-quality health care system covering nearly all costs, even including long-term care. More than 90 per cent of the population are covered through the country's statutory health care insurance program.

In general, within the EU and EEA there are rules allowing an employee to remain part of his own national security system despite working abroad, provided he is sent abroad for a limited period which is not envisaged to exceed 12 months. Conversely, the state to which the employee is seconded will usually provide that the employee is exempted from contributing to its social security system whilst he is still covered by the system of his own state. If permanent employment is envisaged from the outset, the employee will be subject to the social security system of the state in which the work is performed from the start of employment. In respect of non-EU or EEA member states, this issue is subject to any bilateral agreements.

The cost of treatment in public hospitals is covered by public health authorities, except for a small charge from the start of hospital treatment up to a maximum of 14 days. Private insurance is recommended for specialist medical treatment outside the German National Health Service, which can be very expensive.

## Tax Liability

Germany has entered into an extensive network of income tax treaties with all western European and many other countries in the world. The concept of the German income tax treaties generally means that the tax exemption method applies for business income from a permanent establishment in the other state, for income from immovable properties situated there, and from independent and dependent personal services rendered in the other contracting state.

Income of all natures and origins received by a person residing in Germany, as well as income received by a non-resident from a German source, is taxable in Germany.

This general rule is subject to the provisions of international tax treaties between Germany and other countries. Each situation should therefore be reviewed in the light of the relevant treaties.

German source income received by employees in Germany who are non-residents for tax purposes is generally subject to withholding tax at rates which are frequently lower than the corresponding income tax rate applying to residents. For example, wages paid in 2001 are exempt up to € 9,839, and the amount between this figure and €28,548 is taxed at a rate of 15%. A 25% rate applies to the portion of wages exceeding this amount.

However, such non-resident employees must file a German tax return, and the difference between the withheld amount and the normal amount of tax payable – if any – will be payable.

Depending upon the existence and the terms of any tax treaty between Germany and the person's country of tax residence, this tax may be subject to a credit against income taxes payable in the home country.

Depending on how long they stay, whether they work in Germany or in several countries and, above all, on whether their families are present in Germany, expatriates may (1) remain non-residents for tax purposes and thus be subject to German taxation only on income from a German source or (2) become tax-paying residents, in which case their worldwide income is subject to German income tax.

Taxation of expatriates' compensation may be reduced if they exercise part of their activities outside Germany ("temporary assignment" clause in contract of employment, split salary, expatriation bonus, etc.) and receive a bonus for these activities outside Germany, or reimbursements of expenses not subject to tax under German law or reimbursements which by their nature are taxable.

## Work Contracts

The investor does not need a work contract to work in the country.

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