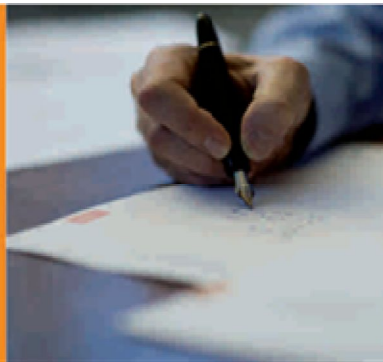


# Thümmel, Schütze & Partner

## RECHTSANWÄLTE



# Setting up, legal environment, tax issues and entry barriers to consider when investing in Germany

Patrick Dahm, 12 October 2009

“The barriers are not erected  
which can say to aspiring talents  
and industry, ‘Thus far and no  
farther.’”

Ludwig van Beethoven

# Setting up in Germany

# Means of Doing Business

- Direct selling or purchasing
- Use of distribution channels
- Licensing
- Setting up of business vehicle
- Acquisition of interest
- Contract as instrument of risk control

# Legal Forms of Doing Business

- Sole proprietorship
- General partnership
- Limited partnership
- Limited liability company
- Stock corporation
- Societas Europaeae, a transnational entity on European level

# Limited Liability Company (GmbH)

- Minimum share capital of €25,000 required, of which €12,500 must be paid before entered in commercial registry
- Notarial form required for certain corporate action (formation, share transfer)
- Normally no share certificates issued
- Two corporate bodies:
  - Shareholders' meeting
  - Managing director(s)
- Sole foreign directorship possible
- Supervisory board mandatory only if more than 500 employees

# Limited Liability Company (GmbH)

- Cash contributions or contributions in kind
- Most recent legislative reform:
  - “Entrepreneurial Company”
  - Statutory minimum capital from €1 to €24,999, but 25% of profits must be put into reserves
  - Must point out status (e.g. by adding “UG (haftungsbeschränkt)” to company name)
  - Share capital must be fully paid up when applying for registry
  - No capital increase by contributions in kind

# Stock Company (AG)

- Must maintain minimum share capital of €50,000
- Capital must be fully subscribed and, at formation, have at least 25% of equity capital paid up
- Shares must have a minimum par value of €100
- Three tier structure:
  - General Shareholders' Meeting
  - Supervisory Board
  - Board of Management
- If corporation has more than 2,000 employees, 50% of supervisory board must be made up of employee representatives
- Shares are freely transferable
  - Bearer shares
  - Name shares (share register maintained by corporation)
  - Name shares with restricted transferability

# Legal Environment, Issues to Consider

# Dispute Resolution

- State courts
  - Reciprocal recognition and enforcement of judgements for payment between Germany and Singapore
  - Security for costs
- Arbitration
  - UN Convention of 10 June 1958 on the Recognition and Enforcement of Foreign Arbitral Awards
- Mediation

# Arbitration

- Ad hoc arbitration
- Institutional arbitration
  - International Chamber of Commerce, Paris (ICC)
  - German Institution of Arbitration, Cologne (DIS)
- German arbitration law

# Conflict of Laws

- Free choice of law allowed
- Limits include:
  - Compulsory German law
  - Ownership in goods
  - Corporate matters, e.g. form, articles of association
- International private law

# Sale and Purchase

- UN Convention of 11 April 1980 on the International Sale of Goods (“CISG”), also called “Vienna Convention”
- Currently 74 member states
- Incoterms 2000

# Sale and Purchase

- Domestic law of (commercial) sale and purchase governed by German Civil Code and German Commercial Code
- Major remedies of the purchaser
  - Repair or replacement delivery
  - Repudiation or reduction of price, damages
  - Liability in case of chain supply of consumer products
- Obligation to inspect and notify defects

# Standard Business Terms

- Individually negotiated contract terms are not standard business terms
- Priority of individual contract terms
- Standard business terms are ineffective if they unreasonably disadvantage the other party to the contract with the user
- Certain prohibited (i.e. “unreasonably disadvantageous”) clauses
  - with the possibility of evaluation
  - without the possibility of evaluation
- Case law on unreasonable disadvantages

# Security Interest

- Simple creation by contractual agreement, no registration
- Simple retention of title clauses
- Retention of title clauses creating a quasi-retention of title to newly manufactured products
- Assignment clauses creating a right to proceeds of a resale

# Immigration

- New Immigration Act since 2005
- Restrictive immigration policy
- Immigration Act governs issuance of a residence permit for exercising business under following conditions:
  - Overriding economic or specific regional interest
  - Business likely to have positive impact on economy
  - Financing is secured by equity capital or binding loan commitment

# Immigration

- Presumption of certain conditions in case of investment exceeding €1,000,000 and the creation of 10 jobs
- Certain discretion of local immigration authorities taking into account:
  - Feasibility of business case
  - Entrepreneurial experience of applicant
  - Capital investment
  - Impact on local employment and training
  - Contribution to innovation and research

# Immigration

- Involvement of local authorities, business agencies or Chambers of Industry of Commerce
- General preconditions include:
  - Secure means of subsistence
  - Health insurance
  - Sufficient accommodation
  - No criminal record
  - Compliance with visa application procedure
  - Integration course in case of insufficient command of German language and introduction to German society

# Labour Law

- Relation between employers and employees subject to legislation, collective agreements and contracts
- German constitution guarantees the right to form “associations to safeguard and improve working and economic conditions”
  - Freedom of coalition: unions
  - Freedom to negotiate collective agreements
- Employment contract as special type of service contract
- Employment contract completed by and construed to collective and company agreements

# Labour Law

- Legal right to up to six weeks continued payment of 80% of salary when sick
- Standard periods of notice of termination, depending on:
  - Number of employees
  - Length of service
  - Collective agreements
- Termination only effective when socially justified (Employment Protection Act)

# Labour Law

- Notification of local employment agency in case of large-scale dismissals
- Large-scale notices of termination only become valid when approved by local employment agency
- Exception: reasonable cause (e.g. behaviour of employee)

# Labour Law

- Cooperation between employers and employees according to Labour Management Relations Act
  - Staff of five employees or more may found works council
  - Number of council members depends on size of company
  - Right of co-determination in certain social matters, personal decisions and right to information on particular operational matters

# Labour Law

- Co-determination, mainly applying to limited liability companies (GmbH) and stock companies with more than 2,000 employees
- Minimum of 24 working days paid leave per year
- Safety and employee protection principles:
  - 8 working hours per day
  - 11 hours of rest
  - Sundays and public holidays are off

# Commercial Distribution

- Contracts
  - Sales, commercial agency
  - distribution, franchising, marketing, promotion, advertising
- Statutory law
  - European law
  - Civil Code, Commercial Code
  - Unfair Competition Act, Act against Restraints on Competition
  - Law for special industry sectors (e.g. health & pharmaceuticals, chemicals, foodstuff, electronics)
- Case law

# Commercial Distribution

- Foreign manufacturer likely to organise German market activities through:
  - Importers (cum wholesale distributors)
  - Franchise contractors
  - Direct sales retail customers (e.g. chains of stores)
  - Direct sales to end customers
- Identification of sales opportunities and support with sales logistics by commercial agent

# Commercial Distribution

- Commercial sales or sales support facilities can be set up as:
  - Own business
  - Third party owned business
  - Partly owned business
- Regardless of organisational setup: rules and regulations apply

# Commercial Distribution

- Commercial distributors purchase and sell in own name and on own account
- Distributorship agreements to consider e.g.:
  - Exclusivity, marketing and promotion, warehousing, minimum stock requirements, brand protection
  - after sales service, purchase and resale related terms and conditions, minimum purchase obligations
  - manufacturer/distributor/end user warranty, shipping
- European and German competition laws

# Commercial Distribution

- Commercial agents
  - Independent merchants appointed by a principal on a long-term basis to solicit sales opportunities for the principal either by entering into contracts on behalf of the principal or by sending offers to the principal who then will conclude contract directly
- Comprehensive statutory rules and regulations for commercial agency
  - Indemnity compensation payable to commercial agent at end of agency relationship (maximum one year gross commission)

# Commercial Distribution

- Competition law
  - Treaty of the European Community prohibits all agreements that appreciably affect competition
  - Nullity of competition-affecting agreements unless exempted
  - Block exemptions or individual exemptions
  - Decentralised control system

# Tax

# Taxation of Companies

- AG and GmbH subject to corporate income tax on their worldwide income if corporate head office maintained in Germany (resident company)
- Non-resident corporations subject to tax on income from within Germany (non-resident company)

# Taxation of Companies

- Corporate income tax rate of 15% of profits, regardless if income retained or distributed
- Additional “solidarity surcharge” of 5.5% is levied on corporate income tax
- Municipal trade income tax at rates ranging from 12% to 20% (average:18%)

# Taxation of Companies

- Dividends received by resident company from subsidiary exempt from corporate income tax
  - But 5% of dividends treated as non-deductible business expense and taxed accordingly
  - Only applicable if company holds at least 15% of subsidiary's nominal share capital at the beginning of the fiscal year
- Withholding tax of 25% (plus 5.5% solidarity surcharge) on dividends paid to shareholders
- Capital gains generally treated as business income

# Taxation of Companies

- Determination of taxable income based on annual report
- All assets and liabilities to be assessed as per balance sheet date at the end of the fiscal year
- Reform of accounting principles by 2010
- Charges for arm's length services rendered by foreign parent company to German subsidiary deductible

# Taxation of Companies

- Consolidated tax return
  - Group of companies with German company as major shareholder
  - Members of the group of companies may offset their losses against their profits
  - Conclusion of a profit and loss pooling agreement with a term of at least five years

# Taxation of Companies

- Germany party to tax treaties with about 90 countries (mostly based on OECD Model Tax Convention), e.g.:
  - all European countries
  - USA
  - Russia
  - China
  - India
  - Singapore
- Profits generated in permanent establishment in the other treaty state tax-exempt in Germany
- Interest income tax-exempt in country of source and taxed in Germany (unless permanent establishment in country of source)
- Real estate income (including capital gains from sale) taxable in country of location only

# Taxation of Companies

- Transfer pricing for goods and services between German companies and foreign affiliates to comply with arm's length principle
- Else:
  - Adjustment by German tax authorities
  - Substantial penalty taxes

# Taxation of Companies

- Value added tax
  - Normal rate at 19%
  - Reduced tax rate at 7% for certain goods and services
- Withholding tax at 15% on payments for construction work
- Real estate transfer tax
  - Normal rate at 3.5%
  - Federal states may charge higher rates (e.g. Berlin: 4.5%)
  - Also triggered if at least 95% of shares in real estate owning company are transferred

Thank you.

# Thümmel, Schütze & Partner

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