INVESTING IN GERMANY

Legal and tax aspects

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Content

A. The European Union and Germany

The European Union (EU) is a community of 28 European states and the world's biggest economy. Its member states together produce the world's largest gross domestic product (GDP), representing 20.9% of the worldwide GDP[1].

The current population of the EU countries is about 500 million. The purchasing power of half a billion people makes the EU the world's most lucrative consumer market. Consequently, the EU is one of the most important trade partners in the world, accounting for 15% of international trade and 22.5% of services[2].

According to the latest Foreign Direct Investment Confidence Index of global management consulting firm A.T. Kearney[3], three EU member states are among the ten best-rated investment destinations worldwide: Germany, the United Kingdom and France. An investor seeking to enter the European Union market will look at a number of criteria when choosing the location, such as the general investment landscape, the condition and reliability of the transport, communications and energy infrastructures, the availability of well-qualified employees, the competitiveness of the tax system, the available options for setting up businesses and the employment regulations that may be applicable, to name but a few. You can find an overview of the main investment criteria for doing business in Germany in Section G.

Germany is one of the main drivers of the EU economy and one of the most attractive investment destination in Europe. Renowned as a strong and stable business location, Germany offers investors an excellently developed infrastructure, a highly skilled and educated workforce and an outstanding research environment. But also a taste for innovation and the international dimension and global reach of its economy make Germany a highly attractive investment destination[4].

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1 Eurostat Press Office, The EU in the world – economy and finance (STAT/14/142, 09 September 2014).

2 European Commission, European Union Trade and Investment 2014 (Publication Office of the European Union, 2014), 3.

3 A.T. Kearney GmbH, 'The 2014 A.T. Kearney Foreign Direct Investment Confidence Index' (14th edn, June 2014).

4 Germany Trade and Invest, Press release of MBWi and GTAI, dated 3. November 2014).

B. Investing in Germany

A foreign investor faces a multitude of options on how to structure a market entry in Germany.

As a rule, corporate foreign direct investments will be structured either by setting up a company branch (*Zweigniederlassung*) or by setting up a corporate entity, usually in the form of a GmbH or AG.

The following chapter gives an overview of a variety of options, a summary of which you can find in Section G.

I. Establishment of a company branch

If a company wishes to operate in Germany, in addition to establishing a completely legally independent subsidiary, there is also the possibility of setting up a company branch.

Setting up a company branch does not involve establishing a legal entity separate from the company based at the head office. The branch remains, legally and in terms of organisation, part of the company based at the head office and in this respect is subject to the law applicable at the location of the head office.

A distinction is made between independent company branches (*Zweigniederlassung*) and dependent company branches (*unselbständige Niederlassung* or *Filiale*) (also referred to as business premises).

1. Independent branch (branch establishment)

According to §§ 13 et seq. of the German Commercial Code (*Handelsgesetzbuch*, HGB)[5], an independent branch is a branch that is geographically separated from the head office and has been established as an additional long-term base of the company. The typical characteristics of a branch office are

[5] German Commercial Code in the version published in the Federal Law Gazette Part III under the classification number 4100-1, last amended by Article 11 of the Law of 24 April 2015 (BGBl. I p. 642).

- Separate management
  There is a branch manager who represents the company branch independently in business transactions.

- Separate capital resources
  The branch office possesses its own operating capital. However, a minimum sum is not prescribed.

- Separate accounting and balance sheet preparation
  The branch office usually keeps its own business accounts and prepares an independent annual balance sheet.

- Certain duration
  The branch office does not merely handle short-term transactions, but, like the head office, also pursues those of long-term.

Since the branch office is not an independent company but part of the company as a whole, its name is, as a rule, identical to that of the main company. Additions such as 'German office' are possible. The manager of the branch office represents it independently in external dealings. They must be vested with a power of attorney (general commercial power of attorney or power of procuration) which authorises them to act for the branch office. However, the debtor in terms of any liabilities is always the natural person or legal entity of the main company, not the branch office itself.

The branch does not need to be registered at the location of the registered head office abroad, but in the German commercial register. This provides it with its own registered office, its own commercial register number and its own jurisdiction. The application for registration must be submitted to the commercial register in writing, and be notarised. Those persons at the head office vested with power of representation are responsible for completing the above steps.

2. Dependent branch (business premises)

A company can also have several business premises which are in no way independent but fully dependent on the head office. They have no capital resources of their own, do not act independently in business dealings and do not keep separate accounts. They are only separated geographically, but in no way organisationally, from the main enterprise. For example, business premises may not issue invoices in their own name, their company name must be the same as that of the head office and they do not need to be registered in the commercial register. Only the application for registration of a trade needs to be submitted to the local trade licensing office.

II. Representative offices

German commercial and trade law does not provide for the concept, which is common in other countries, of the 'representative office' as a form of entrepreneurial activity. Although a foreign company can set up a representative office in Germany, such a representative office can not undertake independent commercial activity on behalf of the foreign company. It does not need to be registered with the trade licensing office, nor does it need to be registered in the commercial register. According to the German Banking Act (*Kreditwirtschaftsgesetz*, KWG)[6], only banks with a registered office abroad require the approval of the German supervisory authority for the banking industry in order to establish a representative office.

Often, a representative office simply consists of an office from which one person establishes business contacts or cultivates existing contacts. However, this representative is not vested with a power of attorney by the foreign company and thus does not conclude transactions, either in their own name or in the name of the company. As soon as the office is used by the foreign company as a base for commercial operations and it thus begins to function as a part of the foreign company's own organisation, it legally constitutes a branch establishment which, depending on the degree of dependence on the head office, either only represents a dependent branch (= business premises) or a true branch establishment in terms of the commercial code which must then also be registered in the commercial register.

Therefore, although a representative office can be set up and used in advance of an entrepreneurial activity, it cannot be used for the conduct of commercial activity by the company, since this would make it a branch establishment.

III. Establishment of a sole proprietorship

The establishment of a company in the form of a sole proprietorship is a suitable form of entry for small businesses. The formalities are quite straightforward: the company simply needs to be registered with the trade licensing office.

The business is run solely by the proprietor, who is personally liable through his or her entire private and business assets. The company does not need to be registered in the commercial register. However, it can be registered voluntarily, as a result of which the entrepreneur becomes a registered businessman (*eingetragener Kaufmann*, e.K.).

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[6] German Banking Act in the version of the Announcement of 9 September 1998 (BGBl. I p. 2776), last amended by Article 2 of the Law of 1 April 2015 (BGBl. I p. 434).

If the company is not registered in the commercial register, no detailed accounts need be kept; simple cash-based accounts are sufficient.

The possibility of operating a company as a sole proprietorship is limited. As soon as the company's activities expand and exceed certain limits, the entrepreneur is obliged to run the company according to commercial principles and register it in the commercial register. He or she must then also prepare annual financial statements, i.e. a balance sheet and income statement.

IV. Establishment of partnerships

When setting up a new company it first must be decided whether to form a partnership or a corporate entity. In the case of a partnership, the individual identity of the partners is very important. The personal nature of the partnership gives rise to the following fundamental characteristics:

- The partnership has no legal personality of its own; each fully liable partner is jointly and severally liable for the company.
- Each partnership consists of at least two persons and has at least one partner who is personally liable for the company's liabilities with their private assets.
- The principle of inherent office applies, i.e. the company has, in its members, 'born' corporate bodies; the appointment of third parties as corporate bodies is not permitted.
- The purpose of the company is primarily pursued through the personal commitment, creditworthiness and private assets of the partners.
- Voting in the meeting of fully liable partners takes place by headcount. Decision-making fundamentally follows the principle of unanimity.
- The conclusion of an agreement is sufficient for the company to be established.
- The partners cannot be replaced at will, with the consequence that the death, resignation or insolvency of a partner can affect the existence of the company.

The three most important forms of partnership are the *Gesellschaft bürgerlichen Rechts* (GbR) (partnership under German civil law), the *offene Handelsgesellschaft* (OHG) (general partnership) and the *Kommanditgesellschaft* (KG) (private limited partnership).

1. The Gesellschaft bürgerlichen Rechts or 'GbR' (partnership under German civil law)

In order to form a GbR, you need at least two partners who pursue a common aim. This form of company which, like all partnerships, does not represent a legal entity, is therefore not generally intended to remain in existence long term but rather is merely created to achieve a common purpose such as the construction of a dam by several construction companies, for example. The partners in the GbR enjoy equal rights and are fully liable with their private assets for liabilities arising from the undertaking. It is not necessary to draft written articles of association, although it is advisable.

The GbR is not limited to the relationship among the partners, but it may enter into legal transactions with third parties. It can acquire rights, enter into commitments, bring actions before a court or have actions brought against it.

Each GbR whose purpose is to conduct commercial trade is automatically classified as an OHG and must comply with the regulations applicable to this form of company.

2. The offene Handelsgesellschaft or 'OHG' (general partnership)

In the case of an OHG, at least two partners join together to conduct a commercial business under a joint company name. In contrast to the GbR, the company is obliged to apply for registration in the commercial register.

The OHG does not represent a legal entity, although the law grants it a certain amount of autonomy. For example, the OHG can, under its company name, acquire rights and enter into liabilities, acquire property and bring actions before a court or have actions brought against it.

As a fundamental rule, all partners are authorised to manage and represent the company externally. Each partner is jointly and severally liable with their entire private assets for the company's liabilities. This means that the creditors can seek out any partner and demand from them the entire amount which the company owes the creditor.

3. The Kommanditgesellschaft or 'KG' (private limited partnership)

The *Kommanditgesellschaft* is a special form of the OHG. It possesses no legal personality of its own, although its legal position corresponds in some respects to that of a legal entity, and it can thus acquire rights, enter into liabilities and bring actions before a court or have actions brought against it.

a) The partners in the KG

To form a KG, at least two partners are required to join together with the purpose of conducting a commercial business. However, in contrast to the OHG, the liability of at least one partner is limited to the amount of a particular contribution of assets. In the case of the KG, there are thus two types of partner, and there must be at least one of each type, namely

- a partner with unlimited personal liability, referred to as a general partner;
- a partner whose liability is limited to the amount of a particular contribution of assets, referred to as a limited partner.

Since general partners do not necessarily need to be natural persons, it is also possible, and widespread practice, to use a GmbH as a personally liable partner. In the resulting GmbH & Co. KG, a limitation of the liability of the general partner is effectively achieved, since by law the liability of a GmbH is limited to its own company assets.

b) Management and representation

As a fundamental rule, only the general partners in a KG are authorised to manage the company. The limited partners are simply granted a right of control, but it is possible for the management authority to be formulated in departure from the legal rule in the articles of association. The limited partners are also excluded by law from representing the company externally. However, it is possible for individual limited partners to be granted a power of attorney (e.g. power of procuration, general power of attorney), thereby allowing them to act for the KG in external dealings.

c) Articles of association

As with the other forms of partnership, written articles of association are not a legal requirement. However, the drafting of written articles of association is strictly recommended when establishing any company. The costs of legal advice should not be a deterrent in this respect. As a rule, they are much lower than the costs and losses incurred if disputes critical to the existence of the partnership arise between the partners because no articles exist, or because the articles of association are deficient. Articles of association for the establishment of a KG should therefore at least contain the following provisions:

- name of the company;
- registered office of the company;

- purpose of the company;
- partners and their share in the company capital;
- management and representation;
- participation in profits and losses;
- drawing right;
- contractual term;
- termination or continuation of the company in the event of the withdrawal or death of a partner;
- succession;
- expulsion of partners;
- assignment of a share in the company;
- liquidation.

d) Registration of the KG in the commercial register

The KG—like the OHG—must be registered in the commercial register at the municipal court within whose jurisdiction the company's registered office is located. The registration must contain

- the surname, first name, date of birth and place of residence of each partner;
- the name of the company, the location of its registered office and its business address within Germany;
- the powers of representation of the partners;
- the limited partners and the respective amount of their capital contribution.

The application for registration must be made by all partners in the KG and in notarised form. The general partners as well as any appointed authorised signatories must provide a specimen of their signatures, stating the company name, to be kept by the court.

V. Establishment of a corporate entity

A corporate entity is principally distinguished by the following characteristics:

- It has its own legal personality, i.e. it is a legal entity which can sue and be sued, has to pay taxes on its profits ('corporation tax') and can acquire property (e.g. land).
- The shareholders of a corporate entity will not be held personally liable with their private assets.
- The directors and management board members need not hold a share in the capital.
- Voting at the shareholders' meeting is always based on equity interests.

The most common forms of corporate entity are the GmbH and the AG.

1. Establishment of a GmbH (German limited liability company)

A *Gesellschaft mit beschränkter Haftung* (GmbH) is an independent legal entity under private law and as such it is itself the bearer of rights and obligations. It is a trading company and can be formed for any permissible purpose, including non-commercial purposes. The establishment of a GmbH begins with the drafting of the articles of association and ends with the registration of the GmbH in the competent commercial register, which is kept by the municipal court within whose jurisdiction the company's registered office is located. It involves the following steps:

a) Drafting the articles of association

The articles of association require notarisation (§ 2 para. 1 GmbHG[7]). Representation by proxy is permissible, but this requires at least a notarised power of attorney. An individual can also found a GmbH and draft the articles of association (§ 1 GmbHG). The articles of association must contain at least the following:

(1) Name of the company

The company name is the name under which the GmbH is registered in the commercial register and operates externally within the market. Fundamentally, the shareholders are free in their choice of the company name. However, the company name must always contain the legal-form addition '*Gesellschaft mit beschränkter Haftung*' or a generally understandable abbreviation of this designation ('GmbH').

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[7] Limited Liability Companies Act in the version published in the Federal Law Gazette Part III under the classification number 4123-1, last amended by Article 15 of the Law of 24 April 2015 (BGBl. I p. 642).

It should also be noted that the permissibility of the company name depends on the circumstances of the individual case; it is recommended that the permissibility of the chosen company name be established bindingly with the competent chamber of industry and commerce (IHK).

(2) Registered office of the company

According to § 4a GmbHG, the location at which the company has business operations, or where the company management is based or from which the company is administered should be specified in the articles of association as the company's registered office in Germany. The head office of a company, i.e. the effective place of business/centre of effective administration/centre of effective management, does not need to be identical to the registered office. Fundamentally, the relocation of the head office to any place within Germany or abroad will not require any amendment to the articles of association.

If the senior business management duties are not in fact carried out in Germany, making use of the necessary resources available there, this could possibly lead, for tax purposes, to the company having dual domicile: in Germany and in the country in which the senior business management duties are effectively carried out. Depending on the applicable double taxation agreement, this could lead to disadvantages under the terms of the agreement (double taxation). Moreover, the relocation of the management office abroad could give rise to the potential risk of liquidation taxation in accordance with §§ 11, 12 KStG[8] as a result of the management 'moving' abroad following the establishment of the company. Such conflicts can only be avoided if the actual management duties are also permanently conducted from the company's registered office. This is particularly important because the way such arrangements are treated in terms of tax has not yet been clarified.

(3) Object of the Company

A GmbH can pursue any legally admissible aims. The field of activity of the GmbH should be set forth as precisely and accurately as possible in the articles of association.

(4) Nominal capital and shares in the business

The nominal capital of the GmbH must be at least EUR 25,000 and consists of one or more shares in the business (depending on the number of founders of the company). Except in the simplified procedure (see VI.1.b), the acquisition of several shares in the business by one shareholder is already possible upon establishment

[8] Corporation Tax Act in the version of the Announcement of 15 October 2002 (BGBl. I p. 4144), last amended by Article 2 of the Law of 1 April 2015 (BGBl. I p. 434).

of the company (§ 5 para. 2 clause 2 GmbHG). Accordingly, pursuant to § 3 para. 1 no. 4 GmbHG the number and nominal amounts of the shares in the business that each shareholder acquires are included in the minimum required content of the articles of association and must be included in the list of shareholders with consecutive numbers (§ 40 para. 1 GmbHG).

The nominal capital can be provided not only in cash but in the form of tangible assets; however, this is only permissible if it is expressly provided for in the articles of association.

(5) Special services on the part of the shareholders

If, in addition to the provision of capital contributions, the shareholders are required to assume additional obligations towards the company, these must also be specified in the articles of association. Such special services may, for example, involve additional contributions on top of the initial contribution (capital surplus) or the obligation to grant loans.

(6) Other provisions

In general, further provisions are included in the articles of association, such as stipulations concerning the representative and management authority of the directors (possibly including a list of transactions requiring approval) and the convening and conducting of shareholders' meetings.

b) Establishment through the simplified procedure—the model statutes

With the Law on the Modernisation of the Private Limited Companies Act and the Combating of Misuse (*Gesetz zur Modernisierung des GmbH-Rechts*, MoMiG)[9] legislators have provided for so-called model statutes for simple cases of incorporation. One procedural simplification is that the model statutes comprise not only the articles of association but also the appointment of the directors and the list of shareholders, which reduces the number of documents required.

The model statutes can be used if the GmbH has a maximum of three shareholders and only one director, only cash contributions are provided and only one share in the business per shareholder is agreed.

The content of the model statutes is limited to the date, register of deeds/number, notary, location of the notary's office, shareholders, company name, registered office, the corporate objective company, nominal capital, distribution of shares in the business

[9] Law on the Modernisation of the Private Limited Companies Act and the Combating of Misuse (MoMiG) of 23 October 2008 (BGBl. I 2008, p. 2026).

between the shareholders, name, date of birth and place of residence of the managing director and special comments by the notary, supplemented with provisions on representation and costs of establishment.

Departures from the model statutes are only permissible to a limited extent; complicated formulations are thus not permitted.

The use of model statutes entails a slight privilege in terms of costs; however, this is countered by a number of disadvantages; for example, the simplified procedure does not allow the appointment of more than one director.

While the model statutes may be useful for simple cases, as soon as the structure becomes more sophisticated, the disadvantages outweigh the advantages. It is therefore likely that this simplification will only be of theoretical benefit to foreign investors.

c) Appointment of the directors of the company

The GmbH has one or more directors. The directors are appointed either in the articles of association themselves or at the first general meeting, which is held immediately following the notarisation of the articles of association.

Only natural persons with unlimited legal capacity can be appointed as directors. They do not need to be German nationals.

Details on the rights and duties of the directors will be given below.

d) Provision of the nominal capital and opening of a bank account

In view of the fact that the shareholders of a GmbH are not personally liable, and only the company's assets are available to creditors, the shareholders must actually make their shares in the business available to the company.

If the company is formed by way of a capital contribution in cash by one shareholder, this shareholder must immediately pay ¼ of each share into the business, but no less than half the minimum nominal capital of EUR 12,500 in total.

For this purpose the director shall, immediately following notarisation of the articles of association, open a company bank account in which the shareholders can deposit their contributions.

A company which is not yet registered in the commercial register can also have a bank account opened as a so-called company 'being established' (*in Gründung*), or 'i.G.' for short.

The management bodies (directors) as well as all founding members are entitled to open an account. The following documents must be submitted when opening the account:

- notarised articles of association;
- resolution on the appointment of the directors;
- copy of the application for entry in the commercial register;
- valid passport or ID of the applicant;
- if necessary, a short term visa of the applicant.

e) Application and registration of the company in the commercial register

All directors must apply for the registration of the establishment of the GmbH in the relevant commercial register. The commercial register is a register of all traders and trading companies which can be inspected by anybody, free of charge, at the local municipal court; it can also be accessed in electronic form online at: www.handelsregister.de.

It contains information on the name of the company, its legal form and its shareholders. The municipal court in whose district the company has its registered office is responsible to maintain the register.

The application for registration in the commercial register must be made in notarised form. Representation by proxy is not permitted.

The following documents, in certified form, must be submitted to the commercial register with the application for registration:

- certified copy of the notarised articles of associations and appointment of the directors;
- list of the shareholders, indicating the surname, first name, date of birth and place of residence of each shareholder as well as the nominal amounts of the shares held by each shareholder;
- if non-cash contributions are agreed: documents confirming that the value of the non-cash contributions corresponds to the value of the share in the business which are taken over in return;
- a written confirmation by the directors that they have not been convicted of a financial or insolvency-related offence, nor have been prohibited from practising a profession;
- a written confirmation by the directors that the contributions relating to the shares in the business held by the shareholders have been provided and that the subject of the contributions is, with final effect, at the free disposal of the directors;

- nature and scope of the representative authority of the directors.

The commercial register checks the formalities associated with the establishment of the GmbH.

The costs for the notary, including registration in the commercial register, depend on the amount of the nominal capital. The establishment of a GmbH with a nominal capital of EUR 25,000 would involve notary's fees of approx. EUR 500 to EUR 700.

2. The Unternehmergesellschaft (haftungsbeschränkt) (entrepreneurial company (with limited liability))

According to § 5a GmbHG, it is possible to establish companies with a share capital of less than EUR 25,000. This is the so-called '*Unternehmergesellschaft haftungsbeschränkt*' (entrepreneurial company with limited liability), or '*UG haftungsbeschränkt*'. It is a sub-form of the GmbH. Accordingly, the same regulations apply to the UG as apply to the GmbH, though with a number of important differences, which are explained below.

a) Special features relating to the establishment of the company

The most important difference between the UG and the 'classic' GmbH is that it can be founded with a nominal capital of between EUR 1 and EUR 24,999. This makes it of particular interest to persons starting up a new business that only requires a small amount of start-up capital. However, the amount of nominal capital chosen should be adjusted to the specific requirements for the proposed business activity, because the lower the nominal capital, the higher the risk of insolvency. Founding a company with one euro is not therefore practical.

Unlike the 'classic' GmbH the nominal capital of the UG must already be fully paid in as cash contributions prior to registration of the company in the commercial register (§ 5a para. 2 GmbHG). Non-cash contributions are not permitted.

Practical advice: If a foreign investor is entering into a contract with an Unternehmergesellschaft, then the amount of its capital should be checked. In the absence of recoverable assets, supplementary forms of security are recommended (reservation of title, transfer of title by way of security, sureties, or the like).

b) Formation of reserves

In order to ensure the availability of adequate capital resources, the Unternehmergesellschaft may not distribute any profits in full. Instead, it must form a statutory reserve

into which one quarter of the net income for the year, minus the loss carry-forward from the previous year, must be transferred (§ 5a para. 3 clause 1 GmbHG). Apart from a nominal capital increase, this reserve may also be used to balance an annual deficit or loss carry-forward (§ 5a para. 3 clause 2 GmbHG). This obligation ceases once the company's nominal capital is increased to at least EUR 25,000 upon a resolution to amend the articles of the UG.

Failure to satisfy the reserve requirement will result in the annulment of the annual financial statements' approval (analogously to § 256 AktG[10]); this in turn leads to the annulment of a resolution on the appropriation of profits (analogously to § 253 AktG). This can result in repayment claims against the shareholders and liability on the part of the directors arising from § 43 GmbHG.

c) Obligation to convene shareholders' meeting

In departure from § 49 para. 3 GmbHG, a shareholders' meeting must be called immediately if insolvency is impending. This does not require the loss of half of the nominal capital as in the case of the GmbH.

d) Conversion of the UG into a GmbH

The UG can be 'converted' into a normal GmbH by means of a capital increase, without there being any obligation to do so. This procedure takes place in accordance with § 5a GmbHG, outside of the scope of the Reorganisation of Companies Act (*Umwandlungsgesetz*, UmwG)[11]. It is necessary that the company achieves the minimum nominal capital of a GmbH (EUR 25,000), through either cash capital increases or the conversion of the reserves into nominal capital according to the rules on capital increases from company resources in accordance with §§ 57c et seq. GmbHG. In particular, § 57e GmbHG applies, i.e. an audited balance sheet must be submitted. Once the capital increase comes into effect, the special regulations no longer apply and the company becomes a full GmbH.

Practical advice: The UG can be used as a good instrument for establishing an initial presence quickly and economically on the German market. If business is successful, a GmbH can then be created by converting the reserves into capital.

e) UG (haftungsbeschränkt) & Co.

As the UG is nothing but a new form of a GmbH, a UG (*haftungsbeschränkt*) & Co. KG can be set up for the same purposes as a GmbH & Co. KG.

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[10] Stock Corporations Act in the version of the Announcement of 6 September 1965 (BGBl. I p. 1089), last amended by Article 3 of the Law of 24 April 2015 (BGBl. I p. 642).

[11] Reorganisation of Companies Act in the version of the Announcement of 28 Oktober 1994 (BGBl. I p. 3210; 1995 I p. 428), last amended by Article 11 of the Law of 24 April 2015 (BGBl. I p. 642).

If an UG is involved, the obligation to form reserves under § 5a para. 3 GmbHG can be de facto rendered ineffective because the KG agreement may stipulate that profits will be made by the limited partner only, but not by the general company. The law does not affect the admissibility of such contractual waiver of the general partner to generate profits.

3. The corporate bodies of the GmbH

The GmbH acts, as a legal entity, through its corporate bodies. The corporate bodies of the GmbH are the shareholders' meeting, the directors and, optionally, the supervisory board.

a) The shareholders' meeting

According to the legal concept, the shareholders' meeting (*Gesellschafterversammlung*) is the highest decision-making body of the GmbH. It is responsible for the fundamental transactions of the GmbH, in particular

- the amendment of the articles of association;
- the dissolution of the company;
- the approval of the annual financial statements and the appropriation of profits.

The shareholders' meeting can decide all matters within its competence as long as this is not prohibited by law or by the articles of association. In particular, it can intervene directly in the management of the company by issuing instructions.

The participants of the shareholders' meeting generally arrive at their decisions through the adoption of resolutions. The law stipulates special requirements in terms of the majority required for resolutions concerning specific issues, such as the amendment of the articles of association or the dissolution of the company. Otherwise, resolutions are passed with a simple majority. However, different rules may be stipulated in the articles of association.

b) Directors

The directors (*Geschäftsführer*) form the representative body of the GmbH. Only natural persons may become directors. They do not have to be shareholders of the GmbH (third-party representation). The law makes a distinction between the management of the company and the representation of the company by the directors.

Representation involves the authority of the directors to represent the company externally in all legal and business transactions, i.e. with customers and suppliers,

the authorities, etc. In contrast, management concerns the scope within which the directors are granted authority within the company to manage the company's business operations, i.e. the limits, in terms of content or amount, within which they are authorised to carry out transactions by the shareholders.

The authority to manage concerns the entire scope of the company, both in business terms and in technical terms—unless otherwise stipulated—for ordinary and also extraordinary legal transactions. The authority to manage does not include the amendment of the articles of association and a number of other rights under articles of association. The articles of association therefore usually contain a limitation to the extent that the directors require the approval of the shareholders for transactions outside of the 'normal course of business'. Frequently, a list of legal transactions requiring approval is also specified, whereby the directors' internal authority to manage is restricted.

In this context, however, it must be noted that the statutory power of representation of the directors for the company remains unrestricted and cannot be limited. Even if the directors are required internally by the company to observe restrictions imposed upon them in respect of the power of representation by the articles of association or by resolutions of the shareholders' meeting, these restrictions in the relationship between company and the directors on the power of representation do not, in principle, have an impact on the power of representation externally between the company and its contractual business partners.

The directors are only subject to the legal restrictions of § 181 BGB, on the basis of which they may not act simultaneously in their own name and in the name of the company (prohibition of self-contracting) and they may not simultaneously represent the GmbH and a third party in a transaction between said third party and the company (prohibition of multiple representation). Self-contracting and multiple representation are only allowed if they are explicitly permitted, e.g. in the articles of association, or in individual cases through a resolution by the shareholders' meeting.

In addition, a potential misuse of a director's representative authority can be limited in that the company appoints several (at least two) directors and grants them joint representative authority. In this case, the company can only be represented externally with legal force by two directors jointly (genuine joint representation) or by one director together with an authorised signatory (non-genuine joint representation). If, in contrast, only one director acts, then this is only binding on the company if the other directors have either empowered the acting director to do so prior to the transaction or approved his or her declarations retrospectively.

Further to the directors' obligation to represent and manage the company, they are also subject to other specific obligations. For example, they are responsible for convening and preparing shareholders' meetings. In addition, directors are responsible for entries

in the commercial register, they fulfil tax obligations on behalf of the company and are responsible for fulfilment of the accounting obligations of the GmbH, such as the keeping of trading books and the preparation of an opening balance sheet. The directors are also responsible for the preparation of the annual financial statements, the submission of these to the shareholders' meeting, and for the submission to the operator of the electronic Federal Gazette (*elektronischer Bundesanzeiger*) and publication of the company's reporting documents.

Finally, it should be pointed out that, in the event of grounds for insolvency of the company, the directors are obliged, without culpable delay and no later than three weeks following the occurrence of said grounds for insolvency, to apply for the opening of insolvency proceedings (§§ 17-19 InsO).

Digression: rights and obligations of the authorised signatories

The power of procuration (*Prokura*) is a special authorisation which, according to the regulations of the German Commercial Code, can only be issued by the proprietor of the commercial business or their legal representative. In the case of a GmbH, the power of procuration is issued by the directors, notwithstanding any internally necessary approval by the shareholders' meeting.

Only natural persons can be granted power of procuration. The power of procuration becomes effective at the time of its issue, which can take place without adherence to formal requirements. It lapses immediately, irrespective of registration in the commercial register, upon revocation, which may be carried out at any time. Both the issue and the lapse of the power of procuration must be reported for registration in the commercial register.

Pursuant to § 49 para. 1 HGB, the power of procuration empowers the holder to carry out all kinds of transactions and legal acts, in or out of court, which are associated with the management of a commercial branch, with the sole exception that the authorised signatory is only empowered to sell and encumber plots of land if he or she has been specifically granted the relevant authority. A limitation of the power of procuration vis-à-vis third parties is not allowed. A personal limitation of the power of procuration is only possible in the form of a 'branch power of procuration' (i.e. limitation to one branch office or independent branch establishment) or as joint power of procuration (several persons may only represent the company jointly).

Otherwise, the power of procuration is also limited through the so-called principal transactions, which may only be conducted personally by the proprietor of the commercial business. These include fundamental and structural decisions. The authorised signatory cannot therefore, for example, sell or discontinue the commercial business, enter registrations and sign on behalf of the company in the commercial register, issue powers of procuration or sign the annual financial statements.

c) The supervisory board

The supervisory board (*Aufsichtsrat*, also called the advisory board) is not a mandatory corporate body of the GmbH. However, the shareholders may make provision for such a board in the articles of association (optional supervisory board). On no account does the supervisory board have a management function. It simply monitors and supervises the management and provides them with advice on certain decisions.

Only in certain cases is the GmbH obliged to have a supervisory board. These cases are as follows:

- § 1 para. 1 of the One-third Participation Act (*Drittelbeteiligungsgesetz*, DrittelbG)[12] requires the establishment of a supervisory board in the case of a GmbH which employs more than 500 employees. One third of the members of such a supervisory board must be representatives of the employees. In calculating the number of employees of the GmbH, according to the One-third Participation Act, employees of operations of dependent companies are deemed to be employees of the controlling company if a control agreement exists between the two companies or if the dependent company is incorporated into the controlling company.

- Pursuant to §§ 1, 6 para. 1, 7 of the Co-determination Act, a mandatory supervisory board must be established in companies which typically employ more than 2,000 employees. The board must consist in equal parts of representatives of the employers and employees. Companies in the mining and steel industries which fulfil the prerequisites of the two Mining and Steel Industry Co-determination Acts (*Montan-Mitbestimmungsgesetze*) are among those companies exempt from this obligation.

- The Mining and Steel Industry Co-determination Act (*Montan-Mitbestimmungsgesetz*, MontanMitbestG)[13] requires the establishment of a supervisory board with rights of co-determination in a GmbH with more than 1,000 employees. The Mining and Steel Industry Co-determination Act applies to companies in the mining and iron and steel producing industries. The Supplementary Mining and Steel Industry Co-determination Act (*Montanmitbestimmungsergänzungsgesetz*, MontanMitbestGErgG)[14] extends the provisions of the Mining and Steel Industry Co-determination Act to parent companies of groups which, while not themselves fulfilling the prerequisites set forth in the Mining and Steel Industry Co-determination Act, head a group characterised by companies involved in the mining and steel industries.

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[12] One-third Participation Act in the version of the Announcement of 18 May 2004 (BGBl. I p. 974), last amended by Article 8 of the Law of 24 April 2015 (BGBl. I p. 642).

[13] Mining and Steel Industry Co-determination Act in the version published in the Federal Law Gazette Part III under the classification number 801-2, last amended by Article 8 of the Law of 24 April 2015 (BGBl. I p. 642).

[14] Supplementary Mining and Steel Industry Co-determination Act in the version published in the Federal Law Gazette Part III under the classification number 801-3, last amended by Article 8 of the Law of 24 April 2015 (BGBl. I p. 642).

4. Miscellaneous

a) Amendments to the articles of association

Resolutions pertaining to the amendment of the articles of association must be notarised. Amendments to the articles of association must be registered in the commercial register by the directors of the company in notarised form; the full text of the (revised) articles of association must be submitted to the commercial register.

The amendments to the articles of association come into force only at the time of registration in the commercial register.

b) Liability of the shareholders

The shareholders are not personally liable for the liabilities of the company. Fundamentally, the company is only liable with its corporate assets.

An exceptional direct liability on the part of the shareholders can only be considered under very limited preconditions, such as in the case of undercapitalisation, a combination of personal and company assets or spheres of activity, a threat to the continued existence of a company in a qualified de facto group and the misuse of corporate structures. The latter is assumed if the absence of personal liability on the part of the shareholder has been deliberately used to the detriment of the creditors and none of the cases mentioned before applies.

c) Preservation of capital

The assets of the company required in order to maintain the nominal capital may not be paid out to the shareholders (§ 30 GmbHG). Any payments made contrary to this prohibition must be refunded to the company by the relevant shareholder (§ 31 GmbHG). If the refund cannot be obtained from the relevant shareholder, then the other shareholders are liable for the amount which is to be refunded, insofar as it is required in order to satisfy the company's creditors, in proportion to their stake in the business. In addition, the company's directors are also obliged to provide compensation.

d) Reporting and auditing obligation

Each GmbH is obliged to prepare annual financial statements (balance sheet, income statement and notes). The specific scope of the obligation to prepare the annual financial statements as well as the auditing and disclosure of the annual financial statements depends on the size of the company.

- In the case of a small corporate entity, no management report needs to be prepared in addition to the annual financial statements. The annual financial statements must be prepared within the first six months of the following business year.

  The annual financial statements of a small corporate entity are not subject to any auditing obligation. They must be submitted to the competent commercial register immediately after being presented to the shareholders, and at the latest before the end of the 12th month of the following business year and then immediately announced in the Federal Gazette (*Bundesanzeiger*).

  Small corporate entities are those which do not exceed at least two of the three following characteristics:

  - balance sheet total of EUR 4,840,000;
  - sales revenues of EUR 9,680,000;
  - a yearly average of 50 employees.

- The annual financial statements of medium-sized and large GmbHs must include a management report. The annual financial statements and management report must be prepared within the first three months of the business year. The annual financial statements and management report of medium-sized and large corporate entities must be audited by an independent auditor.

  Medium-sized corporate entities are those which exceed at least two of the aforementioned characteristics.

  Large corporate entities are those which exceed at least two of the three following characteristics:

  - balance sheet total of EUR 19,250,000;
  - sales revenues of EUR 38,500,000;
  - 250 employees on a yearly average.

5. Purchasing a GmbH

As well as the conventional establishment of a new GmbH, another possibility is to acquire an already existing GmbH. This can involve the purchase of a so-called **shell GmbH**, which has become an empty shell because the company has discontinued its

business operations and no longer possesses significant assets, but is still registered in the commercial register. It is also possible to acquire from specialised providers a so-called **shelf company** which has not yet started any business operations. The extra costs incurred (in addition to the share capital, the establishment costs and costs of any legal and tax advisors) usually amount to approx. EUR 2,500.

According to the GmbHG, notarisation of the sale and assignment of the shares in the business is also always required for the purchase of an existing GmbH. The assignment must be registered with the commercial register.

In most cases an amendment of the articles of association is also necessary, since the company name and object of the company are usually changed. This amendment also requires notarisation and must be registered in the commercial register.

In summary, the acquisition of an existing GmbH requires the following:

- contract of purchase and assignment for the shares in the business;
- notarised resolution concerning the amendment of the articles of association, including the new company name and objective of the company;
- application for the registration in the commercial register of:
  - assignment of the shares in the business and submission of a new list of shareholders;
  - release of old directors from office and appointment of new directors;
  - amendment of the articles of association.

6. Establishment of an Aktiengesellschaft or 'AG' (public limited company)

The *Aktiengesellschaft* (AG) is also a legal entity under private law and as such it is itself the bearer of rights and obligations. Only the company's assets are liable for liabilities of the company towards creditors. If the shares in the company are traded on the stock exchange, one speaks of a listed Aktiengesellschaft.

Establishing an AG involves the following steps:

a) Drafting of the articles of association

In order to form an AG, a notarised deed of incorporation (articles of association) is first required. An AG can also be founded by a single person. The articles of association must contain the following minimum components:

- company name and registered office of the company;
- object of the company;
- amount of the share capital;
- division of the share capital into either par-value shares or no-par shares; in the case of par-value shares: their nominal amounts and number of shares, in the case of no-par shares: their number;
- if there are several categories of shares, the number of shares in each category;
- whether the shares are bearer shares or registered shares;
- number of management board members;
- special benefits granted to individual shareholders or third parties;
- formation costs incurred by the company;
- in addition, in the case of non-cash contributions:
  - the subject of the non-cash contribution;
  - the person from whom the company acquires the non-cash contribution;
  - the nominal amount or the number of no-par shares to be granted in return for the non-cash contribution.

(1) Forms of shares and categories of shares

A minimum share capital of EUR 50,000, which is divided into shares, is required for the formation of an AG. Each share thus represents a fraction of the share capital.

(2) Forms of shares: par-value shares and no-par shares

The shares can be issued in two different forms, either as par-value shares or as no-par shares. A combination of both forms of shares is not possible.

Par-value shares are characterised by the nominal value of the share being marked on the share. They must be denominated in the value of at least one euro.

No-par shares do not represent a fixed amount of the share capital of a company, but a percentage shareholding. The quota is not marked on the share, since it changes with each capital increase or reduction. The shareholding quota of a no-par share can be calculated on the basis of the share capital set forth in the articles of association and the number of shares.

(3) Distinction between bearer shares and registered shares

Shares can be issued as bearer shares or as registered shares. Both forms of shares can also exist together.

In the case of the anonymous **bearer share**, the holder of the certificate is a shareholder in the company. The share certificate serves as documentary proof of the shareholder's interest in the AG. The transfer of bearer shares can take place anonymously, which means, however, that the company cannot exercise any influence on the shareholder structure. Notifications to the shareholders must, accordingly, be published in publicly accessible media.

In the case of **registered shares**, the names and addresses of the shareholders are known to the company and are recorded in a register, the so-called shareholders' book. The transfer of registered shares can only be validly effected through re-registration of the shareholder in the shareholders' book, which, however, requires that the company be provided with proof of the proper transfer of the shareholding. The transfer of registered shares can be made subject to the company's approval in the articles of association (so-called '**registered shares with restricted transferability**'). This makes it possible for the company to exercise influence over the shareholder structure and, for example, defend itself against hostile takeovers.

(4) Different categories of shares

Fundamentally, each share, as an **ordinary share**, also confers a voting right. Multiple voting right shares are not permitted. Shares without voting rights are only permissible if the shares are provided, in return, with a dividend preference which is to be paid out later. In the case of these so-called **preference shares**, the shareholder has all shareholder's rights with the exception of the voting rights.

b) Appointment of the supervisory board and the management board of the AG

The founders appoint the first supervisory board for the first business year, which then in turn appoints the first management board. Only natural persons with full legal capacity can be appointed as members of the supervisory board and the management board.

c) Formation report and formation audit

The formation report regarding the establishment of the company is prepared by the founders. The report must include, *inter alia*, whether and to what extent shares have been acquired for a management board member or supervisory board member during the establishment of the company. In the case of establishment through non-cash capital contributions, the key circumstances on which the appropriate nature of the performances as non-cash contributions depend, must be explained.

The members of the management board and the supervisory board must examine the formation process. The examination must cover the following points in particular:

- Is the information provided by the founders concerning the acquisition of the shares or concerning the capital contributions to the share capital complete?

- Does the value of the non-cash contributions reach the minimum issue price of the shares to be granted in return or the value of the benefit to be granted in return?

- Description of the nature of each non-cash contribution as well as specification and description of the valuation methods applied in determining its value.

In the case of establishment through non-cash capital contributions or in the case that the founders include members of the management board or the supervisory board, the formation audit must be performed by external auditors appointed by the court.

d) Deposit of the share capital

Before the company can be registered in the commercial register, at least a quarter of the minimum issue value must be paid into an account held by the company in the case of cash contributions. If the shares were issued at a price higher than the minimum issue price, this additional amount must also be placed at the free disposal of the management board. Where the AG is set up by only one person, said person must also provide a security for the amount exceeding the amount paid in, for example, in the form of a bank guarantee.

e) Registration and entry of the AG in the commercial register

All founders, management board and supervisory board members must apply for registration of the company in the commercial register. The application must be notarised. The court examines the registration documents filed by the notary and in case of doubt obtains an opinion from the chamber of industry and commerce or the chamber of trades. If there are no obstacles to registration, the AG is normally registered in the commercial register after approximately six to eight weeks, after which time it enjoys its own legal personality. The registration must be published in the Federal Gazette and in another publication medium.

The costs of establishing an AG depend on the share capital. The following costs should nonetheless be envisaged:

- notarisation of the articles of association;
- notarisation of the application for registration in the commercial register;
- registration in the commercial register;
- publication of the registration in the commercial register;
- additional legal advice from a lawyer or notary.

7. The corporate bodies of the AG

The AG acts, as a legal entity, through its corporate bodies. The corporate bodies of the AG are the management board, the supervisory board and the general meeting.

a) The general meeting

All the shareholders exercise their rights in the general meeting (*Hauptversammlung*), which represents the decision-making body within the AG. The general meeting has competence only in those cases prescribed by law; it does not enjoy universal competence. Its competence extends predominantly to regularly recurring and structural measures such as

- the appointment of the supervisory board members;
- the appointment of the auditor of the financial statements;
- the appropriation of the balance sheet profit;
- the formal approval of the actions of members of the supervisory board;
- amendment of the articles of association;
- measures for raising and reducing capital;
- the dissolution of the company.

The general meeting is thus not responsible for management matters, unless so requested by the management board.

At least once a year, the shareholders convene to pass resolutions. Certain formalities have to be observed prior to a general meeting as well as during the exercise of the voting rights during the general meeting.

(1) Calling the general meeting

The general meeting is normally convened by the management board. They must announce the meeting at least one month ahead of the meeting date in the company's designated publications, i.e. at least in the electronic Federal Gazette, which represents a generally accessible source for a normally unspecified group of addressees. The Federal Gazette is published by the Federal Ministry of Justice (*Bundesministerium der Justiz und für Verbraucherschutz* – BMJV) and is operated by Bundesanzeiger Verlagsgesellschaft mbH, Cologne; www.bundesanzeiger.de.

The announcement must at least include the following content:

- statement of the company name with correct legal form and registered office of the company;
- time of the general meeting, stating date and time of the day;
- venue for the general meeting with exact address;
- conditions for participation and the exercise of voting rights;
- agenda of the general meeting;

The general meeting is held at the registered office of the company, unless otherwise provided for in the articles of association. If the shares are listed for trading at a German stock exchange, then the general meeting can also take place at the location of the stock exchange.

The law makes no stipulation regarding the timing of the general meeting. A date should therefore be set taking into consideration feasibility and customary practice. The general meeting of a publicly held corporation may not therefore take place on a Sunday or public holiday. Nor should it commence before 8 o'clock in the morning.

In addition to stating the subject of the resolutions, the announcement of the agenda must also include the order in which these will be dealt with. The information must be specific enough for the shareholders to recognise the subjects proposed for discussion and resolution without further queries.

If all shareholders or their representatives are present and if they all agree, the general meeting can also pass resolutions without observing the statutory forms

and periods of notice. Admittedly, this will mainly be of relevance and interest to small corporate entities rather than publicly held corporations.

(2) The conduct of the general meeting

At the general meeting, a register of those shareholders in attendance is to be drawn up, stating their place of residence and the percentage of their shareholding, as well as the category of the shares. It is not strictly necessary for the shareholders to appear in person as they can also be represented by proxy. In this case, the name and address of the proxy must also be recorded in the register. The same applies to the exercise of the voting right by a banking institution.

The register must be made available to all participants before the first vote. Essentially, its purpose is to establish a quorum, to enable the voting result to be determined and to allow more rapid judgment of exclusions of voting rights.

The general meeting must have a chair: The chair is chosen by vote unless already specified in the articles of association. Management board members cannot be chosen. The usual practice is that the articles of association name the chairperson of the supervisory board as chair of the meeting.

The chair opens and closes the general meeting and deals with the subjects proposed for resolution in the order published in the agenda. The chair shall invite the speakers to take the floor, limit—if necessary—speaking time and take measures to impose order on individual participants in the general meeting.

Each shareholder, in his or her capacity as a participant in the general meeting, has an inalienable right to information which is primarily intended to allow the shareholder to obtain the information necessary to cast their vote.

The chair of the meeting initiates and leads the voting on the motions raised and rules on the outcome of the resolution.

In order to ensure proper documentation of the general meeting of a listed AG, each resolution must be certified through registration by a notary. In the case of unlisted companies, the private record kept by the chair of the meeting is sufficient if the meeting does not pass any resolutions on fundamental issues.

b) The management board

The management board (*Vorstand*) manages the Aktiengesellschaft under its own responsibility. It is also the legal representative body of the AG in judicial and extrajudicial matters. It is subject to the control of the supervisory board, to which it is obliged to report. However, it is not bound by instructions from the supervisory board or instructions issued by the general meeting.

The management duties and obligations of the management board include

- the preparation and implementation of resolutions placed before the general meeting;
- the keeping of trading books;
- the preparation of the annual financial statements;
- the obligation to apply for insolvency in the event of insolvency or over-indebtedness of the company;
- the obligation to call an extraordinary general meeting in the event of the loss of half of the share capital;
- the obligation to collect the employees' social insurance contributions;
- the fulfilment of the company's tax obligations.

The management board is appointed by the supervisory board for a maximum term of five years. It can consist of one person or several persons. In the case of a share capital exceeding EUR 3 million, the management board must consist of at least two persons, unless otherwise stipulated in the articles of association.

The management board members are jointly authorised to manage and represent the company, unless otherwise stipulated in the articles of association. The representative authority cannot be restricted in terms of external dealings. However, internally it can be agreed that certain transactions require the approval of the supervisory board.

c) The supervisory board

The supervisory board (*Aufsichtsrat*) has the function of supervising the management board in the performance of its management duties. Management tasks cannot be assigned to the supervisory board. However, it is possible and also common practice that certain types of transactions may only be conducted with the approval of the supervisory board. Said list of transactions requiring approval must be specified in the articles of association, but can also be defined through a resolution of the supervisory board. The supervisory board is authorised to inspect and examine all books and documents of the AG as well as the portfolios of securities and inventories of goods. Other duties of the supervisory board include

- issuing the audit assignment for the annual and consolidated financial statements to the auditor and
- representing the AG with respect to all matters concerning the members of the management board.

The supervisory board consists of at least three members, but the articles of association can stipulate a higher number of members, divisible by three. However, the law limits the number of supervisory board members in the case of companies with a share capital of

- up to EUR 1.5 million, to a maximum of nine members;
- more than EUR 1.5 million but less than EUR 10 million, to a maximum of 15 members;
- more than EUR 10 million, to a maximum of 21 members.

A supervisory board member cannot at the same time be a management board member or permanent proxy for a management board member. The position as authorised signatory of the AG is also incompatible with the exercise of the supervisory board mandate.

As a controlling body, the supervisory board is required to hold at least one meeting every half calendar year, or two in the case of listed companies. A record must be kept of the meetings of the supervisory board, which must be signed by the chairman of the supervisory board.

8. Comparison between GmbH and AG

The most significant differences between a GmbH and an AG can be summarised as follows:

- The director of a GmbH is bound by the instructions of shareholders, whereas the management board of an AG is free in its entrepreneurial decisions and is only subject to control by the supervisory board.
- The transfer of GmbH shares requires notarisation, whereas AG shares are freely transferable like other goods.
- In the case of a GmbH, the shareholders can demand to inspect the business documents at any time, whereas in the case of an AG only the supervisory board, not the individual shareholder, has the right to inspection.
- One advantage of the AG in comparison with the GmbH is the possibility, through the issue of shares, to acquire a widely spread share capital.

VI. Combined forms of company—the GmbH & Co. KG

The GmbH & Co. KG is a special manifestation of the *Kommanditgesellschaft* (KG), in which the personally liable partner (general partner) is not a natural person but a

Gesellschaft mit beschränkter Haftung (GmbH). The GmbH & Co. KG is frequently used if a large number of limited partners contribute cash amounts and, in view of the high volume of financing, no natural person is desired to assume the position of personally liable partner.

1. Establishment

In order to set up a KG, at least two persons, one general partner and one limited partner, are needed. The company is created through establishment, i.e. usually through the drafting of articles of association. These are typically agreed in writing, although this form is not prescribed by law.

The time at which the company comes into being can be deferred by agreement between the parties, for internal purposes, to a later date than that of the adoption of the articles of association. In order to avoid personal liability on the part of the limited partners, it is recommended that the company only be allowed to come into being at the time of its registration in the commercial register.

2. Share capital

There is no legal minimum share capital for the KG itself. The nominal capital of the general partner GmbH must amount to at least EUR 25,000.

Capital contributions can be provided as cash or non-cash contributions, in the case of both the general partner GmbH and the KG. In the case of non-cash contributions to the KG, no auditing by an auditor or other expert is required by law.

In the case of the KG, in terms of the capital contributions to be provided, a distinction is made between the liable contribution which is to be registered in the commercial register and any limited partner's contribution provided in addition to this.

3. Shareholders' liability

The general partner's liability is unlimited. The limited partner's liability is restricted to the liable amount registered in the commercial register. Limited partners will not be held liable once they have made their investment and the money or property contributed has not been returned to them.

The general partner's entrepreneurial liability risks are incurred by the general partner GmbH, whose shareholders are strictly not liable for the company's liabilities. This

consequently leads to a de facto limitation of the liability of the general partner. Since the GmbH is only liable in the amount of its nominal capital (at least EUR 25,000) and the limited partners strictly assume no personal liability, the characteristic features of a partnership (personal unlimited liability) are circumvented in the case of the GmbH & Co. KG.

4. Representation

The management and representation of the GmbH & Co. KG follow the same principles as the KG. As general partner, the GmbH, therefore has the (sole) authority to conduct the business of the KG as well as represent it externally. The limited partner has no authority to represent the company.

An interesting aspect of this arrangement is that the GmbH requires a managing director, since as a legal entity it is not itself capable of acting. This conflicts with the principle of self-representation applicable to partnerships and means a person who is not a partner in the company and who does not bear the risk of personal liability, can conduct the company's business or represent the company (so-called third-party representation).

If the limited partners are shareholders in the general partner GmbH and they also perform a management function, then they have comprehensive management authority.

5. Amendments to the articles of association

Amendments to the articles of association can be made in accordance with the provisions of the articles of association, which generally require a written shareholders' resolution. If no specific majorities are stipulated for amendments to the articles of association, the unanimous approval of the shareholders is needed.

6. Nature of the shares in the company/voting rights

Each limited partner holds a limited partner's share. Resolutions to be passed by the shareholders strictly require the approval of all the shareholders called on to participate in the passing of the resolutions. However, in compliance with the principle of equal treatment, the articles of association can stipulate otherwise—as is often the case in practice—and, for example, in the case of majority votes, link voting rights to the amount of liable capital contributed, the statutory limited partner's contribution or the total of both amounts.

7. Transfer of limited partner's shares

Due to the personal nature of the position of partner in a KG, the transfer of limited partner's shares is restricted by law. Consequently, particular prerequisites for a valid transfer are that the articles of association allow it to happen or that all other partners agree to it. The transfer of limited partner's shares is not strictly subject to any formal requirements, unless stated in the articles of association. Since any new limited partner will be liable for existing debts of the company, the transfer of the share in the KG should always be made subject to the condition of its registration in the commercial register.

8. Auditing of financial statements

Both the KG and the GmbH must prepare their own annual financial statements. In the case of the typical GmbH & Co. KG, the general partner GmbH is usually a small corporate entity and enjoys the concessions associated with this.

9. Dissolution

The dissolution of a GmbH & Co. KG takes place by law upon the expiry of the period of time for which the company was formed, through a resolution passed by the shareholders, through the opening of insolvency proceedings concerning the company's assets or through a decision by the courts.

VII. Legal framework conditions for the acquisition of companies

1. Advantages of acquiring a company

One of the advantages of acquiring an existing European or German company already active in the market is, that the foreign investor acquires the existing distribution network and is thus spared the costs of having to develop its own one from scratch. In addition, the newly acquired customer base can be used for the marketing of the company's own products. The foreign investor also gains access to new technologies and to the knowledge of the target company. Small and medium-sized companies in Germany in particular possess a considerable wealth of expertise.

A further advantage is the acquisition of experienced management staff and highly qualified personnel. The German labour market in particular offers a rich pool of qualified employees. The acquisition of a company offers the possibility to streamline the employee structure and reduce HR costs.

A further advantage for non EU investors—especially investors from emerging markets—is the possibility to raise additional capital on German and European capital markets.

2. Restrictions on foreign investors

There are no fundamental legal barriers to the acquisition of a German company. However, when acquiring a German company, the foreign investor has to take into consideration certain particularities.

a) Endangerment of important security interests

According to the Foreign Trade and Payments Act (*Außenwirtschaftsgesetz*, AWG)[15] and the Satellite Data Security Act (*Gesetz zum Schutz vor Gefährdung der Sicherheit der Bundesrepublik Deutschland durch das Verbreiten von hochwertigen Erdfernerkundungsdaten*, SatDSiG)[16], exceptions apply to the acquisition of German companies or of shares thereof, if these companies

- manufacture or develop military weapons or other armaments;
- manufacture cryptographic systems which are authorised for the transmission of state-classified information; or
- operate high-quality remote sensing equipment.

However, this only applies in a few specific cases in order to protect the security interests of the Federal Republic of Germany, particularly security policy or military interests[17]. In such events, the direct or indirect acquisition of shares must be reported to the Federal Ministry of Economics and Technology (*Bundesministerium für Wirtschaft und Technologie*, BMWi) if a foreign investor holds at least 25% of the voting rights in said company[18].

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[15] Foreign Trade and Payments Act in the version of the Announcement of 26 June 2006 (BGBl. I p. 1386), last amended by Article 1 of the Decree of 25 March 2014 (BAnz. 2014 AT 31.03.2014 V1).

[16] Satellite Data Security Act of 23 November 2007 (BGBl. I p. 2590).

[17] § 7 para. 1 of the Foreign Trade and Payments Act, § 6 para. 2 no. 2a) of the Control of Military Weapons Act (Gesetz über die Kontrolle von Kriegswaffen, KrWaffKontrG) in the version of the Announcement of 22 November 1990, BGBl. I p. 2506, last amended by Article 345 of the decree 31 October 2006 (BGBl. I 2006, p. 24072), § 10 para. 1 clause 4 of the Satellite Data Security Act (SatDSiG) in conjunction with § 24 para. 3 SatDSiG.

[18] § 52 of the Foreign Trade and Payments Regulations in conjunction with § 7 para. 1 no. 1, para. 2 no. 5 AWG.

Example: When the Russian AFK Sistema AG tried to acquire 25% plus ones share in Deutsche Telekom AG, the German Federal Intelligence Service expressed considerable concern over the danger of unauthorised parties accessing the telecommunications between authorities, businesses and private individuals.

b) Protection of public policy or security

Following extensive deliberation, the law on the amendment of the Foreign Trade and Payments Act and the Foreign Trade and Payments Regulations (*Außenwirtschaftsverordnung*, AWV)[19] came into force on 24 April 2009. On the basis of this amendment, the BMWi also has the option, in individual cases, to examine and—with the approval of the federal government—prohibit the acquisition of 25% or more of the voting rights in domestic German companies by investors based outside the EU if this is deemed essential in order to guarantee 'the public policy or security of the Federal Republic of Germany'. Such acquisition need not be registered or approval obtained prior to the acquisition. A review is initiated by the BMWi itself if, for example, it becomes aware of the transaction through company announcements or press reports. Following conclusion of the acquisition agreement, the BMWi can initiate an investigation procedure within three months. If an investigation is initiated, then the investor must submit all relevant documents to the BMWi, who subsequently has a period of two months in which to review the acquisition and, if necessary, impose certain conditions or prohibit the acquisition outright. Once these periods have expired, the review procedure cannot be reinitiated. If not prohibited, the acquisition cannot be challenged following expiry of this period.

However, given the lack of reporting obligations, in order to avoid legal uncertainties, the investor can request a legally binding certificate of non-objection from the BMWi prior to conclusion of the acquisition agreement. This confirms that the investment does not constitute a threat to public policy or public security. If the BMWi does not launch a formal review within one month of receiving the investor's application, it is assumed that the certificate has been issued.

The acquisition agreement remains valid throughout the entire examination procedure. However, it may still be invalidated in case of prohibition.

It can be assumed, for example, that significant shareholdings by foreign investors in companies within the defence industry, energy generation and telecommunications sectors in Germany fall within the scope of the law. Whether banks, airlines or software companies, for example, can also be deemed to be strategically important is unclear. However, the planned amendment should not present any obstacles to the acquisition of small and medium-sized companies.

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[19] Foreign Trade and Payments Regulations in the version of the Announcement of 2 August 2013 (BGBl. I p. 2865), last amended by Article 1 of the Law of 31 October 2014 (BAnz. 2014 AT 06.11.2014 V1).

c) Restrictions under cartel law

The acquisition of a company may be subject to the provisions of cartel legislation. A distinction should be made here between European and German merger control provisions. Initially, two things are of importance to purchasers and sellers: firstly, whether the acquisition of a company is in fact subject to merger control, and secondly—if this is the case—whether the acquisition is permitted.

(1) Merger control according to European cartel law

The acquisition of a company is examined exclusively according to the provisions of European cartel law if the following two criteria are fulfilled:

- the investor must acquire a controlling influence on the target company as a result of the merger;
- the merger must be of community-wide importance.
- The merger is of community-wide importance if, cumulatively,
- the worldwide turnover of the companies involved (acquiring group and target company) is greater than EUR 5 billion;
- at least two companies have a turnover of EUR 250 million in the EU each; and
- the companies involved do not achieve more than two thirds of their EU turnover in the same EU country; in other words the restrictions on competition resulting from the merger may not be concentrated on one member state.

A merger which does not reach the aforementioned threshold values is still of community-wide importance if

- the worldwide turnover of all participating companies amounts, in aggregate, to more than EUR 2.5 billion;
- the turnover of all participating companies exceeds EUR 100 million in at least three member states;
- in at least three of the aforementioned member states the turnover of at least two participating companies each amounts to more than EUR 25 million; and
- the community-wide turnover of at least two participating companies each exceeds EUR 100 million.

This does not apply if the participating companies each achieve more than two thirds of their community-wide total turnover in the same member state.

Mergers of community-wide importance must be notified. The notification must be submitted to the European Commission following conclusion of the agreement, publication of a takeover offer or the acquisition of a shareholding establishing control, and prior to implementation. On receipt of the notification, the Commission initiates preliminary proceedings in order to summarily examine the prerequisites for a possible prohibition. A decision must strictly be announced within a maximum period of 25 working days. This period commences on the first working day after the notification comes into effect. If there are sufficient grounds for concern regarding the conformity of the merger with the competition rules, the Commission moves on to the second examination phase, the principal proceedings.

This concludes with either clearance, clearance subject to conditions or prohibition of the transaction. With the opening of the principal proceedings, a new stage of the proceedings begins with a new deadline. The Commission then has a further 90 working days to review the planned merger in detail and determine its compatibility with the common European market. Only if it is cleared by the Commission or in the event that the Commission fails to complete preliminary or main proceedings on time may the notified merger be effected. Until this time there is a prohibition on implementation.

(2) Merger control under German cartel law

If the European merger control regime is not applicable, the acquisition can fall within the scope of the law against restrictions on competition (*Gesetz gegen Wettbewerbsbeschränkungen*, GWB)[20].

The decision criterion for the Federal Cartel Office (*Bundeskartellamt*) is whether the merger will create or reinforce a market-dominating position. German cartel law also provides for a prohibition on implementation of the merger prior to clearance as a preventive measure. Legal transactions which are concluded contrary to this prohibition are invalid.

The German merger control procedure with prior notification and a prohibition on implementation pending clearance shall apply if

- the purchaser/purchasing group **and** the target company achieve worldwide sales revenues of more than EUR 500 million; and

[20] Act against restrictions on competition (GWB) in the version of the Announcement of 15 July 2005 (BGBl. I p. 2114), last amended by Article 5 of the law of 21 July 2014 (BGBl. I p. 1066).

- the purchaser/purchasing group **or** the target company achieve domestic sales revenues of more than EUR 25 million and another participating company achieves sales revenues of more than EUR 5 million.

The German prohibition on implementation lapses if the Federal Cartel Office fails to reply within one month following receipt of the complete notification. If the Federal Cartel Office fails to announce, within the one month period, through the so-called monthly letter, that it has commenced a review, the prohibition on implementation lapses after four months, unless the Federal Cartel Office approves the merger beforehand.

A merger which has been prohibited under cartel law can be permitted through a ministerial permit. A prerequisite for this is that the restriction on competition which has occurred is either balanced by the overall economic benefits of the merger or is justified by an overwhelming public interest.

Example: The merger of E.ON AG with Ruhrgas AG was approved through a ministerial permit on 18 September 2002, even though the Federal Cartel Office and the Monopolies Commission had previously expressed serious concerns.

d) Restrictions on disposal, requirement of approval by third parties

(1) Restrictions under public law

In many cases, economic activity in Germany requires official approval. For example, approval must be obtained for the manufacture, transport and storage of radioactive materials, for aviation companies and for the extraction of raw materials.

A distinction should be made between two cases: if the conduct of the business is tied to a personal approval of the operator, the foreign purchaser will only be able to operate the business if he or she is granted approval. However, if the conduct of the business depends on the approval of a specific facility, and the acquired enterprise already holds said approval, the continuation of the activity through acquisition does not require any further official approval. It must therefore also be established beforehand—e.g. during the due diligence process—which approvals are required for the planned activity and whether or not these have already been obtained.

(2) Further restrictions

It may be necessary to obtain additional approvals when purchasing a company.

These approvals may also arise from the company purchase agreements, for example they may stipulate approval by the supervisory board, the advisory board or the shareholders of the purchaser or seller. In the event that only a part of the shares in the company are sold, it may be necessary to observe pre-emptive rights of other shareholders or obtain the approval of the company or the other shareholders.

However, the law may also stipulate an obligation to obtain approval. If an AG pledges to sell its entire company assets or a great part thereof, then the contract will only be valid with the approval of 75% of the general meeting (§ 179a AktG). It is the prevailing opinion that the provisions of § 179a AktG also apply to other forms of company, including, without limitation, to the GmbH. In addition, there are other uncodified requirements of approval by the general meeting or shareholders' meetings (cf. rulings of the German Federal Court of Justice (*Bundesgerichtshof*, BGH) in the Holzmüller and Gelatine cases).

The approval of the general meeting of an AG is also required if an important part of the business operation or an important subsidiary is sold. If a company is sold from an estate, possible restrictions under the law on inheritance must be considered, e.g. provisional succession, execution of the will or administration of the estate.

3. Issues to be clarified prior to acquisition

Before entering the actual acquisition phase, several preliminary issues first need to be clarified:

a) Selection of the target, the target of an acquisition may be a company of any form

b) Asset deal or share deal

The acquisition of a company can take place either through the takeover of shares in the target company (so-called share deal) or through the acquisition of individual assets of the target company (so-called asset deal).

Liability, tax and contractual considerations are of key importance in determining the manner of company acquisition.

(1) Liability of the purchaser

The purchaser naturally wishes to avoid liability risks. Anyone who buys shares buys the target company with all its good and bad qualities, hence they run the risk that there may be 'skeletons in the closet'. Purchasers can protect themselves through guarantees, but the usefulness of the guarantees depends on the credit-worthiness of the seller. Purchasers also prefer to avoid the trouble and expense of enforcing guarantees. An alternative way to get around these risks can be to take over the target company by way of an asset deal. Through an asset deal, the purchaser only acquires certain assets and/or contractual relationships, but no debts.

(2) Tax aspects

From a fiscal perspective, the following scenarios need to be taken into consideration:

- If a natural person sells holdings in a GmbH or shares in a company in which such person had an interest of at least 1% within the last five years, then the profit derived from the sale is taxed subject to the part-income method, according to which 40% of the profit from a sale is tax-free. Furthermore, a profit from a sale remains tax-free if the natural person selling the shares acquired a shareholding in a GmbH/AG before 1 January 2009 and within the last five years had a shareholding of less than 1% in the GmbH/AG and the speculation period of one year has elapsed. This privilege does not apply to shareholdings in a GmbH/AG which were acquired after 1 January 2009; rather, such profit from a sale is subject to tax at a flat rate of 26.375% (flat rate withholding tax, including solidarity surcharge).

- If a natural person sells their entire shareholding in a KG or an OHG, then the profit on sale is fully taxable according to the individual tax rate of the seller. A reduction in the tax rate is possible—on socio-political grounds—if the seller has reached the age of 56 or is permanently incapable of working. If these preconditions are fulfilled, a maximum of EUR 5 million of the profit on the sale is taxed upon application at a reduced tax rate. The reduced tax rate is approx. 56% of the individual tax rate, but no less than 14%. The taxpayer can only claim this reduction once. In addition, the taxpayer is granted an exempted amount of EUR 45,000, which is however reduced by the amount by which the profit on sale exceeds EUR 136,000. The sale of a natural person's full shareholding is exempt from trade tax.

The above concessions (reduced tax rate, exempted amount, exemption from trade tax) do not apply if only a part of a stake in a partnership is sold.

- If a corporate entity sells holdings in a GmbH or shares, then 95% of the profit on sale are tax-free.

- If a corporate entity sells shares in a KG or an OHG, then the profit on sale is fully subject to corporation tax. Trade tax is also due, although in this case it is the KG/OHG which owes the trade tax, which is generally reflected in a reduction in the corresponding purchase price.

- For the purchaser, acquisition by way of an asset deal is generally more favourable, since individual assets can be written off over the subsequent period and in this way taxable profit is reduced. The same applies to the acquisition of shares in partnerships which—like an asset deal—is regarded in tax terms as an acquisition of a part of the economic assets contained in the partnership. This

means in the case of shares in partnerships, the value added on the assets that is embodied in the purchased dormant reserves can be reported in the so-called 'supplementary balance sheets' and also written off. In the case of a share deal, the shareholding being acquired would have to be reported as fixed assets and cannot be written off, but can be written down in the event of permanent value impairment.

- Furthermore, in the case of an asset deal or a share deal, in the form of the acquisition of shares in partnerships, the purchaser can, in principle, deduct the entire financing costs (such as interest on loans taken out for the purchase price) as operating expenses. If the purchaser of shares in a GmbH is a natural person, they may only deduct 40% under the part-income method, whereas a corporate entity can in principle also deduct its entire financing costs for tax purposes.

However, any deduction of financing costs is subject to the application of the 'earnings stripping rule' (*Zinsschranke*).

- In the case of a share deal relating to a GmbH/AG, any existing loss carry-forwards (as well as interest carry-forwards resulting from the 'earnings stripping rule') must be considered lost, proportionately, with a—direct or indirect—acquisition of over 25% to 50%, whereas the loss carry-forwards are lost completely with a share acquisition of over 50%. In addition, loss carry-forwards can also be lost with a share acquisition of less than 25% if, taking into account both other shares acquired prior to 1 January 2008 and also subsequent share acquisitions, a quota of at least 50% was acquired and added to the company's 'primarily new operating assets' by 31 December 2012.

- In the case of an asset deal, no value added tax is due on the purchase price plus the assumed liabilities if, on the basis of the total of all acquired assets, it can be assumed that a company has been acquired as a whole, see § 1 para. 1a UStG[21].

- In the case of an asset deal, if the purchase price relates to a plot of land, property transfer tax must also be paid (between 3.5% and 6.5%, in each case in relation to the agreed purchase price). In the case of a share deal, if the company to be purchased has real estate holdings, property transfer tax is due if (in the case of a partnership) at least 95% of the shares in the company are transferred to new partners within a period of five years, whereas in the case of a corporate entity at least 95% of the shares in the company coming to be owned by the purchaser is generally subject to property transfer tax. Both variants can also be fulfilled through a corresponding indirect share acquisition. Since 2013, the 'economic' transfer (i.e. without a change of the shareholder's legal status) is

[21] Turnover Tax Act (Umsatzsteuergesetz,UStG) in the version of the Announcement of 21 February 2005 (BGBl. I p. 386), last amended by Article 11 of the Law of 22 December 2014 (BGBl. I p. 2417).

considered circumvention. The basis for calculating the property transfer tax in the case of a share deal is a specific 'standardised value' of the property holdings to be determined in accordance with the Valuation Act (*Bewertungsgesetz*)[22].

In summary, this means that, from a fiscal perspective, the seller generally tends to prefer the share deal and the purchaser the asset deal (subject to the normally higher property transfer tax). A careful analysis of the individual case is therefore required in order to determine how the different interests can be balanced in order to optimise the company acquisition from a fiscal perspective.

(3) Contractual aspects and formal requirements

A share deal contract (at least for shares in a GmbH) must be notarised. An asset deal contract on the other hand does not need a specific form, unless the contract includes real property and/or all of the assets are acquired (§ 311b para. 3 BGB). In such cases, the asset deal contract must also be notarised. In the asset deal contract each individual asset of the company must strictly be listed in extensive annexes and sold and transferred in accordance with the specific legal rules applicable to the particular group of assets. Also, in the case of the asset deal, all current contracts must be listed and dealt with individually. In particular, the respective parties to the contract must agree to the transfer of the contract. The seller remains liable pending final agreement.

In the case of a share deal, the sale and the transfer (assignment) of the shares in the business is sufficient. However, in this case too, because of the different individual guarantees, the individual assets, liabilities and contracts must be included in detailed form in the contract. This is recommended for both parties: for the seller, because the examination of all assets, liabilities and current contracts prevents later disputes, for the purchaser, because this reduces risks.

4. Process of acquiring a company

The acquisition of a company in Germany largely follows the customary international procedure.

a) Confidentiality agreement

Before information on the target company is disclosed to potential purchasers, a confidentiality agreement should be concluded between the potential seller and purchaser.

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[22] Valuation Act in the version of the Announcement of 1 February 1991 (BGBl. I p. 230), last amended by Article 6 of the Law of 18 Juli 2014 (BGBl. I p. 1042).

It is advisable to precisely define terms such as 'confidential information' and 'confidential treatment' as well as any exceptions, together with stipulations concerning the copying, return or destruction of supplied documents. Contractual penalties and/or liquidated damages should be stipulated in the event of a breach of confidentiality.

b) Letter of Intent

Adopted from Anglo-American legal practice, the Letter of Intent has become established in German law as a preparatory declaration for the company purchase agreement. As a rule it will be a declaration of intent according to which the participants shall commence their contract negotiations. This declaration of intent is not generally intended to have any binding effect.

It can be advisable to sign a legally binding agreement at least regarding the exclusivity and confidentiality of negotiations in order to allow negotiations to proceed without time pressure and to allow the disclosure of sensitive data. These obligations can in addition be protected by appropriate contractual penalties.

c) Due diligence

The seller naturally has an advantage over the purchaser in terms of information and knowledge. They know the key data relevant to the company (balance sheets, annual financial statements, etc.). When purchasing a company, the purchasers must therefore take special measures in order to obtain the information which is important to them. This is done through the due diligence process, whereby the legal, tax, technical and other aspects of the target company are examined.

Within the scope of legal due diligence, the target company is examined for legal weaknesses. Particular attention is paid to aspects such as contractual obligations, liability issues, industrial property rights and subsidy issues.

Due diligence fulfils different functions for each party:

- The due diligence report provides the purchaser with a snapshot of the target company, which provides more information than a conventional interim financial statement.

- If risks are identified in the company, the catalogue of guarantees can be adjusted accordingly.

- The purchaser and seller can negotiate the purchase price on the basis of the findings obtained.

- Following the transfer of the company, the due diligence process makes it easier for both sides to determine whether and to what extent the seller has provided accurate information concerning the characteristics of the company prior to conclusion of the agreement.

- In addition, due diligence provides the purchaser's decision-makers with internal documentation which serves as proof they have received adequate information concerning the risks of the acquisition.

d) Negotiation and conclusion of the company purchase agreement

The negotiation and formulation of the agreement on the purchase and sale of the company requires legal expertise combined with experience of M&A practices. It is advisable to form a specific negotiating team and to discuss expectations regarding the timescale, i.e. 'milestones', 'signing date', 'closing date' etc. It is also advisable to record aspects that have already been negotiated in writing, i.e. in the form of minutes of the negotiations.

Following an intensive due diligence examination, the seller will often only give a few additional guarantees. The purchaser, on the other hand, will usually want to have both the intensive preliminary examination as well as comprehensive guarantees.

It is advisable to include separate provisions on guarantees in the contract, since the statutory provisions governing the purchase of a company in Germany are often not feasible. It has proven worthwhile in the past to agree strict liability guarantees. The legal consequences in the event of failure to comply with the guarantees should also be stipulated: either the purchaser should be treated as if the guarantees were correct or a contractual penalty is agreed. A reversal of the purchase agreement may only be considered as a last resort.

e) Closing

The term 'closing' regularly describes the point in time in which shares in fact pass to the acquirer. Apart from payment of the purchase price, the parties to a contract must often meet additional requirements at closing, such as conclusion of certain side agreements or provision of securities.

f) Post-merger

Following conclusion of the agreement, the company transaction must be executed in practical form. For example, entries must be made in the commercial register (e.g. change in company name), the purchase price may need to be adjusted, the support of those employees in key positions within the target company must be secured, a new management structure and organisation have to be created, communication within

the company must be standardised, any existing contracts need to be transferred, and legal disputes need to be avoided (so-called post-merger litigation). It may be useful for the adviser who was consulted in connection with the transaction to continue to provide advice and assistance.

5. Tax issues

Tax issues often have a decisive influence on the acquisition of a company. The structure of many acquisition procedures can only be explained from a tax perspective.

a) Regular taxation of German corporations

German corporations (such as an AG or GmbH) which either have their management or their registered office in Germany are strictly obliged to pay corporation tax, meaning that their entire worldwide income is subject to German taxation (unless otherwise provided in applicable double taxation agreements). The corporation tax is calculated according to the taxable income of the corporation and therefore includes the difference between all the corporation's revenues and all associated operating expenses. However, exceptions need to be taken into consideration where income of the corporation is (largely) tax-free and operating expenses are (largely) not taken into account. This applies in particular to income from dividends and income the corporation earns from the sale of shareholdings in other corporations.

Corporations with unlimited tax liability are currently subject to a standard corporation tax rate of 15%. In addition there is a 'solidarity surcharge' of 5.5% on the corporation tax, meaning the total tax rate amounts to 15.825%. Corporations with unlimited tax liability are also subject to trade tax. Foreign corporations must pay trade tax if they operate commercially in Germany, German corporate entities as a result of their legal form, irrespective of their activities. Due to the nature of trade tax as a tax levied by local authorities, the rate depends on the 'municipal collection rate' of the municipality in which the company has its registered office or in which permanent establishments of the company are located. The effective trade tax rate varies between approx. 14% and 17%; this brings the overall income tax of a corporation with unlimited tax liability to around 30% to 33%.

b) Regular taxation of trading partnerships

German tax law does not treat trading partnerships as separate taxable entities for income and corporate tax purposes, but does so for trade tax and VAT purposes. Although the income of a trading partnership is assessed separately, the result is apportioned between the shareholders according to their respective shareholdings. Income tax and corporate tax are charged at shareholder level. If the shareholders

are natural persons, they are generally taxed at the applicable income tax rate, unless the shareholder applies for the reduced 'reinvestment tax rate' of 28.25% on retained profits. Insofar as corporate entities are shareholders in the partnership, the shares in profits allocated to the corporate entity from the partnership are in turn subject to corporation tax (incl. solidarity surcharge) of 15.825%. In contrast, for the purposes of trade tax (approx. 14% to 17%) and value added tax, the trading partnership is regarded as an independent taxable entity, where natural persons as partners can theoretically offset the trade tax incurred on the level of the partnership against their income tax, as long as the partnership was not created from a GmbH through a change of legal form within the preceding five years.

It should be noted that, for tax purposes, the operating assets of a partnership also include the economic assets made available to the company by the partners known as 'special operating assets', such as plots of land leased to the partnership. An important consequence of this is that upon the sale of a shareholding by a natural person, the relevant economic assets of the 'special operating assets' must also be transferred in proportion, otherwise the 'special operating assets' count as having been withdrawn and will also be subject to the full taxation of dormant reserves.

c) Minimum taxation

With respect to all taxes on income (income tax, corporation tax, trade tax), a loss carry-back can only take place into the immediately preceding assessment period and only up to an amount of EUR 1 million (married couples filing jointly: EUR 2 million). There is no time limit for a loss carry-forward into subsequent assessment periods.

Profits can only be offset with existing loss carry-forwards under the 'minimum taxation' rule up to an amount of EUR 1 million plus 60% of the amount exceeding this.

6. Subsidies

In many German municipalities, investors will find developed commercial zones with all the necessary connections (electricity, water, gas, roads and sometimes even railways).

Depending on the chosen region, investors can sometimes count on extensive state aid. It is therefore worthwhile at the planning stage of an investment to consider the possible subsidies that may be available. In some cases these may even determine the choice of location.

Aid can be granted, in the form of subsidies for the implementation of investment plans or as tax concessions. Investors can receive subsidies both from EU as well as

national support programmes. In Germany, support is usually provided at a regional level; the individual federal states have special organisations for this purpose, namely investment banks.

Example for the state of Brandenburg: The new investment support as part of the regional initiative 'Improving the Regional Economic Structure' is provided for small, mid-sized and large companies:

1. Growth programme for small companies

Small companies can always receive the highest possible grant (35%-40%) for investments eligible for support up to an investment total of EUR 1.5 million under the regional initiative 'Improving the Regional Economic Structure' (GA-G), irrespective of the location and branch of industry.

2. Growth programme for mid-sized and large companies

Mid-sized and large companies can receive the highest possible grant for eligible investments in certain core branches (e.g. energy technology, optics, healthcare). When setting up a production site and investing EUR 500,000, for instance, investors can receive the highest possible support (15%-30%) for each permanent job created as part of the regional initiative 'Improving the Regional Economic Structure' (GA-G).

C. Investing in real estate in Germany

I. Introduction

There are numerous possibilities for investing in real estate in Germany. For example, undeveloped plots of land and plots of land containing existing buildings which may be used for commercial or residential purposes can be purchased. Currently, residential properties are particularly popular with investors.

Real estate investments can be important in asset planning, either as provision for old age or a value-oriented capital investment. They often have a stable value and are therefore regarded as a safety-oriented investment in tangible assets. The long-term nature of these investments often ensures a stable asset growth.

It is important to obtain as much information as possible concerning the proposed form of investment. Expectations and risks should be transparent and quantifiable for the investor.

II. No special conditions for foreign investors

The key characteristic of the real estate market is the transferability of ownership of land. The dynamic nature of the market comes from the fact that investors can acquire a plot of land which does not yet belong to them, realise a new development or conversion project on the site and then absorb the capital from the plot of land not only through letting, but also by selling it.

Foreign natural and legal persons can acquire land in Germany just as German investors.

III. Plots of land and property

There are various possibilities for acquiring property. In terms of the type of property, a distinction should be made between residential and commercial properties. In Germany, the legal regulations governing the purchase of property make no distinction between properties used for residential or commercial purposes.

The purchaser can

- acquire a plot of land containing an existing building. A distinction must be made here as to whether the building on the site is a new or existing building;

- acquire a plot of land with the obligation on the part of the seller, as developer or general contractor, to construct a particular building, or have it constructed.

1. Definition of a plot of land

The term 'plot of land' is not defined by law; its meaning is assumed to be generally understood. In general terms, a plot of land refers to a part of the earth's surface which is clearly defined and used for a particular purpose.

The entire surface area of Germany has been surveyed and is recorded, by cities, districts, cadastral sections and parcels, in an official land survey register, which is maintained according to regional law.

According to the German Civil Code (*Bürgerliches Gesetzbuch*, BGB)[23], the land and building, with the objects permanently associated with its construction, form a unit. They cannot be the subject of separate rights. Ownership of the plot of land therefore also extends to the building. There is no such thing as ownership of parts of a building, only co-ownership of the—developed or undeveloped—plot of land according to notional fractions in accordance with § 1008 BGB.

In addition to full ownership of plots of land, important special forms of ownership include condominium and building lease.

2. Condominium

In addition to the regulations set forth in the German Civil Code, the provisions of the Condominium Act (*Wohnungseigentumsgesetz*, WEG)[24] in particular, play an important role when purchasing residential properties. According to the Condominium Act, it is possible to purchase individual apartments in a building. Condominium involves a co-ownership share in a plot of land in combination with the separate ownership of an apartment or self-contained part of the building not used for residential purposes (§ 1 para. 2, 3 WEG). It thus represents a mixture of sole and co-ownership.

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[23] German Civil Code in the version of the Announcement of 2 Januar 2002 (BGBl. I p. 42, 2909; 2003 I p. 738), last amended by Article 1 of the Law of 21 April 2015 (BGBl. I p. 610)..

[24] Law on Condominium and Long-term Right of Tenure (Condominium Act) of 15 March 1951, BGBl. I p. 175, corrected p. 209, last amended by Article 4 para. 6 of the Law of 1 October 2013 (BGBl. I p. 3719).

3. Building lease

A building lease means—from the point of view of the leaseholder—the sellable and heritable right to own a building structure on or below the surface of a plot of land owned by a third-party owner. From the point of view of the owner, the building lease is a limited right *in rem* encumbering their plot of land. The building lease has historical origins and tends to play a minor role in Germany. As a rule, the term of the lease is 99 years.

The building lease is itself treated like a plot of land and is also registered in section II of the land register. It can be encumbered, for example with property liens. It is usually agreed that the leaseholder must pay the owner of the plot of land a one-off consideration or monthly payments, which is known as ground rent.

The building lease is established through an agreement between the owner and leaseholder and registration in the land register. The building lease lapses with expiry of the agreed period of time. Following expiry of the agreed period, the leaseholder is not required to remove the building from the plot of land; they simply receive a payment for the value of the building.

IV. Direct investment as asset or share deal

The acquisition of a plot of land can take place either on the basis of a straightforward land purchase agreement (asset deal) or through the takeover of shares in a holding company (share deal).

The way in which the property is acquired should always be chosen and structured taking into consideration tax aspects. A transaction structure which is optimised in terms of tax considerations is essential.

1. Asset deal

The investor and the seller conclude a purchase agreement which contains the undertaking to transfer ownership of the plot of land to the investor. The purchase agreement must be notarised. The requirement of notarisation extends to all arrangements the parties make in connection with the transfer of ownership, such as preliminary agreements.

However, ownership of the plot of land is only transferred to the purchaser with the agreement of the parties and registration of the transfer in the land register.

a) Agreement

The aim of the agreement must be that ownership of the clearly defined plot of land is transferred from the seller to the purchaser.

The agreement for the purpose of transfer of ownership of a plot of land (known as conveyance) must, pursuant to § 925 para. 1 BGB, strictly be declared 'in the simultaneous presence of both parties before the responsible official', i.e. before the notary. This formal requirement is intended to convey the importance of the transfer of ownership of the plot of land to the participants. At the same time, the responsible notary should ensure compliance with all regulations. Moreover, the land registry office only registers the transfer of ownership if the conveyance is proven in officially certified form.

b) Registration

As a further requirement, the transfer of ownership must also be registered in the land register (*Grundbuch*). The constitutive effect of registration in the land register prevents the contractual acquisition of land rights outside of the land register. However, as long as the seller is still the owner, they may also conclude a further purchase agreement with a third party. If this third party is then registered in the land register as the (new) owner of the plot of land, then the (original) purchaser must accept this. The (original) purchaser can only claim compensation from the seller on the grounds of non-fulfilment of the concluded purchase agreement.

The purchaser can, for example, minimise the risk by arranging for the registration of a priority notice of conveyance in their favour. The subsequent registration of a third party as owner in the land register would then be invalid with respect to the (original) purchaser.

2. Share deal

In contrast to the asset deal, in property transactions of this kind, the share deal also offers beneficial tax aspects regarding the seller's profit on the sale, namely the use of the part-income method in the case of natural persons (= 60% of the profit on the sale is taxed at the corresponding personal tax rate plus solidarity surcharge and, where applicable, trade tax), and a 95% tax exemption in the case of corporations, i.e. corporate entities (= only 5% of the profit on the sale is subject to corporate/trade tax plus solidarity surcharge) as seller. Under certain circumstances, natural persons owning property that has been used for non-commercial purposes for at least 10 years can even sell their property tax-free. With a share deal, the purchaser has the possibility, when acquiring a share up to a given quota (see below, point 3), to avoid property transfer tax altogether. In many cases, value added tax risks can also be avoided with a share deal.

The procedure followed in a share deal essentially depends on the legal form of the holding company, which is usually either a GmbH or GmbH & Co. KG.

a) GmbH

In the case of a GmbH, both the contractual (purchase) agreement and the enforceable transfer deed on the transfer of a share in the business require notarisation. Acquisition of the share is generally completed with the assignment, unless the parties have previously agreed to a special condition. The acquisition of the share in a GmbH is therefore usually significantly quicker with regard to the desired economic objective than the direct acquisition of the plot of land.

The assignment of a share in the business is not normally tied to other prerequisites. However, the articles of association may also require the approval of the company or the shareholders or pre-emptive rights on the part of the other shareholders. In this case, the share purchase agreement should already contain all the necessary approvals or waivers.

When formulating the share purchase agreement, particular attention should be paid to the inclusion of agreements or guarantees concerning the properties of the share or the land. One example of a share-related guarantee is the assurance that the sold shareholding is legally valid and that the seller can freely dispose of it; that it is not encumbered with rights of third parties, especially not attached or pledged. A property-related guarantee includes, *inter alia*, the assurance that the seller company is the owner of the plot of land and that the land is free of encumbrances.

b) GmbH & Co. KG

In the case of acquisition of shares in a GmbH & Co. KG, both the shares in the GmbH and the limited partners' shares in the KG are acquired.

There are a number of issues that need to be noted regarding the acquisition of limited partners' shares. In contrast to the acquisition of shares in a GmbH, the acquisition of a limited partners' share is possible without any formal requirements, insofar as shares of the corresponding general partner GmbH, which are subject to formal requirements, are not acquired at the same time. The assignment of the share to the purchaser and the withdrawal of the previous limited partner shall only become legally valid once they have been recorded in the commercial register.

However, the effectiveness of this assignment should be subject to the condition precedent of registration in the commercial register. This is the only way to effectively limit the liability of the purchaser towards the company's creditors to the limited partner's interest. Irrespective of registration in the commercial register, with the assignment of the limited partner's share the purchaser becomes a shareholder in the KG.

3. Trade tax on rental income

The rental income earned by a real estate investment company (GmbH or a GmbH & Co. KG with a GmbH as 100% limited partner) is strictly subject to both corporation tax (15.825%) and trade tax (around 14% to 17%). However, the pure administration of property assets by a company, be it a GmbH or GmbH & Co. KG, can be exempt from trade tax regarding the collected rent payments, insofar as the company exclusively administers its own property holdings, especially if it only lets or leases them. Nevertheless, such an administrative function does not apply if the company also provides the tenants with extra commercial services, or if, in addition to the property holdings, items of operating equipment, which can also be a fixed component of the property, are also let.

Therefore, if the company is exclusively involved in the administration of assets, with correct organisation the nominal overall tax burden can effectively be reduced to 15.825%.

V. Due diligence

Due diligence involves the examination of the property to be acquired. The aim of the due diligence process is to create a basis in the form of a due diligence report for the detailed valuation of the property and to reveal the risks associated with the acquisition with a sufficient period of advance notice.

The result of the due diligence process often has an effect on the agreements in the purchase agreement, such as guarantee agreements, guarantees and/or purchase price retentions.

The examination usually entails the seller making information on the property available to the potential purchaser's advisers in a data room for a limited period of time. The material is either brought physically to a data room or made available for inspection virtually through password-protected internet access.

In the case of a legal due diligence exercise carried out by specialist lawyers, all legally relevant aspects of the transaction are identified, examined and evaluated accordingly. Legal due diligence is often accompanied by a tax, financial and economic due diligence.

Legal due diligence is usually divided into six sections: the situation of the property, tenancy agreements, public law, environmental law, insurance policies and pending legal disputes.

1. Situation of the property

The plots of land are recorded, from a factual perspective, by the land survey registry offices and in legal terms by the land registry offices. In any property transaction, the land register and, if applicable, the building lease register must be inspected in order to ascertain the ownership situation, to determine any restrictions on use and disposal and whether there is mention of any financing charges. Restrictions on use and disposal are reflected in the value of the plot of land, because they affect the usability of the plot of land.

2. Land register law, registration

The land register is a record of all plots of land and sets forth the *in rem* legal circumstances relating to the plot of land. In particular, it provides information on the owner of the relevant plot of land. The land register is kept by the local municipal court. The municipal court district is divided into several land register districts (parishes). In the land register districts, the land registers are in turn ordered according to volume and folio. The land registry office keeps a separate land register folio for each plot of land.

In order to obtain a registration, a written application must be filed with the land registry office. As a rule, the purchaser's application for registration in the land register is included in the notarised deed, meaning the submission of this deed to the land registry office will suffice as an application for registration. Acquisition, change and revocation of ownership and other rights to plots of land are registered in the land register and all registrations remain visible. If an entry is to be deleted, this is noted accordingly in the land register. The old entry is underlined in red to show that it has been deleted. The land register simply shows the *in rem* legal circumstances. The land register does not show whether the plot of land is let or leased, or whether there is a contractual pre-emptive right.

The owner is registered in section I of the land register. In the case of several joint owners, the respective quotas of the entitled parties are also entered, or the legal relationship between the co-owners.

Encumbrances of the plot of land, priority notices, restrictions and land register annotations are entered in section II of the land register. These encumbrances are either taken over by the purchaser or deleted.

Mortgages, annuity land charges and other land charges are entered in section III of the land register.

Pursuant to § 891 BGB it is assumed that a right shown in the land register or the revocation of a right entered in the land register counts for and against the holder of

the right or former beneficiary, as being proven, unless this proof is refuted through evidence to the contrary.

3. Priority notice

Under German property law, the priority notice (*Vormerkung*) represents an announcement in the land register of a future acquisition of title to a plot of land, to which the party in whose favour the priority notice was entered has a claim based upon contract or tort. In practice, the most frequent form is the priority notice of conveyance, which announces a conveyance, or the legal transfer of ownership. The priority notice is governed by §§ 883 et seq. of the BGB.

In Germany, the acquisition of a plot of land or of a title to a plot of land takes place in two stages. Firstly, it requires a contract in which the parties agree on the acquisition of title by one party and secondly, registration of said acquisition of title in the land register. The purchaser of a plot of land can only be sure of their rights to the purchased property once they are recorded in the land register as the new owner.

Because the registration in the land register takes some time and the parties themselves have no influence on the registration (which is carried out by the relevant officials), there is a risk for the purchaser of the plot of land or the title to the plot of land that, before declaration of the acquisition of title in the land register, the still entitled seller could sell or use the plot of land to the detriment of the imminent purchaser. A compensation claim by the creditor for breach of contract by the debtor would be the only possible recourse. A claim against the third party for the granting of title to the plot of land itself is ruled out due to the *inter partes* effect of the obligations involved. A priority notice of conveyance should therefore be registered to protect the purchaser.

4. Restrictions on use and disposal

Restrictions on the use of the plot of land arise from the encumbrances entered in section II. The scope and extent of the encumbrances are often not apparent from the land register alone, so the agreements that underlie the relevant easement should also be consulted in order to determine the precise content.

a) Usufruct

Usufruct (*Nießbrauch*) grants the usufructuary the right to make comprehensive use of the encumbered property. This includes the deriving of benefits according to § 99 BGB, such as products and other yields of the property.

The beneficiary is not only entitled to beneficial use with respect to the other party to the agreement, but enjoys the right of beneficial use with respect to any other person(s).

Pursuant to § 837 BGB the granting of usufruct to immovable objects takes place through informal agreement and registration in the land register.

b) Easement

The easements (*Grunddienstbarkeit*) frequently found in the land register are an encumbrance on a plot of land in favour of a third party. It may, for example, be agreed that the third party can use the encumbered plot of land in certain ways, that certain actions may not be carried out on this plot of land or that the exercise of a right is excluded. A so-called right of way can also be agreed, according to which a path across a plot of land owned by a third party may be used for pedestrian or vehicular access.

The easement is created through agreement between the owners and registration in the land register of the encumbered plot of land. Additional registration in the land register of the controlling property is possible, but not obligatory.

The creation of an easement acts as a right *in rem*; the right encumbers the plot of land. Subsequent purchasers of the neighbouring property may also make use of the right. Subsequent owners of the encumbered property must also tolerate the exercise of the right.

c) Limited personal servitude

Limited personal servitude (*beschränkte persönliche Dienstbarkeit*) is the authority of a certain person to use the encumbered plot of land in certain ways. The purpose of this easement can be that the beneficiary him- or herself uses the encumbered plot of land in certain ways, that the owner of the encumbered plot of land may not carry out certain actions or that the owner of the encumbered plot of land is not entitled to certain rights of defence. Limited personal servitude is created through agreement between the owner and beneficiary and registration in the land register.

d) Public charges

Public charges are created by operation of law, without registration in the land register, unless their registration is specially permitted or required by law (§ 54 German Land Register Act (*Grundbuchordnung*, GBO)[25]. Public charges include, for example, public infrastructure development contributions in accordance with §§ 127 et seq. German

[25] German Land Register Act in the version of the Announcement of 26 May 1994 (BGBl. I p. 1114), last amended by Article 2 of the Law of 5 December 2014 (BGBl. I p. 1962).

Town and Country Planning Code (*Baugesetzbuch*, BauGB)[26], road-building contributions in accordance with regional bylaws, rates due pursuant to § 9 German Land Tax Law (*Grundsteuergesetz*, GrStG)[27], canal charges in accordance with the regional laws on municipal charges or chimney sweeping charges pursuant to § 25 para. 4 German Chimney Sweeping Law (*Schornsteinfegergesetz*, SchfG)[28].

5. Financing encumbrances

Mortgages and land charges serve to secure monetary claims. If the landowner fails to meet their payment obligations, the holder of the mortgage or land charge can, after obtaining a title to payment, levy execution on the property. The land register does not show whether and in what amount the underlying claim of an entry still exists, or whether and to what extent the creditors' demands have been met.

a) Mortgage

A mortgage (*Hyopthek*) is an encumbrance *in rem* of a plot of land, not associated with possession, in order to secure a monetary claim (§ 1113 BGB). In terms of its creation and existence it is fundamentally dependent on a claim. The secured claim for which the mortgage is created is always a monetary claim. The debtor may be the owner or a third party.

b) Land charge

In contrast to a mortgage, a land charge (*Grundschuld*) does not depend on the existence of a secured claim. The land charge is, like the mortgage, an encumbrance created through agreement and registration as an uncertificated land charge or as a certificated land charge through the additional handover of the land charge certificate (§ 1117 BGB), without there having to be any claim.

6. Tenancy agreements

Valid medium- or long-term tenancy agreements are an important factor in the yield from a real estate investment. The effectiveness and long-term validity of a tenancy agreement is assessed on the basis of the provisions on tenancy law in the BGB and Federal Court of Justice case law in the area of tenancy law.

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[26] German Town and Country Planning Code in the version of the Announcement of 23 September 2004 (BGBl. I p. 2414), last amended by Article 2 of the Law of 20 November 2014 (BGBl. I p. 1748).

[27] German Land Tax Law in the version of the Announcement of 7 August 1973 (BGBl. I p. 965), last amended by Article 38 of the Law of 19 December 2014 (BGBl. I p. 2794).

[28] German Chimney Sweeping Law in the version of the Announcement of 26 November 2008 (BGBl. I p. 2242), last amended by Article 2 of the Law of 1 April 2015 (BGBl. I p. 434).

In this context, the distinction between residential and other tenancies is actually very important; examples include applicability of the provisions regarding rent increases in the BGB, the calculation of the period of notice of termination or the issue of compliance with the rules on protection against termination of a tenancy.

Residential tenancy means that the parties agree to the provision of property for residential purposes in return for payment. Business premises tenancy means that property is leased by the tenant for the purposes of commercial gain.

a) Entry into the existing tenancy

Pursuant to § 566 BGB, a purchaser only enters into existing tenancy agreements by law if the landlord and owner were previously identical. In this respect, the purchaser takes over all rights and obligations associated with the tenancy from the seller.

b) Compliance with written form

When examining tenancy agreements, particular attention should be paid to the stipulation of the term of the agreement in question.

§ 550 BGB stipulates that if a tenancy agreement for a period exceeding one year is not entered into in written form, then it is regarded as agreement with an indefinite term and can as such be terminated on expiry of one year following handover of the residential premises. If there is no written agreement, the fixed-period lease is transformed into a tenancy for an indefinite period. In this case the tenants can terminate the lease giving the three months' notice provided for in § 573c para. 1 BGB. This provision is mainly applicable in respect of commercial leases.

In the case of protected residential tenancies, a specific tenancy term can now only be agreed subject to strict preconditions, in the case of fixed-period tenancy agreements in accordance with § 575 BGB.

With regard to compliance with the written form requirement, the correct representation of the parties to the tenancy agreement and any violation of the term of acceptance should also be checked, especially if a period of more than 14 days has elapsed between the signatures of the parties.

Where there are supplements to the tenancy agreement, it should be ensured that correct reference is made to the main agreement.

c) Index-linking of rent

In the case of longer-term commercial tenancy agreements, it is common practice to have an agreement to adjust the rent on the basis of an official index. The absence

of such a clause can have a depreciative effect, since any loss of purchasing power occurring over the term of the lease is not compensated for.

d) Deposit

When examining tenancy agreements it should also be established whether arrangements have been made for the payment of a deposit. This minimises the risk of non-payment of rent. It should be noted that, pursuant to § 566a BGB on the termination of the tenancy, irrespective of whether the deposit has been passed on to the purchaser, they nonetheless are responsible for its return. This only fails to apply if the cash deposit was invested separately from the assets of the landlord.

e) Additional costs

Additional costs must be explicitly listed in the tenancy agreement and the costs charged to the tenants, otherwise it will be assumed that the payment of rent includes the additional costs.

f) Maintenance

Considerable costs can arise as a result of obligatory repairs. If the tenancy agreement contains no stipulations concerning repairs, the landlord is responsible for the maintenance of the property and is fully liable to the tenants for ensuring that the property is suitable for the contractually agreed use, without any defects.

g) Rights of withdrawal

Particular attention must also be paid to the agreement of contractual rights of withdrawal, such as through failure to obtain planning permission or delayed completion of a building.

h) Standard agreements

In the case of standard agreements, certain points that are legally governed by §§ 305 et seq. BGB need to be considered.

7. Public-law aspects

It must also be established whether the property to be acquired was constructed in accordance with official building law regulations and relevant planning permission has been obtained.

a) Planning law

When it comes to evaluating construction projects, German planning law makes a fundamental distinction between three zoning categories. The most important is between the outer and inner zone, with the main intention of protecting the outer zone against uncontrolled building (development).

(1) Outer zone

The outer zone (*Außenbereich*) refers to the areas that lie outside of the built-up areas of the locality and for which no qualified development plan exists. A fundamental ban on construction is presumed for the outer zone; only projects connected with the land (such as agriculture, power stations, research facilities, military installations, etc.) are permissible. Because only projects of this nature are permitted in the outer zone, they are referred to as 'privileged projects'. More detailed regulations can be found in § 35 BauGB.

(2) Inner zone

The inner zone (*Innenbereich*) refers to the unplanned areas within the built-up parts of the locality. The evaluation of construction projects in the inner zone is based on § 34 BauGB. According to this, the nature and extent of use of a new construction project is judged in relation to the existing built-up surrounding area. The character of the area also plays an important role.

(3) Planned inner zone

The third category is represented by those areas which lie within the areas covered by development plans, i.e. those that are scheduled for development. Since these generally involve existing or new development areas, they are also referred to as the 'planned' inner zone.

(4) Content of a development plan

§ 9 BauGB defines what can be included in a development plan (*Bebauungsplan*). However, each element to be included must have a planning justification. The specific details and dimensions pertaining to uses are taken from the Land Use Ordinance (*Baunutzungsverordnung*, BauNVO)[29], which supplements § 9 BauGB.

The more well-known assessments include area type (purely residential zones, general residential zones, village zones, mixed zones, core zones, commercial zones)

[29] Land Use Ordinance in the version of the Announcement of 23 Januar 1990 (BGBl. I p. 132), last amended by Article 2 of the Law of 11 June 2013 (BGBl. I p. 1548).

with the corresponding catalogues of uses and the upper limits for useful dimensions (e.g. floor space index, building heights, number of floors). The Land Use Ordinance also defines construction methods and areas of land which can be built on and regulates the legitimacy of ancillary buildings, parking spaces and garages.

b) Planning permission

Planning permission (*Baugenehmigung*) is the official permission for the construction, alteration or change of use of buildings. In many regional building regulations, the demolition and removal of buildings does not require planning permission, just a simple notification.

Planning permission officially attests the developer the acceptability of their building project in terms of those official regulations which need to be examined in planning procedures. Following completion of the building—possibly also at intermediate stages in the case of large construction projects—the regional building regulations provide for the approval of the building or inspection during construction, the scope of which is left to the building authorities. During approval/inspection, any building defects are recorded; the approval for use or occupation is only granted once these have been rectified.

c) Registers of construction and maintenance obligations

The obligation to construct and maintain (*Baulast*) is the public-law counterpart to the easement, otherwise known as 'public easement', which is an obligatory undertaking intended to secure compliance with certain planning and building regulations. For example, there may be the obligation to provide a certain number of parking spaces.

The public easement is created through the provision of a building obligation by the landowner to the responsible building authority. Public easements are not registered in the land register; it is therefore essential that the register of construction and maintenance obligations be inspected if there is such a register under the relevant regional law.

d) Infrastructure development

When acquiring undeveloped plots of land, particular attention must be paid to infrastructure development and the costs associated therewith. The purchase agreement should stipulate who is responsible for the costs incurred.

The full infrastructure development includes public infrastructure development (roads, green spaces etc.) and the laying of the distribution network for water, waste water, gas, electricity, telephone and cable up to the boundary of the property.

Any infrastructure development costs can lead to a considerable financial burden in addition to the actual purchase price. The infrastructure development contribution

must be paid by the party who owns the property at the time the contribution notice is issued. It should be noted that some time can elapse between completion of the infrastructure facilities and the issue of the contribution notice.

Utility connections from the boundary of the property to the building are laid by the utility company itself. The ensuing additional costs are generally charged to the developer. In the case of an infill or rear development, details of the remaining infrastructure measures to be carried out and the anticipated costs should be obtained in writing from the local authority and the utilities company before signing the real estate contract.

e) Restrictions on disposal and pre-emptive rights

Public law restrictions on disposal protect the interests of the general public, to which the interests of the owner must be subordinated. Public law restrictions on land ownership are intended to ensure that the plot of land, parts or properties thereof remain, as far as possible, available for the implementation of public interests.

The following official restrictions on disposal could significantly affect the value of a property and must therefore be examined in detail:

- restrictions on traffic according to the BauGB: restrictions on traffic due to reparcelling of building land, restrictions on traffic under special town planning laws;
- boundary determination procedure pursuant to §§ 80–84 BauGB;
- restrictions on disposal to protect touristic areas pursuant to § 22 BauGB, in areas covered by an environmental conservation statute, in order to protect building use pursuant to § 35 para. 5 BauGB, according to agricultural law, economic and social legislation and for public legal entities;
- public sector rights of pre-emption.

f) Conservation of historical buildings

It should be ascertained whether any conservation orders have been issued. If the property is listed, in its entirety or in part, as a historical building, then this has a significant impact, particularly on the possibility of future structural alterations. It may also have an effect on necessary maintenance costs, which could mean considerable financial expenses. In Germany, legislative competence for the conservation and upkeep of historical buildings lies with the individual federal states. Listing as a historical building generally represents a burden for the owners, because of the legal maintenance obligations.

8. Environmental law (existing contamination)

The property may be affected by existing biological or chemical contamination. An examination of the building ground is advisable in order to minimise risks. In the event of soil contamination being found on a property, the purchaser risks being held liable by the responsible administrative authorities.

According to § 4 para. 3 of the Federal Soil Protection Act (*Bundesbodenschutzgesetz*, BBodSchG)[30], in addition to the party responsible for the contamination, the landowner is obliged, *inter alia*, to clean up the soil and water in such a way that no permanent hazards or significant losses or damages are caused to individuals or to the general public.

According to the BBodSchG, there is also no obligatory deadline for the clean-up process.

An extract from the contaminated land survey register (*Altlastenkataster*) provides an initial indicator for quantification of the risk of existing contamination. If there are grounds for suspecting contamination, more detailed studies are then subsequently carried out. For example, if contamination is suspected, the necessary soil and groundwater samples are collected and analysed.

9. Insurance

Insurance policies taken out by the seller for the building being offered for sale can also be of relevance. Pursuant to § 95 para. 1 German Insurance Contract Act (*Versicherungsvertragsgesetz*, VVG)[31], property damage insurance policies, such as insurance for operating premises, natural hazard insurance or fire insurance, are transferred by law to the purchaser. It is possible for the purchaser to cancel these policies; however, the statutory period of notice of cancellation of one month from acquisition of the property must be complied with, § 96 para. 2 clause 2 VVG. In practice, new insurance policies are usually taken out on the date of handover.

10. Legal disputes

Any legal disputes in connection with the property are also relevant for the purchaser; alongside legal disputes with tenants, public-law disputes with neighbours also often occur.

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[30] Federal Soil Protection Act of 17 March 1998 (BGBl. I p. 502), last amended by Article 5 para. 30 of the Law of 24 February 2012 (BGBl. I p. 212).

[31] German Insurance Contract Act in the version of the Announcement of 23 November 2007 (BGBl. I p. 2631), last amended by Article 2 para. 49 of the Law of 1 April 2015 (BGBl. I p. 434).

VI. Purchase agreement

The acquisition of ownership to the plot of land requires

- a contractual agreement of sale in notarised form;
- the agreement of the participants concerning the transfer of ownership—referred to as conveyance;
- registration of the change of ownership in the land register, which takes place upon approval and application.

1. Purchase agreement

a) Parties to the purchase agreement

The parties of the sale of a property are known as the seller and purchaser. There may be several persons on each side. Other persons may also be involved, such as a guarantor for the payment of the purchase price.

Special considerations arise if married couples purchase or sell a property, as well as in the case of inheritance issues and restrictions on disposal on the part of the seller, for example as a result of insolvency, compulsory auction or forced administration. In this case, there are additional requirements to be complied with.

In addition to private persons, institutional investors such as closed or open real estate funds or real estate investment companies may also be parties to a purchase agreement.

b) Content of the purchase agreement

Any agreement whereby someone undertakes to transfer ownership of a property to another natural or legal person requires notarial certification. The same applies to an agreement whereby someone undertakes to purchase a property (§ 311b para. 1 BGB). Undertakings to create or revoke, sell or purchase a building lease pursuant to § 11 of the Building Leases Act (*Erbbaurechtsgesetz*, ErbbauRG)[32] and the obligation to grant or revoke separate ownership pursuant to § 4 para. 3 WEG must also be notarised.

An agreement on the sale or purchase of a property that is concluded without notarisation is null and void.

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[32] Building Leases Act in the version published in the Federal Law Gazette Part III under the classification number 403-6, last amended by Article 4 para. 7 of the Law of 1 October 2013 (BGBl. I p. 3719).

Certain minimum requirements apply to the land purchase agreement. For example, it must at least specify the object of the purchase, the identity of the purchaser and the seller, and the purchase price.

The purchase agreement usually also stipulates the time of the transfer of ownership and the transfer of benefits and charges, the time at which the purchase price is due for payment, liability for legal and material defects, responsibility for infrastructure development costs and the liability for costs and taxes.

The purchase agreement must also specify when the handover of the property to the purchaser will take place and the point at which the risk of accidental destruction or accidental deterioration, benefits and charges as well as liability for public safety, will be transferred to the purchaser.

As a rule, the risk of accidental destruction or accidental deterioration of the property is transferred to the purchaser on handover (§§ 446, 434 BGB). In exceptional cases, the risk can be transferred to the purchaser before the handover of the property, namely when the purchaser is in default of acceptance.

Very often, property purchase agreements provide for an exclusion of guarantees. This means that the seller wishes to avoid providing any warranty that the property is free of harmful substances and existing contamination or that the soil has certain load-bearing properties or that the groundwater has a certain depth. The purchaser should be very cautious if there is an exclusion of guarantees. In the event that the purchaser agrees to this, sight unseen, and later establishes that the purchased land requires alterations or additional measures in order to allow the planned building to be constructed, the purchaser will in no way be able to hold the seller liable, and will be responsible themselves for any problems that may arise.

There is also the risk that the purchaser may incur additional costs and that the project will become significantly more expensive. In the worst case scenario, the purchaser may find that the purchased property is unfit for the intended purpose.

In order to minimise the risks of purchasing real property, it is advisable to have the purchase agreement drawn up by a lawyer who has experience in property law. Through skilled negotiation with the seller, the lawyer can help the parties to agree on provisions which are advantageous to the purchaser.

2. Conveyance

The *in rem* agreement between the parties (the conveyance) is normally included in a special, separate clause of the contract and its validity does not depend on the validity of the transaction under the law of obligations.

3. Registration

Registration in the land register completes the acquisition of title (§ 873 para. 1 BGB). It also determines the priority of the title pursuant to § 879 BGB and establishes the assumption of correctness of the land register in accordance with § 891 BGB.

In order to safeguard the purchaser, the registration of a priority notice of conveyance should be agreed in the purchase agreement and applied for. As soon as this is entered, the purchaser is largely protected. On no account should the purchase price be paid until the priority notice of conveyance has been registered. It should be agreed in the contract that this only becomes due once, *inter alia*, this entry has been made. The notary should verify fulfilment of the preconditions for payment. Payment should only be made once the notary has informed the purchaser in writing that these preconditions have been fulfilled.

On his or her part, the seller should not agree to the purchase price becoming due on or after the purchaser has been registered as the new owner. However, the purchaser is safeguarded by the priority notice of conveyance insofar as it accounts for the fact that the purchase price is to be paid after it has been registered. After the purchase price has been settled, the deletion of the priority notice of conveyance is applied for and effected. At the same time, the purchaser is registered as the new owner. This, too, can be agreed in the purchase agreement.

As a rule, the seller will have encumbered the property. In this case, the purchaser must take care that he or she only pays the purchase price and is registered as the new owner once he or she has been informed in writing by the notary that these encumbrances have been deleted.

a) Public approvals

The validity of the sale of real property is in part dependent on official approvals of various kinds. These include permission to sell agricultural land or real estate in the new Bundesländer and approval for the protection of touristic areas in accordance with § 22 BauGB. The contractual agreement can in fact be concluded before obtaining these approvals, conveyance can also be declared beforehand and a priority notice of conveyance registered. However, the change of ownership can only be registered in the land register if the land registry office is provided with proof of the official approvals.

b) Attestations

These approvals do not include pre-emptive rights and the clearance certificate concerning property transfer tax pursuant to § 22 GrEStG[33]. However, they are prerequisites

[33] Property Transfer Tax Act in the version of the Announcement of 26 February 1997 (BGBl. I p. 418, 1804), last amended by Article 14 of the Law of 25 December 2014 (BGBl. I, p. 1266).

for the execution of the purchase agreement. Statutory pre-emptive rights to the property may, for example, involve pre-emptive rights on the part of nature conservation and heritage conservation authorities or pre-emptive rights under the BauGB. The statutory pre-emptive right provided for in §§ 24, 28 para. 1 clause 2 BauGB blocks registration in the land register. Registration in the land register requires the submission of a confirmation that the pre-emptive right does not exist or is not being exercised.

c) Costs

(1) Notary costs and court costs

The notary is responsible for the notarisation of a property purchase agreement. The notary is an independent holder of a public office. In exercising their office, they are obliged to act independently and impartially and not as the representative of one party. The notary is also under an obligation to maintain confidentiality.

The party which has to bear the costs associated with the purchase of the property is, as a rule, contractually agreed. However, both parties are liable towards the notary.

Pursuant to § 448 para. 2 BGB, the purchaser of a property must, by law, bear the costs of notarisation of the purchase agreement, conveyance and registration, including the costs of the declarations required for registration. These costs also include those which arise because other rights created in the agreement need to be entered in the land register, in particular a mortgage for the purchase price, a right of usufruct, a land charge or other encumbrance in section II of the land register.

(2) Property transfer tax

The contracting parties are liable for the property transfer tax as joint and several debtors (see § 13 para. 1 GrEStG). According to § 426 para. 1 clause 1 BGB, the purchaser and seller would each have to bear 50% of the tax. However, as a rule, payment of the property transfer tax is contractually assumed by the purchaser alone.

Pursuant to § 18 GrEStG, the notary is obliged to notify the revenue authorities of purchase agreements. The property transfer tax amounts to between 3.5% and 6.5% of the purchase price, e.g. 6% in Berlin since 1 April 2014, 5% in Brandenburg since 1 April 2011.

Property transfer tax can also be charged in the case of a share deal. This is generally the case if the purchaser acquires more than 95% of the shares in a limited liability real estate company or if, in the case of a property partnership, a change of partnership holdings of at least 95% takes place within five years. However, the basis for the calculation of property transfer tax in a share deal is determined according to a special 'standardised value'.

When it comes to choosing the property company the shares in which are to be transferred by way of a share deal, partnerships are primarily chosen if, in particular, a direct allocation in tax terms of losses from the property company to its shareholders is desired, although this depends on the amount of the capital contribution or on the amount of the partner's liable capital entered in the commercial register. From the seller's perspective, the sale of shares in a corporate entity can be of interest in tax terms, because only 95% of any resulting profits on sale are effectively taxed if the shares are held and sold by a corporate entity.

(3) Agent's costs

In order to find a suitable plot of land to be developed, it is often necessary to seek the assistance of an agent. The agent charges commission for their services, which is usually calculated as a percentage of the purchase price of the property. Agents' fees vary according to the region.

Some purchase agreements contain stipulations, according to which the agent can demand their fee directly from the purchaser, even if the sale was commissioned by the seller. This means the purchaser will have to pay the agent's fee in addition to the actual purchase price.

There is often uncertainty as to whether the agent is entitled to demand a fee because the purchaser believes the agent's activities were of no importance to the conclusion of the purchase agreement. An agent must arrange a transaction concerning an immovable object or prove that the opportunity existed to conclude such a transaction. This is usually done by naming the vendor and arranging a viewing of the property. The agent can only demand a fee once the property purchase agreement has been concluded.

VII. Financing

In principle, investors may choose between the direct and the indirect form of real estate investment.

In the case of a direct purchase of a property, ownership of the property is acquired with all rights and obligations.

In the case of indirect investment, the investor does not acquire ownership of the property. Instead, they provide capital which is invested in property.

The financing of a real estate transaction can thus take the form of either financing through loans or through institutional financing, i.e. by finding co-investors to participate in the project.

1. Financing through loans

The provision of outside capital by banks or insurance companies is the classic form of financing. It is tied to numerous conditions. The banks attempt to minimise the financing risks as far as possible through a detailed analysis of the creditworthiness of the customer and the property, as well as by means of stipulations or covenants (conditions) in the loan agreement.

As an alternative to taking out a loan, under certain circumstances the purchaser can, with the approval of the lender, also take over existing loans taken out by the seller. In particular, this saves the purchaser notary costs and court costs.

a) Land charge

In practice, land charges are used most often to secure loans and credits.

A distinction is made between uncertificated land charges (*Buchgrundschuld*), which are simply registered in the land register, and certificated land charges (*Briefgrundschuld*), for which a land charge certificate is also required.

Land charges are not tied to the legal existence of a particular claim and can be transferred on their own account. Land charges can therefore serve as security not only for individual claims, but also for several liabilities, including future ones.

The land charge and loan are linked through the statement of collateral purpose (declaration of purpose for land charges). Following repayment of all loans secured through the land charge, the statement of collateral purpose becomes a claim to restitution. This claim is the right to re-transfer the land charge, the right to a waiver by the creditor as well as the right to deletion. In practice, this claim is usually limited by the credit institutions to a mere right to deletion.

In addition to the actual amount of the land charge, the interest on the land charge and the additional payments are entered. The interest on the land charge also secures claims which, for example, may arise through the insolvency of the customer and exceed the nominal amount of the land charge.

b) Subjection to compulsory execution

It is also usual in some cases for the owner to subject themselves to immediate compulsory execution against the property pursuant to § 800 of the Code of Civil Procedure (*Zivilprozessordnung*, ZPO)[34]. This means that compulsory execution against the

[34] Code of Civil Procedure (ZPO) in the version of 5 December 2005 (BGBl. I p. 3202, corrected 2006, p. 432 and 2007, p. 1781), last amended by Article 1 of the Law of 8 July 2014 (BGBl. I p. 890).

property is possible without a judgment being required beforehand. This also applies in the event of a transfer of the property.

In addition, in some cases the subjection to immediate compulsory execution against the entire assets in the amount of the land charge and the additional payments is agreed. Pursuant to § 794 para. 1 clause 5 ZPO, compulsory execution can be levied under this deed without a judgment being necessary for this purpose, though in this case exclusively against the person who has subjected themselves. It does not therefore extend to a new owner.

c) Collateral value

The collateral value is important since it determines the amount of the possible loan. It is assessed according to the lending guidelines of the credit institution in question and its value is intended to represent the resale value which can be achieved in the long term.

d) Determination of the collateral value

(1) Asset value method

The asset value method is used for owner-occupied homes. The asset value consists of the value of the building and land. The land value is calculated by multiplying the price per square metre that can be achieved in the long-term by the area of the plot. The value of the building can be determined on the basis of the general building index. The value of the building can also be determined by calculating what would be regarded as appropriate construction costs and subtracting a risk deduction of 10% to 30% from this figure.

(2) Rental value method

The rental value method is applied in the case of let properties. A discounted amount resulting from the difference between rental income and all costs is determined.

The banking institution lends a certain percentage of the determined collateral value, usually 60% to 80%. In the case of insurance loans, the quota is often only 45%. Loans which do not exceed this range are provided at relatively favourable interest rates. These mortgages are secured through first priority real estate liens, and in the event of a compulsory auction, are first paid from the proceeds of the auction. Should there be a need for further credit, credit institutions may grant additional loans, which have a higher interest rate. They are secured through second priority real estate liens.

Additional financing requirements can also be covered through building society loans.

e) Financing power of attorney

Since the purchaser only acquires ownership upon registration in the land register, and this is only requested once the purchase price has been paid, the purchaser requiring a loan has a problem since no credit institution will provide a loan without securities.

For this reason it should be agreed in the notarised agreement that the seller grants the right to have a charge registered on its property in order to allow the loan to be secured.

2. Institutional financing

Institutional financing can be provided through open and closed real estate funds and real estate investment trusts.

Other products such as project developments funds, real estate trading funds and so-called opportunity funds or certificates are currently still of lesser relevance.

a) Open real estate funds

Open real estate funds are separate trust assets in the form of real estate with at least 15 properties managed by a capital investment company. As a rule, open real estate funds are set up by banks and insurance companies as separate trust assets and are administered in trust. They are not subject to limits either in the number of investors nor in the volume of the fund. Quotas in open real estate funds are freely sellable. At least 51% of the fund's assets must be formed of property.

The part of the profits which is based on the increases in value of the properties is tax-free. The remaining profit derived from rental income is taxed as income from capital assets.

b) Closed real estate funds

Closed real estate funds are limited in the number of investors and in the volume of the fund. Their purpose is the financing of properties.

Closed real estate funds are usually set up as a GmbH & Co. KG. Limited partners' quotas in the company are generally offered for sale over a certain placement period. Once the planned capital ratio is achieved, the fund is closed.

The purchaser of a quota in a closed fund usually becomes a limited partner, with all the associated opportunities and risks.

c) Real estate investment trusts

Real estate investment trusts (REIT) are companies whose business activities largely revolve around the acquisition, management and sale of properties. Their stock exchange listing leads to a continuous market valuation of the quotas and enables participation in professionally managed property portfolios for relatively low transaction costs.

VIII. Special problems arising in the area of building and architectural law

Building law and architectural law represent specialist areas in the field of civil law. They are particularly relevant if a property is to be built on the piece of land that is acquired.

1. Architect's copyright

The architect's copyright can become a cost pitfall for the purchaser even in the case of apparently purely functional office buildings.

§ 2 no. 4 of the Copyright Act (*Urheberrechtsgesetz*, UrhG)[35] protects works in the visual arts, including architectural works, and the plans and designs for such works.

A building can be deemed to be a work of architecture if it is a unique creative work resulting from design activity and displays individual creative qualities.

If alterations are to be made to a copyright-protected work during the course of renovation or conversion, it should be noted that alteration is strictly prohibited pursuant to § 39 UrhG. This means alterations are not permitted without the consent of the architect. The architect may also be entitled to distribution and reproduction rights and rights to mention by name.

Pursuant to § 97 para. 1 UrhG, infringement of copyright through unauthorised alteration can give rise to claims for damages and injunctive relief.

If possible copyrights are involved, it should be established whether consent to later alteration was agreed in the original architect's contract. If this is not the case, the purchaser should insist on indemnification by the seller.

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[35] Law on copyright and related property rights (Copyright Act) of 9 September 1965 (BGBl. I p. 1273), last amended by Article 1 of the Law of 1 October 2013 (BGBl. I p. 3728).

2. Developer model

In the developer model, in terms of the construction work, contractual relations only exist between the purchaser and the developer on the one hand and between the developer and the participants in the construction work and architects on the other hand.

The participants in the construction work have no claim to payment against the purchaser; nor, conversely, does the latter have any warranty rights.

From a legal perspective, the developer contract is a mixture of purchase agreement and contract for goods and services and is subject to the strict regulations of the agents and developers ordinance (*Makler- und Bauträgerverordnung, MaBV*)[36].

In particular, if the contract is concluded at a time at which the building work has not yet been completed, the contract will contain elements of the contract for goods and services. The MaBV governs payments in accordance with the current progress of work. The developer undertakes to construct the property in accordance with the agreed building specification and then hand it over to the purchaser and transfer ownership of the property to them.

Since it involves the sale of real property, the developer contract must be notarised. In terms of *in rem* rights, it is usual for the developer to retain ownership until payment is completed. The purchaser should therefore safeguard him or herself through the registration of a priority notice of conveyance.

3. General contractor contract

The general contractor performs all the construction services involved in the construction of the building. This form of building contract, as a type of contract for goods and services, is referred to as a general contractor contract. In contrast to the sole contractor, the general contractor has agreed with the developer that he may subcontract (partial) services. However, this does not alter the fact that the general contractor is the sole contract partner of the developer and bears full responsibility for the entirety of the works.

In this case, the property is conveyed and transferred to the purchaser prior to the commencement of building work. All building works therefore become the purchaser's property.

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[36] Ordinance on the obligations of agents, loan and investment brokers, investment advisers, developers and building managers (Agents and Developers Ordinance) of 7 November 1990 (BGBl. I p. 2479), last amended by Article 2 of the Ordinance of 2 May 2012 (BGBl. I p. 1006).

D. Aliens law

Whereas EU citizens do not require a visa either for entry or for longer-term residence for working purposes in the Federal Republic of Germany, a general visa requirement does apply to many foreign nationals. The visa must be applied for, prior to entry, at a German embassy or German consulate within the respective country. Once obtained, a visa entitles the holder to enter Germany and remain in the country for a period of up to a maximum of 90 days within a 180 days period. Travellers may also apply for multiple-entry visas for several years (five years maximum).

Any non-EU citizen who wishes to remain in Germany for longer than 90 days must hold a valid residence permit (*Aufenthaltstitel*). Depending on the purpose of the stay, there are different types of residence permits which are governed by the Residence Act (*Aufenthaltsgesetz*, AufenthG)[37] as well as supplementary ordinances. Residence permits can be granted for the following purposes:

- residence for the purpose of gainful employment;
- residence for the purpose of study;
- residence for family reasons;
- residence on the grounds of international law or on humanitarian and political grounds.

Apart from the settlement permit and the EC long-term residence permit, all residence permits are issued for a limited period of time.

I. Procedure for the issue of a residence permit

1. Application for a national visa to enter Germany

Non-EU nationals wishing to take up residence in Germany require a so-called national visa, which is different from a normal tourist visa (known as 'Schengen visa')

[37] Law on the Residence, Economic Activity and Integration of Foreigners in the Federal Territory (Residence Act) of 25 February 2008 (BGBl. I p. 162), last amended by Article 1 of the Law of 23 December 2014 (BGBl. I p. 2439).

The national visa must be applied for at the responsible German embassy or consulate and requires approval from the aliens authority (*Ausländerbehörde*) at the future place of residence. On the basis of the documents provided by the German embassy, the authority will decide upon the visa to be granted and, later, the residence title applied for.

The aliens authority examines the general prerequisites for the issue of the residence permit under the Residence Act (AufenthG). As a rule, the issue of a residence permit requires

- possession of a recognised passport;
- that means of subsistence are assured;
- that the applicant's identity and nationality are confirmed;
- that no grounds for deportation exist;
- that no interference with or endangerment of public interests can be expected;
- that the applicant entered the country legally (with a visa).

The decision of the aliens authority concerning the issue of the residence permit is linked to the decision of the Federal Employment Agency (*Arbeitsagentur*) concerning the issue of a work permit.

2. Application for the issue of a residence title

The residence title must be applied for at the competent aliens authority before the visa, usually granted for a period of three months, expires. The residence permit is granted at relatively short notice, based on the findings of the examination for the issue of the entry visa.

3. Registration of residence

Within one week of moving to a new residence in Germany, the new address must be notified to the local residents registration office (*Einwohnermeldeamt*). As a rule, you will be required to appear in person, bring your passport and prove that you reside at the new address (e.g. by submitting a rental agreement or a property purchase contract).

II. Forms of residential permit

The following forms of residence permit are of practical importance:

1. Residence permit for self-employed activities of foreign investors

Foreign investors can obtain a residence permit for the purpose of self-employment in accordance with § 21 AufenthG. Applicants making investments, e.g. through forming a GmbH, holding a sufficient share in its nominal capital (at least 50%) and holding a management position, such as managing director, are deemed to be self-employed in terms of residence law. It is important, however, that the applicant does indeed perform management duties.

A residence permit for self-employed non-EU citizens is issued if the following three prerequisites are met:

- there is an economic interest in or a regional need for the planned activity in Germany;
- the activity is expected to have positive effects on the economy;
- personal capital on the part of the foreigner or a loan undertaking is available to implement the business idea.

In the past, the first two conditions were deemed met if EUR 250,000 were invested and at least five jobs were created. Currently, the law does not stipulate any minimum investments or number of jobs to be created by these investments. This gives the various regions a certain flexibility in granting residence permits to investors.

The aliens authority takes its decision on the basis of its analysis of the sustainability of the project, the business experience of the investors, the sums invested, the effects on the German employment market at the location of a company's registered office and the type of activity, e.g. investment into research and innovation. The authority also takes into account the opinion given by the competent chamber of industry and commerce and/or business promotion agency on the basis of the documents submitted by the investor when applying for the national visa (business plan, business concept, financial planning, etc.). The Federal Employment Agency is not involved in the process.

The residential permit for the purpose of self-employment is issued for an initial period of no more than three years. Upon request of the investor, the permit can be extended for an unlimited period once the project has been implemented and the investor has sufficient means of subsistence.

2. EU Blue Card for highly qualified foreign employees

According to § 19a AufenthG, the so-called EU 'Blue Card' can be obtained, through a simplified procedure, by foreign nationals who possess a university degree or similar qualification. It is a long-term residence allowing the holder to work in Germany. The EU Blue Card is valid for a maximum of four years after the first application. The EU Blue Card will be issued if the following conditions are met:

- The applicant must possess a German or recognized foreign university degree or a foreign university degree comparable to German standards. Also relevant professional work experience of five or more years can be deemed sufficient.

- The applicant has signed an employment contract or received an employment offer.

- The applicant receives a certain minimum salary. The minimum annual salary is stipulated in § 2 para. 1 No. 2 of the Employment Regulation (*Beschäftigungsverordnung*, BeschV)[38] and amounts to ²/₃ of the of the annual gross income ceiling for state pension insurance contributions (2015: EUR 48,000).

- The applicant must possess a permit to exercise a profession in Germany where such permit is required. In Germany, a special permit is required for certain professions, such as human medicine professions, tax consultants, lawyers, etc.

For shortage occupations as defined by the law, e.g. scientists, mathematicians, engineers, doctors and IT specialists, the minimum required annual gross salary is lower: 52% of the annual gross salary ceiling for state pension insurance contributions (2015: EUR 37,752). In this case, however, the EU Blue Card can be issued only with the approval of the Federal Employment Agency. There will be no so-called priority check, only a check of compliance of the employment conditions with national standards.

3. Residence permits for the purposes of employment

Any non-EU citizen seeking long-term employment in Germany can apply for a residence permit for the purposes of employment in accordance with § 18 AufenthG. In terms of aliens law, employment means that a person is gainfully employed and not self-employed. Gainful employment means that a contract exists under which a person is paid to perform services in a relationship of subordination, i.e. the person is required to follow directions and is integrated into a third-party working organisation. Under Ger-

[38] Regulation on the Employment of Foreigners (Employment Regulation – BeschV) in the version of the Announcement of 6 June 2013 (BGBl. I p. 1499), last amended by Article 2 para. 2 of the Law of 6 November 2014 (BGBl. I p. 1683).

man aliens law, the managing director of a GmbH who owns no, or almost no, shares in a company is considered an employee.

The residence permit for the purposes of employment can be granted if the following conditions are met:

- The applicant has a concrete job offer.
- The law allows the applicant access to the German job market.
- There are no preferred job-seekers (i.e. German citizens, EU citizens, EEA citizens) for the specific job (so-called priority check).
- The employment conditions must be comparable to those on which German staff is employed.

The Federal Employment Agency verifies fulfilment of the above conditions, except for the first one. The residence law follows the principle that the German job market should be primarily reserved for German and EU citizens. However, non-EU citizens may get access to the German job market where the law or intergovernmental agreements so provide or if their employment will have no negative effect on the German job market. Such intergovernmental agreements have been signed with only a few countries, such as Australia, Israel, Japan, Canada, New Zealand, the Republic of Korea and the USA.

The law also provides for exceptions with regard to the requirement of approval from the Federal Employment Agency. No approval is required in the following, non-exhaustive, cases of fixed-term employment:

- Managers:

  Officers with full power or attorney, members of a corporate body that are entitled to legal representation or managerial employees operating outside Germany who are designated for a job at board, directorate and business management level or to work in any other senior position that is crucial for the development of the company.

- Highly qualified personnel:

  These are in particular scientists or teachers in prominent function or scientific personnel in key positions.

The law also stipulates cases where the Federal Employment Agency must approve the employment of a foreign national, but will not carry out a priority check. This applies, *inter alia*, to executive employees and other persons with specialist knowledge who

are employed by a German-based company and to foreign citizens who are sent to Germany by an internationally operating company or business group as part of their internal staff exchange programme.

4. Settlement permit

The most comprehensive form of residence, the unlimited-period settlement permit, is usually subject to strict preconditions. According to § 9 para. 2 AufentG, the freedom to take up permanent residence is granted if the following preconditions are fulfilled:

- possession of a residence permit for five years;
- assurance of means of subsistence;
- at least 60 months' compulsory or voluntary contributions to the statutory pension insurance scheme have been paid;
- there are no objections on grounds of public security or public policy;
- permission for employment or other gainful occupation;
- possession of adequate knowledge of the German language as well as familiarity with German law and society and the German way of life;
- access to adequate housing.

Foreigners who have graduated from a German university may be granted a settlement permit under less strict conditions. They must have held a residence permit for two years and have a job commensurate with their degree. Furthermore, they must have paid at least 24 months' compulsory or voluntary contributions to the statutory pension insurance scheme.

Self-employed individuals may obtain a settlement permit if their business project is sustainable, the means of subsistence are assured and they have held a residence permit for self-employed persons.

Foreigners who own the EU Blue Card can apply for permanent residence after 33 months if they have paid compulsory or voluntary contributions to the statutory pension insurance scheme for this period. If they have sufficient knowledge of the German language, the period is reduced to 22 months. This is a significant shortening of the time necessary to acquire the permanent residence permit from five to less than two years.

5. EC long-term residence permit

The EC long-term residence permit is an equivalent to the freedom of establishment. It resembles the permanent residence permit. The application conditions differ, however. Requirements are as follows:

- residence in Germany with a prior residence permit for five years or longer;
- assurance of one's and next of kin's livelihood through stable and regular income;
- no adverse grounds of public security;
- adequate knowledge of the German language and familiarity with German law and society and the German way of life; and
- adequate housing.

In contrast to the settlement permit, permission of employment and a minimum 60-month payment into the state pension insurance are both not mandatory. However, the requirements regarding the previous residence permit are stricter and the assurance of livelihood also extends to next of kin.

6. Family reunification

The family members of foreign investors and employees, namely their spouses and children, may obtain a residence permit for family reunification purposes. Fundamentally, the following prerequisites apply:

- the foreign national whose family is to join him or her holds a long-term residence permit for Germany;
- the foreign national and applicant has access to adequate housing in Germany;
- the applicant's livelihood must be assured. The livelihood is deemed assured if the applicant is able to pay for it (including adequate health insurance) without any state support. In this context, the financial contributions of all family members to the household income are taken into account.

If the above conditions are met, the spouse of a foreign national has the right to be granted a residence permit, provided the spouse is 18 years of age and has a basic command of the German language.

Underage children of foreign nationals have the right to be granted a residence permit for family reunification purposes if both their parents or their single parent hold a long-term residence permit for Germany.

E. Employment law

I. German employment law

1. Overview

German employment law is neither standardised nor definitively codified. There is therefore no special code of employment and no standard law governing employment contracts. Rather, German employment law is—insofar as it is governed by legal norms at all—covered by a number of other different laws. The judicial development of the law is also very important. German employment law can be divided into three areas:

- Individual employment law:

  This includes the rules on the drafting, content and termination of employment contracts.

- Collective employment law:

  This governs the legal relationships between the coalitions under employment law (trade unions, employers and employers' associations) and the bodies representing the workforce (work councils and staff councils as well as executives' representative committees).

- Occupational health and safety legislation:

  This covers the obligations that the individual employer must fulfil with respect to public authorities and which have a direct effect on the individual employees.

2. Sources of law

Both supranational and national sources of law are of importance to German employment law. The supranational sources of law include

- primary EU law (TFEU, TEU);

- secondary EU law (regulations and directives);

- decisions by the European Court of Justice;
- the European Social Charter (ESC);
- the European Convention on Human Rights (ECHR).

Since there is no code of employment in Germany, the national legal norms governing employment are embodied in numerous different laws. Regulations governing individual employment law include, *inter alia*,

- the German constitution (*Grundgesetz*, GG)[39];
- the German Civil Code (§§ 611 et seq. BGB);
- the German Industrial Code (*Gewerbeordnung*, GewO)[40];
- the Protection of Employment Act (*Kündigungsschutzgesetz*, KSchG);
- the Part-time and Limited-term Employment Act (*Teilzeit- und Befristungsgesetz*, TzBfG)[41];
- the Federal Holidays Act (*Bundesurlaubsgesetz*, BUrlG)[42];
- the Working Hours Act (*Arbeitszeitgesetz*, ArbZG)[43];
- the Minimum Wage Act (*Mindestlohngesetz*, MiLoG)[44];
- the Occupational Health and Safety Act (*Arbeitsschutzgesetz*, ArbSchG)[45];

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[39] German constitution in the version published in the Federal Law Gazette Part III under the classification number 100-1, last amended by Article 1 of the Law of 23 December 2014 (BGBl. I p. 2438).

[40] German Industrial Code in the version of the Announcement of 22 Februar 1999 (BGBl. I p. 202), last amended by Article 10 of the Law of 15 April 2015 (BGBl. I p. 583).

[41] Part-time and Limited-term Employment Act in the version of the Announcement of 21 December 2000 (BGBl. I p. 1966), last amended by Article 23 of the Law of 20 December 2011 (BGBl. I p. 2854).

[42] Federal Holidays Act in the version published in the Federal Law Gazette Part III under the classification number 800-4, last amended by Article 3 para. 3 of the Law of 20 April 2013 (BGBl. I p. 868).

[43] Working Hours Act in the version of the Announcement of 6 June 1994 (BGBl. I p. 1170, 1171), last amended by Article 3 para. 6 of the Law of 20 April 2013 (BGBl. I p. 868).

[44] Minimum Wage Act of 11 August 2014 (BGBl. I p. 1348).

[45] Occupational Health and Safety Act of 7 August 1996 (BGBl. I p. 1246), last amended by Article 8 of the Law of 19 October 2013 (BGBl. I p. 3836).

- the Continued Payment of Wages Act (*Entgeltfortzahlungsgesetz*, EntgFG)[46];
- the Maternity Protection Act (*Mutterschutzgesetz*, MuSchG)[47];
- the Proof of Substantial Conditions Applicable to the Employment Relationship Act (*Nachweisgesetz*, NachwG)[48];
- social security codes III-XI (including: health insurance, pension insurance, accident insurance, protection of the severely disabled, long-term care insurance).

Collective employment law is governed by, *inter alia*,

- the German constitution (Art. 9 GG on freedom of association);
- collective wage agreements:
  In Germany, the collective wage agreement (*Tarifvertrag*) is a written contract between the parties to the collective wage agreement; these are the employers or employers' associations on the one hand and trade unions (representing the employees) on the other. The legal framework for a collective wage agreement is the Collective Wage Agreements Act. The collective wage agreement contains legal norms which regulate the content, conclusion and termination of the employment relationship as well operational and industrial relations questions.
- works agreements:
  The works agreement (*Betriebsvereinbarung*) is a contract between the employer and the works council (*Betriebsrat*) which formulates binding norms for all employees of the works. A works agreement can cover all aspects in which the works council enjoys a legal right of co-determination. The core area of this co-determination involves co-determination in social aspects (for example the length and distribution of working hours). Insofar as a matter is already covered by a collective wage agreement, as a rule this can no longer be the subject of a works agreement (priority of collective agreements). The works council is the statutory body representing the employees' interests and exercising the right of co-determination with respect to the employers.

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[46] Continued Payment of Wages Act of 26 May 1994 (BGBl. I p. 1065), last amended by Article 8 of the Law of 21 June 2012 (BGBl. I p. 1601).

[47] Maternity Protection Act in the version of the Announcement of 20 June 2002 (BGBl. I p. 2318), last amended by Article 6 of the Law of 23 October 2012 (BGBl. I p. 2246).

[48] Proof of Substantial Conditions Applicable to the Employment Relationship Act in the version of the Announcement of 20 July 1995 (BGBl. I p. 946), last amended by Article 3a of the Law of 11 August 2014 (BGBl. I p. 1348).

- Industrial Relations Act:
  Essentially, the Industrial Relations Act (*Betriebsverfassungsgesetz*, BetrVG)[49] regulates the rights of the works council. It establishes the rights of participation and co-determination of the works council in personnel, social and economic matters within the works.

II. Recruitment of employees

In Germany, the search for personnel is assisted, generally free of charge, by the Federal Employment Agency, which has agencies in all major German cities. Private employment agencies may also be used, though these charge agency fees. When looking for specialist personnel, it may also be possible to contact universities; there are also numerous internet employment exchanges in Germany.

III. The definition of an employee

The differentiation between employees and other personnel (such as commercial agents) is of great relevance as the protective regulations under employment law often only apply to employees. Employers are obliged to make contributions towards the social insurance of their employees, incurring extra costs (see XII. below). According to case law, employees are those persons who, on the basis of a private-law contract, are obliged to perform services in a relationship of subordination. The criterion of the non-independent nature of the services performed is of particular relevance here. These are classed as being non-independent if the employee is required to follow directions and is integrated into a third-party working organisation. In various areas of German employment law there is also still a distinction between workers and salaried employees, which in reality hardly plays any role nowadays. Originally, salaried employees were a smaller and more highly qualified group of employees as opposed to the broad majority of workers.

1. Executive employees

Executive employees (*leitende Angestellte*) are accorded a special role in Germany. They are at the top of the operational hierarchy, below the senior management, but are at the same time employees. Their status is unique because they are subject to direction as employees on the one hand but also exercise the functions of employers with respect to the rest of the workforce (management functions) on the other. The German legislator takes this special role into account in a number of ways:

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[49] Industrial Relations Act in the version of the Announcement of 25 September 2001 (BGBl. I p. 2518), last amended by Article 3 para. 4 of the Law of 20 April 2013 (BGBl. I p. 868).

- The law on public working hours is not applicable to executive employees.
- The regulations on the protection of employment apply less strictly to executive employees.
- Under the works constitution, executive employees are not represented by the works council, but can elect their own representative bodies (executives' representative committees).

2. Trainees

Persons taken on for occupational training (*Auszubildende*) are also classed as employees. Where no specific provision is made under the Occupational Training Act and the Protection of Young Persons in the Workplace Act, the relevant regulations on contracts of employment are applicable. In the case of trainees, the employment relationship is characterised by the purpose of training. The Occupational Training Act provides for special rules intended to ensure appropriate occupational training. However, a distinction should be made between trainees and volunteers, work experience employees and interns, to whom the Occupational Training Act does not apply.

3. Underage employees

The majority age in Germany is 18 years. A minor can only sign an employment contract with the consent of their legal guardian (usually father and mother). As a rule, no employment contract can be concluded with young persons below the age of 15, even with consent of a legal guardian.

IV. Conclusion and content of employment contracts

1. Form of the employment contract

An employment contract can be concluded verbally or in writing. If only a verbal employment contract exists, then the employer is, however, according to the Proof of Substantial Conditions Applicable to the Employment Relationship Act, obliged to provide the employee with a written copy of the essential conditions of the employment contract within one month following the beginning of the employment relationship. In view of this requirement, and in order to avoid problems relating to evidence in any court proceedings, the conclusion of a written employment contract is recommended.

2. Content of the employment contract

a) Limited-term and unlimited-term contracts

Under certain preconditions, limited-term employment contracts can be concluded. The permissibility and content of such employment contracts are regulated in the Part-time and Limited-term Employment Act. An effective limitation of term requires written form. The duration of a limited-term employment contract can be determined in terms of calendar months or according to the type, purpose or nature of the work performed. When an employer takes on a new employee, limitation of the term of their employment contract up to a maximum of two years is possible without stating grounds for the limitation of term. Where the limited term of the contract is longer than two years, however, the reason for the limitation must be set forth in writing. Permissible grounds for a limitation of term include

- temporary requirement;
- entry into a profession following training or study;
- the special nature of the employment (seasonal work);
- probation;
- special reasons associated with the person of the employee.

Moreover, limited-term employment contracts can be concluded without material grounds during the first four years of existence of a newly-founded company. The employee on a limited-term employment contract may not be placed in a worse position than employees employed for an unlimited period.

b) Part-time employment contract

Under the Part-time and Limited-term Employment Act, part-time employees may also not be placed in a position worse than full-time employees, unless there is a material reason for this. Unlike full-time employees, part-time employees must be paid pro rata, in accordance with their reduced working hours. The employer and employee should agree on part-time working if the employee wishes a reduction in working hours. The entitlement to part-time work only exists with respect to employers with more than 15 employees. The employer can deny the employee's request for part-time work on operational grounds. The Part-time and Limited-term Employment Act also stipulates that part-time employees who wish to change their working hours are to be informed of available part-time or full-time positions and given preference in the future filling of positions, unless this is not feasible due to important operational reasons or working

hour requests by other employees. Finally, employers must also advertise suitable positions as being part-time.

c) Probationary period

The agreement of a probationary period can be arranged through a limited-term employment contract (see point V.2.a) or through a probationary period clause in an unlimited-term employment contract. The probationary period in Germany lasts a maximum of six months. During the probationary period, the employment relationship can be terminated by either party on two weeks' notice, unless a longer period of notice is stipulated in a collective wage agreement, for example.

d) Duties and working location

The scope of the employee's duties, as well as their working location, should be specified in the employment contract. A redeployment of the employee in the form of an assignment abroad must be contractually agreed between employer and employee and cannot be ordered within the scope of the employer's managerial authority (see point VI.). The redeployment of an employee to another city (to perform an equivalent job) is also only possible if this has been agreed in the employment contract or collective wage agreement, or if the employee agrees to it. Redeployment within the same city is feasible as long as this does not involve undue hardship.

e) Working hours and overtime

The working hours are based on the provisions of the employment or collective wage agreement. When setting working hours, the stipulations of the Working Hours Act as well as the occupational health and safety regulations must be complied with. The occupational health and safety regulations include the Protection of Young Persons in the Workplace Act, the Maternity Protection Act and the Shop Closing Times Act. The Working Hours Act is based on the principle of an 8-hour work day. The daily working hours can be extended to up to ten hours if, within an equalisation period of six months or 24 weeks, the average daily working hours do not exceed eight hours. According to the statutory regulations on breaks, after a working period of more than six hours, a break period of at least 30 minutes must be provided for and a break of at least 45 minutes must be provided for after a working period of more than nine hours. The minimum break time can be divided into several smaller breaks, but each break must be at least 15 minutes. No employee can be required to work for longer than six hours without a break. Special protective regulations apply to employees who work at night. Working on Sundays and public holidays is—except in a few exceptional circumstances—not permitted. Moreover, in workplaces with a works council, this has a say in defining the beginning and end of the working day, the arrangements for breaks and the distribution of weekly working hours.

In order for the employees to be legally obliged to work overtime, employers require a basis of various enabling provisions. Thus, employees are only obliged to work overtime if this is stipulated in the collective wage agreement, a works agreement, an agreement in the employment contract, a practice within the workplace known to the employees, or, in emergencies, as an ancillary obligation on the part of the employee arising from the employment contract (duty of good faith).

f) Wages

Employees' wages are usually fixed through collective wage agreements or agreed upon in the employment contract, which refers to the wages defined in the collective wage agreement. The employer must withhold income tax, solidarity surcharge, church tax as well as the employees' social insurance contributions (health, pension, long-term care and unemployment benefit insurance). The employer must pass on these retained amounts to the relevant authorities. Also on the basis of collective wage agreements or agreements in the employment contract, employees are often entitled to non-cash benefits from the employer.

If the amount of the remuneration has not been fixed by the parties to the employment contract, the law in Germany provides for the 'usual remuneration', i.e. the remuneration which an equally qualified employee is paid in the industry and the region. In case of doubt, this is the wage according to the relevant collective wage agreement.

Throughout Germany, a statutory minimum wage of EUR 8.50 per hour must be paid as from 1 January 2015. There are still exemptions for some industries, which are planned, however, to expire in 2017. The Minimum Wage Act has no effect on higher remuneration entitlements under employment contracts or collective wage agreements.

g) Continued payment of wages in the event of illness

All employees and trainees, even those employed for short periods or on a part-time basis, are entitled to continued payment of their wages for a period of up to six weeks in the event of their being unfit for work through no fault of their own, provided they have been employed for a continuous period of four weeks.

The employee is obliged to notify the employer immediately of their unfitness for work and its anticipated duration. In the case of illness exceeding three days, the employee must submit an official sick note from a doctor no later than the following day.

h) Holidays

The legal national minimum holiday entitlement (paid holiday) is 24 working days in the calendar year, based on a 6-day work week. In the case of a 5-day working week, the

legal entitlement is reduced to 20 working days. It should be noted that the minimum holiday entitlement is often fixed through collective wage agreements which extend the holiday entitlement to approximately six weeks. Therefore, many employment contracts provide for such entitlements. Moreover, the legal minimum holiday entitlement is increased in the case of the seriously disabled. However, the minimum holiday entitlement only comes into effect after a waiting period of six months from the beginning of the employment relationship. In the case of an employment relationship which ends before six months have elapsed, the holiday entitlement is calculated pro rata according to actual full months of employment. The employee's preferences are to be taken into consideration in setting the date on which holidays are to be taken. However, this does not apply if urgent operational requirements do not allow this. The transfer of the holiday entitlement to the next calendar year is only permissible if justified by urgent operational reasons or reasons relating to the person of the employee. In this case holidays must be taken in the first three months of the following year.

3. Contracts of employment with directors (GmbH) and management board members (AG)

Directors and management board members are corporate bodies of the company who perform the functions of employers, and are therefore strictly not employees. The appointment of directors of a GmbH and management board members as corporate bodies of the company is an act under company law and must be distinguished from the conclusion of an employment contract. The employment contract governs the personal rights and obligations between the director/management board member and the company. A distinction must also be made between termination of office and termination of the employment contract. Relief from office, like voluntary retirement from office, is possible at any time and without statement of grounds, unless otherwise stipulated in the shareholders' agreement or in the articles of association. The termination of the contract of employment must take place separately. The legal literature and case law differ as to which employment law norms apply to the contract of employment of a director of a GmbH. Irrespective of whether the director of a GmbH is sometimes exceptionally classified as an employee, labour courts are strictly not responsible for legal disputes between the director and the company.

V. Management authority of the employer

An employment contract naturally cannot cover all details of an employment relationship. For this reason, the employer enjoys a legally certified management authority (right of direction) with respect to the employees. This management authority authorises the employer to determine what duties the employees are required to perform, when and where, and in what way. Moreover, the employer can stipulate the internal

workplace rules within the scope of their management authority, for example smoking bans, the obligation to wear protective clothing, etc. In addition to stipulations in the employment contract, the management authority is also limited through collective wage agreements or works agreements or through the rights of co-determination of the works council and through legislation.

VI. Protection against discrimination

In Germany, employees are comprehensively protected against discrimination on grounds of gender, sexual orientation, disability, race or ethnic origin, age, as well as religion and ideology, in particular through the General Equal Treatment Act (*Allgemeines Gleichstellungsgesetz*, AGG)[50] which came into force in 2006.

VII. Termination of employment relationships

1. Through limitation of term

An employment relationship automatically ends if the parties to the employment contract have agreed on a limited term or a condition for termination from the outset. Limited-term employment contracts end without termination on expiry of the agreed time or with achievement of the agreed purpose. The employer must notify the employee in writing of the end of a limited-term employment contract concluded for a fixed purpose two weeks beforehand.

2. On reaching retirement age

At present, an employee has the basic entitlement to the statutory old-age pension on reaching retirement age. As of 2012, the age limit or the reaching of retirement age will have to be calculated individually, since legislators will be increasing the retirement age, in stages and depending on the year of birth, from 65 to 67 years. There are also a number of special regulations for certain occupational groups, seriously disabled persons and others. However, this does not mean that an employment relationship automatically ends upon the employee reaching retirement age. In order to prevent an over-ageing of the workforce, in many companies collective wage agreements, works agreements or individual employment contracts do stipulate age limits on the basis of which the employment relationship ends on the employee reaching retirement age.

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[50] General Equal Treatment Act of 14 August 2006 (BGBl. I p. 1897), last amended by Article 8 of the Law of 3 April 2013 (BGBl. I p. 610).

3. Through a severance agreement

The severance agreement—the termination of the employment relationship by mutual agreement—is very popular in practice. In comparison to termination of employment (outlined in the next section), the severance agreement has the advantage that it avoids protracted and costly court disputes concerning the validity of the termination. Neither the law on the protection of employment nor the right of participation of the works council apply where a severance agreement is concluded. The severance agreement is popular with employees because it does not carry the stigma of dismissal and employees typically receive a payment as compensation for the termination of the employment relationship. However, the law stipulates certain conditions to be fulfilled to avoid a waiting period during which no unemployment benefit will be paid (e.g. due to leaving a job for no good reason). This needs to be taken into account when negotiating severance agreements.

Severence agreements are often signed after notice of termination has been given, governing the conditions of an amicable termination of the contract. If an employee files an action under the Protection of Employment Act[51], judicial conciliation may still be a route to reach agreement on the terms of an amicable termination of the contract.

4. Through unilateral termination

In the case of termination, one party to the employment contract unilaterally declares the termination of the employment relationship. Both parties have a right to termination, although stricter preconditions apply to the employer. Employment contracts can be terminated by giving notice of termination with the notice periods stipulated by the law or as agreed in the employment contract or collective wage agreement, or an extraordinary termination (without notice) can be declared if the contract is terminated for cause. The content of the notice of termination—in particular the time at which the employment relationship is to end—must be clear and unequivocal, since the terminating party will be held responsible for any uncertainties. Moreover, the notice of termination must be in writing and be delivered to the recipient. It is not necessary to state the reason for termination in the case of contractual termination, in the case of termination without notice this is only required at the demand of the employee or if this was stipulated in the employment contract, works agreement or collective wage agreement.

a) Contractual termination

Notice of contractual termination may be given only for an objective reason in order to be legally valid. However, insofar as the Protection of Employment Act applies in

[51] Protection of Employment Act in the version of the Announcement of 25 August 1969 (BGBl. I p. 1317), last amended by Article 2 para. 2 of the Law of 20 April 2013 (BGBl. I p. 868).

the case of termination by the employer, there must be a socially justifiable reason for a contractual termination. The required periods of notice must also be observed. Basically, the statutory period of notice that employer and employees must observe is four weeks, with the termination taking effect on the 15th of the month or the end of a calendar month. Depending on the duration of the existing employment relationship, the statutory period of notice is extended as follows:

Time with the company	Notice required
2 years	1 month with effect from the end of a calendar month
5 years	2 months with effect from the end of a calendar month
8 years	3 months with effect from the end of a calendar month
10 years	4 months with effect from the end of a calendar month
12 years	5 months with effect from the end of a calendar month
15 years	6 months with effect from the end of a calendar month
20 years	7 months with effect from the end of a calendar month

These periods of notice can be extended or reduced in collective wage agreements. The basic period of notice (four weeks with effect from the 15th of the month or the end of a calendar month) may be extended for termination by the employee, but must not exceed the notice period applying to the employer. The automatic extension of the basic notice period, as shown above, for notice given by the employee must be explicitly stated in writing in the contract.

As an exception, the basic period of notice does not apply in the case of temporary employment (three months), and in enterprises in which generally no more than 20 employees are employed. The period of notice during an agreed probationary period, lasting no longer than six months, is two weeks and can be reduced only through a collective wage agreement. Contractual termination is only possible in the case of limited-term employment relationships if this was agreed in accordance with the employment contract or collective wage agreement.

b) Extraordinary termination

There must be substantial grounds, i.e. 'cause', for extraordinary termination (without notice). Substantial grounds are constituted if it is unreasonable for the terminating party to continue the employment relationship until the end of the period of notice of termination. Extraordinary termination must be the very last resort for the terminating party if all less severe measures (warning, reassignment, contractual termination) have been exhausted. Both parties to the employment contract can declare extraordinary termination. Typical grounds for dismissal without notice by the employer include

- persistent refusal of work by the employee;

- feigned illness;
- betrayal of company and business secrets;
- suspicion of having committed a criminal offence.

Possible grounds for termination without notice by the employee include

- non-payment of employee's wages over a longer period;
- wilful or grossly negligent endangerment of the life and health of the employee;
- continuous and significant exceeding of the maximum legal working hours.

c) Hearing of the works council

If a workplace has a works council, it must be granted a hearing before any termination of employment by the employer. The works council can contest an extraordinary termination in writing within three days and a contractual termination within one week. The works council examines issues such as whether the employer has taken into consideration the employee's personal circumstances and whether employees might be able to remain employed in a different position within the company. Even if the works council contests a termination, the employer may still terminate the contract. The works council's objection does not render the termination invalid, but will have consequences in any subsequent legal action for unfair dismissal.

d) Protection of employment

In Germany, the regulations of the Protection of Employment Act impose a strict general protection of employment. This is intended to protect employees against unfair dismissal. A dismissal is fair if it is based on grounds which lie in the person or behaviour of the employee or result from urgent operating necessities which do not allow continuing employment with the company.

Unfair dismissal does not terminate the employment relationship. The employee concerned still has the right to be employed. German employment protection law does not provide for any unilateral termination of an employment contract by the employer and payment of a severance payment, except for contracts with executive employees. Nevertheless, severance packages can be agreed in settlement negotiations, and this is done frequently. Severance payments basically amount to 0.5 monthly salaries per year of employment. Depending on the circumstances of the individual case (chances of a court action for unfair dismissal to succeed, particularities of the specific case, economic strength of the company, etc.), the amounts actually agreed may deviate considerably from the above rule, though.

The Protection of Employment Act differentiates between employment relationships that commenced before and after 1 January 2004. If the employment relationship began on or after 1 January 2004, the Protection of Employment Act generally applies if more than ten employees (excluding trainees) are employed in the works. For employment relationships which already existed on 31 December 2003, the Protection of Employment Act applies if, as a rule, more than five employees were employed in the works at that time who are still employed in the works at the time of termination. The application of the Protection of Employment Act also requires that the employment relationship to be terminated has existed for longer than six months without interruption at the time of termination.

Contractual and extraordinary termination by the employer can be divided into three sub-categories according to the grounds for termination: termination on personal grounds, termination on grounds of behaviour and termination on operational grounds.

e) Termination on personal grounds

In the case of termination on personal grounds, there must be objective grounds in the person of the employee, for example physical or intellectual unsuitability or a decline in performance. The most frequent case of termination on personal grounds is termination due to illness on the part of the employee. However, case law imposes strict requirements in terms of the justification of termination on grounds of illness. Alcohol dependency or other addictive conditions can also justify a termination on personal grounds.

f) Termination on grounds of behaviour

Termination on grounds of behaviour is possible if the employment relationship is affected through the behaviour of the employee, in particular in cases of culpable breach of contract, for example refusing to perform particular tasks, falsifying expenses, or insulting colleagues or superiors. Before termination on grounds of behaviour takes place, the employee must always be given an official warning. In this warning, the employer outlines the offensive behaviour and points out that the employee can expect to be dismissed in the event of any repetition. There are very few cases where a termination on grounds of behaviour without notice can be valid.

g) Termination on operational grounds

Termination on operational grounds by the employer is a frequent case of termination. Prerequisites include operational necessities which justify the loss of the job and thus termination of employment. Termination on operational grounds typically results from a decline in business (decrease in orders or sales) or due to an organisational action on the part of the employer (reduction in size or closure of the works or a change of production method). The corporate decision to restrict or reduce productivity of operations is not subject to review by the courts. However, in case of dispute, the employer

must prove that the position of the employee who has been made redundant was lost as a result of the corporate measure. If urgent operational requirements necessitate staff cutbacks and if several comparable employees are in line for termination on operational grounds, the employer then must make a decision based on social criteria. This involves examining which employee would suffer least hardship through loss of their job, taking into consideration the amount of time they have spent with the company, their age and family commitments (as well as any serious disability). This employee will be given notice of termination. A works agreement can also stipulate how to assess the social criteria in such cases. In certain situations, it is possible to agree a so-called 'list of names' with the works council. Such document lists the names of the employees to be given notice of termination, which makes things clearer should legal action for unfair dismissal be taken later.

h) Special protection of employment

In addition to the general protection of employment, a special protection of employment arising from various different laws applies to groups of persons requiring special protection. For example, the following employees enjoy special protection of employment:

- pregnant women and mothers up to four months following delivery;
- employees during parental leave;
- severely disabled persons;
- works council members.

These employees are subject to a prohibition of termination of employment, or rather their employment may only be terminated in exceptional cases and is subject to the approval of state authorities.

VIII. Co-determination by employees

1. Co-determination within the workplace

The term co-determination (*Mitbestimmung*), within the context of the workplace, covers the legal provisions concerning the rights of co-determination of employees within a workplace, based on the Industrial Relations Act and the Executives' Representative Committee Act (*Sprecherausschussgesetz*, SprAuG) (for executive employees)[52].

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[52] Executives' Representative Committee Act in the version of the Announcement of 20 December 1998 (BGBl. I p. 2312, 2316), last amended by Article 222 of the Regulation of 31 October 2006 (BGBl. I p. 2407).

a) Industrial Relations Act

The Industrial Relations Act from the year 1972 governs the works constitution, i.e. the fundamental code of industrial cooperation between employers and employees. In particular, it provides employees with a right of co-determination on the part of the works council in social, personnel-related and economic matters relating to the works.

b) Works council

Works councils are elected in works with more than five permanent employees who are entitled to vote, at least three of whom are electable. If these prerequisites are met, the employees do not only have the right to elect a works council, but the law actually assumes that a works council is, in fact, set up. However, there is no obligation to have a works council. This decision is at the sole discretion of the employees of a given workplace. The works council represents the employees in the works and represents the interests of the employees with respect to the employer. The individual responsibilities and powers of the works council are set forth in the Industrial Relations Act.

2. Board-level representation

In contrast to co-determination in the workplace, board-level representation involves not the formation of a co-determination body, but representation within existing corporate bodies (in particular in the supervisory board) through employees' representatives and thus the possibility of influencing corporate decisions.

The legal basis for board-level representation includes the Co-determination Act, which applies to all corporate entities with more than 2,000 employees. In the companies covered by the Co-determination Act, representatives of the shareholders and representatives of the employees each make up half of the members of the board. The employees' representatives are elected by the company's employees.

For companies within the mining industry as well as the iron and steel industry, the rights of representation within the corporate bodies are set forth in the Mining and Steel Industry Co-determination Act.

The One-Third Participation Act applies to corporate entities with fewer than 2,000 but more than 500 employees. This law stipulates that one third of seats on the supervisory boards of companies must be occupied by employees' representatives.

IX. Collective employment law

1. Trade unions and employers' associations

The constitutionally protected trade unions and employers associations are of great importance in Germany. Around 20% of all German employees are members of a trade union, and collective agreements apply in 50% of West German companies in contrast to only 32% of East German companies. These figures, however, should not be misunderstood to suggest that more than half of all German employees are paid wages below collective agreement standards. In particular larger companies are subject to collective wage agreements. Companies that are not bound by collective wage agreements often pay wages and offer benefits provided for in collective agreements. Trade unions and employers' associations play an important role in shaping employment and economic conditions in Germany. This takes place above all through the conclusion of collective wage agreements, which can also be brought about through industrial dispute measures (in particular strikes). In addition, they advise and support their members and participate in the processes of legislation and government administration.

The trade unions are primarily organised according to branches of industry. A few of the most important trade unions which are members of the Confederation of German Trade Unions (*Deutscher Gewerkschaftsbund*, DGB, 6.1 million members) as umbrella organisation are:

- the industrial unions — approx. 2.9 million members
  (*IG Bergbau, Chemie, Energie; IG Metall*; etc.)

- the United Services Union — approx. 2 million members
  (*Vereinte Dienstleistungsgewerkschaft*, ver.di)
  ver.di is the world's biggest individual union

The employers' associations are also organised according to the industry federation principle. The common umbrella organisation is the Confederation of German Employers' Associations (*Bundesvereinigung der Deutschen Arbeitgeberverbände*, BDA).

2. Collective wage agreements

The collective wage agreements contain legal norms which regulate the content, conclusion and termination of an employment relationship as well as questions relating to the workplace and industrial relations.

The non-mandatory statutory law allows partners in a collective wage agreement to agree to different arrangements—both to the advantage and to the disadvantage of

the employees. The provisions set forth in a collective wage agreement apply directly and in mandatory form to an employee if they are a member of a trade union and the employers themselves have concluded a collective wage agreement or are a member of an employers' association which concludes collective wage agreements in their name. In addition, the application of a collective wage agreement or individual provisions of a collective wage agreement can be agreed between the employer and the employee in the employment contract. In practice, where collective wage agreements are implemented, employees who are not organised into trade unions are usually treated in exactly the same way as unionised employees. However, there is no legal entitlement to such treatment.

A distinction can be made between the following types of collective wage agreement: fundamental questions, e.g. general working conditions such as holidays and working hours, are regulated in an industry-wide collective agreement. In a framework collective agreement, employees are grouped into wage and salary groups. The regional collective agreement applies to a regionally limited area and the 'in-house' or 'company collective agreement' applies to an individual company.

3. Works agreements

Works agreements are very widely used in German companies. They are concluded in writing between the employer and the works council and are an important instrument in joint decision-making. Works agreements are subordinate to the collective wage agreements and therefore may not cover areas which have already been covered through collective wage agreements. Works agreements contain norms regarding questions relating to the workplace and industrial relations. Typically, the so-called workplace rules are also formulated through works agreements. For example, works agreements cover

- rules on the distribution of working hours;
- basic rules on holidays;
- arrangements concerning the use of technical monitoring equipment.

Works agreements apply directly and in mandatory form to all employees in the workplace.

X. Employment disputes

The labour courts are fundamentally responsible for employment disputes. The procedure followed before German labour courts is set forth in the Labour Courts Act

(*Arbeitsgerichtsgesetz*, ArbGG)[53], which makes a distinction between judgment and decision proceedings. Judgment proceedings are all individual legal proceedings, i.e. legal disputes between employees and employers arising from the employment relationship. In the judgement proceedings, a conciliation hearing takes place first, the aim of which is to arrive at an 'amicable' settlement of the legal dispute. Decision proceedings take place in matters arising from the Industrial Relations Act and the Co-determination Acts. These are also referred to as collective proceedings. Geographically, the labour court within whose district the respondent has their registered office has jurisdiction. The labour court consists of a presiding full-time judge and two lay judges representing employees and employers. Each of the three judges has the same voting right. It is possible to appeal against judgments by the labour court before the regional labour court. The regional labour court also rules on appeals against the decisions of the labour court. There is one regional labour court in all federal regions, the only exceptions being North Rhine-Westphalia (3) and Bavaria (2) as well as Berlin and Brandenburg regions (having a joint labour court). Appeals against the decisions of the regional labour courts can be lodged with the Federal Labour Court (*Bundesarbeitsgericht*) based in Erfurt.

A particularity of proceedings before labour courts is that both parties have to bear their own costs of first instance, irrespective of the outcome of the proceedings.

XI. Basic principles of German social insurance law

Social security in the Federal Republic of Germany is largely organised in the form of a contributions system in which the risks to be insured are borne collectively by all insured persons. Irrespective of their individual income and contributions, all insured persons are largely and comprehensively protected against various life risks. The vast majority of the German population are insured, on a voluntary or compulsory basis, under the social insurance system.

Most of them are gainfully employed. Under the system, employers and employees pay half of the social insurance contributions. The employer does not only withhold and pay the wage tax, but also withholds the employee's share of the social insurance contributions, adds the employer's share and then pays the full amount to the competent social insurance carriers. The employee and the employer each pay a sum equalling approximately 20% of the employee's gross salary.

The system is essentially based on five columns:

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[53] Labour Courts Act in the version of the Announcement of 2 July 1979 (BGBl. I p. 853, 1036), last amended by Article 2 of the Law of 11 August 2014 (BGBl. I p. 1348).

1. Health insurance

The benefits under the statutory health insurance system (*Krankenversicherung*) are essentially intended to maintain, restore or improve the health of the insured persons. The range of functions is diverse and ranges from preventive measures, treatment of the sick and rehabilitation to the payment of sickness benefits, pregnancy benefits and maternity protection as well as necessary medical care during travel abroad.

All German employees are fundamentally required to take out insurance if their monthly gross salary does not exceed a maximum limit which is adjusted each year (EUR 4,125 in 2015). If their monthly income exceeds the threshold value, employees can choose whether they wish to insure themselves through the statutory scheme or through a private health insurance scheme. Even if an employee is insured under a private scheme, the employer will pay a portion of the contributions.

Since 1 January 2015, the standard contributions rate under the statutory health insurance system is 14.6% of the employee's monthly gross wages which are subject to social insurance contributions. The employer and the employee each pay half of the contributions.

2. Long-term care insurance

This insurance offers its beneficiaries protection against the financial consequences of a need for long-term care and in this event provides assistance and nursing services. However, long-term care insurance (*Pflegeversicherung*) is not a full insurance which makes contributions by the insured persons and other agencies unnecessary. According to the legal definition, insured persons are classed as being in need of care if, due to a physical, mental or emotional disorder, they require significant assistance in performing everyday tasks on a long-term basis, i.e. in all likelihood for at least six months. The degree of the need for care is determined by the medical service of the health insurance organisation. The legislator has provided for three levels of long-term care:

- care level I = significantly in need of care;
- care level II = severely in need of care;
- care level III = most severely in need of care.

However, claimants are only entitled to benefits under the long-term care insurance if they were insured under a long-term care insurance scheme for at least five years before making the application (waiting period). Long-term care insurance is a compulsory insurance policy and is linked to health insurance. Anyone who has statutory

health insurance also belongs to the associated long-term care insurance scheme. Voluntarily insured persons must take out private long-term care insurance.

The financing of long-term care insurance is, as in the case of health insurance, borne equally by the employee and the employer. The contribution rate is fixed by law and, as of 1 January 2015, amounts to 2.35% of the monthly gross wage, the ceiling being the same as for statutory health insurance contributions. As from of the age of 23, employees who have no children pay a supplementary contribution of 0.25%.

3. Pension insurance

As a wage substitute, the payment of old-age pensions, reduced capacity pensions as well as survivors' pensions are among the central functions of pension insurance (*Rentenversicherung*). The scope of benefits depends on the amount of the contributions paid in. A precondition for receiving an old-age pension following retirement is reaching the statutory age limit, 65 years until 2011. In view of increasing life expectancy, a gradual adjustment to 67 years has started in 2012. The regular retirement age of employees born after 1963 will be 67. Currently, it is possible to retire at age 63 if pension insurance contributions have been paid for 45 years. However, this age limit is also gradually increased. A pension can also be applied for earlier if the applicant is seriously disabled or has worked in certain occupations.

The pension insurance covers rehabilitation measures and also promotes social involvement. As well as the provision and financing of treatment or retraining intended to counteract, prevent or overcome reduced capacity to work, the pension insurance pays out to compensate for reduced earning capacity if an employee is no longer able to work regularly.

The statutory pension insurance is primarily financed through the contributions of the contributors, employees and employers. Both pay half of the contribution rate applicable to employees (currently 18.7% of gross wages). There is an income ceiling for compulsory pension insurance contributions, which currently is EUR 6,050 in West Germany and EUR 5,200 in East Germany (1 January 2015).

4. Unemployment insurance

In Germany, all persons who do more than a minimal amount of paid work are strictly obliged to contribute to the statutory unemployment insurance scheme (*Arbeitslosenversicherung*). As a rule, employees and employers pay half of the contribution towards job creation measures; the remaining financing comes through levies, government funding, voluntary additional insurance contributions as well as other sources

of income. The contribution rate is currently 3% of the employee's gross wages, the ceiling being the same as for statutory pension insurance contributions.

Examples of the benefits and services funded through unemployment insurance include

- payments in case of unemployment;
- job-seeking advice and support;
- finding jobs for claimants;
- providing assistance for persons starting a business.

5. Accident insurance

The statutory accident insurance (*Unfallversicherung*) is a form of third-party liability insurance for employers. If employees suffer an occupational illness or an accident during performance of their work, including the way to or from work, this is covered by the statutory accident insurance. The central functions are the prevention of accidents at work and occupational illnesses as well as work-related health risks by providing advice to companies in all areas of health and safety. Other benefits include restoring the health and capacities of employees following accidents at work or occupational illnesses and compensating the insured persons or their surviving dependents through monetary benefits. Employers are required by law to participate in and, unlike other types of insurance, pay the contributions on their own. The amount of the contributions is determined through an annual assessment procedure on the basis of previous average requirements and the actual contributions vary greatly depending on the industry of the employer.

F. Overview of the German tax system

I. Overview

The German tax system comprises two basic tax categories: direct and indirect taxes. For direct taxes, the taxable entity also bears the tax burden, e.g. income tax, corporation tax and trade tax.

For indirect taxes, the tax debtor transfers the tax burden to a third party. The most important indirect tax is value added tax. In the case of value added tax on the supply of goods and services by entrepreneurs, the latter will usually pass the value added tax incurred on to the end user through a correspondingly higher selling price. Indirect taxes further include, in particular, excise taxes such as the tax on mineral oil and on tobacco.

II. Types of tax

1. Income tax

The German Income Tax Act (*Einkommensteuergesetz*, EStG)[54] covers seven different types of income: income from agriculture and forestry, income from business, income from self-employment, income from employment (wages and salaries), income from capital investments, income from rental and leasing and other income. Any accrual of amounts not falling under one of these seven categories is not subject to German income tax.

a) Unlimited tax obligation

Natural persons who have either their domicile or their usual place of residence in Germany have an unlimited obligation to pay income tax. This means that all their net worldwide income is taxed in Germany, irrespective of the country in which the income was generated. There may be exceptions to this general principle under double taxation agreements.

For the purposes of German national tax law, a natural person is considered to have their domicile in Germany if they own a home that they obviously wish to keep and

[54] German Income Tax Act in the version of the Announcement of 8 October 2009 (BGBl. I p. 3366, 3862), last amended by Article 2 para. 7 of the Law of 1 April 2015 (BGBl. I p. 434).

use. It should be noted in this context that even people having a secondary residence or a holiday home may be deemed to have their domicile in Germany, which will lead to unlimited taxation in Germany.

Under taxation legislation, a natural person is considered to have their usual place of residence in Germany if circumstances indicate that the residence is not simply of a temporary nature. However, the law presumes that a natural person has their usual place of residence in Germany if they remain there permanently for a period of more than six months.

The above definitions of domicile and usual place of residence may be superseded by definitions in double taxation agreements. This needs to be examined on a case-by-case basis.

(1) Tax assessment basis and assessment of taxable income

The tax assessment basis is the natural person's net worldwide income. In order to calculate this, the natural person's income from all sources is first assessed and then subdivided into individual types of income. In a next step, the costs linked to the various incomes, specifically operating expenses or other tax allowable costs, are deducted from the individual forms of income. Finally, all net amounts of the individual types of income are combined into a total which, following further deductions such as special expenses and extraordinary burdens, ultimately forms the assessment basis for the applicable tax rate in the form of 'taxable income'. Only investment income is exempt from this net balance; this is determined separately and is subject to the special tax rate of flat rate withholding tax.

(2) Tax rates

The taxable income of unlimited taxpayers—with the exception of investment income—is subject to a progressive tax rate. The following tax rates applied for the tax year 2014:

Income below EUR 8,354 p.a. is exempt from income tax. The tax rate for income between EUR 8,355 and EUR 52,882 rises progressively from 14% to 42%. The tax rate of 42% also applies to income between EUR 52,882 and EUR 250,730. If the total income exceeds EUR 250,730, the amount of income exceeding EUR 250,730 is taxed at the maximum tax rate of 45%.

The withholding tax on dividends charged on investment income of natural persons is charged at a flat rate of 25% and is, in most cases, already deducted at source by the respective debtor. The flat rate taxation is linked to the prohibition of a deduction of investment income-related expenses. Investment income taxed at source does not have be included in the tax return. However, it may be advisable to declare such

investment income (e.g. for the assessment of losses, crediting of foreign taxes or in the event of an applicable overall tax rate of less than 25% in individual cases). Investment income that is not taxed at source must be included in the tax return.

Couples (and civil partners) who are both subject to unlimited taxation in Germany may reduce their tax burden through splitting income taxation (joint assessment). In such cases the income earned by the spouses is taxed as follows: At first the tax rate applicable to half of the joint income is determined. Then the full joint income will be taxed at this reduced rate.

In addition, a solidarity surcharge (*Solidaritätszuschlag*) in the amount of 5.5% of the income tax is levied.

b) Limited tax obligation

Natural persons who have neither their domicile nor their usual place of residence in Germany are subject to a limited tax liability, i.e. they are only taxed in Germany on certain income originating from German sources.

(1) Tax assessment basis and assessment of the taxable income

Income is usually classed as domestic income subject to a limited tax liability if the income has a particularly close connection with Germany, e.g. income from a commercial operation which can be assigned to business premises in Germany, or income derived from letting property holdings located in Germany. In assessing the taxable income, in principle any operating or other expenses can that are connected economically with domestic income can be deducted. In the case of taxpayers with limited tax liability, the deduction of special expenses is severely restricted, whereas the deduction of extraordinary charges is prohibited completely.

(2) Tax rates

For taxpayers with limited tax liability, the same tax rates as those described above for taxpayers with unlimited tax liability generally apply, but no basic exempted amount is allowed.

It should be noted that various forms of domestic income of a taxpayer with limited tax liability such as wages, dividends, remunerations for licensing rights or other rights of use and payments e.g. to supervisory board members are subject to a German taxation at source of 15% to 30%. In general, the German revenue authorities retain these withholding taxes at certain fixed tax rates—irrespective of the individual tax rate of the limited tax liability taxpayer—since in most cases the retention of withholding tax is definitive with respect to limited tax liability taxpayers. However, where a double taxation agreement restricts Germany's right

to tax at source, a taxpayer with limited tax liability may be entitled to a refund or offset of the excess withholding tax paid in Germany. According to the European Union Savings Directive (Council Directive 2003/48/EC), the same applies to certain investment income. In certain cases, the withholding tax may be reduced at source. A reduction of the withholding tax requires that the taxpayer must apply for certain concessions.

2. Corporation tax

Corporations are independent taxable entities. Accordingly, the taxable income is determined on the level of the corporation and it is also the corporation which is liable for tax.

a) Unlimited tax obligation

Corporations which have either their management or their registered office in Germany are subject to an unlimited tax obligation.

(1) Tax assessment basis and assessment of the taxable income

The tax assessment basis for corporations with unlimited tax liability is their net worldwide income. It should be noted that the income of a domestic corporation (especially a GmbH or AG) is classified by law as business income, irrespective of the business activity that is conducted by the corporation. This means that corporations are automatically subject to trade tax, on the sole ground of their legal form.

Pure asset management companies may avoid all or part of the trade tax through reduction rules (e.g. real estate leasing companies).

All income from business operations of a domestic corporation must be included in the assessment of the taxable income. However, there are various exceptions:

- Dividends received from other corporations are excluded from the taxable income if the corporation holds an interest of at least 10% in the corporation distributing the dividends (otherwise, dividends received from other corporations will not be excluded from the taxable income). However, 5% of these dividends count as non-deductible operating expenses, which means that, in economic terms, 5% of the dividends paid out to the corporation are taxed. Thus, in practice, 95% of the dividends are exempt from German corporation tax. This basically also applies to trade tax with a few modifications that need to be examined on a case-by-case basis. This tax exemption does not apply to dividends from shares that are held as part of current assets or belong to the trading books of banking institutions. The details need to be examined on a case-by-case basis.

- Profits from the sale of a shareholding in another corporation are also usually tax-free; again, however, 5% of the profit on the sale is classed as non-deductible operating expenses, meaning 5% of the profit on the sale is taxed. In 2013, dividends from free float shares became subject to taxation. There are plans to also tax profits from a sale of free float shares (i.e. from shares below 10%) in the future.

All operating expenses associated with the generation of the income can be deducted from the income of the corporation. Deductible operating expenses include

- wages and salaries of employees of the corporation, including management board salaries;

- depreciation: in general, economic assets can be written off using a linear scale (i.e. in equal parts) over the usual service life. If the economic assets involve property, the amount of depreciation is 3% of the acquisition costs annually (2% or 2.5% for residential buildings);

- financing costs such as interest which were paid on a loan taken out for business purposes. However, under the 'earnings stripping rule' the deduction of interest can be restricted in exceptional cases if, in principle, the negative interest balance (interest expenses minus income from interest) exceeds the amount of EUR 3 million. In this case, no more than 30% of the corporation's tax EBITDA is deductible, though the remaining non-deductible interest can be carried forward. In terms of trade tax, 25% of all financing costs are non-deductible, which leads to an effective trade tax burden on the financing expenses of approx. 3.25% to 4.25%. Other expenses, such as rent or payments for licence rights, can—despite their 'expense' nature—effectively lead to trade tax burdens of up to 2%.

(2) Tax rates

German corporations are currently subject to a standard corporation tax rate of 15% plus a solidarity surcharge of 5.5% on the corporation tax, resulting in a total burden of 15.825%. In addition to this, there is a locally variable trade tax of around 14% to 17%, so that the nominal overall tax comes to around 30% to 33%.

b) Limited tax obligation

Corporations which have neither their registered office nor their management in Germany are subject to a limited corporation tax obligation.

(1) Tax assessment basis and assessment of the taxable income

Like natural persons subject to a limited tax liability, foreign corporations are only taxed in Germany on any income originating from German sources.

However, in contrast to German corporations, the income of foreign corporations is not, by law, automatically classified as income subject to trade tax. This requires that the foreign corporation maintains a business establishment in Germany.

(2) Tax rates

Corporations with a limited tax liability are also subject to corporation tax at a standard rate of 15% plus a solidarity surcharge of 5.5% on the corporation tax, resulting in a total burden of 15.825%. If permanent business establishments are maintained in Germany, local trade tax of approx. 14% to 17% is also applicable, so that the nominal overall tax burden is, as in the case of a corporation with unlimited tax liability, around 30% to 33%.

3. Withholding tax

a) Income subject to taxation at source

Various forms of income from German sources, such as wages and salaries, dividends or certain interest payments, are subject to German withholding tax. This applies to both taxpayers who are domiciled in Germany and taxpayers who are not domiciled in Germany. In general, the German fiscal authorities may initially retain these withholding taxes at certain fixed tax rates; in the case of taxpayers with unlimited tax liability, these withholding taxes are regularly deducted in the assessment procedure. Only the flat rate withholding tax on investment income of 26.375% is compensatory.

Even if a taxpayer is not domiciled in Germany but generates income in Germany, German regulations on taxation at source remain unaffected, even where a double taxation agreement or the EU Parent-Subsidiary Directive (Directive 2011/96/EU) apply. As a rule, taxation at source is definitive, there will be no assessment. Insofar it should be noted that full or partial exemption from German taxation at source always follows a formal exemption procedure. Domestic taxpayers under an obligation to pay withholding tax may make use of exemptions only once they have received a final exemption certificate issued by the German authorities. If withholding tax was paid although the German revenue authorities should not have taxed at source under double taxation agreements or Community law, a refund procedure must be initiated.

It should also be noted that Germany is very strict when it comes to concessions in respect of withholding tax. In individual cases, the granting of concessions under a double taxation agreement or Community law may be refused on the basis of a regulation known as the ‘anti-treaty shopping’ or ‘anti-directive shopping’ rule.

The aforementioned scenario and steps that can be taken to avoid an overpayment of tax in Germany are outlined in the following example of a dividend payment by a German corporate entity to an investor domiciled abroad.

b) Example

Payment of a dividend by a German corporate entity to a shareholder domiciled abroad.

(1) German tax law

Insofar as the dividends are paid to a foreign corporation or a foreign natural person, the German corporate entity paying the dividends is obliged to withhold 26.375% capital gains tax and pay the tax to the relevant authority. However, German law provides for a refund of $^{2}/_{5}$ of the tax if the foreign corporation is a shareholder of the German entity, so that the remaining taxation at source would be 15%.

(2) Community law

If the prerequisites of the EU Parent-Subsidiary Directive are fulfilled, the dividends paid may be completely exempt from capital gains tax. This requires a minimum holding percentage of 10% in a non-tax exempt company domiciled in the EU (or the EEA). A formal exemption procedure needs to be followed, during which the responsible authority checks whether the strict requirements (see point a) above) have been met.

(3) Double taxation agreements

Under German double taxation agreements, as a rule, dividends paid by a German corporate entity to a person domiciled in the country that is party to the agreement may be taxed in both countries. However, the German tax rate must not exceed 5% or 10% of the gross dividend if the dividend is received by a company holding an interest of 10% or more in the German corporate entity. In all other cases, including natural persons as recipients of the dividends, the German tax must, as a rule, not exceed 15%.

The reduction of the capital gains tax rate to the relevant 'treaty rate' also requires a formal exemption procedure to be followed. If the full tax amount was withheld, a refund can be claimed through another formal procedure. In both cases, the competent authority will in particular examine whether the strict requirements (see point a) above) have been met. Essentially, the foreign company has to prove that it pursues a sustainable business and is not simply used as an 'empty shell' to reduce taxation at source.

4. Taxation of permanent establishments

a) German tax law

The German Tax Code (*Abgabenordnung*, AO)[55] defines 'permanent establishment' as any fixed place of business or facility serving the business of an enterprise.

According to the German Income Tax Act, income attributed to the German permanent establishments of a foreign company are qualified as domestic income from business operations and are therefore subject to German income or corporation tax.

Accordingly, the permanent establishments of a foreign corporation are subject to corporation tax in the amount of 15% plus solidarity surcharge of 5.5%, i.e. in total 15.825%. If the German permanent establishment belongs to a foreign natural person, then the income tax in Germany is subject to a progressive tax rate of 14% to 45% plus solidarity surcharge of 5.5%, without any tax-exempt amount. In addition, the income of German permanent establishments is subject to trade tax at around 14% to 17%, depending on their location.

Germany has implemented the so-called 'authorised OECD approach' and, as a result, a permanent establishment is treated as a separate and independent enterprise for the purposes of transfer pricing tax rules, insofar ignoring the fact that a permanent establishment in legal terms is a dependent business unit of a company.

b) Avoiding double taxation

To avoid double taxation, many tax treaties or double taxation agreements address this issue. In terms of a double taxation agreement, the term 'permanent establishment' generally refers to a permanent business establishment in Germany through which all or part of the business of a company is conducted. This is often the case if a management office, a branch establishment, an office or a production facility is located in Germany.

According to many double taxation agreements, company income can generally be taxed in the country in which the company is located. However, insofar as the company conducts its business activities in a country through permanent establishments located there, the income is taxed in the country in which these establishments are located.

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[55] German Tax Code in the version of the Announcement of 1 October 2002 (BGBl. I p. 3866; 2003 I p. 61), last amended by Article 2 of the Law of 22 December 2014 (BGBl. I p. 2417).

5. Taxation of partnerships

a) German tax law

According to German tax law, partnerships are not treated as separate tax entities, but are deemed as being transparent in tax terms, with the exception of trade tax and VAT. This means that only the partners in the partnership are subject to income or corporation tax. Accordingly, the partners in the partnership are themselves liable to pay income or corporation tax on the income attributable to them. However, the income is determined at partnership level and the income so determined will form the basis on which the (prorated) taxes to be paid by the individual partners are assessed.

For natural persons there is the possibility to apply for those profits which are not withdrawn to be taxed at the reduced tax rate of 28.25% (plus solidarity surcharge). In the event of these amounts being withdrawn later, a supplementary taxation of 25% (plus solidarity surcharge) applies. Due to this later supplementary taxation, such a procedure is really only worthwhile in the case of very high income from the company and with relatively long reinvestment periods (interest effect).

b) Avoiding double taxation

The treatment of partnerships in terms of taxes may lead to difficulties where double taxation agreements exist. In Germany, partnerships are fundamentally treated as being 'transparent' for many tax purposes (with the exception of value added tax), meaning each partner is taxed individually on their share. It should also be noted that certain income and expenses incurred by the partners themselves in connection with the partnership, are directly attributed to the partnership for German taxation purposes. Therefore, it is important to identify differences in the tax treatment of partnerships in advance. In such cases, double taxation (or other undesired taxation) can be avoided by an appropriate design of the partnership.

Germany has implemented the so-called 'authorised OECD approach' and, as a result, partnerships are treated as a separate and independent entity for the purposes of transfer pricing tax rules.

6. Value added Tax

a) Subject of the tax

Value added tax (*Umsatzsteuer*, USt) is charged on the following transactions:

- delivery or other performance by an entrepreneur within the country in return for payment;

- the import of objects from third-party countries into the country (= any country which is not an EU member);

- intra-EU acquisition within the country in return for payment;

Essentially, the taxability of a turnover in Germany depends on whether the delivery or other service takes place in Germany according to the applicable regulations on the determination of location.

As a rule, value added tax is owed to the tax authorities by the party performing the service or delivery. In certain constellations, however, it is the responsibility of the recipient of a service or delivery to withhold and pay the value added tax to the tax authorities (e.g. when buying property or receiving deliveries or services from entrepreneurs who are not domiciled in Germany). This is called the 'reverse charge' and the recipient will be held liable for payment of the tax.

German VAT law is increasingly influenced by European legal standards. In view of the existence of a single European market (free movement of goods and services) these standards are of great importance and often dealt with by the European Court of Justice.

b) Tax assessment basis

Value added tax is charged on the basis of the payment, i.e. the value of the consideration for the delivery or other service, with the value added tax itself not being taken into account when assessing the value of the consideration.

c) Tax rate

The general value added tax rate in Germany is 19%. In addition, a reduced rate of 7% applies to certain transactions—for example the delivery of basic foodstuffs.

d) Tax exemptions

Certain transactions are completely exempt from value added tax, such as the sale of property holdings, the letting and leasing of property holdings, the granting of loans, and doctor's services.

e) Input tax

If goods or services are provided by one entrepreneur to another entrepreneur for their company, the entrepreneur receiving the goods or services has the possibility to reclaim the value added tax in the form of input tax from the revenue authorities, as long as they have received an invoice for the goods or services in question duly made

out by the entrepreneur providing the goods or services. Basically, value added tax between business entities is therefore effectively neutral. However, a refund of input tax is excluded if the entrepreneur receiving the goods or services in turn uses them for tax-exempt turnover.

7. Trade tax

German business enterprises are generally subject to a trade tax (*Gewerbesteuer*) at an effective rate of 14% to 17%, depending on the municipality in which the business enterprise is based or maintains a permanent establishment.

The assessment basis for trade tax is initially determined in accordance with the provisions of the Income Tax Act or the Corporation Tax Act (profit = trade earnings) and is subject to certain trade-tax modifications in a next step. In particular, financing costs are effectively taxed with a trade tax burden of 3.25% to 4.25% as a result of add-backs. However, other expense items, such as rent payments for immovable or movable economic assets or licence payments, may effectively be charged with a trade tax of up to approx. 2%. Conversely, the simple administration of properties by companies can, under certain preconditions, be completely exempt from trade tax.

Foreign companies are not subject to any trade tax in Germany as long as they do not maintain any permanent establishment in Germany.

8. Property transfer tax

Property transfer tax (*Grunderwerbsteuer*) is charged on various transactions in connection with property located in Germany. These include

- the acquisition of property (asset deal);
- a change in partnership interests of 95% or more in relation to the shares in a partnership within a 5-year period if the partnership's assets include property assets in Germany (share deal);
- at least 95% of the shares in a corporate entity coming to be held by a single shareholder or controlling and controlled undertakings, if the corporation's assets include property assets in Germany (share deal).

With respect to share deals, it should be noted that it is not only the legal transfer that matters. Since 2013, the economic transfer of 95% or more of the shares has been considered to be a transaction subject to property transfer tax as an attempt of the

German legislator to prevent an excessive use of the so-called RETT blocker structures. There are still many details to be worked out.

The rate of property transfer tax is between 3.5% and 6.5% and, as a matter of rule, is charged on the basis of the purchase price paid to the seller. If there is no purchase price, the assessment basis is determined according to a special 'standard value' which often is considerably lower than the fair market value. In principle, both the seller and the purchaser are joint and several debtors in terms of the property transfer tax; in practice, the property transfer tax burden is transferred contractually to the purchaser. If at least 95% of the shares in a partnership are transferred (see above, point two), the partnership itself must pay the property transfer tax. If all the shares come to be owned by one person, the tax is owed by the purchaser.

9. Inheritance and capital transfer tax

Inheritance or capital transfer tax (*Erbschaft- und Schenkungsteuer*) is charged on the basis of the Inheritance Tax Act (*Erbschaftsteuergesetz*, ErbStG)[56]. The provisions of the law have repeatedly been subject to review by the Constitutional Court. The latest reform of inheritance law in 2009 has also been the result of an earlier objection raised by the Constitutional Court. In 2014, the Constitutional Court once more found parts of the Inheritance Tax Act to be non-compliant with the Constitution, notably the special rules governing operating assets explained in point e) below. The legislator will now have to reform this aspect of the law in the short term.

The inheritance legislation has also repeatedly been subject to objections within the European Union and some provisions, like the flat rate reduction of the tax-exempt amount for beneficiaries not resident in Germany, have been found not to comply with European legal standards.

a) Subject of the tax

Inheritance or capital transfer tax is normally due on transfers of assets which do not involve payment if the deceased, at the time of their death, the donor, at the time of the donation, or the sponsor, at the time of the endowment, is domiciled in the country. These are usually persons who have their domicile or usual place of residence in Germany or (without their domicile or usual place of residence in Germany) German citizens who have not remained abroad for longer than five years.

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[56] Inheritance Tax Act in the version of the Announcement of 27 Februar 1997 (BGBl. I p. 378), last amended by Article 30 of the Law of 26 June 2013 (BGBl. I p. 1809).

If no participants in the transfer are domiciled in Germany, the obligation to pay inheritance or capital transfer tax (restricted exclusively to domestic assets) comes into effect. Examples of such domestic assets are

- property assets in Germany;
- operating assets located in Germany, e.g. economic assets which are part of a German business enterprise, if permanent establishments are maintained in Germany for the purposes of this business enterprise;
- a stake of more than 10% in a German corporation held by a shareholder (together with other persons related to them in terms of § 1 para. 2 of the International Tax Relations Act (*Außensteuergesetz*))[57];
- mortgages, land charges or other claims or rights, if these are secured through domestic property holdings.

b) Tax assessment basis

As a basic rule, on the basis of the inheritance/capital transfer tax reform which came into effect on 1 January 2009, for the purpose of determining the tax assessment basis, all transferred assets are valued at their actual value.

c) Exempted amounts

The tax-exempt amount for persons with unlimited liability for inheritance or capital transfer tax depends on the degree of relationship between the donor and the beneficiary. The amount ranges from EUR 20,000 for unrelated persons up to EUR 500,000 for married couples and EUR 400,000 for children. In addition, the transfer of family homes to the married partner and to children can, under certain preconditions, be exempt from inheritance/capital transfer tax.

d) Tax rate

The tax rate depends both on the amount of the tax assessment basis and also on the degree of relationship. In the case of married couples, children and other close relations, the tax rate rises progressively from 7% to 30%. In the case of unrelated taxpayers, the inheritance or bequest is taxed at rates of 30% to 50%. The lowest tax rate applies to inheritances or bequests with an assessment basis of between EUR 1 and EUR 75,000 over the applicable exempted amount. The highest tax rate applies to inheritances or bequests with an assessment basis from EUR 26,000,000 over the applicable exempted amount.

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[57] International Tax Relations Act in the version of the Announcement of 8 September 1972 (BGBl. I p. 1713), last amended by Article 8 of the Law of 22 December 2014 (BGBl. I p. 2417).

e) Special rules governing operating assets

In the case of operating assets to be transferred (individual business, shares in commercial partnerships, shares in corporate entities with a shareholding of over 25%, otherwise on agreement of bundling of voting rights and limitations on disposal) there are two options, which must each fulfil certain preconditions:

- An 85% reduction of the assessment basis can be chosen insofar as the operating assets which are to be transferred contain a maximum of 50% non-realisable assets, the assets are held for a further five years and the total wages at the end of this period amount to at least 400% of the initial wages total of the business at the time of transfer.

- A 100% reduction can also be chosen insofar as the operating assets which are to be transferred contain a maximum of 10% non-realisable assets, the assets are held for a further seven years and the total wages at the end of this period amount to at least 700% of the initial wages total of the business at the time of transfer.

If the above criteria are not fulfilled, the operating assets being transferred are only partially taxed; the market value will apply for the calculation of this taxation. As mentioned earlier, the German legislator will have to review and modify the above principles following a decision of the German Federal Constitutional Court of 17 December 2014.

G. Overview of investment criteria and legal forms of doing business in Germany

General conditions	Taxes (taxation of holding companies)
■ No special restrictions on foreign investments, capital transactions, currency transfers or the repatriation of profits; ■ Very good logistical and transport infrastructure; ■ Very good and reliable telecommunications infrastructure; ■ Very high level of education and training; ■ Very high level of technological and scientific expertise. ■ Biggest population within the EU; ■ Strongest economy within the EU.	■ Corporation tax (incl. solidarity surcharge) on all income except dividends: 15.83%; ■ Trade tax on all income except dividends from approx. 14% to 17% (depending on the location of the registered office of the holding company); ■ As a rule 95% of the dividends received from other corporations are exempt from corporation tax and from trade tax with shareholdings over 10%; ■ For individuals who hold shares as part of their private assets: flat rate withholding tax (incl. solidarity surcharge) in the amount of 26.375% on all dividends; ■ Financing costs are only deductible within the scope of the 'earnings stripping rule' (= 30% of the EBITDA as long as the net interest balance is greater than EUR 3 million); deductible financing costs under the 'earnings stripping rule' are subject to approx. 3.25% to 4.25% effective trade tax; ■ According to the 'minimum taxation' rule, only profits of EUR 1 million plus 60% of the amount exceeding said threshold can be offset against existing loss carry-forwards; ■ Loss carry-forwards are lost, pro rata, with a shareholding acquisition of over 25% to 50%; in the case of shareholding acquisitions of over 50%, they are lost completely (within 5 years); due to the 'old rule' which continues to be applicable in parallel, a share acquisition of less than 25% can also lead to a loss of loss carry-forwards; ■ Double taxation agreements with 95 countries worldwide.

Corporate entities and establishment costs	Employment law and laws relating to foreign nationals
■ Establishment costs: ■ *GmbH*: EUR 25,000 nominal capital plus state fees and consultancy costs; ■ *Unternehmergesellschaft (haftungs-beschränkt)*: nominal capital of EUR 1 to 24,999; ■ *AG*: EUR 50,000 share capital plus state fees and consultancy costs; ■ Operating costs: ■ Tax advice: variable costs, depending on scope and extent of advice; ■ Accounting: approx. EUR 2,000 to EUR 3,000 per year for small enterprises; ■ Balance sheet accounting/auditing: approx. EUR 2,000 to EUR 5,000 per year for small enterprises; ■ Social insurance costs: ■ Employer's contribution towards social insurance (health, unemployment and pension insurance) in the amount of 19.5% of the gross income.	■ Residence permit/work permit; ■ Easy to obtain a temporary residence permit for directors, executive employees and highly-qualified specialists; ■ Permit for commercial activities and employees on short-term assignment; ■ Employment law: ■ Tightly regulated and employee-friendly; ■ Well-trained and qualified employees; ■ Minimum wage in certain sectors and as from 2015 nationwide.

Overview of legal forms

Legal form	Sole trader	Gesellschaft bürgerlichen Rechts (GbR, partnership)	offene Handels-gesellschaft (OHG, general partnership)
Proprietor	Entrepreneur (businessman/woman)	Partners	Partners
Minimum number of shareholders (partners)	n.a.	2	2
Minimum capital in EUR	n.a.	None	None
Management	Proprietor	All partners	All partners
Liability	Personal and unlimited liability	Personal and unlimited liability on the part of all partners	Personal and unlimited liability on the part of all partners
Profit sharing	Entire profits are at the disposal of the proprietor	According to shares	4% of equity interest, the rest is evenly distributed
Entry in commercial register	Possible as registered business man/woman (*eingetragener Kaufmann* (e.K.))	Not possible; immediately becomes a general partnership upon registration	Required

Kommandit-gesellschaft (KG, limited partnership)	Gesellschaft mit beschränkter Haftung (GmbH, corporate entity)	Unternehmer-gesellschaft (UG, corporate entity)	Aktiengesellschaft (AG, corporate entity)
Partner with unlimited liability (general partner) Partner with limited liability (limited partner)	Shareholders	Shareholders	Shareholders
General partner: 1 Limited partner: 1	1	1	1
General partner's contribution: none Limited partner's contribution: any amount	25,000; in the case of an UG (*haftungsbeschränkt*), from 1 to 24,999	from 1 to 24,999	50,000
General partner	Directors	Directors	Management board
General partner: personal and unlimited Limited partner: up to the amount of the limited partner's contribution	Limited by the amount of the nominal capital	Limited by the amount of the nominal capital	Limited by the amount of the share capital
4% of equity interest, the rest is evenly distributed	Proportionally	Proportionally	Proportionally (dividends)
Required	Required	Required	Required

H. Useful addresses for investors in Germany

Contact	Adress
Baden-Württemberg International Gesellschaft für internationale wirtschaftliche und wissenschaftliche Zusammenarbeit mbH	Willi-Bleicher-Strasse 19 70174 Stuttgart Tel.: +49 711 22787-0 Fax: +49 711 22787-22 www.bw-i.de
Berlin Partner für Wirtschaft und Technologie GmbH	Ludwig Erhard Haus Fasanenstrasse 85 10623 Berlin Tel.: +49 30 46302-500 www.berlin-partner.de www.berlin-sciences.com www.businesslocationcenter.de
Invest in Bavaria im Bayerischen Staatsministerium für Wirtschaft, Infrastruktur, Verkehr und Technologie	Prinzregentenstrasse 28 80538 Munich Tel.: +49 89 2162-2630 Fax: +49 89 2162-2803 www.invest-in-bavaria.com
Invest in Bavaria bei Bayern International GmbH	Prinzregentenstrasse 22 80538 München Tel.: +49 89 24210-7500 Fax: +49 89 24210-7557 www.invest-in-bavaria.com
ZAB ZukunftsAgentur Brandenburg GmbH (ZAB)	Steinstrasse 104 – 106 14480 Potsdam Tel.: +49 331 660-3000 Fax: +49 331 660-3840 www.zab-brandenburg.de

WFB Wirtschaftsförderung Bremen GmbH	Kontorhaus am Markt Langenstrasse 2 – 4 (Eingang Stintbrücke 1) 28195 Bremen Tel.: +49 421 9600-10 Fax: +49 421 9600-810 www.wfb-bremen.de
Germany Trade and Invest	Friedrichstrasse 60 10117 Berlin Tel.: +49 30 200 099-0 Fax: +49 30 200 099-812 www.gtai.com
HWF Hamburgische Gesellschaft für Wirtschaftsförderung mbH	Wexstrasse 7 20355 Hamburg Tel.: +49 40 227019-0 Fax: +49 40 227019-29 www.hwf-hamburg.de
HA Hessen Agentur GmbH	Konradinerallee 9 65189 Wiesbaden Tel.: +49 611 950 17-80 www.hessen-agentur.de
Hessen Trade & Invest	Konradinerallee 9 65189 Wiesbaden Tel.: +49 611 95017-85 www.htai.de
Invest in Mecklenburg-Vorpommern GmbH	Schlossgartenallee 15 19061 Schwerin Tel.: +49 385 592250 Fax: +49 385 5922522 www.invest-in-mv.de
NRW.INVEST GmbH	Völklinger Strasse 4 40219 Duesseldorf Tel.: +49 211 13000-0 Fax: +49 211 13000-154 www.nrwinvest.com

Investitions- und Strukturbank Rheinland-Pfalz (ISB)	Holzhofstr. 4 55116 Mainz Tel.: +49 6131 6172-0 Fax: +49 6131 6172-1299 www.isb.rlp.de
gwSaar Gesellschaft für Wirtschaftsförderung Saar mbH	ATRIUM Haus der Wirtschaftsförderung Franz-Josef-Röder-Straße 17 66119 Saarbrücken Tel.: +49 681 9965-400 Fax: +49 681 9965-444 www.invest-in-saarland.com
Wirtschaftsförderung Sachsen GmbH (WFS)	Bertolt-Brecht-Allee 22 01309 Dresden Tel.: +49 351 2138-0 Fax: +49 351 2138-399 www.wfs.sachsen.de
IMG Investitions- und Marketinggesellschaft Sachsen-Anhalt mbH	Am Alten Theater 6 39104 Magdeburg Tel.: +49 391 568 99 0 Fax: +49 391 568 99 50 www.img-sachsen-anhalt.de
WTSH Wirtschaftsförderung und Technologietransfer Schleswig-Holstein GmbH	Lorentzendamm 24 24103 Kiel Tel.: +49 431 66666-0 Fax: +49 431 66666-700 www.wtsh.de
Landesentwicklungsgesellschaft (LEG) Thüringen mbH	Mainzerhofstrasse 12 99084 Erfurt Tel.: +49 361 5603-0 Fax: +49 361 5603-333 www.leg-thueringen.de

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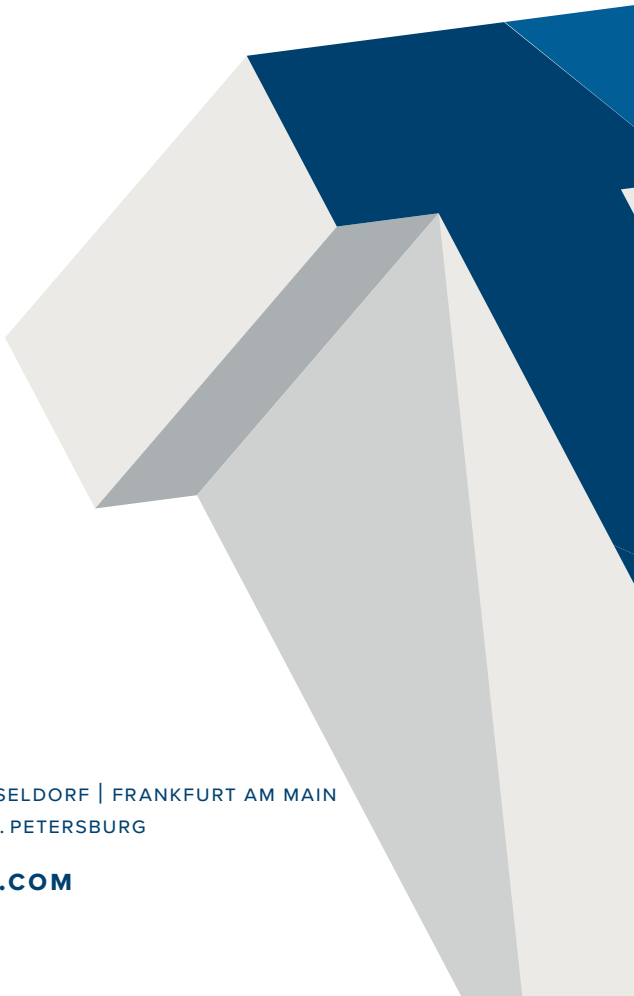

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