

INVESTING IN GERMANY

DEAL STRUCTURING FROM A LEGAL AND TAX INTERFACE PERSPECTIVE

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Investing in Germany is different than investing in the U.S. However, although Germans also know about share and asset deals in addition to knowing about founding companies and businesses, investors should still know some facts about German companies and their respective liability schemes and tax treatments. The legal and tax structure of a business is something to be particularly considered in structuring acquisitions of assets or shares in a German company.

LEGAL TYPES OF COMPANIES

German law distinguishes between corporations (*Kapitalgesellschaften*) and partnerships (*Personengesellschaften*). The most important differences between these legal types are the liability of the company and its respective shareholders/partners, and taxation matters.

Corporations

The two major types of corporations are the stock corporation (*Aktiengesellschaft*; in short: AG) and the limited liability company (*Gesellschaft mit beschränkter Haftung*; in short: GmbH). The GmbH is the most com-

mon form of incorporated companies for small and mid-market businesses in Germany. The AG is the corporate form assumed by many of Germany's largest corporations. The main advantage of an AG is that its shares may be transferred relatively simply and can be listed on a stock exchange. The purchase and transfer of shares in a GmbH have to be notarized before a German Notary. The minimum subscribed capital amounts to € 25,000 for a GmbH and € 50,000 for an AG. GmbHs are managed and represented by their managing director(s) and AGs by their management board. Generally, the managing directors or members of the management board are authorized to represent the corporation acting jointly. Exceptions to this rule require a regulation in the corporation's statutes. While an AG always requires a supervisory board consisting of at least three members, a GmbH is generally not obligated, but is free to install a supervisory board, unless German law for employee protection stipulates otherwise. The necessity of a supervisory board depends on the numbers of employees at the GmbH.

The managing directors of a GmbH

generally have to follow respective shareholders' resolutions and instructions. In contrast, the management board of an AG is more independent from the shareholders' meeting in its day-to-day business decisions.

Partnerships

The two major types of partnerships that are used for business enterprises are the general commercial partnership (*Offene Handelsgesellschaft*, in short: OHG) and the limited partnership (*Kommanditgesellschaft*, in short: KG). An OHG requires at least two partners, who are always fully liable for the OHG's liabilities. A KG requires at least two partners as well, but only one of them ("the general partner") needs to be liable in an unlimited fashion. The partner's liability can be largely limited to a specific amount ("the limited partner"), which is registered with the German commercial register (*Handelsregister*). Often a GmbH is implemented as general partner of a KG (so called GmbH & Co. KG). Such an amalgamation leads partially to the combination of advantages of both corporations and partnerships.

TAXES

Even more interesting is the choice of a specific legal form to be made by evaluating German tax matters. As a rule, never decide on company matters without evaluating current and future tax issues and vice versa.

The most important taxes in Germany are corporate income tax (CIT) (tax rate: 15%), personal income tax (tax rate: 14% up to 45%), trade tax (TT) (tax rate: at about 15% depending on the entity's main location and its branches) and value added tax (VAT) (tax rate: 7% or 19%).

Income taxes and trade tax

German tax law does not have a "check-the-box selection" or something comparable. As a rule, the legal form of entity governs the applicable taxes:

Corporations are subject to corporate income tax at a tax rate of 15%, solidarity surcharge in the amount of 5.5% of the CIT, subject to trade tax (+/-15%) and generally taxed separately. However, in particular based on so called profit and loss transfer agreements, a highly regulated tax group between corporations under control of another entity can be established. Partnerships are not subject to corporate income tax but are transparent for income tax purposes. In order to calculate the personal income tax burden of each partner, the taxable profit is determined at the company level and allocated to the individual partners according to their level of participation.

VAT and real estate transfer tax

The major German transaction tax is value added tax at a rate of 19% levied on services and goods; there is also a reduced rate of 7% for specific goods, and some services like health services are completely VAT exempt. Real estate transactions (including specific transfers and direct or indirect amalgamations of shares in real estate holding companies) trigger real estate transfer tax. The rate varies from state to state and ranges from 3.5% to 6.5% of the respective real estate value.

Withholding tax

Except for specific inter-group dividend distributions by a corporation to its shareholders, dividend payments generally trigger a 25% withholding tax on capital income (*Kapitalertragsteuer*) plus a solidarity surcharge. According to the regulations in the Double Tax Treaty (DTT) between the U.S.A. and Germany, the withholding tax rate can be reduced, if additional specific requirements in the German Tax Law can be met.

ACCOUNTING

German companies generally may choose to apply German generally accepted accounting principles (German GAAP: *HGB*) – or International Financial Reporting Standards (IFRS). While the regulations of IFRS are in broad parts comparable to US GAAP, the German GAAP is still driven by some principles deviating from the US GAAP regulations. Even if a company applies IFRS for internal and external reporting purposes, it still has to prepare an additional balance sheet in accordance with German GAAP as a basis for the tax balance sheet and the annual CIT and TT returns.

PERMITS

Generally, there are no restrictions placed upon foreigners who wish to establish a company in Germany. For conducting business in Germany, the German company has to register with a local trade office in order to receive a general business license (*Gewerbeschein*). Additionally, there are some regulated industries for which special licenses are required, e.g. insurance and banking.

EVALUATION AND DECISION

Keeping in mind these legal and tax basics and the knowledge that these matters combined are even more complex, an investor can move forward. According to our experience, purchasing investors often ask for advice from lawyers when their discussions with sellers of a German business have progressed a great deal. Such an approach more often than not leads to the fact that a legal and tax structure which would be more advantageous for the investor is no longer feasible, because of the discussion and early determination of key issues, e.g. a share versus asset deal, between the parties. A decision regarding a share or asset deal often depends on the fact whether an entire business or part of a business are purchased, and in which legal form the business is currently conducted.

One general advantage of a share deal is that at first sight the transfer of the shares only affects the shareholders' level, and the company level is usually not directly influenced. But there are also some disadvantages: possible risks and liabilities not identified when carrying out due diligence may still exist at the company level. Furthermore, the direct or indirect transfer of shares in a German company can lead to a forfeiture of tax loss carried forward at the company level. The avoidance of such consequences requires strong interface advice in the field of corporate and tax law. Also the implementation of a potentially intended debt push down for tax purposes sometime

requires more effort than expected.

Asset deals are usually more complex because the assets have to be identified and determined within the purchase contract, but the investor has the possibility to choose explicitly what he wants to buy. With regard to contracts with third parties, the consent of the third party for the transfer of the respective contract from the seller to the purchaser is necessary. Therefore, starting timely discussions with third parties before signing a purchase contract is important. Certainly, such discussions are only appropriate at an advanced stage of negotiations between seller and purchaser. Company liabilities remain with the company unless the purchase contract stipulates otherwise, or unless a special statutory liability under German law applies, e.g. because of the purchaser continuing the business under the same business name as the seller. One effect of an asset deal is definitely the allocation of the purchase price to the purchased goods, and the subsequent possibility to write them off, which also applies to the good will.

RECOMMENDATION

When evaluating an acquisition, we generally recommend considering the interface issues of organizational, financial, legal and tax paying grounds at a very early stage of the acquisition process. This requires legal advisors with commercial lenses and strong experience in tax legal interface advice. And even more important, solutions for problems that may arise can be found by evaluating the entire spectrum of financial, legal and tax implications at an early stage, which also affects (and reduces) the investor's costs.



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