

Corporate Aspects of Trading and Investing Germany

1. INTRODUCTION

Below please find a brief article on the different ways to enter the German market, as well as the setting up of a German subsidiary or holding company in Germany. This article outlines the most commonly used profit-driven entities and the basic consequences thereof under German corporate and tax law. This article is specifically not intended to deal with the entire range of German entities and their legal consequences. Most emphasis will be put on the German limited liability companies (GmbH and AG), as they are most frequently used when setting up a German subsidiary or holding company. A further commonly used company form is the GmbH & Co. KG, which will also be addressed. For a more detailed overview of all possibilities and consequences under German law, please feel free to contact the persons mentioned in the header of this chapter.

2. METHODS OF MARKET ENTRY IN GERMANY

2.1 DISTRIBUTION AND AGENCY

Both the distributor and agent distribute goods from a certain suppliers/manufacturers, yet their legal positions differ.

An agent is a person/company that conveys sales contracts on a commission basis for its principal. If the person/company buys products in its own name and on its own account for resale purposes it is acting as distributor and its "commission" is the margin between purchase and selling price. In Germany no general licence/permit requirements exist.

German Agency law, in conformity with the applicable EU directive highly protects the agent and ensures that at the end of the contract term, the agent can claim a compensation for the customer base conveyed by him.

Distribution is governed by civil law provisions on the sale of goods. The parties are generally free to agree all aspects provided they comply with cartel law and the German Ordre Public. Under certain conditions (e.g. integration in the manufacturer's distribution network) the distributor may invoke the same protection as an agent (minimum notice periods for termination, compensation claim etc.).

2.2 BRANCH

Establishing a business can be done by opening a branch ("*Niederlassung*"). A branch office is part of the organization and the legal entity of the foreign company establishing it. The branch has no separate legal existence or estate.

It may be organized as an independent branch ("*Zweigniederlassung*"). Such independent branch has to be registered in the Commercial Register. The branch name must be the same as the

foreign entity's name though additions showing their character as independent branch are admissible. The independent branch can have its own representatives who can be a foreign national as well. If it is set up as a dependent branch ("*Betriebsstätte*") the company name must be identical with the one of the headquarter.

2.3 PARTNERSHIPS

Partnerships under German law are basically "contractual entities", entitled to a partnership capital that is separated from the private capital of each of the partners. Partners' private creditors cannot recover private debts of partners directly from the partnership capital. They can, however, attach claims of the shareholders against the partnership, such as profit distribution claims. There is no limitation of liability of the partners for debts of the partnership, as creditors may hold each of the partners personally liable for debts of the partnership. Currently, German law recognizes two separate types of partnerships for trade purposes: (i) *Offene Handelsgesellschaft* (general partnership) and (ii) *Kommanditgesellschaft* (limited partnership).

The "*Kommanditgesellschaft*" is similar to the "*Offene Handelsgesellschaft*", with the only addition that it includes a limited partner next to the personally liable partner(s). This limited partner is only obliged to contribute capital – for which he will receive his fair share in the profits of the partnership – but is not involved in business operations. The limited partner cannot be held personally liable for debts of the partnership (except when he actually did involve himself in business operations or insofar as he did not pay its capital contribution), as a consequence whereof his losses may be kept limited to the capital contributed.

With the exemption of the obligation to register certain data of the partnerships with the German Commercial Registers, there are no formalities attached to setting up a partnership. A German partnership does partially qualify as a separate legal entity, but not – for example - for income taxation issues, so that partnerships are regarded as "transparent" and the partners will be taxed directly.

A popular company form in Germany is a limited partnership with a limited liability company as general (and managing) partner (GmbH & Co KG). Liability of the general partner is unlimited only in theory, as the capital of the GmbH represents the actual limit of exposure to creditors.

2.4 GERMAN LIMITED LIABILITY COMPANIES: GMBH AND AG

Foreign subjects, either individuals or companies, may incorporate and own shares in a German limited liability company. There are two types of limited liability companies: public limited liability companies ("*Aktiengesellschaft*" or "AG") and private limited liability companies ("*Gesellschaft mit beschränkter Haftung*" or "GmbH").

In order to meet the needs of founders who, at the start, only have low nominal capital, recent modifications of the Act on Limited Liability Companies ("*Gesetz betreffend die Gesellschaften mit beschränkter Haftung*" or "GmbHG") have introduced the Entrepreneurial Company with limited liability ("*UG (haftungsbeschränkt)*"), which is not a new legal form, but a GmbH that is also governed by the GmbHG and that may be set up without a specific minimum nominal capital. The incorporation of a UG (haftungsbeschränkt) requires a minimum share capital of at least € 1, whereas the incorporation of a normal GmbH requires a minimum share capital of € 25,000.

But, since the UG (*haftungsbeschränkt*) is to progressively accumulate the minimum share capital of the normal GmbH, it may not fully distribute profits but must transfer one-quarter of the net income for the year to a legal reserve until the statutory minimum capital of € 25,000 is reached.

Formation of a GmbH requires a notarial deed and registration with the Commercial Register. Incorporation of a GmbH usually takes some weeks.

The AG may have one or several national or foreign shareholders. The incorporation of an AG requires minimum stated share capital of € 50,000. Incorporation of an AG usually takes some weeks.

The use of shelf companies in urgent cases is permitted and frequently used (available on the market for approximately € 3,500 (UG (*haftungsbeschränkt*) / € 28,000 (normal GmbH) / € 56,000 (AG); including the minimum share capital).

3. FORMATION OF A LIMITED LIABILITY COMPANY

Both the GmbH and AG are to be incorporated by means of a notarial deed of incorporation, executed by a German civil law notary. This deed will contain the articles of association and will also state, *inter alia*, the share capital, the number of shares issued. The incorporator(s) / shareholder(s) may be both (foreign and/or German) individuals and/or companies, who will either have to appear before the civil law notary or grant a notarised power of attorney to a representative such as a lawyer. Under German law it is possible to have a sole shareholder.

Contribution/payment on shares

Shares in the GmbH and AG may be funded both in cash and/or in kind. In case of a funding in cash a bank statement will have to be issued by a Bank, confirming that the share capital is indeed deposited in a separate bank account in the name of the GmbH/AG to be incorporated. For “sole shareholder” companies, the share capital has to be fully paid in, otherwise incorporation of a GmbH can be done with half the share capital paid in and incorporation of an AG can be done with a quarter of the share capital paid in. It must be maintained during the company's lifetime. Contribution in kind requires a report on the contribution in kind that justifies the sufficiency of the contribution in kind that, in case of an incorporation of an AG, has to be audited.

As mentioned, the UG (*haftungsbeschränkt*) is a GmbH, but the particularity is that the full capital contribution must be made in cash already prior to the application for the entry in the Commercial Register. In addition, non cash contributions are not possible.

Registration Trade register // prior activities

The incorporation having taken place, the civil law notary shall see to it that the GmbH and/or AG (and certain of its data, e.g. managing directors, business address) are entered into the German Commercial Registers. If it is desirable to have the activities of the GmbH/AG yet to be incorporated already started this can be done as GmbH/AG “in process of being incorporated”. However, incorporators and representatives' risk, under certain circumstances, to be held personally liable for acts carried out in during the period up till the moment of actual incorporation.

It is important to note that third parties may fully trust and base themselves upon the filings in the German trade registers (such as the names of the managing directors and their powers to represent the GmbH/AG).

Finally, both the GmbH and AG are obliged to (yearly) publicise their (simplified) annual accounts with the German trade register, except for small companies. Not having these data filed may under circumstances lead to personal liability of the managing directors.

Main differences GmbH/AG

Holding and financing companies usually adopt the GmbH-form as it is less complicated. As compared to a GmbH, the AG is more intensely regulated. However, because its shares are freely transferable with only few formal requirements, the AG is more suitable for collecting public funds, for being listed on a stock exchange, for foreign or other investors and employee incentives etc.

It is generally possible to convert a GmbH into an AG, and vice versa.

4. MANAGEMENT OF A LIMITED LIABILITY COMPANY

The management of a GmbH consists of at least one managing director who may also be the sole shareholder. Generally, no Supervisory Board is required by law (except in case the GmbH is subject to co-determination by the employees, i.e. if it has more than 5,000 employees) but may be established by the shareholders. Foreign subjects can act as managing director ("*Geschäftsführer*").

The AG is represented by the board of directors ("*Vorstand*") which, depending on the size of the company, may consist of one or several board members. The board of directors is appointed and controlled by the mandatory supervisory board ("*Aufsichtsrat*"), which is appointed by the general assembly of the shareholders (so called two-board system).

Responsibilities

Whereas the managing directors / the Board of Directors (the "Management") manages the company on a day-to-day basis and provides for the determination and execution of corporate policy, the Supervisory Board's task, if applicable, is to supervise and advise the Management. The members of the Supervisory Board must let themselves be guided by the interests of the shareholders, as well as the interests of the Company and the undertaking connected with it. They have no executive function whatsoever. In that respect please note that under German law, the Supervisory Board does not manage the Company. German company law clearly distinguishes the Supervisory Board from the Management. It is not permitted to be a member of both Supervisory Board and Management at the same time.

Appointment and corporate accounts

Both the Management and the Supervisory Board, if applicable, of a GmbH are appointed, suspended and dismissed by the general meeting of shareholders. The Board of Management of the AG is appointed, suspended and dismissed by the Supervisory Board. Both may only be natural persons (whether foreign or not). The Management must keep adequate records of the GmbH/AG's business, in particular the corporate books. It must prepare annual accounts and within six months after the end of the financial year submit them to the general meeting of

shareholders for both approval and adoption. If applicable, these accounts need to be co-signed by the Supervisory Board.

Representation

The powers of representation of a GmbH/AG will rest with the Management (or – when stipulated in its articles of association – with each manager / two managers / one manager and one other person with general power of attorney acting jointly). When certain decisions of the Management are made subject to approval of the Supervisory Board or general meeting of shareholders, the Management will nevertheless be authorised to represent (and legally bind) the Company, despite the lack of required approval.

5. OFFICERS' LIABILITY OF A LIMITED LIABILITY COMPANY

Each Managing Director and each Supervisory Director is obliged vis-à-vis the GmbH/AG to properly fulfil his task (§§ 43 (2), 52 (1) GmbHG, §§ 93 (2), 116 AktG – "Aktiengesetz"). Failure to do so will make him liable towards the Company. Only if a Managing Director or a Supervisory Director has not acted with the diligence due by a businessman acting orderly and conscientiously, will he be liable. He will not be held liable, if he could reasonably assume to act for the good of the company on a reasonable information basis. An individual member of the Management or Supervisory Board may exculpate himself and prove that he was not to blame for the wrongdoing and that he has not been remiss in taking measures to avert the consequences thereof. If a shareholder resolution of the company has been the basis of damage, the Management and the Supervisory Directors cannot be held liable. Only the GmbH/AG itself can hold the director liable under §§ 43 (2), 53 (1) GmbHG, 93 (2), 116 AktG (not a shareholder or creditor).

§§ 93 (5), 116 AktG provides for the "external liability" of Managing Directors and of Supervisory Directors of an AG, insofar as damages cannot be obtained by the company, and only for certain types of management / supervisory failure. The external liability of Managing Directors of a GmbH is not expressly regulated by statute, however, external liability is accepted by case law under specific circumstances, e.g. in case of delayed initiation of insolvency proceedings. Supervisory Directors of a GmbH are generally liable as are Supervisory Directors of an AG, the scope of external liability is held to be much narrower, however. The details of external liability of management and supervisory board of a GmbH are in dispute.

In addition, Management and members of the Supervisory Board may be liable if they commit a tort in their capacity as Managing Director and/or member of the Supervisory Board which would also be a tort if they acted for themselves. For instance, if they enter into a commitment on behalf of the Company knowing that it could not meet this commitment in due time, they may be liable themselves.

6. TAXATION OF PROFITS

In Germany the method of taxation depends on the legal form of the tax subject.

The profits of limited liability companies and their permanent establishments in Germany are subject to corporation (income) tax ("KSt") and trade tax ("GewSt"). Corporation tax is an annual tax based on the corporation's profit according to the corporation's balance sheet. Trade tax is also an annual tax on profits, its rate depending on the municipality in which the business

has its seat. The accumulated tax rate from these two taxes is between 33 - 40 %. However, corporations usually find ways to reduce tax liability by sophisticated tax planning measures.

A 20% withholding tax rate applies to dividend distributions.

Individuals residing in Germany for more than 6 months per year pay income tax ("ESt") on their annual worldwide revenues. Non-residents are taxed (usually by withholding) on their income accrued in Germany only. Dividends paid out to individuals are subject to income tax only by half of the amount received, the withholding tax already paid may be deducted. Profits of partnerships, including the GmbH & Co. KG, are subject to income tax due by the partners (instead of KSt due by corporations) and to trade tax as are the corporations.

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