



Holme Roberts & Owen

Rechtsanwälte · Attorneys at Law

The HRO-Guide to Doing Business in Germany

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NOTE

The Munich office of Holme Roberts & Owen („HRO“) has acted as counsel for several cross-border M&A and capital markets transactions, international financing and debt arrangements and has an experienced team of litigators and arbitrators with international dispute resolution emphasis. HRO has assisted numerous foreign companies, primarily from the U.S. with their expansion and access into the German market.

The most frequently asked questions as well as the basics of German law from a practical point of view have been set forth in HRO's GUIDE TO DOING BUSINESS IN GERMANY, which is updated from time to time.

This 3rd edition reflects the current state of legislation as of May 2009.

WHAT LAW APPLIES

GERMAN LAW. Germany is composed of 16 states, the largest of which is the State of Bavaria. Although state law may be relevant in some instances, the most important areas of law for companies operating in Germany, such as corporate, tax, employment and intellectual property are regulated on a national level, by federal statutes. As in every continental European country, German law is based on the civil law system, as opposed to the Anglo-American common law system. In general, German courts work fast and efficient with regard to corporate registration matters.

EUROPEAN LAW. All members of the European Union, including Germany, are subject to European Law, the main goal of which is to harmonize legislation within the European Common Market. European Law is promulgated in the form of Treaties, Regulations and Directives. European Treaties and European Regulations are effective in Germany regardless of whether they have been implemented into Germany's national law. For example, EU rules regarding competition as set forth in Art. 81 of the EC Treaty, apply directly to companies doing business in Germany. In most cases, however, foreign companies doing business in Germany are regulated by European Directives, which are the most common form of European legislation and in general are being implemented into national law. As a result, German federal statutes remain the primary body of law, applicable to companies doing business in Germany.

GOVERNMENT SUPPORT AND SUBSIDIES

On a federal level, certain loan programs can be achieved through the state bank "KfW Mittelstandsbank", for companies investing in their German business. The KfW Enterprise Loan can be applied for through any German commercial bank. It provides for low interest rates, securitization and guarantees (www.kfw-mittelstandsbank.de). Further subsidies may be granted on a state level, mostly depending on the amount of jobs to be created. On an EU level, certain programs are available as well (www.welcomeurope.com).

CHOOSING A BUSINESS ENTITY

LEGAL ENTITY / SUBSIDIARY. In most cases, foreign companies conduct business in Germany through a separate subsidiary in the form of a GmbH (*Gesellschaft mit beschränkter Haftung*). A GmbH is very similar to the US limited liability company. The liability of its shareholders is limited. The GmbH is a widely-used, and therefore a widely-understood, corporate form. Taxation of a GmbH typically does not affect the business of the parent company because as an independent legal entity, the GmbH is subject to independent taxation in the jurisdiction it is established. The statutory minimum share capital for a GmbH is 25,000 Euro. Since 2008 a new GmbH sub-type, the so-called entrepreneurial company (*Unternehmergesellschaft* or *UG*) even allows for a minimum share capital of 1 Euro. The characteristics of GmbH and UG are explained in greater detail below.

BRANCH OFFICE. A foreign company may do business in Germany as a dependent or independent branch office. In contrast to a GmbH subsidiary, a branch is not a separate legal entity. A dependent branch generally has less autonomy than an independent branch, which has its own management, accounts, balance sheet and assets. There is no minimum capital requirement. As a formal requirement, an independent branch must be registered with the appropriate Commercial Register (*Handelsregister*). In comparison to a subsidiary (e.g. GmbH), the main disadvantages of establishing a branch office are an increased risk of personal liability, the requirement of translating and filing the articles and bylaws of the foreign parent company and a more complicated tax process. If a foreign company operates through a branch office, it will be treated as a permanent establishment (*Betriebsstätte*) and income attributable to the branch is subject to taxation in Germany. Be aware that the definition of a permanent establishment according to German income tax law may differ from the definition as set forth in a Double Taxation Treaty. As a consequence, the permanent establishment's income may be subject to taxation in Germany without triggering tax benefits as set forth in the Double Taxation Treaty. This may only complicate tax and accounting processes and result in adverse tax consequences for the foreign parent company. Another risk to avoid is starting a business without a formal legal structure. Under German law, tax authorities may assume a branch office to exist if a business is operated in Germany without an official legal structure. In such a case, the profits would be subject to taxation and additional penalties may be possible.

OTHER BUSINESS FORMS UNDER GERMAN LAW. In addition to the foregoing options, it is also possible to conduct business as a commercial partnership (*Kommanditgesellschaft* or *Offene Handelsgesellschaft*) or a stock corporation (*Aktiengesellschaft* or *AG*, see overview below). In comparison to a GmbH, any form of partnership carries an increased risk of personal liability. The AG has more stringent formal requirements, including a higher statutory minimum capital of 50,000 Euro. Since 2004, the Societas Europaea (SE) is available as an additional form of corporate entity (minimum share capital of 120,000 Euro). However, the benefit of a SE is that it may change its registered seat within each EU member country easily. Otherwise, benefits of a SE are limited since there is no harmonized legal frame work and still mostly national rules regulate the SE.

Legal entity or branch office:

The choice between doing business in Germany through a branch or a separate legal entity is largely tax-driven and depends on intended operations in Germany. As to the formal structure of a separate legal entity both corporate forms - GmbH and AG - have the advantage of limited liability. The GmbH offers more flexibility with respect to its internal structure and the dealings of its management and shareholders, whereas the AG offers an easier way of acquiring capital or transferring shares. Partnerships offer management greater flexibility in tailoring the internal affairs of the company to the individual needs of the partners, a more direct management by the partners, fewer publication requirements, easier dissolution and distribution of capital to the partners.

THE „GMBH“ (LIMITED LIABILITY COMPANY)

NATURE OF A GMBH. A GmbH is a commercial trading company with its own legal personality that can be established for any lawful purpose. The GmbH is a capital-based company. That is, unlike a partnership, the main feature of the GmbH. A GmbH incorporated in Germany may also operate abroad. The reform of the German law governing limited liability companies in 2008 has introduced a new subtype of the GmbH, the so-called entrepreneurial company (*Unternehmersgesellschaft* or *UG*), which can be formed without the traditional minimum capital requirements.

CAPITAL OF A GMBH. The statutory minimum share capital (*Stammkapital*) of a GmbH is 25,000 Euro, which is divided into shares (*Geschäftsanteile*). The shares can be split at will down to shares in the nominal amount of 1 Euro. For the establishment of an UG, a minimum share capital of 1 Euro is sufficient.

Advantages of the GmbH:

The main advantage of the GmbH is the restriction of liability of the shareholders to the amount of contributed share capital. In addition, the owners have great flexibility in drafting the articles of the GmbH making the GmbH an equally suitable corporate form for small, medium or large enterprises. On the other hand, the shares in a GmbH cannot be traded publicly, as is the case with a stock corporation (AG). It may, however, be easily converted into an AG (*Umwandlung*). Otherwise, there are no restrictions on sale, except that a transfer of shares, as well as any changes to the articles, must be notarized to be effective.

FORMAL REQUIREMENTS. The formal steps for establishing a GmbH include the adoption of a charter (Memorandum and Articles – *Gründungsprotokoll und Gesellschaftsvertrag*), the appointment of a managing director or managing directors (*Geschäftsführer*), the payment of the owners' initial capital contributions (*Einzahlung des Stammkapitals*), and the notarization of the charter and registration with the commercial register. This process may be shortened by purchasing a shelf GmbH, which is already established and registered with the commercial register. Shelf companies (*Vorratsgesellschaften*) have transacted no business and therefore have no existing obligations. The purpose and name of the shelf company may be changed to suit the individual situation.

COSTS TO ESTABLISH A GMBH OR AN UG. Including the minimum statutory capital (25,000 Euro), attorneys' fees, notary fees and the completion of the basic formal requirements, the costs of establishing a GmbH typically amount to approximately 30,000 Euro. Accordingly the costs to establish an UG amount to approximately 5,000 Euro (depending on the share capital). It is standard procedure to purchase an unused shelf company which typically can be transferred in a single business day. This is an easy way for foreign shareholders to quickly establish a GmbH subsidiary that can commence business operations immediately.

THE AG (STOCK CORPORATION)

NATURE OF AN AG. An AG is a commercial trading company with its own legal personality. The organs of the AG are the management board (*Vorstand*), which bears sole responsibility for management, the supervisory board (*Aufsichtsrat*), which appoints and controls the management and the general meeting of shareholders (*Hauptversammlung*).

CAPITAL OF AN AG. The statutory minimum share capital (*Grundkapital*) of an AG is 50,000 Euro, which is to be paid in cash or in kind and is divided into the equivalent amount of shares (*Aktien*). Shares are issued as shares with nominal value (*Nennbetragsaktie*) or as non-par value shares (*Stückaktie*). The minimum nominal value (*Nennbetrag*), if any, is 1 Euro. The articles of the AG must specify whether shares are issued to bearers (*Inhaberaktien*) or to registered holders (*Namensaktien*). Bearer shares are more common in practice and are transferable by agreement and assignment. Registered shares are transferable by endorsement. The founders of an AG can be individuals or legal entities. There are no restrictions on foreign ownership.

Advantages of the AG:

Both with the GmbH and the AG, liability of the shareholders is limited to the amount of contributed share capital. As AG shares may be held and traded publicly, an AG structure allows a business to acquire substantial sums of capital from the public capital markets. Shareholders are not liable for obligations of the AG. AG shares can be transferred easily, in private or public stock market transactions. An AG is the preferred option for larger businesses.

FORMAL REQUIREMENTS. The formal steps for establishing an AG include the determination of the charter (Memorandum and Articles – *Gründungsprotokoll und Satzung*), the contribution of share capital, appointment of the members of the governing bodies, provision of formation report, formation scrutiny and entry in the commercial register.

COSTS TO ESTABLISH AN AG. Including the full minimum statutory capital (50,000 Euro), attorneys' fees, notary fees and the completion of the basic formal requirements, the costs to establish an AG is typically about 57,000 Euro. An AG may be purchased as a shelf company (*Vorratsgesellschaft*), which is an easy way for foreign shareholders to quickly establish an AG subsidiary that can operate immediately.



TAXATION

TAXES ON PROFITS. Profits arising from commercial enterprises are subject to various taxes in Germany, including corporation tax, trade tax, value added tax (VAT) and withholding tax. The rate at which a foreign parent company or shareholder is taxed may vary, depending on the terms of the relevant double taxation treaty.

German – US – Double Taxation Treaty:

Based on the Double Taxation Treaty between Germany and the USA, a US parent company's branch office will only be taxed on the profits arising from the commercial activity in Germany. If a separate legal entity is established in Germany, corporation tax will arise and dividend payments out of the corporation's profits will be subject to a maximum of 5 percent taxation in Germany if the receiving person is a corporation controlling at least 10 % of the company's voting shares. If this is not the case maximum taxation of dividend payments out of Germany according to the Double Taxation Treaty Germany-USA is 15%.

CORPORATION TAX. Profits are subject to corporation tax (*Körperschaftsteuer*), which is levied only at the entity level. Corporation tax is levied at a flat rate of 15% (plus solidarity surcharge of 5.5% thereon).

TRADE TAX. Profits of the German company are also subject to trade tax (*Gewerbesteuer*). The percentage varies from 7% to 17.2% depending on the relevant taxing municipality. Together with the corporation tax, the effective tax rate on profits usually ranges between 23% and 33%.



VALUE ADDED TAX (VAT). VAT (*Umsatzsteuer*) applies to all commercial activities involving the production and distribution of goods or the provision of services. It is considered a consumption tax because it is ultimately passed on to the consumer. VAT is levied as a percentage of price (in most cases 19%), which means that the actual tax burden is visible at each stage in the production and distribution chain. It is collected fractionally, via a system of deductions whereby taxable persons (i.e., VAT-registered businesses) can deduct from their VAT liability the amount of tax they have paid to other taxable persons on purchases for their business activities. This mechanism ensures that the tax is neutral regardless of how many transactions are involved.

WITHHOLDING TAX. Dividends and royalties paid by the German corporation to the parent company are subject to withholding tax. The tax rate generally varies between 15% and 25% (plus solidarity surcharge of 5.5% thereon). Withholding tax reductions or exemptions may be available under certain Double Taxation Treaties (see above for dividends).

EMPLOYMENT ISSUES

FORM OF EMPLOYMENT CONTRACTS. Employment agreements do not have to be in writing in order to be valid. However, the employer shall set forth and sign the essential contractual conditions in writing (e.g. name and address of the contractual parties, beginning of employment, amount of remuneration contractual term, place of work and vacation).

SALARY, INCOME TAX AND SOCIAL INSURANCE CONTRIBUTIONS. As consideration for the contractual services by the employee, the employer is obliged to pay the (collectively or individually agreed) remuneration as well as statutory social security contributions.

- **Salary.** Except of certain industries, such as the construction, commercial cleaning and postal services sectors, no minimum wage is prescribed by German law. However, all employees have the right to a minimum of 20 working days leave per year (based on a week of 5 working days) and are entitled to continued payment of their salary during such leave. Employees also have a legal right to continued payment of salary in the event of sickness, up to a maximum of six weeks. Working hours may not exceed 40 hrs per week.
- **Income Tax.** Individuals are subject to personal income tax. Tax rates generally range from 14% to 45% (e.g., for an annual income of 50,000 Euro, the effective income tax rate would be approximately 26% plus solidarity surcharge of 5,5% thereon). Employers must withhold such amounts and pay it to the competent tax office to the effect that employees receive the net amount only. Employers who fail to withhold income tax properly may be subject to penalties and subsequent payment.
- **Social Contributions.** Germany has a compulsory social security system that covers health insurance, old-age benefits, unemployment benefits and nursing care insurance. Health insurance benefits also extend to the non-working spouse and children of the employee. Contributions to the social security system are shared equally between the employer and the employee. The sum of such contributions typically amounts to approximately 40 % of an employee's gross income. The employer is required to withhold the employee's share of the contribution, which must be paid out to the competent authority together with its own share.

WORKERS' COUNCIL. If there are at least five regular full-time employees, at least three of which have been with the company for more than six months, employees have the right to establish a workers' council (*Betriebsrat*). The workers' council has the right of participation in certain social and personnel matters and the right to information on specific economic matters. Once established, such workers' council is entitled to certain participation and information rights that must be complied with.

PROTECTION FROM DISMISSAL. Standard periods apply where notice of termination is given (usually depending on the duration of the employment). If the company employs more than ten individuals on a regular basis, employees are entitled to statutory dismissal protection. In this case, the termination of an employment by the employer is only legally effective, if it is based on a legitimate

termination reason, such as employee misbehavior, illness or operational reasons, such as job elimination and the employer has diligently selected the employee subject to the termination, according to social reasons, e.g. age, children, marital status etc. Under exceptional circumstances, dismissal without observing a notice period is possible, if reasonable cause exists and it is unbearable for the terminating party to continue the employment.

Termination Practice:

German Labor Courts usually act at a rule of thumb when proposing or deciding upon severance payments following an allegedly unfair termination. Such rule provides for a severance payment to the employee between 0.5 - 1.5 monthly salary payments per year of employment.

FORMALITIES OF RESIDENCE AND WORK PERMIT. Citizens of foreign countries who desire to work in the Federal Republic of Germany may have to apply for a residence permit and a work permit.

German Immigration Law:

Whether a residence and/or a work permit is required for citizens of foreign countries who desire to work in the Federal Republic of Germany, is determined by highly complex German immigration laws which regulate a multitude of individual cases. Essential criteria of immigration law that govern the access to such permits are in particular the origin and education of the respective employee, whether the employee already has its residence in Germany or not, what particular job he intends to have, and whether he is related to someone already working in Germany.



EU AND EEA NATIONALS. Citizens of the European Union countries Austria, Belgium, Cyprus, Denmark, Finland, France, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Sweden, Spain and United Kingdom of Great Britain, and citizens of the member states of the European Economic Area (“EEA”) Norway, Iceland and Liechtenstein as well as citizens of Switzerland may rely on the EU-principle of labour mobility, i.e. they have the right to commence an employment in another EU membership state, including the corresponding rights to entry and of residence. Thus, such citizens do neither require a residence nor a work permit.

NEW EU NATIONALS. Citizens from those EU countries that joined the EU on May 1, 2004 (Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Slovenia and Slovakia) and January 1, 2007 (Bulgaria and Romania), respectively, only have a limited access to the German labour market. Although such citizens do neither need a visa in order to enter the country nor a residence permit to stay in Germany, they are required to obtain a specific work permit called "*Arbeitserlaubnis-EU*" for a transitional period (until April 30, 2011, for the countries that joined the EU in 2004 and until December 31, 2013, for the countries that joined the EU in 2007). As a rule, such work permit is granted by the competent Employment Agency only to employees with skills which require a professional training of at least 3 years according to German law, and only if no other domestic employees are available for this position. Such work permit is usually granted for one year.

NON-EU NATIONALS. Foreigners who desire to work in Germany and who are neither EU / EEA nationals nor citizens of Switzerland need a residence permit or a visa in order to enter the country. Dependent upon certain criteria, in particular the nature of the intended job, the competent Aliens Department (*Ausländerbehörde*) involves the competent Employment Agency (*Arbeitsagentur*) which in general approves of the intended employment if, in particular, (i) the intended employment of a foreigner does not adversely affect the domestic labour market, (ii) no domestic employees are available for this position and (iii) the foreigner will not be employed on worse conditions than comparable German employees. Certain employees, however, do not require the Employment's Agency's approval if specific conditions are met, such as executives, journalists, students, scientists or foreign employees of a foreign company who intend to work for a German-based subsidiary.

INTELLECTUAL PROPERTY

Rights in intangible goods, such as those created when dealing in or licensing software, movies or other know-how, are among the most valuable goods of the commercial trade and are protected by German intellectual property law primarily in the form of copyrights, trademarks and patents. However, these provisions often differ substantially from similar US laws. For example, in most cases, the application of German intellectual property statutes is mandatory and may not be altered by private contract.

COPYRIGHTS. Literary, musical, graphic and audio-visual works may be protected by German copyright law. Software is likewise subject to copyright protection. Copyright protection arises automatically upon creation of an original work fixed in a tangible medium of expression. No registration or copyright symbol (©) is required to achieve protection.

- **Application to Foreign Nationals.** German copyright law applies to German or other European Nationals as creators of the work. It also applies to other individuals if their works are published for the first time in Germany, provided that they are citizens of a country that is a signatory to the Bern Convention for the Protection of Literary and Artistic Works (which includes the United States).
- **Copyright Ownership.** Under German law, the initial copyright in a work belongs to its author himself, even if the work was created on behalf of another party. In this respect, the German approach differs from the American “work made for hire” doctrine set forth in Section 201 (b) of the US-Copyright Act. Under German law the owner may not dispose of his ownership of the copyright as such but may licence his work to the greatest extent.
- **Licensing of Copyrights.** An exclusive copyright license gives the licensee the right to unrestricted commercial use and exploitation of the licensed work. In contrast, a non-exclusive license grants the licensee merely the right to use the licensed work in the manner stipulated in the license, which may be limited as to place, time or purpose. In case of doubt, German Law provides that exploitation rights are transferred to the licensee only to the extent required to achieve the purpose of the relevant license (*Zweckübertragungstheorie*).
- **Impact on Contracts.** In practice, it is important to draft license agreements that allow the licensee to acquire all necessary rights. The drafting should not be overbroad, however, because the author of a work is entitled to demand an appropriate remuneration for every exploitation of the work. Therefore, the range of the transferred rights should be defined carefully, even though it may be possible to transfer all rights. If an employee creates computer software, the contractual situation is easier, because according to the copyright law, the employer is exclusively entitled to exercise all economic rights in the software.

TRADEMARKS. A registered trademark can be protected as a German or European Community trademark. In Germany, a registered trademark is protected for a period of ten years starting from the day after registration, which period can be extended for successive ten year periods. A trademark may consist of any signs capable of being represented graphically, particularly words, including personal names, designs, letters, numerals, the shape of goods or of their packaging, provided that such signs are capable of distinguishing the goods or services.

- **Reasons for Trademark Protection.** A trademark protects the company's name, and its related investments to build brand name recognition. The holder of a trademark may initiate legal proceedings against trademark infringers who use identical or similar trademarks or who dilute the trademark.
- **Means of Obtaining Protection.** A trademark may become protected by registration at the German Trademark Office (German Trademark) or at the European Office for the Harmonization in the Internal Market (European Community (EC) Trademark) or by use of the trademark or the company's name in commerce. Furthermore, any U.S.-Trademark owner can easily extend the trademark protection to Germany and the European Union through an International Registration with the World Intellectual Property Organization according to the Madrid Protocol. The Madrid Protocol is an international treaty that allows a trademark owner to seek international registration of his trademarks in any of the signatory countries to the Protocol.
- **Trademark Rights.** Use of a protected trademark is prohibited without the consent of the trademark holder. In Germany the trademark holder may enforce the trademark through a preliminary injunction or bring an action for omission or damages. Damages may be calculated based on the actual loss to the holder, the imposition of a license fee or on the amount of profits earned by the infringer. Punitive damages are not recoverable.

PATENTS. German and European patent law affords the legal right to exclude others from making, using or selling a patented invention for up to 20 years, commencing with the filing date. Patents may be granted for any invention that is new, involves an inventive step and is capable of industrial application.

- **Computer Programs.** Patentable subject matter must be of a technical nature and related to a particular technical field. Thus, in principle, a patent cannot be obtained for computer software in general. However, in practice, software can be patented if it constitutes part of an invention that is technical in nature and incorporated into a "device." In general, the conditions for protecting software are much more difficult to meet in Germany than in the U.S.
- **Novelty.** The invention must be new and may not constitute prior art. An invention is not new if it has been made available to the public before the priority date of the application. In contrast to U.S. patent law, there is no grace period and so called "absolute novelty" is required.
- **Employee Inventions.** To resolve the tension between the intellectual property principle that inventors automatically obtain personal patent rights and the labor law principle that an employee's work generally belongs to the employer, the Employee Invention Act provides that an employee must notify his/her employer of "service inventions" made during employment. The employer is then entitled to claim the invention in exchange for reasonable remuneration. For this reason, potential inventions of the employee should be addressed in the employment agreement.

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The Munich office of HRO is established as an entity separate from HRO's U.S. offices,
as Holme Roberts & Owen Germany LLP.

If you are in need of advice, we would be very pleased to assist you.

Please do not hesitate to contact any of the attorneys listed below.



Holme Roberts & Owen
Rechtsanwälte · Attorneys at Law

HRO MUNICH

PLEASE FEEL FREE TO CONTACT

Jens Röhrborn

jens.roehrborn@hro.com

Dr. Jörg Ritter

joerg.ritter@hro.com

Gudrun Moll

gudrun.moll@hro.com

Dr. Peter Katko

peter.katko@hro.com

Dr. Ulrich Fülbier

ulrich.fuelbier@hro.com

Dr. Christian Sirch

christian.sirch@hro.com



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Rechtsanwälte · Attorneys at Law