

HRO CONTACTS

MUNICH

Jens Röhrborn

jens.roehrborn@hro.com

Dr. jur. Jörg Ritter

joerg.ritter@hro.com

Dr. jur. Hannes Berger

hannes.berger@hro.com

Michael Sinhart

michael.sinhart@hro.com

Dr. jur. Peter Katko

peter.katko@hro.com

David P. Kunstle

david.kunstle@hro.com

DENVER

Garth B. Jensen

garth.jensen@hro.com

Dominic A. Lloyd

dominic.lloyd@hro.com

LONDON

Thomas E. Laursen

thomas.laursen@hro.com

SAN FRANCISCO

Ola L. Clinton

ola.clinton@hro.com

James Wesley Kinnear

wesley.kinnear@hro.com

Robert L. Stolebarger

robert.stolebarger@hro.com

March 2003

Copyright 2003, Holme Roberts & Owen

Business in Bavaria:

Important Legal Issues



Holme Roberts & Owen

Rechtsanwälte · Attorneys at Law

State Agency for Media
and Information Technologies
(BayernMIT)

www.hro.com

Maximilianstrasse 34, D-80539 München | Tel +49 (89) 38 39 80-0 Fax +49 (89) 38 39 80-99

MUNICH | DENVER | BOULDER | COLORADO SPRINGS | LONDON | SALT LAKE CITY | SAN FRANCISCO



ERWIN HUBER
State Minister
Head of the Bavarian Governor's Office

Dear Ladies and Gentlemen,

It is a pleasure for me not only as State Minister for Media and ICT, but also as Head of the Supervisory Board of our inward investment agency gotoBavaria, to congratulate you for taking this brochure and considering to do business in Bavaria. International Law Firms like Holme, Roberts & Owen are important advisors in the process of corporate relocation. They provide vital orientation and useful help in exploring new horizons.

gotoBavaria also runs an office in Palo Alto, California, and operates from there as an investment promotion team for media and ICT firms in the Bay Area. Our Headquarters are in Munich, Germany, which is the so called Silicon Valley of Europe with 20,000 ICT companies and their 240,000 employees.

As a matter of fact, HRO has worked with gotoBavaria closely for a number of years already. In the process of business development in new markets—like Europe might be one for you—gotoBavaria offers advice, guidance, business contacts and being integrated in our large networks.

We regularly invite to a large Partnering Conference with professional business matchmaking. We organize more than one thousand business talks during such an event. So this is a must to get an easy market entry. But without lawyers and tax specialists, your operations abroad, setting up an office after closing the first deals with European customers will be more of a challenge than a successful opportunity. Our friends have known the European market quite well. To the attorneys and staff of HRO let me finally express my best wishes for success and to you, of course, I would like to say: gotoBavaria!

Erwin Huber
State Minister
Head of the Bavarian Governor's Office
email: erwin.huber@gotoBavaria.org
www.gotoBavaria.org



We at Holme Roberts & Owen are delighted that you are considering doing business in Bavaria. To assist you with this exciting possibility, we have prepared the following summary on some of the key legal issues involved in such a challenging transition. This summary is not intended to address all of the issues related to an investment or expansion into the Bavarian market, and it does not constitute legal advice with respect to any specific situation. If you are in need of such advice, we would be very glad to assist you. Please do not hesitate to contact any of the attorneys listed in the margin of the first page of this HRO Alert.

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 the national level, by federal statutes. Each of these substantive areas is discussed briefly below.

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, which are set forth in Art. 85 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 must be implemented into national law to be effective. As a result, German federal statutes remain the primary body of law that is applicable to companies doing business in Germany.

CHOOSING A BUSINESS ENTITY

GMBH (LIMITED LIABILITY COMPANY) 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, in that the liability of its shareholders is limited to the capitalization of the company. The GmbH is a widely-used, and therefore 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. The statutory minimum share capital for a GmbH is 25.000 Euro. The characteristics of a GmbH 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. A branch office is relatively easy and inexpensive to establish. There is no minimum capital requirement, and there are no significant formal requirements, except that an independent branch must be registered in the appropriate Commercial Register (*Handelsregister*). In comparison to a subsidiary (GmbH), the main disadvantages of establishing a branch office are an increased risk of personal liability and a more complicated tax process. If a foreign company operates through a branch office, it will be treated as a permanent establishment and income attributable to the branch is subject to taxation in Germany. In determining such taxable income, German tax authorities will assess the earnings of the entire company, including earnings of the foreign parent in its home country. This not only complicates tax and accounting processes but also may result in adverse tax consequences for the foreign parent.

OTHER BUSINESS FORMS. 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*). In comparison to a GmbH, any form of partnership carries an increased risk of personal liability, and the AG has more stringent formal requirements, including a higher statutory minimum capital of 50.000 Euro.

AN OVERVIEW OF 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 statutory minimum share capital for a GmbH is 25.000 Euro; otherwise, the share capital is determined by the articles of the GmbH and corresponds with the sum total of the owners' capital contributions.

ADVANTAGES OF THE GMBH. The main advantage of the GmbH is that liability is limited to the amount of contributed share capital. In addition, the owners have great flexibility in drafting the charter (Memorandum and Articles) of the GmbH, which makes the GmbH an equally suitable corporate form for small, medium or large companies. On the other hand, the ownership interests in a GmbH cannot be traded publicly, as is the case with a stock corporation (AG). A GmbH 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 Satzung*), the appointment of a manager or managers (*Geschäftsführer*), the payment of the owners' initial capital contributions (*Einzahlung des Stammkapitals*), and the notarization of the charter and registration in 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 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.

COST TO ESTABLISH A GMBH. Including the minimum statutory capital (Euro 25.000), attorneys' fees, notary fees and the completion of the basic formal requirements, the cost to establish a GmbH is typically about Euro 30.000. It is standard procedure to purchase an unused shelf company (*Vorratsgesellschaft*) which typically can be established and transferred in a single business day. This is an easy way for foreign shareholders to quickly establish a GmbH subsidiary that can operate immediately.

AVOIDING CERTAIN RISKS. An appropriate accounting system should be implemented to ensure compliance with the following obligations:

- maintenance of capital level
- monitoring risk of insolvency
- liability for social contributions.

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.

CORPORATION TAX. Profits are subject to corporation tax, which is levied only at the entity level. Corporation tax is levied at a flat rate of 25%.

TRADE TAX. Profits of the company are also subject to trade tax. The percentage varies from 15% to 20% depending on the relevant taxing municipality. Together with the corporation tax, the effective tax rate on profits usually ranges between 40% and 45%.

VALUE ADDED TAX (VAT). VAT 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 16%), 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, interest and royalties are subject to withholding tax. The tax rate generally varies between 20% and 25%. Withholding tax reductions or exemptions may be available under certain tax treaties.

EMPLOYMENT ISSUES

FORM OF EMPLOYMENT CONTRACTS. There is no general requirement that employment contracts be in writing. However, essential provisions, including any individual terms and conditions that differ from the default statutory provisions, should be in writing to provide evidence of the intent of the parties.

PROTECTION FROM DISMISSAL. The employer-employee relationship comes to an end by:

- termination of the contract by mutual agreement
- end of the term of the contract of employment
- notice of termination of the contract of employment

Standard periods apply where notice of termination is given (usually four weeks). If the company regularly employs more than five individuals, employees are entitled to special dismissal protection in that a notice of termination may be issued only in the case of illness, employee misbehavior or job elimination. In exceptional circumstances, dismissal without a period of notice is possible if reasonable cause exists due to the behavior of the employee.

FIXED-TERM CONTRACTS. Under certain conditions, the special dismissal protection for employees described above may be limited by fixed-term contracts if:

- There is an objective reason for the limitation; or
- The contract is limited to a maximum of two years; or
- The company does not regularly employ more than five individuals.

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. The workers' council has the right of participation in certain social and personnel matters and the right to information on specific economic matters.

SALARY, INCOME TAX AND SOCIAL INSURANCE CONTRIBUTIONS. The primary labor costs are salaries (agreed collectively or individually) and statutory social security contributions.

- **Salary.** No minimum wage is prescribed by law in Germany. However, all employees have the right to a minimum of 20 working days leave per year. Employees are entitled to wages or salaries during such leave. They also have a legal right to continued payment of wages in the event of sickness, up to a maximum of six weeks.
- **Income Tax.** Individuals are subject to personal income tax. Tax rates generally range from 19.9% to 48.5% (e.g., for an income of Euro 50.000, the income tax rate would be approximately 25%). Employers must withhold such amounts so that employees receive a net amount. Employers who fail to withhold properly may be subject to penalties.



- **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 it then pays together with its own contribution. For example:

An employee (married with one child) receives an annual salary of 50.000 Euro from the employer together with a governmental child allowance of 1.800 Euro. The employer deducts income tax (7.900 Euro) and social contributions (9.500 Euro), resulting in an annual net income of 34.400 Euro. The total cost to the employer, including salary and insurance contributions, amounts to approximately 60.000 Euro.

LABOR AND RESIDENCE PERMITS

Citizens of foreign countries who desire to work in the Federal Republic of Germany must have a residence permit and a work permit. No work permit is required for self-employed individuals or managing directors of a legal entity.

RESIDENCE PERMIT. Most European and American nationals may obtain the necessary residence permit after they have arrived in Germany.

WORK PERMIT. The work permit is issued after a residence permit has been granted. Individuals who qualify as "Highly-Qualified Foreign Specialists in Information and Communications Technology," may be able to obtain a work permit on easier than standard terms. Qualified "specialists" usually hold a university diploma relevant to the work for which the permit is being issued.

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 in the form of copyrights, patents and trademarks. However, these provisions often differ substantially from similar US laws. For example, in most cases, the application of German intellectual property statutes is compulsory 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, and may also be protected by patents. Copyright protection arises automatically upon creation of an original work fixed in a tangible medium of expression. No registration or copyright symbol (©) is required.

- **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). In practice, this means that if a computer program is first published and sold in Germany, the programmer may be able to claim rights under German copyright law, even if the programmer is a national of a foreign country, such as the U.S.

- **Protected Persons.** Under German law, the initial copyright in a work vests in the author of the work, even if the work was created for another party. In this respect, the German approach differs from the American “work made for hire” doctrine set forth in section 201 of the US-Copyright Act. Under this doctrine, the copyright in a work commissioned by a third party does not belong to the author of the work, but instead to the third party who commissioned the work. Before exploiting the work, the commissioning party must obtain the right to use and exploit the work from the author.
- **Transfer and Licensing of Copyrights.** Under German Law, 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 by the purpose of the relevant license (*Zweckübertragungstheorie*). Under this principle, work-made-for-hire clauses, which are common under U.S. law, are generally deemed to be void under German law because they purport to assign the copyright to a person other than the author of the work. Furthermore, rights of a type unknown at the time the license was granted, automatically remain with the author (e.g. an agreement from 1960 regarding the exploitation of movie rights cannot include the right to distribute the movie through recently developed means, such as video or DVD).
- **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. Besides license agreements, any other agreement involving the transfer of intellectual property should take these aspects of German copyright law into account.

PATENTS. German and European patent laws afford 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. However, in practice, software can be patented if it constitutes part of an invention that is technical in nature and incorporated into a “device.” This requirement is met if software and hardware elements are combined “as a whole.” 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.

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. In the first 5 years after registration no use of the trademark is required. 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 of one enterprise from those of another.

- **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 has standing to initiate legal proceedings against trademark infringers who use identical or similar trademarks or who dilute the trademark. International trademark protection system is not automatic, but must be obtained country by country.
- **Means of Obtaining Protection.** A trademark may become protected by registration at the German trademark office (German Trademark), 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.
- **German and EC Trademarks.** In general, a German Trademark is faster to register and costs less than the registration of an EC trademark, and there is less risk of infringing on prior trademarks. Although the trademark is effective only in Germany, it is possible to extend protection to additional countries beyond the European Union through an International Registration (IR). An EC Trademark, on the other hand, provides protection within the entire European Community, for which only one registration is required.
- **Benefits of Registration.** Registration effectively protects a trademark, even if there is no use during the first five first years after registration. Registration also provides evidence of existence, ownership and priority, and in a proceeding against infringers, is sufficient to demonstrate ownership of the trademark.
- **Trademark Rights.** Use of a protected trademark is prohibited without the consent of the trademark holder. The trademark holder may enforce the trademark through a preliminary injunction or bring an action for 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.
- **Monitoring of Trademark Infringements.** The holder may monitor the relevant marketplace and enforce its trademark rights bringing lawsuits against potential infringers. Specialized companies assist holders by monitoring against trademark infringements for a fee.

NOTE

A number of German legal terms in the foregoing summary have been translated into English, followed by the original German term in parenthesis for explanatory purposes. Citations to laws and rules follow standard German conventions.

This summary is general in nature and is not intended to be a comprehensive discussion of the issues presented therein. It does not constitute legal advice with respect to any specific situation.

For further questions please do not hesitate to contact any of the attorneys listed in the margin of the first page of this HRO Alert.