ADVANT Beiten

INVESTING IN GERMANY

Legal and tax aspects

Foreword

Dear reader,

It is our pleasure to present this new edition of of our brochure “Investing in Germany”, reflecting the most recent legal developments in Germany until December 2021.

We also use the opportunity to inform you on our new European law firm Alliance **ADVANT**, that we launched on September 15, 2021.

ADVANT is an alliance of BEITEN BURKHARDT in Germany, Altana in France and Nctm in Italy, including more than 600 professionals in 14 locations across Europe and beyond. Built on the core values of trust, excellence, and efficiency, we have combined forces in the most important economies of the European Union to provide legal services to those seeking to expand in or into Europe.

For more details about our alliance, please visit our website http://www.advantlaw.com or see our image brochure at the link: https://www.advant-beiten.com/sites/default/files/downloads/ADVANT%20Brochure%202021_EN.pdf.

We are convinced that **ADVANT Beiten** will offer you an excellent gateway to Germany and to the EU markets, and we hope that this brochure will give you and your company the information and directions required to embarque on the journey!

Best regards,

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Partner | Lawyer | LL.M.
ADVANT Beiten

Content

A. The European Union and Germany

The European Union (EU) is a community of 27[1] European states and the world's biggest economy. Together, the EU Member States produce 18.6% of the worldwide gross domestic product (GDP),[2] the GDP in the world.

With a purchasing power of nearly half a billion people[3] EU is the world's most lucrative consumer market. Consequently, it is one of the most important trade partners in the world, accounting for around 14% of the world's trade in goods[4]. The EU scontribution to trade in services was ever greater. For exports, extra-EU trade accounted for 16.4% of global exports of services while intra-EU trade made up 15.6 %. The import market was similar, with extra-EU trade accounting for 14.8 % of world imports of services and intra-EU trade making up 15.8%.[5]

According to the latest Foreign Direct Investment Confidence Index released by global management consulting firm A.T. Kearney,[6] 4 EU Member States are among the ten best-rated investment destinations worldwide: Germany (3), France (6), Italy (8), and Spain (9).

An investor seeking to enter the European Union market will consider several criteria when choosing the location, such as the general investment landscape, the condition and reliability of transport, communications and energy infrastructure, availability of well-qualified employees, the competitiveness of the tax system, the options available for setting up businesses and the applicable employment regulations, to name but a

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1 The United Kingdom's exit from the EU, often referred to as Brexit, occurred on 31 January 2020, and is governed by the Withdrawal Agreement signed on 24 January 2020.

2 European Commission, "The EU in the world - Statistics Explained (2020 edition)": https://ec.europa.eu/eurostat/documents/3217494/10934584/KS-EX-20-001-EN-N.pdf/8ac3b640-0c7e-65e2-9f79-d03f00169e17, in 2018, the EU-27 accounted for a 18.6% share of the world's GDP while the United States accounted for 24% (data extraction during January and February 2020, accessed on 14 December 2021).

3 Combined EU population is 447 million: EU Commission, "Key Figures on Europe (2021 edition)", https://ec.europa.eu/eurostat/documents/3217494/13394938/KS-EI-21-001-EN-N.pdf/ad9053c2-debd-68c0-2167-f2646efeaec1?t=1632300620367 (data extraction on 1 January 2020, accessed on 14 De-cember 2021).

4 European Commission, Eurostat database: https://ec.europa.eu/eurostat/statistics-explained/index.php/ International_trade_in_goods (data extraction from September 2021, accessed on 14 December 2021).

5 European Commission, "The EU in the world - Statistics Explained (2020 edition)": https://ec.europa.eu/eurostat/documents/3217494/10934584/KS-EX-20-001-EN-N.pdf/8ac3b640-0c7e-65e2-9f79-d03f00169e17 (data extraction during January and February 2020, accessed on 14 December 2021).

6 A.T. Kearney GmbH, "The 2021 A.T. Kearney Foreign Direct Investment Confidence Index": The 2021 Kearney Foreign Direct Investment Confidence Index®: On shaky ground – Kearney (accessed on 14 December 2021).

few. You can find an overview of the main investment criteria for doing business in Germany in Chapter I.

Germany is a key driver of the EU economy and the most attractive investment destination in Europe. Renowned as a strong and stable business location, Germany offers investors excellent infrastructure, a highly skilled and educated workforce and an outstanding research environment. These characteristics, combined with a taste for innovation, a clear international dimension and the global reach of its economy make Germany a highly attractive investment destination[7].

[7] Ernst & Young, "The EY Attractiveness Survey – Europe – June 2021": Foreign investors back Europe, but is Europe back? | EY – Global (accessed 14 December 2021).

B. Corporate law & acquisitions

A foreign investor has a multitude of options when it comes to structuring market entry in Germany.

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

The following chapter provides an overview of the main options. You can find a summary of this information in Chapter I.

I. Establishment of a company branch

If a company wishes to operate in Germany, it has the option of establishing a completely legally-independent subsidiary, or setting up a branch office.

Setting up a branch office does not require the establishment of 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. In this respect, it is subject to the law applicable at the location of the head office.

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

1. Independent branch (branch establishment or branch office)

According to the Commercial Code (Handelsgesetzbuch, HGB)[8], an independent branch is a branch office 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:

[8] Commercial Code (*Handelsgesetzbuch, HGB*) in the version published in the Federal Law Gazette Part III under the classification number 4100-1, last amended by Article 14 of the Law of 22 December 2020 (BGBl. I p. 3256).

- **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 handles short-term transactions, and, like the head office, also pursues long-term business.

Since the branch office is not an independent company but part of the company as a whole, its name is, as a rule, will be identical to that of the main company. Additions such as "German office" are possible. The managers of the branch office represent it independently in external dealings. They must be vested with a power of attorney (general commercial power of attorney (*Generalhandlungsvollmacht*) or power of procuration (*Prokura*)) which authorises them to act for the branch office. However, in the case of liabilities, the debtor will always be the natural or legal person that is the main company, not the branch office itself. The branch is registered in the German commercial register and instead of abroad where the head office is located. This provides the branch office 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 will be responsible for completing the above steps.

2. Dependent branch (business premises)

A company can also have several business premises which are not 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 an application for registration of a trade (business registration) will need to be submitted to the local trade licensing office (see V.1. f)).

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 establish a representative office in Germany, it does not represent independent commercial activity on the part of the foreign company. A representative office 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 Banking Act (*Kreditwesengesetz, KWG*)[9], only banks with a registered office abroad require the approval of the German supervisory authority for the banking industry to establish a representative office.

Often, a representative office is simply 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 his/her 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, it begins to function as a part of the foreign company's own organisation and legally constitutes a branch establishment. Depending on the degree of dependence on the head office, it is either only a dependent branch (= business premises) or it is a true branch establishment in terms of the Commercial Code, which must then also be registered in the commercial register.

While a representative office can be set up and used in advance of any entrepreneurial activity, the company cannot use it to conduct commercial activity, since this would make the representative office a branch establishment.

III. Establishment of a sole proprietorship

The establishment of a company in the form of sole proprietorship (*Einzelkaufmann/-frau*) can be a suitable form of market entry for small business. The formalities are quite straightforward: the company simply needs to be registered with the trade licensing office (see V. 1. f)).

The business is run solely by the proprietor, who is personally liable with 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, which will give the entrepreneur the status of registered businessman (*eingetragener Kaufmann, e.K.*).

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[9] Banking Act (*Kreditwesengesetz, KWG*) in the version of the publication of 9 September 1998 (BGBl. I p. 2776), last amended by Article 4 of the Law of 9 December 2020 (BGBl. I p. 2773).

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

The options for operating a company as a sole proprietorship are 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 sheets and income statements.

IV. Establishment of partnerships

When setting up a new company, the first decision is whether to form a partnership or a corporate entity. While the individual identity of the partners is very important for a partnership, with a corporate entity, the identity of the shareholders is less important than the fact that the company acts externally as an independent unit and the shareholders participate through a more impersonal and limited employment of capital. The personal nature of the partnership gives rise to the following fundamental characteristics:

- The partnership has **no legal personality** of its own; **each partner is jointly and severally liable for the company**.
- Each partnership consists of at least 2 persons and has at least one partner who is personally liable for the company's liabilities with their private assets.
- The principle of inherent powers of corporate offices applies, i.e., the company has, in its members, "born" corporate bodies; third parties may not be appointed as corporate bodies.
- The purpose of the company is primarily pursued through the personal commitment of their effort, creditworthiness, and private assets by 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; as a consequence, the death, resignation or insolvency of a partner can affect the existence of the company.

The 3 most important forms of partnership are the partnership under German civil law (*Gesellschaft bürgerlichen Rechts, GbR*), the general partnership (*offene Handelsgesellschaft, OHG*) and the private limited partnership (*Kommanditgesellschaft, KG*).

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

In order to form a GbR, you need at least 2 partners who pursue a common aim. Like all partnerships, the GbR does not represent a corporate entity and, accordingly, will not generally exist for the long term but will be created to achieve the common purpose, such as the construction of a dam by several construction companies. The partners of a 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 between 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.

Where the purpose of the GbR is to conduct commercial trade, it will be 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 2 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 will be authorised to manage and represent the company externally. Each partner will be jointly and severally liable with their entire private assets for the company's liabilities. This means that creditors can seek out any partner and demand from them the entire amount which the company owes to the creditor.

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

The *Kommanditgesellschaft (KG)* 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 2 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 2 types of partners, 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 assets contributed, 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**, the liability of the general partner is effectively limited, since by law the liability of a GmbH is limited to its own company assets (see VI. 3.).

b) Management and representation

As a fundamental rule, only the general partners in a KG will be authorised to manage the company. The limited partners are simply granted a right of control, but it is possible to formulate the management authority in the articles of association to depart from the legal rule. The limited partners are also excluded by law from representing the company externally. However, individual limited partners may 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 recommended** when establishing any company. The costs of legal advice should not be a deterrent in this respect. As a rule, these costs will be much lower than the costs and losses to be expected if disputes arise that are critical to the existence of the partnership 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;
- object of the company;
- partners and their share in the company capital;
- management and representation;
- participation in profits and losses;
- drawing right;
- duration of the company;
- 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 of the local court within whose jurisdiction the company's registered office is located. 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 (*Geschäftsführer*) and management board members (Vorstand) do not need to 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 Gesellschaft mit beschränkter Haftung or "GmbH" (limited liability company)

A *Gesellschaft mit beschränkter Haftung (GmbH)* is an independent legal entity under private law and as such it is 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 applicable commercial register, which is kept by the local 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**. Representation by proxy is permissible, but this requires at least a notarised power of attorney. An individual can also establish a GmbH and draft the articles of association. The articles of association must at least specify 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, "**Gesellschaft mit beschränkter Haftung**" or a generally understandable abbreviation of this designation ("**GmbH**").

It should also be noted that the permissibility of the company name depends on the circumstances of the individual case; it is **recommended** that with the competent Chamber of Industry and Commerce (*Industrie- und Handelskammer, IHK*) be asked to bindingly confirm the permissibility of the chosen company name.

(2) Registered office of the company

The articls of association should specify that the registered office of the company in Germany is where the company has its business operations, company management is based, or is the location from which the company is administered. 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 with 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 actually performed in Germany, making use of the necessary resources available there, the company could be found to have dual domicile for tax purposes: 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 result in disadvantages under the terms of the agreement (**double taxation**). Moreover, relocating the management office abroad could give rise to the potential risk of liquidation taxation in accordance with Corporate Tax Act (*Körperschaftsteuergesetz, KStG*)[10] 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.

(3) Object of the company

A GmbH can pursue **any legally admissible purposes**. 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 case of the simplified procedure (see V.1.b)), one shareholder may already acquire several shares in the business upon the establishment of the company. The number and nominal amounts of the shares in the business

[10] Corporate Tax Act (Körperschaftsteuergesetz, KStG) in the version of the publication of 15 October 2002 (BGBl. I p. 4144), last amended by Article 7 of the Law of 25 June 2021 (BGBl. I p. 2056).).

that each shareholder acquires must be included in the articles of association and must be consecutively numbered in the list of shareholders.

The nominal capital may be provided in cash or 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

Generally, further provisions will be 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 conduct of shareholders' meetings.

b) Establishment through the simplified procedure – the model statutes

With the Law on the Modernisation of the Private Limited Liability Companies Act and Combating of Misuse (*Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen, MoMiG*)[11] the legislator has provided "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 where it is agreed that the GmbH will hae a maximum of 3 shareholders and only one director, only cash contributions will be provided and each shareholder will have only one share in the business.

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, object of the company, nominal capital, distribution of shares in the business between the shareholders, name, date of birth and place of residence of the director and special comments by the notary, supplemented with provisions on representation and costs of establishment.

[11] Law on the Modernisation of the Private Limited Liability Companies Act and the Combating of Misuse (*Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen, MoMiG*) of 23 October 2008 (BGBl. I 2008, p. 2026).

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

The use of model statutes yields a slight advantage in terms of costs; however, this is countered by several 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 company`s directors

The GmbH has one or more directors. The directors are appointed 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 are described in 3. b) and in their service contracts (see Chapter G. IV. 3).

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 share contributions 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 one-quarter of each share into the business, but no less than half of the minimum nominal capital of **EUR 12,500** in total.

For this purpose, immediately following notarisation of the articles of association, the director should open a company bank account into 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 "in the course of establishment" (*in Gründung*), or "i.G." for short.

The directors as well as all founding members are entitled to open an account. The following documents must be submitted to open the account:

- a certified copy of the notary deed for the incorporatation: this will mainly consist of the notarised articles of association;

- a copy of the shareholders' resolution on the appointment of the directors;

- a copy of the application for entry in the commercial register;

- a copy of proof of existence and proof of power of representation in the case that the parent company itself is a legal entity, i.e., Certificates of Good Standing, Certificate of Incorporation and Certificate of Shareholders, Certificate of Directors and Secretary in most cases, and if necessary, with translation of the documents by a sworn translator, and authorisation by apostille or legalisation;

- an organisation chart of the parent company, indicating its shareholder(s) and revealing the ultimate beneficial owner(s);

- a valid passport or ID of the applicant;

- proof of residential address of the applicant (if the shareholder or the director(s) of the company, for whom the account will be opened, is from another country); and

- sometimes additional KYC ("know your customer") requirements resulting from anti-money laundering requirements and internal regulations of the banks or financial institutions.

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 and can be inspected by anybody, free of charge, at the local 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 local court in whose district the GmbH has its registered office is responsible for maintaining 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 together 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 and percentage of shares compared to the total nominal capital 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 or asset taken over in return;

- written confirmation by the directors that they have not been convicted of a financial or insolvency-related offence, nor have they been prohibited from practising a profession;

- 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 result in notary's fees of approximately EUR 850.

f) Business registration

If a GmbH has been founded, the business **must be registered** before business operations can commence according to the Industrial Code (Gewerbeordnung, GewO)[12]. This also applies in the case of the takeover of an existing business.

The business registration is in principle a mere notification of the commencement of the intended business to the competent administrative authority. An approval of the business by an authority is only required for certain types of business, as defined by statute. Such a business licence is required, for example, for business activities in the financial sector or in other sectors that might be hazardous to the general public, such as gambling or private security.

The authorities responsible for business registration vary depending on the federal state. The relevant competent authority regularly makes a standard form available on the Internet to be used when registering a business. The costs for the administrative

[12] Industrial Code (*Gewerbeordnung, GewO*) in the version of the publication of 22 February 1999 (BGBl. I p. 202), last amended by Article 5 of the Law of 2 March 2021 (BGBl. I p. 327).

procedure differ between the authorities. Administrative costs for the registration vary between approximately EUR 15 and EUR 60. Any failure to comply with the registration requirement is considered an administrative offense; in case of continued and intentional non-compliance, it is considered a criminal offence.

g) Mandatory information on company's letterhead

Under German law, any company letterhead, i.e., notice of the company about business matters to third parties in written or e-mail form, must contain specific information about the company (i.e., the complete company name, legal form, seat of the company) and the relevant company register, the company's registration number in the commercial register, the name(s) of the director(s) and, in the case of a supervisory board, the name of the chairperson of the supervisory board.

In addition, specific tax information (like the VAT identification number and tax identification number) must be included on any invoices issued by the company.

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

It is possible to establish a company 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 an a sub-form of the GmbH. Accordingly, the same regulations apply to the UG as apply to the GmbH, with a number of important differences, as 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 particularly interesting for persons starting up a new business as it only requires a small amount of start-up capital. However, the amount of nominal capital chosen should be adjusted to the specific requirements of the proposed business activity, because the lower the nominal capital, the higher the risk of insolvency. Founding a company with one euro nominal capital is therefore not practical.

Unlike the "classic" GmbH, the nominal capital of the UG must be fully paid up as cash contributions prior to registration of the company in the commercial register. Non-cash contributions are not permitted.

Practical advice: If a foreign investor plans to enter into a contract with a UG, then the amount of its capital should be verified. In the absence of recoverable assets, we recommend obtaining supplementary forms of security (reservation of title, transfer of title by way of security or similar, sureties, or the like).

b) Formation of reserves

In order to ensure the availability of adequate capital resources, the UG may not distribute any profits in full. Instead, it must form a statutory reserve and transfer into it one quarter of the net income for the year, minus the loss carry-forward from the previous year. Apart from a nominal capital increase, this reserve may also be used to balance an annual deficit or loss carry-forward. This obligation ceases once the company's nominal capital is increased to at least EUR 25,000 following the adoption of a resolution to amend the articles of association of the UG.

Failure to satisfy the reserve requirement will result in the annulment of the approval of the annual financial statements, which in turn leads to the annulment of any resolution on the appropriation of profits. This can result in repayment claims against the shareholders and personal liability on the part of the directors.

c) Obligation to convene the shareholders' meeting

A shareholders' meeting shall be convened in any of the circumstances stipulated by law (see 3.a)) or if it is required in the interest of the GmbH. A shareholders`meeting must be called immediately if insolvency is impending. Unlike the GmbH, the loss of half of the nominal capital is not required to trigger a shareholders' meeting.

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 of the Limited Liability Companies Act (*Gesetz betreffend die Gesellschaften mit beschränkter Haftung, GmbHG*)[13], and falls outside of the scope of the Reorganisation of Companies Act (*Umwandlungsgesetz, UmwG*)[14]. The company must achieve the minimum nominal capital of a GmbH (EUR 25,000), through either cash capital increases or the conversion of reserves into nominal capital under the rules on capital increases from the company resources for the GmbHG. In particular, 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.

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[13] Limited Liability Companies Act (*Gesetz betreffend die Gesellschaften mit beschränkter Haftung, GmbHG*) 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 4 May 2021 (BGBl. I p. 882).

[14] Reorganisation of Companies Act (*Umwandlungsgesetz, UmwG*) in the version of the publication of 28 October 1994 (BGBl. I p. 3210; 1995 I p. 428), last amended by Article 1 of the Law of 19 December 2018 (BGBl. I p. 2694).

e) UG (*haftungsbeschränkt*) & Co.

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

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

3. The corporate bodies of the GmbH

As a legal entity, the GmbH acts 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 matters of the GmbH, in particular:

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

The shareholders' meeting can decide on 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 in the shareholders' meeting generally arrive at their decisions through the adoption of resolutions. The law stipulates special requirements in terms of the majority required to adopt 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) The 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.

Fundamentally, the authority to manage concerns the entire scope of the company, in both business and technical terms – unless otherwise stipulated – for ordinary and extraordinary legal transactions. The authority to manage does not include the power to amend the articles of association and various other rights under the 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, the articles of association will also specify a list of legal transactions requiring approval, restricting the directors' internal authority to manage.

In this context, however, it must be noted that the statutory power of dirctors to represent the company remains **unrestricted** and **cannot be limited**. Even if the directors are required internally to observe restrictions imposed on their 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 do not, in principle, have an impact on the power of representation externally, such as vis-á-vis contractual business partners.

Directors are only subject to the **legal restrictions of § 181 Civil Code** (*Bürgerliches Gesetzbuch, BGB*)[15], on the basis of which they may not act simultaneously in their own name and in the name of the company (prohibition against contracting with oneself) and they may not simultaneously represent the GmbH and a third party in a transaction between said third party and the company (prohibition against multiple agency). Contracting with oneself and multiple agency are only allowed if they are explicitly permitted, e.g. in the articles of association, or in individual cases by a resolution of the shareholders' meeting.

In addition, the potential abuse of a managing director's representative authority can be limited if the company appoints several (at least 2) directors and grants them joint representative authority. In this case, the company can only be represented exter-

[15] Civil Code (Bürgerliches Gesetzbuch, BGB) in the version of the publication of 2 January 2002 (BGBl. I p. 42, 2909; 2003 I p. 738), last amended by Article 4 paragraph 6 of the Law of 7 May 2021 (BGBl. I p. 850).

nally with legally binding effect by 2 directors jointly (genuine joint representation) or by one director together with an authorised signatory (non-genuine joint representation). If only one director acts, will only be 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.

Directors will also be subject to other specific obligations. For example, they are responsible for convening and preparing shareholders' meetings. In addition, directors are responsible for ensuring entries in the commercial register are complete and correct, for fulfilling tax obligations on behalf of the company and for the 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 Federal Gazette (*Bundesanzeiger*) and the publication of the company's reporting documents.

Finally, in the event of grounds for insolvency of the company, the directors are obliged to apply for the opening of insolvency proceedings without any culpable delay.

Digression: rights and obligations of the authorised signatories

The **power of procuration** (***Prokura***) is a special authorisation which, in accordance with the provisions of the HGB, 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 approval by the shareholders' meeting that might be necessary internally.

Only natural persons can be granted a power of procuration. The power of procuration becomes effective at the time of its issuance, which can take place without adherence to formal requirements. It lapses immediately, irrespective of registration in the commercial register, upon revocation, which can occur at any time. Both the issue and the lapse of the power of procuration must be registered in the commercial register. 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 business, 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. The power of procuration may not be limited vis-à-vis third parties. 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 by so-called "principal transactions", which may only be conducted 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, apply for registration or sign on behalf of the company in the commercial register, issue powers of procuration or sign the annual financial statements.

c) The supervisory board

Generally, the supervisory board (*Aufsichtsrat*, also sometimes called the advisory board) is not a mandatory corporate body of the GmbH. However, the shareholders may establish a board in the articles of association (optional supervisory board – *freiwilliger Aufsichtsrat*). On no account does the supervisory board have a management function. It simply monitors and supervises the management and advises on certain decisions.

In certain cases, the GmbH is required to have a supervisory board. This includes:

- The One-third Participation Act (*Drittelbeteiligungsgesetz, DrittelbG*)[16] 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. When calculating the number of employees of the GmbH under the DrittelbG, employees of operations of dependent companies are deemed to be employees of the controlling company if a control agreement exists between the 2 companies or if the dependent company is incorporated into the controlling company.

- Pursuant to the Co-determination Act (*Mitbestimmungsgesetz, MitbestG*)[17], a supervisory board is mandatory in companies which typically employ more than 2,000 employees. The supervisory board must be made up of representatives of the employers and employees in equal parts. Companies active in the mining and steel industries which fulfil the prerequisites of the Mining and Steel Industry Co-determination Act (*Montanmitbestimmungsgesetz, MontanMitbestG*)[18] are exempt from this obligation.

- The MontanMitbestG 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

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

[17] Co-determination Act (*Mitbestimmungsgesetz, MitbestG*) in the version of the publication of 4 May 1976 (BGBl. I p. 1153), last amended by Article 7 of the Law of 24 April 2015 (BGBl. I p. 642).

[18] Mining and Steel Industry Co-determination Act (*Montanmitbestimmungsgesetz, MontanMitbestG*) 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).

mining and iron and steel producing industries. The Supplementary Mining and Steel Industry Co-determination Act (*Montanmitbestimmungsergänzungsgesetz, MontanMitbestGErgG*)[19] extends the provisions of the MontanMitbestG to parent companies of groups which, while not themselves fulfilling the prerequisites set forth in the MontanMitbestG, head a group characterised by companies involved in the mining and steel industries.

4. Miscellaneous

a) Amendments to the articles of association

Resolutions pertaining to amendments of the articles of association **must be notarised**. Amendments to the articles of association **must be registered in the commercial register** by the directors **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 or the misuse of corporate structures. The latter is assumed where the absence of personal liability on the part of the shareholder has been deliberately used to the detriment of creditors and none of the cases above applies.

c) Preservation of capital

Assets of the company required to maintain the nominal capital may not be paid out to the shareholders. Any payments made contrary to this prohibition must be refunded to the company by the relevant shareholder. If the refund cannot be obtained from the relevant shareholder, the other shareholders will be liable for the amount which is to be refunded to the extent that is required to satisfy the company's creditors, in proportion to their stake in the business. In addition, the directors will also be 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 this obligation, as well as the obligation to audit and disclose the annual financial statements, will depend on the size of the company.

- In the case of a **small corporate entity**, the annual financial statements must be prepared within the first 6 months of the following business year. No management report needs to be prepared.

  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, at the latest before the end of the 12th month of the following business year and must immediately be submitted to the Federal Gazette (*Bundesanzeiger*).

  Small enterprises are those which do not fulfil at least 2 of the 3 following characteristics:

  - balance sheet total of at least EUR 6,000,000;
  - sales revenues of at least EUR 12,000,000 in the twelve months prior to the balance sheet date;
  - a yearly average of at least 50 employees.

- The annual financial statements of **medium-sized and large GmbHs** must include a management report. The statements and management report must be prepared within the first 3 months of the business year and audited by an independent auditor.

  Medium-sized enterprises are those which exceed at least 2 of the three characteristics above.

  Large enterprises are those which exceed at least 2 of the following 3 characteristics:

  - balance sheet total of at least EUR 20,000,000;

[19] Supplementary Mining and Steel Industry Co-determination Act (*Montanmitbestimmungsergänzungsgesetz, MontanMitbestGErG*) in the version published in the Federal Law Gazette Part III under the classification number 801-3, last amended by Article 26 paragraph 3 of the Law of 3 June 2021 (BGBl. I p. 1534).

- sales revenues of at least EUR 40,000,000 in the twelve months prior to the balance sheet date;

- at least 250 employees on a yearly average.

5. Purchasing a GmbH

Instead of establishing a new GmbH, market access can be gained by acquiring an 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. Conversely a so-called "shelf company", which has not yet started any business operations, can be purchased fro specialist providers. The extra costs incurred (in addition to the share capital, the establishment costs and costs of any legal and tax advisors) usually amount to approximately EUR 3,500.

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

In most cases, it is also necessary to amend the articles of association, 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:

- notarised contract of purchase and assignment of the shares in the business;

- notarised shareholders' resolution concerning the amendment of the articles of association and change of directors, including the new company name and new object of the company;

- notarised application for the registration in the commercial register of:

    - the assignment of the shares in the business and submission of a new list of shareholders;

    - the release of the previous directors from office and appointment of new directors;

    - the amendment of the articles of association.

Practical advice: Before acquiring an existing company, it is advisable to check what liabilities such company still has.

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 the bearer of rights and obligations. Only the company's assets are liable for liabilities of the company towards creditors. Where the shares in the company are traded on the stock exchange, it will be referred to as a listed public limited company (*börsennotierte 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 required. An AG can 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 of each nominal amount; in the case of no-par shares: their number;

- if there are several classes of shares, the number of shares in each class;

- information on whether the shares are bearer shares or registered shares;

- number of management board members or the rules according to which this number is determined;

- 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) Digression: forms of shares and classes of shares

A minimum share capital of EUR 50,000, 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

Shares can be issued in 2 different forms, either as par-value shares or as no-par shares. The two forms of shares may not be combined.

Par-value shares are characterised by the fact that the nominal value of the share is marked on the share. They must be denominated with a 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 is calculated based on 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 registered shares. Both forms of shares can also exist together.

In the case of anonymous **bearer shares**, the holder of a 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; consequently, 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 executed through re-registration of the shareholder in the shareholders' book. This requires that the company is 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 – to a certain extent – 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 such "**preference shares**", the shareholder will have all shareholder's rights except 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 in turn appoints the first management board. Only natural persons with full legal capacity can be appointed as members of the supervisory board and management board. They do not need to be German nationals.

For more details see 7. b) and 7. c).

c) Formation report and formation audit

The founders prepare the formation report regarding the establishment of the AG. 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 report must explain the key circumstances on which the appropriate nature of the performances as non-cash contributions depend.

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 value of the shares or value of the benefit to be granted in return?
- Describe the nature of each non-cash contribution, and specify and describe the valuation methods applied in determining its value.

In the case of establishment through non-cash capital contribution or where 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 of any cash contributions must be paid into an account held by the AG. If the shares were issued at a value higher than the minimum issue value, 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 (*Industrie- und Handelskammer, IHK*). If there are no obstacles to registration, the AG is normally registered in the commercial register approximately 6 to 8 weeks later, after which time it enjoys its own legal personality. The registration must be published in the Federal Gazette and, if applicable, in a further publication medium

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

- 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 Federal Gazette;
- additional legal advice.

f) Business registration and mandatory information on company`s letterhead

The requirement to show the business registration and other information on company's letterhead are similar to the requirements described in 1. f) and g).

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 powers extend 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 management board and the supervisory board;
- the amendment of the articles of association;
- the 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 must convene to pass resolutions. Certain formalities must be observed prior to a general meeting as well as when exercising the voting rights during the general meeting.

(1) Calling the general meeting

The general meeting is normally convened by the management board. The board must announce the meeting at least one month before the meeting date in the company's designated publications, i.e., at least in the Federal Gazette, which is 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, BMJ*) and is operated by Bundesanzeiger Verlags GmbH, 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;
- venue for the general meeting with exact address;
- conditions for participation and the exercise of voting rights;

- procudre for voting by proxy or by postal vote or by way of electronic communication pursuant to Section 118 (1) sentence 2 of the Stock Corporation Act (*Aktiengesetz, AktG*)[20], provided that the articles of association provide for a corresponding form of exercising 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, the general meeting can also take place at the stock exchange premises. Due to the ongoing Covid-19 pandemic, more and more companies are organising and holding their general meetings as virtual meetings or in hybrid form.

The law does not stipulate 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 take place on a Sunday or public holiday, nor should it commence before 8 o'clock in the morning.

In addition to providing the subject of any planned 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 the need to make 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) Conduct of the general meeting

At the general meeting, a register must be kept of those shareholders in attendance stating their place of residence, the percentage of their shareholding, and the category of the shares. It is not strictly necessary for 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.

[20] Stock Corporation Act (Aktiengesetz, AktG) in the version of the publication of 6 September 1965 (BGBl. I p. 1089), last amended by Article 15 paragraph 22 of the Law of 4 May 2021 (BGBl. I p. 882).

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 any exclusions of voting rights to be assessed more rapidly.

The general meeting must have a chairperson: 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 will specifiy that the chair-person of the supervisory board will chair the general meeting.

The chairperson 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. This is primarily intended to enable the shareholder to obtain all information necessary to cast their vote.

The chair of the meeting initiates and leads the voting on 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 an unlisted AG, 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 AG 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 must report. However, it is not bound by instructions issued by the supervisory board or the general meeting.

The duties and obligations of the management board include, among others:

- the preparation of resolutions placed before the general meeting and their implementation as resolved;

- the keeping of trading books;

- the preparation of the annual financial statements;

- the obligation to apply for insolvency in the event of the insolvency or overindebtedness 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 5 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 2 persons, unless otherwise stipulated in the articles of association.

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 for certain types of transactions to only be conducted with the approval of the supervisory board. Any such list of transactions requiring approval must be specified in the articles of association, but can also be more closely defined in a resolution of the supervisory board. The supervisory board is authorised to inspect and examine all of the 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 must consist of at least 3 members, but the articles of association can stipulate a higher number of members, divisible by 3. 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 9;

- more than EUR 1.5 million, to a maximum of 15;

- 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 control body, the supervisory board is required to hold at least one meeting every six months, 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 chairperson.

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 form 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 where many limited partners contribute cash amounts and, in view of the high volume of financing, no natural person should assume the position of personally liable partner.

1. Establishment

To set up a KG, at least 2 persons, one general partner and one limited partner, are required. 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 parties may agree to defer the time at which the company comes into being, for internal purposes, to a date after 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 and start operation 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 be 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, the law does not require the contributions to be audited by an auditor or other expert.

A distinction is made between the liable capital 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 amount registered in the commercial register. Limited partners will not be held liable once they have made their investment provided 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 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 and to 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, which means that 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 and 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, they will 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 resolution will require the unanimous approval of the shareholders.

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

Each limited partner holds a limited partner's share. According to the legal ideal, to be passed by the shareholders a resolution requires 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 the limited partner's shares is restricted by law. Consequently, 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 the 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 shares in the KG should always be subject to 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 a typical GmbH & Co. KG, the general partner GmbH is usually a small corporate entity and enjoys 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, or as a result of a resolution passed by the shareholders, the opening of insolvency proceedings concerning the company's assets or a court decision.

VII. Regulatory framework for the acquisition of companies

Germany considers its **open investment landscape** one of the cornerstones of its economic development. Despite an acknowledgeable tendency within Europe to restore technological sovereignty, the German policy on foreign direct investment remains comparatively liberal. With its central location in Europe, Germany has become an attractive hub for many foreign investors seeking a **gateway into Europe**.

1. Advantages of acquiring a company in Germany

There are many advantages to acquiring an existing European or German company which is already active on the market. A foreign investor can acquire an existing distribution network and is thus spared the costs of having to develop its own network from scratch. The newly acquired customer base can be targeted when marketing of the investor's own products. On the other hand, the foreign investor gains access to new technologies and the know-how of the target company. In particular, small and medium-sized enterprises, recognised as "**hidden champions**" in Germany, often possess a considerable wealth of expertise.

Another advantage lies with the European labour market, which offers foreign investors a rich pool of qualified employees. Furthermore, the acquisition of a German company enables an investor to streamline employee structures and reduce HR costs.

Non-EU investors can also benefit significantly from the possibility to raise additional capital on the German and European capital markets.

2. Restrictions on foreign investors

There are no fundamental legal barriers to acquiring the shares or assets of a European company other than the **foreign investment control** and **merger control** requirements. Any foreign investor seeking to invest in Germany must therefore take the applicable German and EU regulatory frameworks into consideration when planning a transaction.

a) Foreign investment control[21]

The legal basis for the German foreign investment control can be found in the Foreign Trade and Payments Act (*Außenwirtschaftsgesetz, AWG*)[22] and the Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung, AWV*)[23]. However, the German regulatory framework, as well as the regulatory framework of other EU Member States are profoundly influenced by the evolving EU regulations on FDI control[24] and therefore have been subject to multiple revisions in recent years.

The competent German authority is the Federal Ministry for Economic Affairs and Climate Protection (*Bundesministerium für Wirtschaft und Klimaschutz, BMWK*). The *BMWK* is not only in charge of the foreign investment review but also serves as the link to the other European FDI control bodies. The review procedure conducted by the *BMWK* is free of charge.

The German foreign investment control regime can be divided into: (1) sector specific investment control, which mainly applies to military goods and (2) general investment control for critical infrastructure, critical industries, and all other sectors, and **applies to all direct or indirect participations in domestic companies**, irrespective of whether the investment reaches any share-based threshold or monetary threshold such as a turnover or transaction value.

(1) Sector-specific investment control

The sector-specific investment control aims at protecting the essential security interests of the Federal Republic of Germany, in particular German security policy and military interests, and applies to all activities listed in § 60 (1) of the AWV.

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[21] The following overview of the German foreign investment control is based on our firm's latest publication in the *International Comparative Legal Guides (ICLG), Foreign Direct Investment Regimes 2022, Third Edition, Q&A Chapter on Germany, 3 November 2021*, which can be accessed under the following link: https://iclg.com/practice-areas/foreign-direct-investment-regimes-laws-and-regulations/germany.

[22] Foreign Trade and Payments Act (*Außenwirtschaftsgesetz*) in the version of the publication of 6 June 2013 (BGBl. I p. 1482), last amended by Article 1 of the Regulation of 25 August 2021 (BAnz AT 07.09.2021 V1).

[23] Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung*) in the version of the publication of 2 August 2013 (BGBl. I p. 2865), last amended by Article 2 of the Regulation of 25 August 2021 (BAnz. 2021 AT 07.09.2021 V1).

[24] For example, the latest Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union, Official Journal of the European Union LI 79/1, 21.3.2019, p. 1–14.

This list is comparatively short and applies to any (direct or indirect) acquisition of voting rights of at least **10%** in a German company or certain assets of such company (such as a separate business unit or all essential operating resources) by a **non-German investor**, if said target company

- develops, manufactures, modifies, or has actual control over certain goods related to **weapons, ammunition and armaments** or has actual knowledge of or access to the technology underlying such goods; or
- develops, manufactures, modifies, or has actual control over certain **defence-related goods** or has actual knowledge of or access to the technology underlying such goods; or
- manufactures or has manufactured certain **products with IT security functions** for processing classified government information or components of such products that are essential for IT security and the target still is in possession of the underlying technology; or
- qualifies as a **defence-related entity**.

(2) General (cross-sector) investment

The second category of transactions that are subject to governmental control by the *BMWK* is general (cross-sector) investment control, which aims to protect German and European public order and security, as well as the public order and security with regard to certain projects and programmes of European Union interest.

General investment control has three sub-categories: (i) the control of investments into **critical infrastructure**; (ii) the control of investments into **critical industries**, and (iii) the control of investments into **all other sectors**.

Unlike the sector-specific investment review, which applies to any non-German investor, general investment control only applies to those foreign investors based outside of the European Union and the European Free Trade Association (EFTA). However, intra-group transfers outside of the EU and EFTA may be excluded from the German foreign investment review under certain circumstances.

i. Control of investments into critical infrastructure

The general investment control for foreign investments into critical infrastructure applies to the activities listed in § 55a (1) No. 1 – 7 of the AWV. Specifically, this list applies to any (direct or indirect) acquisition of voting rights of at least **10%** in a German company or certain assets of such company (e. g. a separate business unit or all essential operating resources) by a **non-EU/EFTA investor**, if said target company qualifies as

- an **operator of critical infrastructure** (such as in the energy, information technology, telecommunications, transportation, healthcare, water, food, finance and insurance sector);
- a developer of **software for critical infrastructure**;
- an operator in the sphere of **telecommunication**;
- a large **cloud computing** service provider;
- an authorised provider of **telematics infrastructure**;
- a **media** company; or
- a service provider of **state communication infrastructure**.

ii. Control of investments into critical industries

The general investment control for critical industries applies to all activities listed in § 55a (1) No. 8 – 27 of the AWV. This list is much more comprehensive and applies to any (direct or indirect) acquisition of voting rights of at least **20%** in or certain assets of a German company by a **non-EU/EFTA investor**, if said target company qualifies as

- a manufacturer, developer or distributor of certain products in the **healthcare sector**, such as personal protective equipment or related production facilities, essential medicines, medical devices, or in vitro diagnostics;
- an operator of high-quality **geospatial systems**;
- a manufacturer or developer of certain goods applying **artificial intelligence** which can be used for cyber-attacks, disinformation, surveillance or the analysis of location data;
- a manufacturer or developer of certain automated motor vehicles or unmanned aerial vehicles or components essential for **driving control or navigation** or related software;
- a manufacturer or developer of **robots** with specific characteristics;
- a manufacturer, developer or processor in the area of **semiconductors and optoelectronics**;
- a manufacturer or developer of **cybersecurity/IT security products**;

- an operator of certain **aviation** companies, or manufacturer or developer of certain goods or technologies related to avionics, navigation, spacecraft or propulsion systems;

- a manufacturer, developer, modifier, or user of certain goods related to **nuclear materials, facilities and equipment**;

- a manufacturer or developer of goods and essential components of **quantum computing**, quantum communication or quantum-based metrology;

- a manufacturer or developer of certain goods used for manufacturing components made of metal or ceramic materials for industrial applications through the use of additive manufacturing processes ("**3D printers**"), or essential components of such goods or powder materials used during the additive manufacturing processes;

- a manufacturer or developer of certain goods that are specifically designed to operate wireless or wireline **data networks**;

- a manufacturer of certain **smart meter gateways** or security modules;

- a company that employs individuals who work in **vital facilities in safety-sensitive locations**;

- a company that extracts, processes or refines certain **raw materials** or their ores;

- a manufacturer or developer of certain goods which fall under the protection of certain patents or utility models constituting **state secrets**; and

- a company that directly or indirectly cultivates an **agricultural area** of more than 10,000 hectares.

iii. Control of investments into other industries

The general investment control also applies to all other activities not listed as critical infrastructure or a critical industry. However, the legal framework for such other activities deviates from the legal framework for the above-listed activities on two key points: first, the relevant threshold for an acquisistion lies at 25% or more of the voting rights in the domestic company, and second, such an acquisition need not be notified to or approved by the *BMWK* prior to the completion of the transaction.

However, if the *BMWK* considers such acquisition likely to affect the public order and security of Germany or any other European Member State or certain projects

and programmes of European Union interest, it may open an investment review procedure ex officio within five years of the signing of the transaction. To obtain legal certainty for a planned transaction, foreign investors often choose to make a voluntary filing (called an application for a certificate of non-objection). If the *BMWK* does not launch a formal review within two months of receipt of the investor's application, it can be assumed that the certificate has been issued.

Apart from the above thresholds, subsequent participations in a German company will also fall under the scope of German investment control if they reach or exceed certain thresholds (i. e. 20%, 25%, 40%, 50% or 70%). However, when calculating the exact share of voting rights, all other forms of participation through which the foreign investor solely or jointly exercises effective control over the target company must be considered.

(3) Investment review procedure

A transaction **must be reported** to the *BMWK* (immediately after signing) if it falls within the scope of either the sector-specific investment review or the general investment review for critical infrastructure or critical industries and it cannot be consummated (closed) prior to clearance. As the factual completion of such a transaction can result in fines and/or criminal liability, **the respective transaction should not be closed without prior legal consultation and involvement of the *BMWK***. In all other cases, the transaction may be closed prior to obtaining clearance or a certificate of non-objection.

Once the BMWK has gained knowledge of the transaction (either by the investor's notification or its application for a certificate of non-objection, or through public sources), it then has two months to decide whether to initiate formal proceedings. If the BMWK does not initiate formal proceedings within this period, approval is deemed to have been granted. If formal proceedings are initiated, the formal review period lasts up to an additional four months, starting with the submission of a complete filing. However, this formal review period can be suspended or extended by the BMWK under certain circumstances, resulting in a significant lengthening of the total investment review procedure. In complex cases, informal consultations between legal advisers and the BMWK prior to a formal notification can accelerate the review procedure significantly.

The type and degree of information to be provided by an investor depends on the specific review procedure as well as the stage of the respective investment review and includes:

i. Information on the target company, e.g.:

- the company details and information on the management;

- a description of the business activities and industry sector;
- a chart showing the company's shareholding structure, indicating the direct and indirect shareholders' percentage of voting rights;
- a workforce breakdown;
- the turnover of the last three fiscal years;
- a list of business contacts with public authorities or companies in the defence sector over the last five years;
- information on the target company's obligation to protect classified information;
- an indication of the specific category that the target company's business might fall into with respect to the categories subject to sector specific and/or general (cross sector) investment review for critical infrastructure or critical industries; and
- a list of the main suppliers and main customers for the last five years for the goods listed under the sector specific investment review.

ii. Information on the transaction such as:

- a description of the acquisition, including details on the purchase price and the specific type of acquisition (share and/or asset deal); and
- information on the direct and indirect purchasers' share of voting rights in the target company prior to the acquisition as well as the percentage of voting rights to be acquired and other possibilities to exert control over the target company.

iii. Information on the direct and indirect purchaser(s) such as:

- a list of all direct and indirect shareholders of the direct purchaser, including the company details as well as a chart showing the respective percentage of the shareholders' voting rights; and
- the confirmation of the existence or the absence of any (i) governmental control and/or financing, (ii) involvement in activities which had a negative effect on the public order or security of Germany or any other European Member State, or (iii) risk of present or past involvement in activities that would constitute a criminal offence or a misdemeanour in Germany under certain statutory law.

iv. Information on the seller:

- the company details and, in the case the seller qualifies as a foreigner, the designation of a person authorised to accept service of process in Germany.

(4) Conclusion of proceedings

After the parties have provided the *BMWK* with all requested information and the *BMWK* has conducted its review, the transaction may either be completely **cleared** or **subjected to conditions** or **prohibited** in total or in part.

In the case of a prohibition, the transaction will become legally invalid and, if already closed, would have to be unwound by the parties. The *BMWK* can also enforce its prohibition decision by fining subsequent contraventions (such as restrictions on voting rights or the appointment of a trustee). However, it is still rare for the *BMWK* to intervene against foreign investments. As the *BMWK* is bound by the legal principle of proportionality, it considers any remedies proposed by the parties and must accept them if they are suitable to remove its concerns.

However, in our experience, as the decision of the *BMWK* and its assessment are largely based on the information the investor provided during filing, it is crucial for the success of the transaction that the parties **seek legal support at an early stage**.

b) Restrictions under competition law

Acquiring shares in or assets of a German company or entering into a joint venture in Germany may be subject to **merger control** clearance. The German authority in charge of merger control enforcement is the Federal Cartel Office (*Bundeskartellamt*). For large transactions, however, the European Commission has exclusively jurisdiction and decides with effect for the entire EU.

Whether the acquisition of a company is in fact subject to merger control depends, in particular, on the transaction structure and the turnover of the companies involved. Whether the acquisition is permitted or not, then depends on the competitive effects of the transaction.

(1) German merger control

The legal basis of **German merger control** is the Act against Restraints of Competition (*Gesetz gegen Wettbewerbsbeschränkungen, GWB*)[25]. The following types of acquisitions are subject to German merger control:

[25] Act against Restrictions on Competition (Gesetz gegen Wettbewerbsbeschränkungen, GWB) in the version of the publication of 26 June 2013 (BGBl. I p. 1750, 3245), last amended by Article 10 paragraph 2 of the Law of 27 July 2021 (BGBl. I p. 3274).

- an acquisition of (direct or indirect) control over another company or parts thereof;

- an acquisition of all or a substantial part of the assets of another company;

- an acquisition of shares in another company resulting in a situation where the purchaser holds 25% (or more) or 50% (or more) of the shares or voting rights;

- an acquisition that enables the purchaser(s) to exercise (directly or indirectly) a competitively significant influence over another company.

However, the acquisition will only require a merger control filing in Germany if it also meets the following turnover thresholds:

- the combined worldwide group turnover of all participating companies exceeds EUR 500 million; and

- at least one participating company has a group turnover in Germany exceeding EUR 50 million; and

- at least one further participating company has a group turnover in Germany exceeding EUR 17.5 million; or, alternatively, the transaction value amounts to more than EUR 400 million and the target company has significant activities in Germany but achieves a German turnover below EUR 17.5 million.

Several exceptions (e.g., for intracompany transactions) and special rules (e.g., for media mergers) apply. "Participating companies" are generally the purchaser and the target company. However, the turnover of other current/future shareholders in the target company are also taken into account if they retain/acquire (joint) control or 25% (or more) of the shares or voting rights in the target company.

Example: The foreign investor wants to acquire 25% of the shares in a very small German R&D company. The seller will continue to hold the rest of the shares in the target company. The target company itself does not have any sales yet. Nevertheless, the acquisition is subject to German merger control if the foreign investor and the seller meet the turnover thresholds.

The Federal Cartel Office has the power to order large companies to file for merger control clearance of certain acquisitions which neither meet the turnover thresholds nor the transaction value threshold. However, this instrument is largely irrelevant for international transactions as it is only available following a sector investigation and its use is subject to further preconditions. To date, the Federal Cartel Office has never used this power.

The (partial or full) implementation of an acquisition subject to German merger control without prior clearance constitutes an administrative offence. Any legal transactions that are concluded contrary to this implementation prohibition are invalid.

Most transactions are cleared by the *Bundeskartellamt* within **one month** of receipt of the complete notification. The total merger control review process may take **5 months** (or longer) if the *Bundeskartellamt* decides to initiate an in-depth review. These proceedings are concluded with the adoption of a formal decision – either clearance, clearance subject to remedies or prohibition. In rare cases, mergers that have been prohibited by the Bundeskartellamt are permitted through a ministerial authorisation at the request of the parties.

The decision of the *Bundeskartellamt* is based on whether the acquisition will result in a significant impediment to effective competition. That may in particular be the case if the acquisition creates or reinforces a dominant position in one or several markets.

(2) EU merger control

Under **EU merger control** law, acquisitions constitute a merger if they result in a change in the control of a company on a lasting basis. This includes the purchase of a majority interest in a company, as well as the purchase of a minority interest that confers the possibility of exercising decisive influence over the company. The creation of a joint venture that will be jointly controlled by 2 or more companies and will perform on a lasting basis all the functions of an autonomous economic entity is also deemed to constitute a merger.

A merger requires a filing to the European Commission, where the following cumulative conditions are met:

- the combined worldwide group turnover of the participating companies (e.g., purchaser group and target company, or joint venture parents) is greater than EUR 5 billion; and

- at least 2 participating companies have each an EU-wide group turnover of EUR 250 million;

- unless each of the participating companies achieves more than 2/3 of its EU-wide turnover within one and the same EU Member State;

Alternatively, a merger also requires a filing to the European Commission if it meets the following cumulative conditions:

- the combined worldwide group turnover of all participating companies amounts to more than EUR 2.5 billion; and

- at least 2 participating companies have each an EU-wide group turnover of EUR 100 million; and

- in each of at least 3 EU Member States, the combined turnover of all participating companies exceeds EUR 100 million, and in each of at least 3 of these EU Member States, the turnover of each of at least 2 of the undertakings concerned exceeds EUR 25 million;

- unless each of the participating companies achieves more than 2/3 of its EU-wide turnover within one and the same EU Member State.

Before the parties formally file the merger control notification, they will enter pre-notification discussions with the European Commission. On receipt of the final notification, the European Commission initiates preliminary proceedings in order to summarily examine the prerequisites for a possible prohibition. A decision must be announced within 25 working days. If the transaction raises competitive concerns, the European Commission moves on to the principal proceedings.

These Commission investigation concludes with either clearance, clearance subject to conditions or prohibition of the transaction.

The decision criterion for the European Commission is whether the acquisition will result in a significant impediment to effective competition. Like German merger control law, there is a prohibition on implementing the acquisition.

Under EU law, a national competition authority may refer a case to the European Commission or vice versa under certain conditions. In exceptional circumstances, a national competition authority may even refer a potentially problematic transaction to the European Commission even though the transaction is not reportable under national competition law.

(3) Foreign merger control

The acquisition of a German company may also require merger control filings outside Germany. Germany is a leading export nation and German companies have largely free access to the EU market. Many German companies therefore have significant sales outside Germany. This may trigger merger control filing requirements outside of Germany – even in countries where the target company has no subsidiaries or assets.

c) 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 2 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 they are 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 post-acquisition does not require any further official approval. It is therefore vital to ascertain 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 arise from the company purchase agreements, for example, which may stipulate that the approval of the supervisory board, the advisory board or the shareholders of the purchaser or seller is required. 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, there may also be a statutory obligation to obtain approval. If an AG pledges to sell its entire company assets or a significant part thereof, the contract will only be valid with the approval of 75% of the general meeting (§ 179a of the *AktG*). It is the prevailing opinion that § 179a AktG also applies 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 (see the rulings of the 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 inheritance law 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 need to be clarified:

a) Selection of the target

The target of an acquisition may be a company of any form.

b) Share deal or asset deal

A company can be acquired through either the takeover of shares in the target company (so-called "**share deal**") or the acquisition of individual assets of the target company (so-called "**asset deal**").

Liability, tax and contractual considerations are key when determining the manner of acquisition.

(1) Liability of the purchaser

The purchaser naturally wishes to avoid liability risks. Buying shares means buying the target company with all its good and bad qualities, and the risk that there might be "skeletons in the closet". Purchasers can protect themselves through guarantees, but the usefulness of any guarantees depends on the creditworthiness of the seller. Purchasers also prefer to avoid the trouble and expense of enforcing guarantees. An alternative way to get around these risks is 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 said person held an interest of at least 1% within the last 5 years, the profit derived from the sale will be taxed subject to the **part-income method**. Accordingly, 40% of the profit from the sale will be tax-free. The remaining 60% of the profits will be taxable according to the individual tax rate of the seller. Furthermore, the profit from the 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 5 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 will be subject to tax at a flat rate of 26.375% (flat rate *withholding tax*, including **solidarity surcharge** (*Solidaritätszuschlag*)).

- If a natural person sells their entire shareholding in a KG or an OHG, the profit on sale will be 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 pre-conditions are fulfilled, a maximum of EUR 5 million of the profit from the sale will be taxed, upon application, at a reduced tax rate. The **reduced tax rate** is approximately 56% of the individual tax rate, but no less than 14%. The tax-payer can only claim this reduction once. In addition, the taxpayer is granted an exempted amount of EUR 45,000, which will be reduced by the amount by which the profit on the sale exceeds EUR 136,000. The sale of a natural person's full shareholding will be exempt from **trade tax**.

The above concessions (reduced tax rate, exempted amount, exemption from trade tax) do not apply if only 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 the sale is tax-free.

- If a corporate entity sells shares in a KG or an OHG, then the profit on the 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, reducing in this way the taxable profit. The same applies to the acquisition of shares in partnerships which – like an asset deal – is regarded in tax terms as an acquisition of part of the economic assets of 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 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 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 60% 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 carryforwards** are generally completely lost in the event of a direct or indirect acquisition of more than 50% (harmful acquisition of a shareholding). However, under certain conditions regulated in the Corporation Tax Act, the loss carryforward can still be saved.

- 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 business has been acquired as a whole, see § 1 (1a) Turnover Tax Act (*Umsatzsteuergesetz, UStG*)[26].

- In the case of an asset deal, if the purchase price relates to a plot of land, **real estate transfer tax** ("**RETT**") must also be paid (between 3.5% and 6.5%, depending on the federal state where the real estate is located, 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, **RETT** is due, if (in the case of a partnership) at least 90% of the shares in the company are transferred to new partners within a period of 5 years, whereas in the case of a corporate entity, where at least 90% of the shares in the company come to be owned by the purchaser it will generally be subject to R**ETT**. 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 considered circumvention. The basis for calculating the **RETT** in the case of a share deal is a specific "real property value" of the property holdings, determined in accordance with the Valuation Act (*Bewertungsgesetz, BewG*)[27].

From a fiscal perspective, sellers generally prefer the share deal while purchasers favour asset deals (subject to the normally higher RETT). A careful analysis of the specific case is therefore required 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. Conversely, an asset deal contract does not require a specific form unless the contract includes real property and/or all of the assets are acquired. In such cases, the asset deal contract must also be notarised. The asset deal contract must strictly list each individual asset of the company in extensive annexes and these assets must be sold and transferred in accordance with the specific legal rules applicable to the particular group of assets. The asset deal also requires all current contracts to be listed and dealt with separately. 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 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

[26] Turnover Tax Act (*Umsatzsteuergesetz, UStG*) in the version of the publication of 21 February 2005 (BGBl. I p. 386), last amended by Article 29 of the Law of 20 August 2021 (BGBl. I p. 3932).

[27] Valuation Act (*Bewertungsgesetz, BewG*) in the version of the publication of 1 February 1991 (BGBl. I p. 230), last amended by Article 2 of the Law of 16 July 2021 (BGBl. I p. 2931).

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, and for the purchaser, because this reduces risks.

4. Process of acquiring a company

The acquisition of a company in Germany largely follows 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. 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** (LoI, sometimes also called a "**Memorandum of Understanding**", **MoU**) has become established in German law as a preparatory declaration for the company purchase agreement. As a rule, it will be a declaration of the intention to commence their contract negotiations and establishing a framework for these negotiations. This declaration of intent will not generally have any binding effect.

In many cases it is advisable to sign a legally binding agreement, at least regarding the exclusivity and confidentiality of negotiations in order to allow them to proceed without time pressure and to allow the disclosure of sensitive data. These obligations can also 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 to obtain the information which is important to them. This is done through the **due diligence** process, whereby the legal, tax, financial, business, commercial, technical, and other aspects of the target company are examined. The respective data is made available for inspection a limited period of time, either physically in a data room or virtually through password-protected internet access.

The legal due diligence examines the target company for legal weaknesses. Particular attention is paid to aspects such as contractual obligations, liability issues, industrial property rights, subsidy issues, corporate matters, and ownership in shares.
Due diligence fulfils different functions for each party:

- The due diligence report provides the purchaser with a snapshot of the target company, which offers 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 the seller can negotiate the purchase price based on 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 provided accurate information concerning various aspects 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 that they have received adequate information concerning the risks of the acquisition.

- If the purchase price is financed, banks will often require their own additional due diligence or ask for copies of the due diligence reports of other (legal, tax, financial) advisors.

d) Negotiation and conclusion of the purchase agreement

The negotiation and formulation of the agreement on the sale and purchase 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 timing, 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.

After an intensive due diligence examination, the seller will often only make a few additional guarantees. The purchaser, on the other hand, usually wishes to have both the intensive preliminary examination and comprehensive guarantees.

Separate provisions on guarantees should be included 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 on 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 applies. An unwinding of the purchase agreement may only be considered as a last resort.

In light of Brexit and the ongoing Covid-19 pandemic, future global economic uncertainties (e.g., the introduction of international duties) and their effect of the finance markets, as well as political uncertainties, we expect **material adverse change** (**MAC**) clauses to be discussed and negotiated even more intensively in the future – also in Germany.

Whereas AG shares are freely transferable like other goods, the transfer of GmbH shares **requires notarisation**.

e) Closing

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

f) Post-merger

Following the 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 legal adviser that 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 corporations

Corporations (such as an AG or GmbH) with either their management or 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**). 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 corporate tax rate of 15%**. In addition, there is a "**solidarity surcharge**" (*Solidaritätszuschlag*) of 5.5% on 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 within Germany, German corporate entities must pay it because of their legal form, irrespective of their activities. Due to the nature of trade tax and that it is **levied by local authorities**, the rate will depend on the "**municipal collection rate**" of the municipality in which the company has its registered office or the permanent establishment(s) of the company are located. The effective trade tax rate varies between approximately 17% and 19.8%; 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 corporation tax purposes but does do 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** (where the shareholders are natural persons) and **corporation tax** (where an entity is a shareholder) 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. Where corporate entities are shareholders in the partnership, the shares in profits allocated to the corporate entity from the partnership will be subject to corporation tax (incl. solidarity surcharge) of 15.825%. In contrast, for the purposes of trade tax (approximately 17% to 19.8%) and **value added tax**, the trading partnership is regarded as an independent taxable entity, so that where the trade partners are natural persons, they can theoretically offset the **trade tax** incurred on the level of the partnership against their income tax.

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 to the shareholding, The 'special operating assets' otherwise count as having been withdrawn and are subject to the **full taxation of dormant reserves**.

c) Minimum taxation

With respect to income tax and corporation tax, **losses can only be carried back** into the immediately preceding assessment period and only up to an amount of **EUR 1 million** (married couples filing jointly: **EUR 2 million**)[28]. There is no time limit for a loss carryforward into subsequent assessment periods. Note that, a trade tax loss can only be carried forward.

Profits can only be offset with existing **loss carryforwards** up to an amount of EUR 1 million plus 60% of the excess amount under the "minimum taxation" rule.

6. Subsidies

Many German municipalities have 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 investment banks for this purpose.

Example for the State of Brandenburg: New investment support as part of the community initiative "Improving the Regional Economic Structure" (GRW-G) is provided to small, mid-sized and large companies:

a) Growth programme for small companies

Small companies can receive the highest possible grant (30% – 40%) for investments eligible for support with a total investment of between EUR 60,000 and EUR 1.2 million under the community initiative "Improving the Regional Economic Structure" (GRW-G), depending on the location, branch of industry and the project.

[28] In 2021, a EUR 10 million loss (married couples filing jointly: EUR 20 million) could be carried back.

b) Growth programme for mid-sized and large companies

Medium-sized and large companies can receive the highest possible grants for eligible investments in certain core sectors (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 level of subsidies (5% – 20%) for each permanent job created at the site as part of the community initiative "Improving the Regional Economic Structure" (GRW-G).

C. Investing in real estate

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 provisions for old age or a value-oriented capital investment. They often have a stable value and are therefore regarded as a safe investment in tangible assets. The long-term nature of these investments often ensures stable asset growth.

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

I. 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 through lease or sale.

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

II. Types of property

There are various types of property and therefore various possibilities for acquiring property. In a legal sense, there are **plots of land**, **condominiums**, and **hereditary building rights**. In terms of the use 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 for residential or commercial purposes.

The purchaser can acquire a plot of land or a building lease

- containing an existing building (a distinction must be made here as to whether the building on the site is a new or existing building);

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

1. Definition of a plot of land

The entire surface area of Germany has been surveyed and is recorded into cities, districts, cadastral sections and parcels in an official land survey register. Maintained according to regional law, each plot of land is registered under a specific title number (*Flurstück*). This title number notes the ownership and and limiting rights *in rem* recorded in the **land register** (*Grundbuch*), which is maintained by the local courts. Purchase agreements and agreements transferring rights in real estate refer to these registers to define the subject matter.

According to the BGB, the land and buildings, with the objects firmly attached to them, **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.

Generally, assets serving the economic purpose of the plot of land, i.e., spatially and economically related to the plot of land, will also belong to this unit. Purchase agreements usually embrace these assets. Mortgages on the plot of land embrace these assets by law.

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). Within these land register districts, the land registers are ordered according to volume and folio.

To register a **right *in rem*** to a particular plot of land, a notarised application must be filed with the land register. As a rule, the purchaser's application for registration in the land register will be included in the notarised deed, so that the submission of this deed to the land register 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 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 register will note the respective shares of the entitled parties or the legal relationship between the co-owners.

Encumbrances on the plot of land, priority notices, restrictions and land register annotations are entered in section II of the land register. The purchaser either takes over these encumbrances or has them deleted.

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

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 proven, unless this proof is refuted through evidence to the contrary.

3. Condominium

In addition to the regulations set forth in the BGB, the provisions of the Law on Condominium and Long-term Right of Tenure (*Wohnungseigentumsgesetz, WEG*)[29] in particular, play an important role when purchasing residential properties. The Condominium Act makes it possible to purchase individual apartments in a building. A 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. It thus represents a mixture of sole and co-ownership.

4. Hereditiary building right

A **hereditary building right** (*Erbbaurecht*) 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 hereditary building right is a limited right *in rem* encumbering their plot of land. The hereditary building right has historical origins and tends to play a minor role in Germany. It is regulated by the Hereditary Building Right Act (*Erbbaurechtsgesetz, ErbbauRG*)[30]. The term of the hereditary building right can be agreed.

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[29] Law on Condominium and Long-term Right of Tenure (*Wohnungseigentumsgesetz, WEG*) of 12 January 2021, (BGBl. I p. 34).

[30] Hereditary Building Right Act (*Erbbaurechtsgesetz, ErbbauRG*) 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).

The hereditary building right is itself treated like a plot of land and is registered both in section II of the land register as an encumbrance on a plot of land and in a separate building lease land register folio. 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, known as ground rent.

The hereditary building right is established through an agreement between the owner and rightholder and registration in the land register. The hereditary building right lapses with expiry of the agreed period of time. Following expiry of the agreed period, it will depend on the agreements between the owner and the leaseholder whether the building has to be removed from the plot of land or whether the leaseholder receives a payment for the value of the building.

III. Direct investment as asset or share deal

A plot of land may be acquired 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 in consideration of tax aspects. A transaction structure optimised for 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.

For more details with respect to the requirements to the agreement, the conveyance of ownership, priority notice of conveyance and registration in the land register see V.

2. Share deal

In contrast, share deals involving real estate also offer 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 the seller. Under certain circumstances, natural persons who own real estate 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 of up to a given portion (see 3.), to avoid real estate 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) The 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. Acquiring a share in a GmbH is therefore usually significantly quicker way to achieve the desired economic objective than the direct acquisition of the plot of land.

The assignment of a share in the business is normally not tied to other prerequisites. However, the articles of association may also require the approval of the company or the shareholders, or other shareholders may hold pre-emptive rights. 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 by any rights of third parties, especially not attached or pledged. A property-related guarantee includes, *inter alia*, the assurance that the seller is the owner of the plot of land and that the land is free of encumbrances.

b) The GmbH & Co. KG

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

There are several issues that need to be noted regarding the acquisition of the limited partner's shares. In contrast to the acquisition of shares in a GmbH, a limited partner's share can be acquired without any formal requirements, providing the 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 the registration in the commercial register, the purchaser becomes a shareholder in the KG with the assignment of the limited partner's share.

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 subject to both corporation tax (15.825%) and trade tax, which is raised by the municipal authorities and therefore varies within Germany (ordinarily it amounts to 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 on the collected rent payments, to the extent that 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, it lets items of operating equipment, which can also be a fixed component of the property.

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%.

IV. Due diligence

Due diligence involves the examination of the real estate 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 real estate and to reveal the risks associated with the acquisition with a sufficient period of advance notice (see also Chapter B. VII. 4. c)).

Legal due diligence on real estate is usually divided into the following sections: the status of the real estate, restrictions on use and disposal, financing encumbrances, tenancy agreements, public law aspects, environmental law, insurance and (pending) legal disputes.

1. Status of the real estate

In any real estate transaction, the land register must be inspected 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.

a) 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.

In Germany, the acquisition of a plot of land or a title to a plot of land takes place in two stages. First, 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 grant 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.

b) Restrictions on use and disposal

Restrictions on the use of the plot of land arise from the encumbrances entered in section II of the land register. 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 to determine the precise content.

(1) Usufruct

Usufruct (*Nießbrauch*) grants the usufructuary the right to comprehensively use the encumbered property. This includes the deriving of benefits, 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).

The usufruct for immovable objects is granted through informal agreement and registration in the land register.

(2) Easement

Easements (*Grunddienstbarkeit*) frequently found in the land register are encumbrances 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 an agreement between the owners and registration in the land register of the encumbered plot of land. The easement may also be registered in the land register of the neighbouring property that controls the easement right, but this is 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.

(3) Limited easement in gross

A **limited easement in gross** (*beschränkte persönliche Dienstbarkeit*) is the authority of a certain person to use the encumbered plot of land in certain ways. A limited easement in gross can give the beneficiary the right ti use the encumbered plot of land in certain ways, can prevent the owner of the encumbered plot of land from carrying out individual actions or limit the rights of the owner of the encumbered plot of land to use individual rights of defence. An easement in gross is created through agreement between the owner and beneficiary and registration in the land register.

(4) 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 Land Register Act (*Grundbuchordnung, GBO*)[31]. Public charges include, for example, public infrastructure development contributions in accordance with §§ 127 et seq. of the Federal Building Code (*Baugesetzbuch, BauGB*)[32], road-building contributions in accordance with regional bylaws, rates due pursuant to § 9 Real Estate Tax Law (*Grundsteuergesetz, GrStG*)[33] or canal charges in accordance with the regional laws on municipal charges.

c) 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.

(1) Mortgage

A **mortgage** (*Hypothek*) is an encumbrance *in rem* of a plot of land, not associated with possession, in order to secure a monetary claim. Its creation and existence are 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. The mortgage is created by agreement and registration as an uncertificated mortgage or as certificated mortgage through the additional handover of the mortgage certificate.

(2) Land charge

In contrast to a mortgage, a **land charge** (*Grundschuld*) does not depend on the existence of a secured claim. Like the mortgage, the land charge can be uncertificated or certificated. The land charge exists independently from the debt claim. Therefore, land charges are more flexible compared to mortgages and can be used to swap the respective secured debt claims.

2. 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.

[31] Land Register Act (*Grundbuchordnung, GBO*) in the version of the publication of 26 May 1994 (BGBl. I p. 1114), last amended on 5 October 2021 (BGBl. I p. 4607).

[32] Federal Building Code (*Baugesetzbuch, BauGB*) in the version of the publication of 3 November 2017 (BGBl. I p. 3634), last amended on 10 September 2021 (BGBl. I p. 4147).

[33] Real Estate Tax Law (*Grundsteuergesetz, GrStG*) in the version of the publication of 7 August 1973 (BGBl. I p. 965), last amended by Article 38 of the Law of 16 July 2021 (BGBl. I p. 2931).

In this context, the **distinction between residential and other tenancies** is very important; examples include the 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 the property is leased by the tenant for the purposes of commercial gain.

a) Entry into the existing tenancy

A purchaser only enters into existing tenancy agreements by law if the landlord and owner were previously identical. In this respect, the purchaser assumes 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.

Section 550 of the 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 for an indefinite term and can, as such, only be terminated on the expiry of one year following handover of the residential premises. This provision is mainly applicable for commercial leases.

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 according to an **official index**. The absence of such a sentence can have a depreciative effect, since there will be no compensation for any loss of purchasing power occurring over the term of the lease.

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, irrespective of whether the deposit has been passed on to the purchaser, the purchaser will nonetheless be responsible for its return to the tenant on the termination of the tenancy. This will only not apply if the cash deposit was invested separately from the assets of the landlord.

e) Operating costs

Operating costs must be explicitly listed in the tenancy agreement together with the costs charged to tenant, 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 towards 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 in the case of the failure to obtain planning permission or delayed completion of a building.

3. Public-law aspects

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

a) Planning law

When it comes to evaluating construction projects, German planning law makes a fundamental distinction between 3 zoning categories. The most important is between the outer and inner zone, with the main intention of protecting the outer zone against uncontrolled 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 of the BauGB.

(2) Inner zone

The **inner zone** (**Innenbereich**) refers to the unplanned areas within the built-up parts of the municipality. The evaluation of construction projects in the inner zone

is based on § 34 of the BauGB. According to this provision, the nature and extent of use of a new construction project will be assessed 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

Section 9 of the BauGB defines what can be included in a development plan (*Bebauungsplan*). However, each element to be included must have planning justification. The specific details and dimensions pertaining to uses are taken from the Land Use Ordinance (*Baunutzungsverordnung, BauNVO*)[34], which supplements § 9 of the BauGB.

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

Building permission (Baugenehmigung) is the official permission for the construction, alteration or change of use of buildings. Many regional building regulations do not require planning permission for the demolition and removal of buildings, just a simple notification.

Building permission officially attests the acceptability of the developer's building project in terms of those official regulations which need to be examined in planning procedures. Regional building regulations provide for the approval of the building following its completion – possibly also inspections during at intermediate stages of construction, especially in the case of large construction projects – 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.

[34] Land Use Ordinance (*Baunutzungsverordnung, BauNVO*) in the version of the publication of 21 November 2017 (BGBl. I p. 3786), last amended on 14 June.2021 (BGBl. I S. 1802).

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 a "**public easement**", which is an obligatory undertaking intended to secure compliance with certain planning and building regulations. For example, there may be an 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 usually not registered in the land register; it is therefore essential that the register of construction and maintenance obligations be inspected where 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 associated costs. The purchase agreement should stipulate who is responsible for the costs incurred.

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.

Infrastructure development costs can constitute 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 the completion of the infrastructure and the issue of the contribution notice.

Utility connections from the boundary of the property to the building are laid by the utilities 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; the interests of the owner must be subordinate to greater public interest. 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 under the BauGB: restrictions on traffic due to the reparcelling of building land, restrictions on traffic under special town planning laws;
- boundary determination procedure pursuant to the BauGB;
- restrictions on disposal to protect tourist areas pursuant to § 22 BauGB, in areas covered by an environmental conservation statute, in order to protect building use pursuant to § 35 (5) of the 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**, it will have a significant impact, particularly on the possibility of future structural alterations. It may also affect necessary maintenance costs, which could mean considerable financial expense. 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.

4. Environmental law (existing contamination)

The property may be affected by existing biological or chemical contamination. An examination of the building ground is advisable to minimise risks. If soil contamination has been found on a property, the purchaser will risk being held liable by the responsible administrative authorities.

According to the Federal Soil Protection Act (*Bundesbodenschutzgesetz, BBodSchG*)[35], 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 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

[35] Federal Soil Protection Act (*Bundesbodenschutzgesetz, BBodSchG*) of 17 March 1998 (BGBl. I p. 502), last amended on 25. February 2021 (BGBl. I S. 306).

are grounds for suspecting contamination, more detailed studies will subsequently be carried out. For example, if contamination is suspected, the necessary soil and groundwater samples will be collected and analysed.

5. Insurance

Any insurance policies taken out by the seller with respect to the building offered for sale can also be of relevance. Pursuant to the Insurance Contract Act (*Versicherungsvertragsgesetz, VVG*)[36], property damage insurance policies, such as insurance for operating premises or fire and natural hazard insurance, are transferred by law to the purchaser. It is possible for the purchaser to cancel these policies; however, the statutory notice period of one month from the acquisition of the property must be observed. In practice, new insurance policies are usually taken out on the date of the handover.

6. Legal disputes

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

V. Purchase agreement

The acquisition of ownership of the plot of land requires:

- a notarised contractual agreement for sale in notarially recorded 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.

[36] Insurance Contract Act (*Versicherungsvertragsgesetz, VVG*) in the version of the publication of 23 November 2007 (BGBl. I p. 2631), last amended on 11 July 2021 (BGBl. I S. 2754).

1. Form, parties and content of the purchase agreement

a) Form

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

b) Parties

The parties of the sale of a property are known as the seller and purchaser or buyer. 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 or where there are restrictions on disposal on the part of the seller, for example, as a result of insolvency, compulsory auction or forced administration. In this case, additional requirements apply.

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.

c) Content

Any agreement whereby someone undertakes to convey ownership of a property to another natural or legal person requires notarisation. The same applies to an agreement whereby someone undertakes to purchase a property. Undertakings to create or revoke, sell or purchase a building lease pursuant to the ErbbauRG and the obligation to grant or revoke separate ownership pursuant to the WEG must also be notarised.

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

The purchase agreement usually also stipulates the **time of the transfer of possession** and **the transfer of benefits and charges** and the time at which the purchase price is due for payment, as well as providing provisions on liability for legal and material defects, responsibility for infrastructure development costs and liability for costs and taxes.

The purchase agreement must also specify when the handover will take place and the point at which the risk of accidental destruction or accidental deterioration, the 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. 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, real estate 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. If 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 not be able to hold the seller liable and will instead be responsible for any issues that may arise.

There is also a 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 associated with purchasing real estate, it is advisable to have the purchase agreement drawn up by a lawyer who has experience in real estate law. Through skilled negotiations with the seller, the lawyer can help the parties agree on provisions which are advantageous to the purchaser.

2. Conveyance

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

The agreement for the conveyance of ownership of a plot of land must strictly be declared "**in the simultaneous presence of both parties before the notary**". This formal requirement is intended to emphasise 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 register only registers the transfer of ownership if the conveyance is proven in officially certified form.

3. Registration

Registration in the land register completes the transfer of ownership. It also determines the priority of the right and establishes the assumption of correctness of the land register.

Because the registration in the land register takes some time and the parties themselves have no influence over 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 the 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 granting title to the plot of land itself is ruled out due to the *inter partes* effect of the obligations involved.

In order to safeguard the purchaser, the parties should agree in the purchase agreement to the registration of a **priority notice of conveyance** (*Vormerkung*) and an application should be submitted accordingly. As soon as the *Vormerkung* is entered in the land register, the purchaser is largely protected and ensured that the seller will not sell the real estate to a third party in the meantime. On no account should the purchase price be paid before the *Vormerkung* has been registered. The contract should stipulate that the purchase price 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 the preconditions have been fulfilled.

On their 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 *Vormerkung* in as far 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 *Vormerkung* is applied for and implemented. 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 ensure that they only pay the purchase price and are registered as the new owner once they have been informed in writing by the notary that these encumbrances have been deleted.

4. Public approvals and attestations

The validity of the sale of real property is in part dependent on official approvals of various kinds. The contractual agreement can be concluded before obtaining these approvals, conveyance can even be declared beforehand and a priority notice of conveyance can be registered. However, the change of ownership can only be registered in the land register if the land register is provided with proof of the official approvals. These approvals do not include pre-emptive rights or the clearance certificate concerning real estate transfer tax pursuant to the Real Estate Transfer Tax Act (*Grunderwerbsteuergesetz, GrEStG*)[37]. However, these are both prerequisites 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 the BauGB blocks registration in the land register. Registration in the land register requires the submission of confirmation that the pre-emptive right does not exist or is not being exercised.

5. Costs

a) Notary costs and court costs

The notary is responsible for the notarial recording of a real estate purchase agreement. The notary is an independent holder of a public office. In exercising their office, notaries 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.

As a rule, the parties will specify in the contract which party has to bear the costs associated with the purchase of the real estate. However, both parties are liable towards the notary.

The purchaser of a real estate must, by law, bear the costs of notarisation of the purchase agreement, conveyance, notice period of 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.

b) Real estate transfer tax

The contracting parties are liable for the real estate transfer tax as joint and several debtors. The purchaser and seller would each have to bear 50% of the tax. However, as a rule, payment of the real estate transfer tax will be contractually assumed by the purchaser alone.

The notary is obliged to notify the revenue authorities of purchase agreements. **The real estate transfer tax amounts to between 3.5% and 6.5%** of the purchase price, e.g., 3.5% in Bavaria, 6% in Berlin, 6.5% in Northrine-Westphalia.

Real estate transfer tax can also be charged in the case of a share deal. This will generally occur if the purchaser acquires more than 90% of the shares in a limited liability real estate company or if, in the case of a property partnership, a change of

[37] Real Estate Transfer Tax Act (*Grunderwerbsteuergesetz, GrEStG*) in the version of the publication of 26 February 1997 (BGBl. I p. 418, 1804), last amended on 25 June 2021 (BGBl. I S. 2056).

partnership holdings of at least 90% takes place within a period of 10 years. However, the basis for the calculation of real estate transfer tax in a share deal is determined according to a special "standardised value".

Partnerships are primarily chosen as the form of property company, the shares in which are to be transferred by way of a share deal, if, in particular, the desire is to directly allocate, in tax terms, the losses from the property company to its shareholders, although this will depend on the amount of the capital contribution or on the amount of the partner's liable capital as 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.

c) 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 when the purchaser is of the view that the agent's activities were inconsequential to the conclusion of the purchase agreement. An agent must arrange a transaction concerning immovable property or prove that the opportunity to conclude such a transaction existed. 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.

VI. Financing

In principle, investments in real estate can be either direct or indirect.

If the acquisition of real estate is conducted by means of an asset deal or a share deal, it will be a direct investment.

In an indirect investment, the investor does not acquire ownership of the real estate, but participates in institutional real estate funds that provide the capital which is vested in the property.

The type of investment form chosen will depend on various factors. In an indirect investment, the investor may profit from having a professional asset manager. If the investor has sufficient property management resources of its own, a direct investment may be preferred.

1. Direct Investment – Financing through bank loans

The classic financing instrument in Germany for direct investments is the bank loan. Prior to granting the loan, the bank will undertake a detailed analysis of the creditworthiness of the investor and the real estate in question. The bank will seek to mitigate its risks by means of representations and covenants in the loan agreement.

As an alternative to taking out a loan, under certain circumstances the investor may, with the approval of the existing lender, also take over loans taken out by the seller. In most cases, however, investors prefer to select their own financiers and agree their own financing terms with them. The security package required by the banks customarily includes the following: (i) land charge on the real estate; (ii) assignment of rent receivables and insurance claims; (iii) pledge of bank accounts; (iv) and pledge of shares of the purchaser of the property and receivables under the shareholder loan agreements.

a) Land charge

The bank will require that the financed real estate is encumbered by a land charge (*Grundschuld*). A distinction is made between uncertificated land charges (*Buchgrundschulden*), which are simply registered in the land register in favour of the bank, and certificated land charges (*Briefgrundschulden*), for which a land charge certificate (*Grundschuldbrief*) is issued in addition to the registration.

In addition to the actual amount of the land charge which generally reflects the amount of the loan, the land charge is created with interest (*Zinsen*) and ancillary payments (*Nebenleistung*). The amount of interest is not linked to the interest to be paid under the loan agreement and often varies from 12 to 20% p.a. Both, the interest and the ancillary payments are deemed to increase the security for the bank in case of default.

The land charge and loan are linked through a separate agreement between the property owner and the bank, i.e., the statement of collateral purpose (declaration of purpose for land charges) that specifies elements such as when the bank may enforce its rights to the property, what notification periods are required prior to enforcement and when and how the land charge will be released.

b) Subjection to compulsory execution

More often than not, banks will require that the land charge is created with submission to immediate enforcement pursuant to § 800 of the Code of Civil Procedure (*Zivil-*

prozessordnung, ZPO)[38]. Subject to compliance with the contractually agreed stipulations and statutory law, this allows the bank to foreclose on the property without requiring a prior judgment. This also applies in the event of a transfer of the property where the acquired property is encumbered with a land charge.

In addition, the purchaser/borrower is required to provide a so-called "abstract acknowledgment" (*abstraktes Schuldanerkenntnis*) generally in the amount of the land charge and the equivalent interest and ancillary costs of the land charge. In order to facilitate enforcement proceedings in the case of default, the borrower must subject all of its assets to immediate enforcement. Compulsory execution can be levied under this deed without a judgment being necessary for this purpose, though in this case it is exclusively executed against the persons who have supplied the abstract acknowledgment. It does not therefore extend to the new owner of the real estate.

c) Collateral value

The value of the collateral (i.e., the value of the security package at hand) is of particular importance as it determines the amount the bank is willing to lend against the collateral. It is assessed according to the lending guidelines (*Bewertungsrichtlinien*) of the credit institution in question. Two reference points are key to determining the value of the real estate, the market value (*Verkehrswert*) and the lending value (*Beleihungswert*). Other than the market value, the lending value generally reflects the value of the real estate on a long-term basis, regardless of changes in values in the market.

d) Determination of the lending value (Beleihungswert)

(1) Asset value method (Sachwertverfahren)

The asset value method is used for owner-occupied homes. 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. It 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 amount.

(2) Rental value method (Ertragswertverfahren)

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.

[38] Code of Civil Procedure (*Zivilprozessordnung, ZPO*) in the version of 5 December 2005 (BGBl. I p. 3202, corrected 2006, p. 432 and 2007, p. 1781), last amended by Article 11 para. 15 of the law of 18 December 2018 (BGBl. I p. 2639).

The banking institution shall lend a certain percentage of the determined collateral value, usually 60% to 80%. In the case of insurance loans, the quota is often lower. Loans which do not exceed this range are provided at relatively favourable interest rates.

These loans are secured by priority land charges, i.e., in the event of forced proceedings, they will be paid with priority from the proceeds of the auction. Should a need for further funds arise, banks or other finance providers may grant additional loans with a higher interest rate. These are secured through junior liens.

e) Power of attorney

In order to disburse funds under the loan agreement, the banks will require a land charge. To account for the fact that disbursement is required prior to the purchaser becoming the registered owner of the real estate, the cooperation of the seller as the existing owner of the property is required. In most cases, in the notarised sale and purchase agreement for the property, the seller will grant the purchaser a power of attorney to create encumbrances (*Belastungsvollmacht*) on the real estate prior to becoming the registered owner, the details of which will be negotiated.

2. Indirect Investment – Investment Funds

When choosing the form of indirect investment, investments are sometimes made through open-ended and closed-ended real estate funds, considered under the applicable Investment Code (*Kapitalanlagegesetzbuch, KAGB*)[39] as Alternative Investment Funds (Funds). Funds must always invest under the principle of risk sharing, and thus must invest in at least 3 to 5 parcels of real estate.

Additional costs due to regulation, asset management and the involvement of a depositary bank will apply. Fund investments are mostly made by certain investors like insurance and pension schemes, which have to invest in a risk diversified manner.

VII. Special problems arising under building and architectural law

Building 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.

[39] Investment Code (*Kapitalanlagegesetzbuch, KAGB*) in the version of the publication of 4. July 2013 (BGBl. I p. 1981), last amended by Article 4 of the Law of 18 December 2018 (BGBl. I p. 2626).

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.

The Law on copyright and related property rights – the Copyright Act (*Urheberrechtsgesetz, UrhG*)[40] – 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, these alterations will be strictly prohibited pursuant to the 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.

The infringement of copyright through unauthorised alteration can give rise to claims for damages and injunctive relief.

If possible copyright is involved, the parties will need to establish whether consent to later alterations was agreed in the original architect's contract. If this is not the case, the purchaser should insist on indemnification by the seller.

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 construction companies and architects on the other hand.

The construction companies do not have any 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 may be subject to the strict regulations of the Ordinance on the Obligations of Agents, Loan and Investment Brokers, Investment Advisers, Developers and Building Managers (*Makler- und Bauträgerverordnung, MaBV*)[41].

[40] Law on copyright and related property rights – Copyright Act (*Urheberrechtsgesetz, UrhG*) of 9 September 1965 (BGBl. I p. 1273), last amended on 23 June 2021 (BGBl. I S. 1858).

[41] Ordinance on the Obligations of Agents, Loan and Investment Brokers, Investment Advisers, Developers and Building Managers (*Makler- und Bauträgerverordnung, MaBV*) of 7 November 1990 (BGBl. I p. 2479), last amended by Article 1 of the ordinance of 9 May 2018 (BGBl. I p. 550).

In particular, if the contract is concluded before the building work is 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 specifications and then to 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 rights *in rem*, the developer will usually retain ownership until payment is completed. The purchaser should therefore safeguard themselves by registering a priority notice of conveyance.

3. General contractor agreemement

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 the general contractor may subcontract (partial) services. However, this does not alter the fact that the general contractor is the sole contracting 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.

D. Capital markets law

Access to **capital markets** in Germany, which would also open up the capital markets in Europe, can be of interest for foreign companies. The most interesting access to the capital markets is an initial public offering of shares of foreign companies on basis of a special purpose vehicle (SPV) in Europe or the direct issuance of bonds of foreign companies in Germany and/or Europe. In the following we would like to give you an overview on the requirements for listing and post-listings of initial public offerings (**IPO's**) and the issuance of bonds.

I. IPO

Germany has several stock exchanges, including those located in Dusseldorf, Stuttgart, Munich and Frankfurt. The most important stock exchange in Germany is the **Frankfurt Stock Exchange** (FSE). However, for special investments, like bonds, the other stock exchanges in Stuttgart or Dusseldorf could be of interest. The following outlines the requirements of a **listing** as well as the **post-listing** requirements of the **Frankfurt Stock Exchange**, which is one of the world's leading international stock exchanges by revenue, profitability and market capitalisation, offering excellent services and systems for listed companies and investors. It is owned and operated by **Deutsche Börse AG**.

The main advantages of the FSE for international companies are the direct and cost-efficient access to the European capital markets and additional liquidity to finance further growth, the unique market segments based on international transparency and corporate governance standards, the simple and cost-efficient listing and the reduced exposure to inherent deficiencies in the legal systems of emerging markets. Please note: most of the main listing and post-listing requirements of the other stock exchanges in Germany are similar.

1. How is the market organised?

The FSE comprises 2 basic market segments, the **Regulated Market** (*Regulierter Markt*) and the **Open Market** (*Freiverkehr*).

The **Regulated Market** (Prime and General Standard) is subject to the regulatory provisions of the European Union (EU), while the **Open Market** is mainly regulated by **Deutsche Börse AG**.

However, the choice of the specific market segment and the transparency standard of the FSE depends on the goals of the issuer. The **Regulated Market** (particularly **Prime Standard**) is more suitable to well-established, large-scale and mid-sized enterprises, whereas the **Open Market** can be advisable for smaller companies or companies planning to first "test the water" and enter the **Regulated Market** as a second step. Each listed company is automatically included in the FSE indices. Some of these indices (such as DAX®, MDAX®, SDAX® and TecDAX®) include only those issuers, which are listed in the Prime Standard.

The Open Market is divided into the segment **Scale** (Basic Board) for companies which are not yet listed on any other stock exchange recognised by the FSE and the segment **Quotation Board** for companies already listed at an FSE approved stock exchange.

2. What are the main listing and post-listing requirements?

The **listing** and **post-listing** requirements depend upon the market segment chosen by the issuer, as well as the applicable transparency standard. **Scale** provides for a lower set of requirements, whereas the **Prime Standard** sets forth the strictest transparency and ongoing compliance rules for issuers. Most of the **post-listing** requirements are stipulated in the European Market Abuse Regulation[42] which applies to issuers that applied for listing/trading in all market segments. Only the shareholder transparency rules do not apply to shareholders of companies traded on the **Open Market**.

One of the key documents to be prepared in the course of the listing is the prospectus. A prospectus contains information material to potential investors, in particular on the business of the issuer and its financial standing. A prospectus must be approved by the **Federal Financial Supervisory Authority** (*Bundesanstalt für Finanzdienstleistungsaufsicht,* **BaFin**) or by another competent authority in the EU.

If foreign companies are required to draft a prospectus for listing on a **Regulated Market** on the FSE or a public offering of their securities, the mandatory historical financial information, which must be incorporated into the prospectus, must be prepared in accordance with IFRS or an equivalent accounting standard.[43]

[42] Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (Market Abuse Regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC Text with EEA relevance; http://data.europa.eu/eli/reg/2014/596/oj.

[43] Commission Regulation (EC) No. 1289/2008 recognises the GAAP of the People´s Republic of China.

a) Open Market Scale (Basic Board)

A **prospectus** is required for successful placement in the **Scale** segment. In the case of a private placement (no **public offer** and no prospectus needed), the minimum requirement is an inclusion document (i.e. an informational document, containing only the very basic data about the issuer). Unlike the prospectus, an inclusion document does not have to be approved by the **BaFin**. Below are some of the key conditions of **Scale**:

- minimum 2 year of corporate existence (under certain circumstances this requirement may be waived by the Management of the FSE);
- an application by the issuer together with a Deutsche Börse Capital Markets Partner;
- an estimated minimum market capitalisation of EUR 30 million at the time of the inclusion into trading;
- free-float requirement of at least 20% (at least 1 million free float shares);
- fulfilment of at least 3 of the following criteria/ performance indicators:
    - turnover of at least EUR 10 million;
    - earnings of the year at least EUR 0 (not negative);
    - equity capital more than EUR 0 (not negative);
    - at least 20 people employed;
    - cumulated equity capital before IPO of at least EUR 5 million.

The **post-listing** obligations of the issuers in **Scale** are lower as compared to the General and **Prime Standard** and are as follows:

- submission to **Deutsche Börse AG** of the audited annual financial statements including the management report within 6 months of the expiration of the reporting period;
- submission to **Deutsche Börse AG** of the half-year financial statements including the interim management report within 4 months of the expiration of the reporting period;
- continuing updates and submission to **Deutsche Börse AG** of the corporate calendar;
- analysis conferences at least once a year;
- submission of information required for the generation of research report updates for the research provider mandated by **Deutsche Börse AG** within the given time limit;
- *ad hoc* disclosures, directors' dealings, insider lists, insider trading prohibitions, market abuse rules as well as notification of **Deutsche Börse AG** about any significant changes concerning the issuer or included securities (Deutsche Börse's General Terms and Conditions);
- contractual relationship with a supporting Deutsche Börse Capital Market Partner for the overall duration of the inclusion;
- the information must be submitted in German or English.

b) Open Market (Quotation Board)

The main listing requirements for the **Quotation Board** are listing at an FSE-approved stock exchange in Germany or another country (however not on any open market of these exchanges) and an application for inclusion by a trading participant.

The post listing obligations for the Quotation Board depend on the regulations of the FSE approved stock exchange in Germany or another country where the company has its first listing. However, *ad hoc* disclosures, directors' dealings, insider lists, insider trading prohibitions and market abuse rules are applicable to all Open Market segments.

c) Regulated Market (General and Prime Standard)

The General and Prime Standard provide for a greater level of transparency and set forth higher listing requirements for the issuer, in particular:

- minimum 3 years of corporate existence (under certain circumstances this requirement may be waived by the Management of the FSE);
- minimal prospective market value of the securities to be admitted is not less than EUR 1,250,000 (at least 10,000 (underlying) shares);
- requirement of a minimum "free-float" of the outstanding securities (under certain circumstances this requirement may be waived by the Management of the FSE);

- minimum 3 years of reporting history (i. e. publication of the financial statements).

- The post-listing requirements of the General Standard are much broader than those of the Open Market and relate to the issuer's compliance with several continuing obligations and reporting requirements, in particular:

- publication of its annual accounts (not later than 4 months after the end of the financial year);

- publication of half-yearly financial reports (not later than 2 months after the half-year end) and interim management statements;

- disclosure of directors' dealings;

- *ad hoc* disclosure;

- insider lists;

- insider trading prohibitions;

- market abuse rules;

- notification of shareholdings.

The **listing** in the **Prime Standard** carries with it additional **post-listing** requirements: the publication of quarterly reports, the annual publication of a calendar regarding major corporate events, and the holding at least one analyst presentation per year.

3. Main Steps for the listing and timing

The procedure for listing on the FSE generally comprises the following main steps:

- completion of a due diligence investigation (legal, financial, business);

- drafting of the **prospectus**/issuer data form;

- receipt of the BaFin approval regarding the prospectus (if applicable);

- underwriting and offering (if applicable);

- admission to listing/inclusion in trading on the FSE;

- commencement of trading.

II. Bond issuance

Similar to shares, foreign companies may have access to capital markets in Germany through the issuance of **corporate bonds** in Germany and/or Europe. As outlined above, bonds can be listed on the **Regulated Market** (**Prime Standard** and **General Standard**) or on the **Open Market** (**Segment Scale** or **Quotation Board**) of FSE.

1. Listing in the Prime Standard for Corporate Bonds

The FSE offers large members of international corporations an avenue for raising debt capital through the exchange In the form of the **Prime Standard** for **corporate bonds**. The Prime Standard for corporate bonds is geared towards recognised market leaders seeking to sharpen their international competitive edge and enhance their reputation by floating bonds.

The **Prime Standard** for corporate bonds can be accessed via admission to the **Regulated Market**. An application to participate in the segment must be filed by both the issuer and a bank or financial institute.

For the admission to the **Regulated Market** we refer to the main steps outlined above under I. 2. C).

The listing requirements for Prime Standard for corporate bonds are as follows:

- admittance to the **Regulated Market** on FSE with a prospectus;

- the applicant is the issuer in cooperation with a co-applicant (trading participant on the Frankfurter Wertpapierbörse (FWB));

- national accounting standards of the foreign investor or International Financial Reporting Standards (IFRS) apply;

- bond volume placed in the amount of at least EUR 100 million;

- bearer bonds with a denomination of EUR 1,000 each;

- the securities must be deliverable through Clearstream;

- company or bond rating, credit rating, summary of rating report.

The main post-listing obligations for participants are:

- publication and submission of the annual financial report or of the annual financial statements plus the management report within 4 months of the end of the reporting period;
- publication and submission of the half-yearly financial report or of the half-yearly financial statements plus the interim management report within 3 months after the end of the reporting period;
- continuous updates and submissions of the corporate calendar;
- continuous updates and submissions of the company and bond profiles;
- submission of company key figures within 4 months of the end of each financial year;
- submission of a current and valid company or bond rating;
- at least one information event for bond investors and bond analysts each year;
- *ad hoc* disclosures, directors' dealings, insider lists.

Indices

Admission to the Prime Standard for Corporate Bonds spells automatic inclusion in the XETRA Prime Standard Corporate Bond and SXETRA Overall Corporate Bond indices.

2. Open Market Scale

Scale for corporate bonds, the FSE's segment for small and medium-sized enterprises (SMEs), offers an efficient opportunity to raise debt capital through the exchange. The listing of corporate bonds creates strategic room for growth and innovation and increases the company's public profile significantly.

The main requirements for inclusion are:

- and application by issuer together with an applying Deutsche Börse Capital Market Partner;
- the public offer together with a valid and by BaFin approved prospectus;
- national accounting standards of the foreign investor or International Financial Reporting Standards (IFRS) are applied;
- company history of at least 2 years;
- bond volume placed of at least EUR 20 million;
- denomination of corporate bonds separated into partial bonds amounting to a maximum of EUR 1,000;
- bearer bonds that are not subordinated capital market liabilities of the issuer;
- the securities must be deliverable through Clearstream;
- fulfilment of at least 3 of the following criteria/performance indicators:
  - EBIT interest coverage of at least 1.5;
  - EBITDA interest coverage of at least 2.5;
  - total debt/EBITDA of a maximum of 7.5;
  - total Net Debt/EBITDA of a maxiumum of 5;
  - risk bearing capital of at least 0.20;
  - total debt/capital of maximum of 0.85.

The main follow-up inclusion obligations arising from inclusion:

- Submission of the audited annual financial statements including the management report within 6 months of the end of the reporting period;
- Submission of the half-yearly financial statements including the interim management report within 4 months after the end of the reporting period;
- Analysts' presentation at least once a year;
- Submission of current and valid company or bond ratings;
- *Ad hoc* disclosures, directors' dealings, insider lists (by law) as well as notification to the FSE of significant changes to the issuer or included securities (by rules & regulations).

3. Open Market (Quotation Board)

Most corporate bonds were listed on the Open Market of FSE, without any prospectus and bonds with a denomination of at least EUR 100,000 each. The requirements for listing in the Quotation Board and the post-listing requirements are similar to those for the listing of shares outlined in I. 2. B) Open Market (Quotation Board) above, with the exception of the requirement that the bonds should not be listed on a FSE-approved stock exchange in Germany or elsewhere.

4. Main steps for the offering and/or listing

The procedure for listing on the FSE generally comprises the following main steps:

- completion of a due diligence investigation (legal, financial, business);
- drafting of the prospectus or offering memorandum;
- receipt of the BaFin approval regarding the prospectus (if applicable);
- underwriting and offering;
- admission to listing/inclusion in trading from FSE;
- commencement of trading.

5. Green Bonds – Sustainable Bond Investments

Proceeds from the issue of so-called **green bonds** are used to finance environment-related projects. They are issued by banks as well as corporations and governments. There is no legal regulation regarding their classification, but private initiatives have set standards for market transparency to ensure the sustainable quality of the bonds, such as the **Green Bond Principles** of the International Capital Markets Association (ICMA). These guidelines relate to the use of the bond proceeds, the project selection process, management, and ongoing reporting.

Green bonds have the same structure, yield and risk as "normal" **bonds** but the issuer of a green bond uses the proceeds to finance climate protection or environmental projects.

Green bonds can be divided into two categories: those that are on the market without the "green bond" label and those that are specifically marketed as **green bonds** and at best are certified. However, there is no universal standard or mandatory certification for bonds marketed as "green bonds".

Green bonds should meet the ICMA guidelines to be listed in the **Green Bond Segment** of the Frankfurt Stock Exchange. The Green Bond Principles contain four components:

- **Use of issue proceeds:** How the issue proceeds are to be used is described in the bond prospectus. Nine project categories are Green Bond eligible: renewable energy and energy efficiency, pollution prevention and control, management of living natural resources and land, terrestrial and aquatic biodiversity, clean transportation, sustainable water and wastewater management, climate change adaptation, circular economy adapted products, production technologies and processes and green buildings.

- **Project selection process:** The issuer discloses the criteria used to select and evaluate green projects. The issuer also sets out the sustainability objectives of the project.

- **Revenue management'**: The collected revenues must be managed separately. A formal internal process ensures that the proceeds are used exclusively for the lending and investment activities of the green projects.

- **Reporting:** At least once a year, the issuer shall provide information on the investments until the funds have been fully allocated.

E. Award of public contracts

The awarding of public contracts is of great economic relevance in Germany just as it is in other EU member states. Each year, public authorities (federal government, federal states and municipalities) procure goods, services and construction contracts with a **total volume of approximately EUR 300 billion**[44]. The spectrum of public contracts is quite broad, ranging from simple office supplies to extremely complex high-tech instruments or sophisticated consulting services.

I. Legal framework

The legal framework for the award of public contracts is rather **complex and fragmented**.

1. Regulations for contracts above the thresholds

For services with a contract value reaching or exceeding certain thresholds, a **legal regime** applies which is **derived from relevant EU Procurement Directives**. Besides Part 4 of the Act against Restraints of Competition (*Gesetz gegen Wettbewerbsbeschränkungen, GWB*) these are

- the Ordinance on the Award of Public Contracts (*Vergabeverordnung, VgV*)[45] for supplies and services, including independent professional services;
- the Award Procedures for Construction Services (*Vergabe- und Vertragsordnung für Bauleistungen – Teil A, VOB/A*)[46] for public work contracts;
- the Ordinance on the Award of Public Contracts in Specific Sectors (*Sektorenverordnung, SektVO*)[47] for public contracts in the fields of transport, drinking water supply and energy supply;
- the Ordinance on the Award of Public Contracts in the Fields of Sefence and Security (*Vergabeverordnung Verteidigung und Sicherheit, VSVgV*)[48] for defence and security-specific supply and service contracts.

In addition, a simplified regulatory framework known as the Ordinance on the Award of Concession Contracts (*Konzessionsvergabeverordnung, KonzVgV*)[49] applies to the award of building and service concessions.

2. Regulations for contracts below the thresholds

Should the value of the contract to be awarded fall below the relevant EU threshold, a purely national regulatory framework applies which is based on the **budget law** of the German federal government and the federal states:

- the Award Procedures Below Thresholds (*Unterschwellenvergabeordnung, UvgO*)[50] for public supply and service contracts; or
- the Award Procedures for Construction Services (*Vergabe- und Vertragsordnung für Bauleistungen – Teil A, VOB/A*) for public work contracts.

Furthermore, almost all of the German federal states have their own laws governing the award procedure, the so-called "*Landesvergabegesetze*". These laws only apply in the respective federal state and usually regardless of whether the respective contract reaches the relevant EU threshold or not.

3. Thresholds

The thresholds are decisive when it comes to the issue of which legal framework is relevant and must be applied. These are adapted and redefined by the EU Commission every 2 years. Apart from some particularities, the following threshold values apply for 2022 and 2023:

- for procurements of the federal government in the field of public supplies and services: EUR 140,000;

[44] https://simap.ted.europa.eu/european-public-procurement (accessed on 30 November 2021).

[45] Ordinance on the Award of Public Contracts (Vergabeverordnung, VgV) in the version of the publication of 12 April 2016 (BGBl. I p. 624), last amended by Article 2 of the Law of 9 June 2021 (BGBl. I p. 1691).

[46] Award Procedures for Construction Services (*Vergabe- und Vertragsordnung für Bauleistungen – Teil A, VOB/A*) in the version of the last publication of 31 January 2019 (BAnz AT 19.02.2019 B2).

[47] Ordinance on the Award of Public Contracts in Specific Sectors (*Sektorenverodnung, SektVO*) in the version of the publication of 12 April 2016 (BGBl. I p. 624, 657), last amended by Article 3 of the Law of 9 June 2021 (BGBl. I p. 1691).

[48] Ordinance on the Award of Public Contracts in the Fields of Defence and Security (*Vergabeverordnung Verteidigung und Sicherheit, VSVgV*) in the version of the publication of 12 April 2016 (BGBl. I p. 624, 657), last amended by Article 3 of the Law of 9 June 2021 (BGBl. I p. 1691).

[49] Ordinance on the Award of Concession Contracts (*Konzessionsvergabeverordnung, KonzVgV*) in the version of the publication of 12 April 2016 (BGBl. I p. 624, 683), last amended by Article 6 of the Law of 10 July 2018 (BGBl. I p. 1117).

[50] Award Procedures Below Thresholds (*Unterschwellenvergabeordnung, UVgO*) in the version of its publication of 2 February 2017(BAnz AT 07.02.2017 B1).

- for procurements of the federal states and municipalities in the field of public supplies and services: EUR 215,000;

- for the procurement of public supplies and services in the utilities sector and in the field of defence and security: EUR 431,000;

- for construction works consistently EUR 5,382,000.

The value of the contract to be awarded, and, accordingly, whether the relevant threshold value is exceeded or not, is determined by the corresponding contracting authority on the basis of a forecast decision. Such a decision can be reviewed and verified by a court.

II. Foundations and basic principles

The different legal frameworks, applicable to contracts exceeding and contracts below the threshold values respectively, have implications in 2 main aspects in practice: contracts exceeding the threshold values have to be principally tendered and published EU-wide whereas contracts below the threshold values only have to be published nationally (see III.1.). Contracts with a value above the threshold may, in addition, be **reviewed for any procedural errors** upon the request of the tenderers. A specific review procedure applies to such a review either before the Federal Public Procurement Tribunal (*Vergabekammern des Bundes*) of the Bundeskartellamt and the Public Procurement Tribunals of the federal states (*Vergabekammern der Bundesländer*) or, by immediate complaint, before the Higher Regional Courts (Oberlandesgerichte). This review proceedure is not available in the case of below-threshold contracts. In such cases, tenderers may lodge claims regarding procedural breaches only before civil courts (see IV.).

The award of any contracts, regardless of the contract value, is subject to the application of the basic principles of procurement law that the contracting authorities are required to respect: **transparency, equal treatment, non-discrimination, and competition**.

III. Cornerstones of the award procedure

1. Contract notice

In order to ensure transparency, apart from certain exceptions where one or only very few tenderers may be directly approached, the contracting authorities must publicly announce their intended procurements in a manner that allows as many companies as possible to participate. Contract notices of EU-wide invitations to tender must be published in the Official Journal of the European Union. This is carried out centrally via the **Internet portal Tenders Electronic Daily** (TED)[51]. The key parameters of any invitations to tender published on TED are available in all official languages of the European Union.

There is no standard publishing portal available in Germany to announce national invitations to tender for contracts falling below the threshold values. Contracts to be awarded by the German federal government are consistently published on the procurement portal of the federal government[52], yet each federal state maintains its own platform for award procedures[53].

2. Participation of foreign enterprises

Even though EU-wide invitations to tender are addressed to companies from other EU member states und national invitations to tender are in general addressed to enterprises within Germany, **undertakings from non-European countries can also tender for public procurement contracts in Germany**. Regulations leading to a narrowing down the group of participants to the European Union or Germany are principally not provided for in procurement law[54]. If non-European companies are prevented from participating in EU-wide award procedures, judicial recourse before reviewing authorities shall be available to them[55].

However, the contracting authority can always determine in which language the award procedure shall be conducted and the tenders are to be submitted. A limitation to only one language, e.g. German, is not considered a discrimination. Accordingly, for foreign companies who intend to participate in award procedures of German contracting authorities it makes sense not only for legal but also for language reasons to be represented by a domestic company or a domestic consultant.

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[51] https://ted.europa.eu/TED/main/HomePage.do (accessed on 30 November 2021).

[52] https://www.service.bund.de/Content/DE/Ausschreibungen/Suche/Formular.html?view=processForm&nn=4642046 (accessed on 30 November 2021).

[53] E.g., for Berlin this is www.vergabe.berlin.de, (accessed on 30 November 2021).

[54] An exception is made for the utilities sector where, pursuant to section 55 SektVO, contracting authorities may exclude those offers in which more than 50 per cent of the total value of goods originates outside the EU or associated markets. Moreover, the EU Institutions are currently debating plans for an International Procurement Instrument (IPI) that would enable the EU to limit or exclude, on a case-by-case basis, access to its public procurement markets from economic operators originating in the countries that apply discriminatory restrictions vis-à-vis EU businesses (see section 5 below).

[55] Higher Regional Court Dusseldorf, Decision of 31 May 2017 – VII Verg 36/16.

3. Electronic awarding

Since 18 October 2018, the contracting authorities in **EU-wide award procedures** have been required to conduct the procedures **fully electronically**. Accordingly, tenders may only be accepted in electronic form. Tenders submitted in written form must be excluded. The settlement of such award procedures is usually performed via procurement platforms which are easily accessible and simple to use. The tenderer can obtain the complete tender dossier through the platform without going through a complicated registration procedure. For below-threshold contracts, this duty to electronically award contracts does not yet apply. It will be gradually introduced over the next few years but can already be used today.

4. Award criteria, strategic objectives

In addition to the tender specifications, the award criteria will be decisive to a company's decision on whether to take part in a tender procedure. As a result of the transparency requirement, contracting authorities must publish the award criteria and their weighting. **Qualitative criteria** for the award decision are usually also laid down in addition to the price. Moreover, public contractors increasingly pursue political objectives with their invitations to tender. Accordingly, **social and environmental aspects** as well as sustainability aspects are increasingly used as award criteria. This provides companies that are able to render appropriately qualified services with the opportunity to be awarded the contract.

German procurement law further provides the general duty to divide public contracts into lots so that small and medium-sized enterprises **(SMEs) can also take part in such invitations to tender**. The possibilities to form a bidding consortium or to employ subcontractors are further conveniences facilitating the participation of SMEs in public contracts.

5. Sustainability strategy and Green Public Procurement (GPP)

According to the 1987 report of the World Commission on Environment and Development entitled "Our Common Future," sustainable development "meets the needs of the present without compromising the ability of future generations to meet their own needs."[56] In 2001, the European Council passed a sustainability strategy to identify and develop actions that would enable the EU to achieve a continuous long-term improvement of quality of life through the creation of sustainable communities, which were able to manage and use resources efficiently. The second aim was tapping ecological and promoting social innovation.[57]

The consequences for environment, economy and society are increasingly moving into the focus of public procurement. In 2014, the directives of the European Parliament and of the Council first codified sustainability aspects for public procurement, which were transposed in national law in 2016. According § 97 (3) of the GWB, aspects of quality, innovation as well as social and environmental aspects can now be taken into account. This applies to all phases of the award process, from the definition of the suitability criteria[58] to the execution of the contract.[59] In particular, it is also possible to exclude companies that do not comply with environmental or social standards from the award procedure.[60]

Green Public Procurement (GPP) is a voluntary instrument, it has a key role to play in the EU's efforts to become a more resource-efficient economy. It can help stimulate a critical mass of demand for more sustainable goods and services which otherwise would be difficult to get onto the market. GPP is therefore a strong stimulus for eco-innovation. The use of purchasing power to choose environmentally friendly goods, services and works, enables companies to make an important contribution to sustainable consumption and production.[61]

IV. Legal protection

For contracts that are subject to mandatory Europe-wide tendering, tenderers may assert the violation of their rights in review procedures before specific public procurement tribunals. The prerequisite for this is that a defect detected in such a procedure must be initially notified to the contracting authority[62]. Usually there will be a a deadline of 10 calendar days for the notification of such defects. If the contracting authority rejects such a notification, the tenderer has 15 calendar days in which to appeal to the locally competent public procurement tribunal. Failure to comply with this deadline will render the review procedure inadmissible. The public procurement tribunal must take a decision on the application for review within a period of 5 weeks. This guarantees **fast and effective legal protection in award procedures**. An appeal against the decision of the public procurement tribunal can be lodged with the Higher Regional Court as the competent court, which will then fully review and decide on the substance of the case.

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[56] Report of the World Commission on Environment and Development: Our Common Future, p. 41 (https://sustainabledevelopment.un.org/content/documents/5987our-common-future.pdf).

[57] European Commission, Next steps for a sustainable European future, COM (2016) 739 final, p. 2.

[58] Environmental aspects § 49 of the VgV.

[59] § 128 of the GWB.

[60] §§ 123 and 124 of the GWB.

[61] https://ec.europa.eu/environment/gpp/index_en.htm.

[62] § 160 para. 3 GWB.

This particular legal protection does not cover contracts below the thresholds. In such cases, tenderers can seek an injunction against the contracting authority and its intention of award the contract before civil courts prior to the award of the contract or claim damages.

V. International procurement instrument (IPI)

Originally proposed by the Commission in 2012, the **international procurement instrument** is not a new idea but is still an important step towards promoting a level playing field and reciprocity, especially in **accessing third countries' public procurement markets**.[63] "The IPI would be a trade policy tool that aims to

- increase the participation of EU businesses in procurement markets of third countries, and
- provide leverage for the EU in the context of negotiations for opening markets in third countries.[64]

The IPI would enable the EU to limit or exclude, on a case-by-case basis, access to its public procurement markets for economic operators originating in the countries that apply discriminatory restrictions vis-à-vis EU businesses. However, the existing EU commitments with third countries – including the WTO Government Procurement Agreement GPA) and bilateral trade agreements – would remain unaffected by the IPI."[65]

After several revisions and following the Council's agreement in June 2021 on a mandate for the negotiations, the European Parliament updated its position in the form of a new legislative report which was amended by the European Parliament in December 2021. The forthcoming negotiations with the member state governments and the EU Commission ("trilogue") aimed to be completed by spring 2022.

[63] https://www.consilium.europa.eu/en/press/press-releases/2021/06/02/trade-council-agrees-its-negotiating-mandate-on-the-international-procurement-instrument/ (accessed on 30 November 2021).

[64] https://www.medtecheurope.org/news-and-events/news/european-parliament-advances-the-discussion-on-the-international-procurement-instrument-ipi/ (accessed on 30 November 2021).

[65] Council of the European Union, interinstitutional File: 2012/0060, 9175/21, p. 2, No. 2 (https://data.consilium.europa.eu/doc/document/ST-9175-2021-INIT/en/pdf) (accessed on 30 November 2021).

F. Aliens law

Whereas EU citizens do not require a visa for entry, longer-term residence or to work in Germany, a **general visa requirement** applies to most foreign nationals.

As a matter of principle, third country nationals who would like to work in Germany and are currently still abroad need a work visa to enter the country. As a rule, this also applies to cases in which it would be possible to enter the country for a short stay without a visa (Australia, Israel, Japan, Canada, the Republic of Korea, New Zealand, and the United States of America). For nationals of these countries, the EU has only withdrawn the visa requirement for visits of up to 3 months within a 6-month period.

The visa must be applied for prior to entry at a German Embassy or Consulate within the respective country. There are 2 types of visa: **the short–term Schengen Visa** and **the long-term National Visa**.

A Schengen Visa entitles the holder to enter Germany and the other Schengen countries to remain for a **maximum period of 90 days** within a 180-day period. Schengen Visas can be issued for different purposes (like family visits, tourism, or business). Travellers may also apply for **multiple-entry visas** for several years (maximum of 5 years), if this is required for business reasons and the applicant's credibility has been proven through a previous visa.

Any non-EU citizen who wishes to remain in Germany for **longer than 90 days** must apply for a National Visa before entering Germany and for a **residence permit** (***Aufenthaltserlaubnis***) from the local authorities after entering Germany. Depending on the purpose of the stay, there are different types of residence permit, which are governed by the **Residence Act** (**Aufenthaltsgesetz, AufenthG**)[66] as well as supplementary complementary ordinances:

- 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.

[66] Law on the Residence, Economic Activity and Integration of Foreigners in the Federal Territory (Residence Act – *Aufenthaltsgesetz, AufenthG*) of 25 February 2008 (BGBl. I p. 162), last amended by Article 12 of the Law of 9 July 2021 (BGBl. I. S. 2467).

I. Application procedure

1. Application for a national visa to enter Germany

An application for a National Visa must be submitted to the responsible German Embassy or Consulate and requires approval from the relevant **Immigration Authority** (*Ausländerbehörde*) at the future place of residence. The application procedure normally lasts several months. On the basis of the documents provided by the German Embassy, the authority will decide if the requirements for the grant of a residence permit are fulfilled. The Embassy or Consulate will subsequently decide on the issuance of the visa.

The Immigration Authority examines the general prerequisites for the issuance of the residence permit under the AufenthG. As a rule, the issuance of a residence permit requires

- possession of a recognised passport;
- assurance for the means of subsistence;
- confirmation of the applicant's identity and nationality;
- no existing grounds for deportation;
- no expectation of interference with or endangerment to public interests;
- and that the applicant entered the country legally (with a visa).

The German Embassy generally issues residence titles for specific purposes in the form of a visa with a maximum validity of 90 days. Shortly after entering Germany, the visa holder must contact the responsible Immigration Authority in Germany, which then issues the final residence permit.

The decision of the Immigration Authority concerning the issue of the residence permit is linked to the decision of the Federal Employment Agency (*Bundesagentur für Arbeit*) concerning the issue of a work permit.

2. Application for the issuance of a residence permit

The residence permit will be granted by the Immigration Authority at the place of residence. The application for the residence permit must be submitted before the visa (it is usually granted for a period of 3 months). The residence permit is granted at relatively short notice, based on the findings of the examination for the issuance of the entry visa. Residence permits are issued for a limited period and may be extended afterwards if the necessary requirements are still met.

3. Registration of residence

Within 1 or 2 weeks of moving to a new residence in Germany (depending on the local state law), the the foreign national must notified their new address to the **local Residents' Registration Office** (***Einwohnermeldeamt or Bürgeramt***). As a rule, you will be required to appear in person, bring your passport and prove that you reside at the new address, such as by a certification from the landlord.

II. Forms of residence title and other residence permits

There are 4 different residence titles for third country nationals for long-term stays in Germany:

- residence permit (temporary residence title);
- EU Blue Card/ICT Card (temporary residence title);
- settlement permit (permanent residence title);
- EU permit for permanent residence (permanent residence title).

Residence permits are the most common residence titles. Depending on the reason for residence, there are different forms of permits, each with their own requirements. Besides those, the EU law grants special residence titles: **the EU Blue Card is issued to highly qualified employees** and is combined with some privileges compared to holders of other residence permits. **Recipients of the ICT card are expats, i.e., employees who will work in Germany for the same company that they work for abroad**.

At the earliest after 5 years (21 months for holders of an EU Blue Card and 4 years for skilled workers), it is possible to apply for a **settlement permit** (**Niederlassungserlaubnis**) or for an **EU permit for permanent residence** (**Erlaubnis zum Daueraufenthalt-EU**). Both permits are unlimited.

1. Residence permit for self-employed foreign investors

Foreign investors can obtain a residence permit for the purpose of self-employment in accordance with § 21 of the AufenthG. Applicants making investments, e.g., through

the formation of a GmbH, holding a sufficient share in its nominal capital (at least 50%) and fulfilling in a management position (such as director) are acknowledged as 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 3 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 2 conditions were deemed met if EUR 250,000 was invested and at least 5 jobs were created. Currently, the law does not stipulate a minimum level of investments or number of jobs that must be created. This gives the various regions flexibility in granting residence permits to investors.

The Aliens Authority decides on the basis of its analysis of the sustainability of the project, the business experience of the investors, the sums of money invested, the effects on the German employment market at the location of the 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 residence permit for the purpose of self-employment is issued for an initial period of no more than 3 years. Upon request by the investor, the permit can be extended for an unlimited period. Additionally, a settlement permit or an EU permit for permanent residence can be applied for, which last an unlimited period of time.

2. Residence permit for the purpose 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 of the AufenthG. For 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 employee is required to follow directions and is integrated into a third-party operating procedure. Under German immigration law, even the director of a GmbH who owns no (or close to no) shares in a company is considered an employee.

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

- The applicant has a firm offer of employment.
- The applicant fulfils all legal requirements for the access to the German job market in the respective branch (i.e., has all legal access requirements).
- There are no prioritised jobseekers (i.e., German citizens, EU citizens, EEA citizens) for the specific job (so-called "**priority check**" (*Vorrangprüfung*)).
- The employment conditions must be comparable to those which apply to German employees.
    - Means of subsistence are ensured during residence;
    - No objections on grounds of public safety or social order.

The residence law follows the principle that the German labour market should be primarily reserved for German and EU citizens. However, non-EU citizens may get access to the German labour market where the law or intergovernmental agreements stipulate this or if their employment will have no negative effect on the German labour market. Only nationals of the European Economic Area (EEA, EU member states plus Iceland, Liechtenstein, and Norway) and of Switzerland have unrestricted access to the German labour market.

In general, **consent is required from the Federal Employment Agency** (***Bundesagentur für Arbeit***). The law also provides exceptions regarding this consent requirement. Certain types of employment do not require consent, including managers and those engaged in scientific, research and development activities.

Skilled workers from non-EU countries will find it easier to access the German labour market than non-skilled workers because the Bundesagentur für Arbeit does not undertake a priority check. They are also able to come to Germany to look for a job and will be granted a residence permit for up to six months for this purpose. Skilled workers are persons with qualified vocational training or a university education. The qualification as a skilled worker must be recognised by the competent body. The residence permit for a skilled worker is valid for a maximum of 4 years after the first application.

3. EU Blue Card for highly qualified foreign employees

Highly qualified foreign nationals who possess a university degree or comparable qualification can obtain the so-called "**EU Blue Card**" through a simplified application procedure. The EU Blue Card is a long-term residence permit allowing the holder to

work in Germany. **It is valid for a maximum of 4 years after first application or for the duration of the contract and an additional 3 months after the termination**. The EU Blue Card will be issued if the following conditions are met:

- The applicant must possess a German or recognised foreign university degree or a foreign university degree comparable to German standards.
- The applicant has signed an employment contract or received an offer of employment.
- The applicant must receive a certain minimum annual salary. This amounts to two-thirds of the annual gross income ceiling for state pension insurance contributions (2022: EUR 56,400.00).
- The applicant must possess a permit to exercise a profession in Germany if such a permit is required for the specific profession. In Germany, a special permit is required to practice certain professions, such as human medicine professions, tax consultants, lawyers, etc.

For occupations for which there is a shortage of skilled workers, as defined by the law, e.g., natural 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 (2022: EUR 43,992.00).

If the minimum salary limit is not reached, the approval of the *Bundesagentur für Arbeit* is necessary.

4. ICT Card for expats

The **ICT Card** is designed to enable the **intra-corporate transfer of personnel**. It applies to expats who intend to work at a German branch of an international company which previously employed the employee at another site prior to the transfer. This could be a branch office or a subsidiary or – conversely – a headquarter or a holding company.

The transfer changes nothing with respect to the contract between the expat and the company. The employment contract must have lasted for at least 6 continuous months before the transfer.

The ICT Card is granted solely to executives, who occupy management positions within the office or an autonomous corporate department; to specialists, who have a special qualification and work experience in the relevant field; and to trainees, in order to improve their qualifications and professional development. **The ICT card is limited to 3 years** (one year for trainees). It can be extended, but not beyond a total period of 3 years (one year for trainees, respectively).

The holder of the ICT Card may also enter other EU countries for a short period of time on this residence permit.

A worker can be issued with an intra-corporate transferee permit if:

- the branch of the international company is in Germany, whereas the employment contract is with a branch in a non-EU country, has existed for more than 6 continuous months and contains a transfer provision (this maybe agreed upon separate to the employment contract);
- the minimum transfer duration is 90 days;
- the employee is working as an executive, specialist or trainee in the German branch;
- proof of the qualification to perform the work as an executive, specialist or trainee has been provided;
- the *Bundesagentur für Arbeit* has given its approval (some cases are exempt from this requirement).

The ICT Card can only be applied for from the non-EU country where the ICT-transferee resides. Although the initial application can't be made from Germany, the ICT-transferee may apply for an extension of the ICT-Card while in Germany. If the ICT-transferee wishes to apply for another separate ICT-Card after finishing the first transfer, he or she must abide by the cool-down period of 6 months before re-applying.

5. Settlement permit (= Permanent residence permit)

The **unlimited settlement permit**, the most comprehensive form of residence permit, is usually subject to strict preconditions. The freedom to take up permanent residence is granted if the following preconditions are fulfilled:

- possession of a residence permit for 5 years;
- assuring livelihood without needing public assistance;
- at least 60 months of mandatory contributions to the statutory pension insurance have been paid;
- there are no objections on grounds of public safety or social order;
- work permit (permission for employment or other gainful occupation);

- possession of adequate knowledge of the German language as well as familiarity with the social and legal order in Germany;

- access to adequate housing for the applicant and their family.

Settlement permits authorise any type of employment as a permanent residence title.

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 2 years and be working in a job that corresponds to their degree. Furthermore, they must have paid into the statutory pension insurance for at least 24 months.

Highly qualified persons (under the AufentG, e.g., scientists with special knowledge, an instructor or senior research assistant) can immediately receive a settlement permit for employment if they have a firm job offer and can show that their livelihood in Germany is ensured without public assistance. There is no minimum income requirement.

Skilled workers can receive a settlement permit after 4 years if they have job commensurate to their qualifications and have sufficient knowledge of the German language (level B1). They must have paid into the statutory pension insurance for at least 48 months.

Self-employed individuals may obtain a settlement permit after 3 years if their business project is sustainable, the means of subsistence are assured, and they have held a residence permit for self-employed people.

Foreigners who possess the EU Blue Card can apply for an unlimited settlement permit after 33 months, if they have paid compulsory or voluntary contributions to the statutory pension insurance scheme for that period. If they have sufficient knowledge of the German language (level B1), the period is reduced to 21 months.

6. EU permit for permanent residence

The EU permit for permanent residence is an expression of the freedom of establishment. It resembles the permanent residence permit in legal effects. The main difference is that the **EU permit for permanent residence allows the holder to reside in other EU countries, not just Germany**.

The requirements are as follows:

- residence in Germany under a residence title for at least 5 years or longer;

- assurance of livelihood, and that of the next of kin through stable and regular income;

- no adverse impact on public security;

- sufficient knowledge of the German language and familiarity with German society and the legal and social order in Germany; and

- adequate housing for the applicant and their family.

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

7. Family reunification

The family members of foreign investors and employees, namely their spouse and children, may obtain a **residence permit for family reunification purposes**. Despite the title, family members can apply for the visa and for the residence permit simultaneously with the investor or the employee. In general, the following requirements must be met:

- the foreign national holds a long-term residence permit for Germany;

- the foreign national and the applicant (family member) has access to adequate housing in Germany;

- the applicant's livelihood must be secured. The livelihood is deemed ensured if the applicant is able to pay for it (including adequate health insurance) without any state support. For this, the financial contributions to the household income of all family members 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. Knowledge of the German language is not required in several cases, e.g., if it is presumed, it won't be an obstacle for integration in Germany. Spouses of self-employed foreigners, owners of an EU Blue Card or of a highly qualified person or researcher also don't need to prove any basic German language skills.

Underage children (unmarried, not divorced or widowed) of foreign nationals have the right to be granted a residence permit for family reunification purposes if their parents hold or single parent holds a long-term residence permit for Germany.

G. Employment law

I. German employment law

1. Overview

German employment law is not completely codified. There is therefore no special code of employment and no standard law governing employment contracts. Rather, German employment law is – to the extent that it is governed by legal norms at all – covered by several other different laws. The judicial development of the law is also very important. German employment law can be divided into 3 areas:

- Individual employment law:

  This includes the rules on the drafting, content and termination of employment contracts and stipulates the relationship between the individual employees and the employer.

- Collective employment law:

  This governs the legal relationships between the employment law coalitions (trade unions, employers and employers' associations) and the bodies representing the workforce (works 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 individual employees.

2. Sources of law

Both supranational and national sources of law impact German employment law. The supranational sources of law include:

- primary EU law such as the Treaty on the Functioning of the European Union (TFEU), and the Treaty on European Union (TEU)[67];
- secondary EU law (regulations and directives);
- decisions by the European Court of Justice;
- the European Social Charter (ESC)[68];
- the European Convention on Human Rights (ECHR)[69].

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 Constitution Law (*Grundgesetz, GG*)[70];
- the Civil Code (*Bürgerliches Gesetzbuch, BGB*);
- the Industrial Code (*Gewerbeordnung, GewO*);
- the Act on the Protection Against Dismissal (*Kündigungsschutzgesetz, KSchG*)[71];
- the Part-time and Limited-term Employment Act (*Teilzeit- und Befristungsgesetz, TzBfG*)[72];
- the Federal Holidays Act (*Bundesurlaubsgesetz, BUrlG*)[73];
- the Working Hours Act (*Arbeitszeitgesetz, ArbZG*)[74];

[67] Consolidated versions of the Treaty on the European Union and the Treaty on the Functioning of the European Union in the version of the publication of 7 June 2016.

[68] The European Social Charter became effective on 26 February 1965 and was revised in 1996.

[69] The Éuropean Convention on Human Rights came into force on 3 September 1953.

[70] Constitution Law (*Grundgesetz, GG*) in the version published in the Federal Law Gazette Part III under the classification number 100-1, last amended by Article 1 and 2 of the Law of 29 September 2020 (BGBl. I p. 2048).

[71] Act on Protection Against Dismissal (*Kündigungsschutzgesetz, KSchG*) in the version of the publication of 25 August 1969 (BGBl. I p. 1317), last amended by Article 2 of the Law of 14 June 2021 (BGBl. I p. 1762).

[72] Part-time and Limited-term Employment Act (*Teilzeit- und Befristungsgesetz, TzBfG*) in the version of the publication of 21 December 2000 (BGBl. I p. 1966), last amended by Article 10 of the Law of 22 November 2019 (BGBl. I p. 1746).

[73] Federal Holidays Act (*Bundesurlaubsgesetz, BUrlG*) 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).

[74] Working Hours Act (*Arbeitszeitgesetz, ArbZG*) in the version of the publication of 6 June 1994 (BGBl. I p. 1170, 1171), last amended by Article 6 of the Law of 22 December 2020 (BGBl. I p. 3334).

- the Minimum Wage Act (*Mindestlohngesetz, MiLoG*)[75];
- the Occupational Health and Safety Act (*Arbeitsschutzgesetz, ArbSchG*)[76];
- the Continued Payment of Wages Act (*Entgeltfortzahlungsgesetz, EntgFG*)[77];
- the Maternity Protection Act (*Mutterschutzgesetz, MuSchG*)[78];
- the Proof of Substantial Conditions Applicable to the Employment Relationship Act (*Nachweisgesetz, NachwG*)[79];
- Social Security Codes (*Sozialgesetzbuch, SGB*) SGB) 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 Constitution Law (Art. 9 GG on freedom of association);
- collective bargaining agreements:

  In Germany, the **collective bargaining agreement** (***Tarifvertra***g) is a written contract between the parties to the collective bargaining 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 bargaining agreement is the Collective Bargaining Act (*Tarifvertragsgesetz, TVG*)[80]. The collective bargaining agreement contains legal norms which regulate the content, conclusion, and termination of the employment relationship as well operational and industrial relations questions.

[75] Minimum Wage Act (*Mindestlohngesetz, MiLoG*) of 11 August 2014 (BGBl. I p. 1348), last amended by Article 2 of the Law of 10 July 2020 (BGBl. I p. 1657).

[76] Occupational Health and Safety Act (*Arbeitsschutzgesetz, ArbSchG*) of 7 August 1996 (BGBl. I p. 1246), last amended by Article 1 of the Law of 22 December 2020 (BGBl. I p. 3334).

[77] Continued Remuneration Act (*Entgeltfortzahlungsgesetz, EntgFG*) of 26 May 1994 (BGBl. I p. 1014, 1065), last amended by Article 9 of the Law of 22 November 2019 (BGBl. I p. 1746).

[78] Maternity Protection Act (*Mutterschutzgesetz, MuSchG*) in the version of the publication of 23 May 2017 (BGBl. I p. 1228), last amended by Article 57 of the Law of 12 December 2019 (BGBl. I p. 2652).

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

[80] Collective Bargaining Act (*Tarifvertragsgesetz, TVG*) in the version of the publication of 25 August 1969 (BGBl. I p. 1323), last amended by Article 8 of the Law of 20 May 2020 (BGBl. I p. 1055).

- works agreements:

  The **works agreement** (***Betriebsvereinbarung***) is a contract between the employer and the works council (*Betriebsrat*) which establishes binding norms for all employees of the work. A works agreement can cover all aspects for which the works council enjoys a legal right of co-determination. The core area of this co-determination is social aspects (for example the length and distribution of working hours). To the extent that a matter is already covered by a collective bargaining agreement, as a rule this matter 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 employer.

- Works Council Constitution Act:

  Essentially, the Works Council Constitution Act (*Betriebsverfassungsgesetz, BetrVG*)[81] 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 work.

II. Recruitment of employees

In Germany, the search for personnel is assisted, generally free of charge, by the *Bundesagentur für Arbeit*, which has agencies in all 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 and freelancers) is particularly important 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 XI.). According to the case law and the definition in § 611a (1) of the BGB, employees are individuals who, on the basis of a private-law contract, are obliged to perform services in a relationship of subordination; the non-independent nature of the services performed is of particular relevance here. Persons are classed as being **non-independent** if they are required to follow directions and are integrated into a third-party

[81] Works Council Constitution Act (*Betriebsverfassungsgesetz, BetrVG*) in the version of the publication of 25 September 2001 (BGBl. I p. 2518), last amended by Article 4 of the Law of 16 July 2021 (BGBl. I p. 2959).

working organisation. A few areas of German employment law also still distinguish between workers and salaried employees, although this now hardly plays any role in reality. Originally, salaried employees were a smaller and more highly-qualified group of employees than the 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 various ways:

- The law on public working hours is not applicable to executive employees.
- The regulations on the protection againstdismissal 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 (*Berufsbildungsgesetz, BBiG*)[82] or the Protection of Young Persons in the Workplace Act (*Jugendarbeitsschutzgesetz, JArbSchG*)[83], 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 BBiG provides for special rules intended to ensure appropriate occupational training. However, a distinction should be made between trainees and any volunteers, work experience employees or interns, to whom the BBiG – in general –, does not apply.

[82] Occupational Training Act (*Berufsbildungsgesetz, BBiG*) in the version of the publication of 23 March 2005 (BGBl. I p. 931), last amended by Article 14 of the Law of 17 July 2017 (BGBl. I p. 2581, 2613).

[83] Protection of Young Persons in the Workplace Act (*Jugendarbeitsschutzgesetz, JArbSchG*) in the version of the publication of 12 April 1976 (BGBl. I p. 965), last amended by Article 13 of the Law of 10 March 2017 (BGBl. I p. 420,422).

3. Underage employees

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

IV. Conclusion and content of employment contracts

1. Form

An employment contract can be concluded verbally or in writing. According to the Proof of Substantial Conditions Applicable to the Employment Relationship Act (*Nachweisgesetz, NachwG*), if only a **verbal employment contract** exists, the employer is 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

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. 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 for the first time, the employment contract can be limited for a period of up to 2 years without stating any grounds for the limitation of the term. Where the limited term of the contract is longer than 2 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 4 years of existence of a newly-established 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 (*Teilzeit- und Befristungsgesetz, TzBfG*), **part-time employees** may also not be placed in a position worse than that of full-time employees, unless there is an objective 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 to reduce their 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 *TzBfG* also stipulates that part-time employees who wish to change their working hours are to be informed about available part-time or full-time positions and given preference when filling future open positions, unless this is not feasible for important operational reasons or the working hour requests of 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 VI. 2. a)) or through a probationary period provision in an unlimited-term employment contract. The probationary period in Germany lasts a maximum of 6 months. During the probationary period, the employment relationship can be terminated by either party on 2 weeks' notice, unless a longer period of notice is stipulated in a collective bargaining 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. Any **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 V.). The redeployment of an employee to another city (to perform an equivalent job) is – in general – only possible if this has been agreed in the employment contract or a 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 bargaining agreement. When setting working hours, the stipulations of the **Working Hours Act** (*Arbeitszeitgesetz, ArbZG*), as well as the occupational health and safety regulations must be observed. The occupational health and safety regulations include the Protection of Young Persons in the Workplace Act (*Jugendarbeitsschutzgesetz, JarbSchG*), the Maternity Protection Act (*Mutterschutzgesetz, MuSchG*) and the Shop Closing Times Act (*Ladenschlussgesetz, LadSchlG*)[84]. The Working Hours Act is based on the principle of an 8-hour workday. The **daily working hours** can be extended to up to ten hours if, within an equalisation period of 4 months, the average daily number of working hours (taking Saturdays into account as a work day) does not exceed 8 hours. According to the statutory regulations on **breaks**, for 6 hours of work, a break period of at least 30 minutes must be provided and a break of at least 45 minutes must be provided for more than 9 hours of work. The minimum break time can be divided into smaller breaks, but each break must be at least 15 minutes. No employee can be required to work for longer than 6 hours without a break. Special protective regulations apply to employees who work at night. Working on Sundays and public holidays is – except in exceptional circumstances – not permitted. Moreover, in workplaces with a works council, the works council will have 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 employees to be legally obliged to work **overtime**, there must be an enabling provision in place. 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 that is 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 bargaining agreements or agreed upon in the employment contract. The employer must withhold income tax, the solidarity surcharge (*Solidaritätszuschlag*), church tax (Kirchensteuer), 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 bargaining agreements or agreements in the employment contract, employees are often entitled to non-cash benefits from their employer.

If the amount of the remuneration has not been fixed by the parties in 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 under the relevant collective bargaining agreement.

[84] Shop Closing Times Act (*Ladenschlussgesetz, LadSchlG*) in the version of the publication of 2 June 2003 (BGBl. I p. 744), last amended by Article 430 of the Regulation of 31 August 2015 (BGBl. I p. 1474).

Throughout Germany, a **statutory minimum wage** of EUR 9.82 (gross) per hour must be paid as from 1 January 2022 and EUR 10,45 (gross) as from 1 July 2022. The new federal government is currently planning to increase the minimum wage up to EUR 12.00 in 2022. 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 6 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 4 weeks by the respective employer.

The employee is obliged to notify the employer immediately of their unfitness for work and its anticipated duration. In the case of illness exceeding 3 days, the employee must submit an official sick note from a doctor no later than the following working day.

h) Holidays

The legal national minimum **holiday entitlement** (paid holiday leave) is 24 working days in the calendar year, based on a 6-day working 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 bargaining agreements which extend the holiday entitlement to approximately 6 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 6 months from the beginning of the employment relationship. In the case of an employment relationship which ends before 6 months have elapsed, the holiday entitlement is calculated pro rata based on the actual number of 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. Holiday entitlements may only be transferred to the next calendar year if it is justified by urgent operational reasons or reasons relating to the person of the employee. In this case, the leave must be taken in the first 3 months of the following year.

3. Service contracts 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 not strictly 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 a service contract. These service contracts govern 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 service contract. Relief from office, like voluntary retirement from office, is possible at any time without a statement of grounds, unless otherwise stipulated in the shareholders' agreement or the articles of association. The service contract must be terminated separately. The legal literature and case law differ as to which employment law norms apply to the service contract of a director of a GmbH. Irrespective of whether the director of a GmbH is sometimes exceptionally classified as an employee, labour courts do not have jurisdiction over legal disputes between a 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 employees. This management authority authorises the employer to determine which duties the employees are required to perform, when and where, and in what manner. 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 any stipulations in the employment contract, the management authority is limited through collective bargaining agreements or works agreements, as well as 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, religion or belief, in particular through the General Equal Treatment Act (*Allgemeines Gleichbehandlungsgesetz, AGG*)[85].

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

[85] General Equal Treatment Act (Allgemeines Gleichbehandlungsgesetz, AGG) in the version of the publication of 14 August 2006 (BGBl. I p. 1897), last amended by Article 8 of the law of 3 April 2013 (BGBl. I p. 610).

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 2 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. Since 2012, the age limit or the reaching of retirement age needs to be calculated individually, since the retirement age has been increased in stages and depending on the year of birth, from 65 to 67 years. There are also several 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. To prevent an over-ageing of the workforce, many companies collective bargaining agreements, works agreements or individual employment contracts stipulate age limits on the basis of which the employment relationship ends on the employee reaching retirement age.

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 (see below under 4.), 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 against dismissal 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 that must 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 considered when negotiating severance agreements.

Severance 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 Against Dismissal Act (*Kündigungsschutzgesetz, KSchG*), judicial conciliation may still be a route to reaching an 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 within the notice periods stipulated by the law or as agreed in the employment contract or collective bargaining agreement, or extraordinary termination (without notice and with immediate effect) 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 (which means signed by hand) and the original must be delivered to the recipient. It is not necessary to state the reason for termination in the case of contractual termination (unless stipulated by law e.g., for pregnant employees or trainees). In the case of termination without notice, the employer must only state the reason at the demand of the employee or if this requirement was stipulated in the employment contract, works agreement or collective bargaining agreement.

a) Contractual termination

Notice of contractual termination may only be issued for an objective reason in order to be legally valid. However, to the extent that the Protection of AgainstDismissal Act applies, there must be a **socially-justifiable reason** for a contractual termination. The required periods of notice must also be observed. Basically, the minimum statutory period of notice that employer and employees must observe is 4 weeks, with the termination taking effect on the 15th of the month or at 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 notice periods can be extended or reduced in collective bargaining agreements. The basic period of notice (4 weeks with effect on the 15th of the month or at the end of a calendar month) may be extended in the case that the contract is terminated

by the employee, but it 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 if it is to apply.

As an exception, the basic period of notice does not apply in the case of temporary employment (3 months), or in enterprises generally no more than twenty employees. The period of notice during an agreed probationary period, lasting no longer than 6 months, is 2 weeks and can be reduced only through a collective bargaining agreement. A limited-term employment relationships can only be terminated if this possibility was agreed in the employment contract or collective bargaining agreement.

b) Extraordinary termination

There must be **substantial grounds**, i.e., "cause", for extraordinary termination (without notice). Substantial grounds will exist if it is unreasonable for the terminating party to continue the employment relationship until the end of the notice period. 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 trade 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;
- continuously and significantly 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 3 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 KSchG impose a strict general protection of employment, designed to protect employees against socialy not justified dismissals. A dismissal will be socialy justified if it is based on grounds which lie in the person or behaviour of the employee or result from urgent operational needs, which do not allow continuing employment with the company.

An invalid dismissal does not effectively end the employment relationship. The employee concerned still has the right to be actively employed. German employment protection law is only concerned with **reinstatement** and an employer usually cannot claim a **severance payment** or compensation unless the parties mutually agree. Nevertheless, severance packages can be agreed in settlement negotiations, and this is done frequently. Severance payments amount – as a general rule, although no binding stipulation exists – to 0.5 gross monthly salaries per year of employment. Depending on the circumstances of the individual case (chances of success of a court action for unfair dismissal, particularities of the specific case, economic strength of the company, etc.), the amounts actually agreed may deviate considerably from the above rule.

The *KSchG* differentiates between employment relationships that commenced before and after 1 January 2004. If the employment relationship began on or after 1 January 2004, the *KSchG* generally applies if more than ten employees (excluding trainees; part-time employees are taken into account as a percentage of a full-time employee) are employed in the workplace. For employment relationships which existed on or prior to 31 December 2003, the *KSchG* applies if, as a rule, more than 5 employees (employees working part-time are taken into account as a percentage of a full-time employee) were employed in the workplace at that time who are still employed in the workplace at the time of termination. The application of the *KSchG* also requires that the employment relationship to be terminated has existed for longer than 6 months without interruption at the time of termination.

Contractual and extraordinary termination by the employer can be divided into 3 subcategories based on 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, such as physical or intellectual unsuitability for the position 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 detrimentally affected by the behaviour of the employee, especially in cases of culpable breach of contract, for example refusing to perform particular tasks, falsifying expenses, or insulting colleagues or superiors. Before the employment can be terminated on grounds of behaviour, the employee must be given an **official warning**. In this warning, the employer must outline the offensive behaviour and point out that the employee can expect to be dismissed if this behaviour is repeated. There are few cases where termination on grounds of behaviour without notice can be valid.

g) Termination on operational grounds

Employers frequently base the termination of an employment contract on **operational grounds**. The prerequisites include an operational need which justifies the loss of the job and thus the termination of employment. Termination on operational grounds is typically a response to a **decline in business** (decrease in orders or sales) or an **organisational action** on the part of the employer (reduction in size or closure of the workplace or a change of production method). The **corporate decision** to restrict or reduce the productivity of operations is not subject to review by the courts. However, in the 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 several comparable employees could be terminated on operational grounds, the employer must decide based on **social criteria**. This involves examining which employee would suffer the least hardship through the 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 on a so-called "**list of names**" with the works council. Such a document lists the names of the employees to be given notice of termination, which makes things clearer should any (terminated) employee take legal action for unfair dismissal be taken.

h) Special protection of employment

In addition to the general protection of employment, a special protection against dismissal arises under various different laws and applies to groups of persons who enjoy special protection of employment, for example:

- **pregnant women** and mothers up to 4 months following delivery;
- employees on **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, subject to the approval of the relevant state authorities.

VIII. Co-determination by employees

1. Co-determination within the workplace

In a workplace, the term co-determination (*Mitbestimmung*) covers the legal provisions concerning the rights of **co-determination of employees** within a workplace, based on the Works Council Constitution Act (*Betriebsverfassungsgesetz, BetrVG*) and the Executives' Representative Committee Act (*Sprecherausschussgesetz, SprAuG*) (for executive employees)[86].

a) Works Council Constitution Act

The Works Council Constitution Act from 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 through the works council in social, personnel-related and economic matters relating to the workplace.

b) Works council

Works councils are elected in workplaces with more than 5 permanent employees who are entitled to vote, at least 3 of whom are electable. If these prerequisites are met, the employees 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 workplace and their interests with respect to the employer. The individual responsibilities and powers of the works council are set forth in the *BetrVG*.

[86] Executives' Representative Committee Act (*Sprecherausschussgesetz, SprAuG*) in the version of the publication of 20 December 1988 (BGBl. I p. 2312, 2316), last amended by Article 3 of the Law of 14 June 2021 (BGBl. I p. 1762).

2. Board-level representation

In contrast to co-determination in the workplace, board-level representation does not involve the formation of a co-determination body but representation within existing corporate bodies (in particular in the supervisory board) through employee representatives and thus the possibility to influence corporate decisions (see B. III. 3. and V. 7.).

IX. Collective employment law

1. Trade unions and employers' associations

The constitutionally protected **trade unions** and employers' associations are of great importance in Germany. Less than 20% of all German employees are a member of a trade union, and collective agreements apply in approx. 60% of West German companies in contrast to only approx. 40% of East German companies. These figures, however, should not be misconstrued as suggesting that more than half of all German employees are paid wages below the levels set in the relevant collective agreement. Larger companies especially are subject to collective bargaining agreements. Companies that are not bound by collective bargaining 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. The conclusion of collective bargaining agreements is a key element of this, but change can also be brought about through industrial dispute measures (in particular strikes). In addition, trade unions and employers' associations 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 umbrella organisation Confederation of German Trade Unions (*Deutscher Gewerkschaftsbund, DGB*, with 6 million members) include:

- the industrial unions (*IG Bergbau, Chemie, Energie; IG Metall; etc.*) — approx. 3.1 million members
- the United Services Union (*Vereinte Dienstleistungsgewerkschaft, ver.di*)[87] — approx. 2 million members

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*).

[87] ver.di is the world's biggest individual union.

2. Collective bargaining agreements

Collective bargaining 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 bargaining agreement to agree to different arrangements – both to the advantage and the disadvantage of the employees. The provisions set forth in a collective bargaining agreement apply directly and in mandatory form to an employee who is a member of the trade union and the employer has concluded a collective bargaining agreement itself or is a member of an employers' association which concludes collective bargaining agreements in its name. In addition, the application of a collective bargaining agreement or individual provisions of a collective bargaining agreement can be agreed between the employer and the employee in the employment contract. In practice, where collective bargaining 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 bargaining 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 bargaining agreements and therefore may not cover areas which have already been covered through collective bargaining 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*)[88], 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 judgment 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 in connection with the Works Council Constitution Act and Co-determination Acts. These are also referred to as collective proceedings. Geographically, the labour court within whose district the respondent has their registered office or the labour court at the place of work will have jurisdiction.

The labour court – in general – consists of a presiding full-time judge and 2 lay judges representing employees and employers. Each of the 3 judges has the same voting right. It is possible to appeal against judgments by the labour court to the regional labour court. The regional labour court rules on appeals against the decisions of the labour court. There is one regional labour court in all federal regions, with the exceptions of North Rhine-Westphalia and Bavaria (which have 3 and 2 respectively), as well as Berlin and Brandenburg regions (which have a joint regional labour court). Appeals against decisions of the regional labour courts can be brought before the Federal Labour Court (*Bundesarbeitsgericht*) based in Erfurt.

A particularity of proceedings before labour courts is that both parties bear their own costs at 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 and health risks. The vast majority of the German population are insured on a compulsory basis under the social insurance system.

Most insured persons are gainfully employed. Under the system, employers and employees pay approximately half of the social insurance contributions. The employer not only withholds and pays 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.

[88] Labour Courts Act (*Arbeitsgerichtsgesetz, ArbGG*) in the version of the publication of 2 July 1979 (BGBl. I p. 853, 1036), last amended by Article 10 of the Law 5 October 2021 (BGBl. I p. 4607).

The system is essentially based on 5 pillars:

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 4,837.50 in 2021). If their monthly income exceeds this threshold, 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.

In 2021, 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, if this should occur, provides assistance and nursing services. However, **long-term care insurance** (*Pflegeversicherung*) is not full coverage insurance which makes additional contributions by the insured persons and other agencies unnecessary. According to the legal definition, insured persons are classed as needing 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 6 months. The degree of the need for care is determined by the medical service of the health insurance organisation. The legislator has provided for 3 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 long-term care insurance if they were insured under a long-term care insurance scheme for at least 5 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, like in the case of health insurance, as a general rule borne equally by the employee and the employer. The contribution rate is fixed by law and in 2021, amounts to 3.05% of the monthly gross wage; the ceiling is 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

The payment of **old-age pensions**, reduced capacity pensions as well as survivors' pensions as a wage substitute are one of 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 retirement age, which was 65 years until 2011. In view of increasing life expectancy, the retirement age has been gradually adjusted to 67 years since 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 has also been gradually increased. A pension can also be applied for earlier if the applicant is seriously disabled or has worked in certain occupations.

Pension insurance covers rehabilitation measures and promotes social involvement. As well as the provision and financing of treatment or retraining intended to counteract, prevent, or overcome reduced capacity to work, pension insurance compensates 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 18.6% of gross wages). There is an income ceiling for compulsory pension insurance contributions, which currently (2021) stands at EUR 7,100 in (former) West Germany and EUR 6,700 in (former) East Germany.

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 (2021) 2.4% of the employee's gross wages; the ceiling is the same as for statutory pension insurance contributions.

The benefits and services funded through unemployment insurance include:

- payments in case of unemployment;
- job-seeking advice and support (e.g., with applictions and interviews);
- identifying possible suitable jobs for claimants;
- providing assistance for persons starting a business.

5. Accident insurance

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 on the way to or from work, this will be covered by 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 capabilities of employees following accidents at work or occupational illnesses and compensating the insured persons or their surviving dependents with monetary benefits. Unlike other types of insurance, employers are required by law to participate in and 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. The actual contributions vary greatly depending on the industry of the employer.

H. Overview of the German tax system

I. Overview

The German tax system comprises 2 basic tax categories: direct and indirect taxes. For direct taxes, the taxable entity also bears the tax burden, e.g., **income tax** (*Einkommensteuer*), **corporation tax** (*Körperschaftsteuer*) and **trade tax** (*Gewerbesteuer*).

For indirect taxes, the tax debtor transfers the tax burden to a third party. The most important indirect tax is **value added tax** (VAT). 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 the correspondingly higher selling price. Other indirect taxes include excise taxes such as taxes on mineral oil and tobacco.

II. Types of tax

1. Income tax

The Income Tax Act (*Einkommensteuergesetz, EStG*)[89] covers 7 different types of income: income from agriculture and forestry, income from commercial 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 7 categories is not subject to German income tax.

a) Unlimited tax obligation

Natural persons who have their domicile or usual place of residence in Germany have an unlimited obligation to pay income tax. This means that all their net worldwide income will be 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 use. It should be noted in this context that even people who have 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 180 days.

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 the taxable income

The tax assessment basis is the natural person's net worldwide income. For the calculation, 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; it is determined separately and 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 apply for the tax year 2022:

Income below EUR 9,984 p.a. is exempt from income tax. The tax rate for income between EUR 9,984 and EUR 58,596 rises progressively from 14% to 42%. The tax rate of 42% also applies to income between EUR 58,597 and EUR 277,826. If the total income exceeds EUR 277,826, the amount of income exceeding EUR 277,826 is taxed at the maximum tax rate of 45%.

The **withholding tax** on the investment income of natural persons is charged at a flat rate of 25% and is, in most cases, **already deducted at the source** by the respective debtor. The flat rate taxation is linked to the prohibition against deducting investment income-related expenses. Investment income taxed at source does not have to 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

[89] Income Tax Act (*Einkommensteuergesetz, EStG*) in the version of the publication of 8 October 2009 (BGBl. I p. 3366, 3862), last amended by Article 27 of the Law of 20 August 2021 (BGBl. I p. 3932).

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. The solidarity surcharge was abolished in 2021 for so-called low-income earners (natural persons). This means that in future no solidarity surcharge will be levied if the income tax payable is less than EUR 16,956 or EUR 33,912 (single/collective assessment respectively). Above this threshold, a transitional zone applies, in which the solidarity surcharge is not levied in full but is gradually brought up to the full rate of 5.5 percent. For very high incomes (exceeding the new transitional zone), the previous solidarity surcharge remains unchanged. This is the case if taxable income exceeds EUR 96,820 (single persons) or EUR 193,641 (married couples).

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 that are connected economically with the domestic income can be deducted. In the case of taxpayers with limited tax liability, the deduction of special expenses is severely restricted, while the deduction of extraordinary charges is prohibited.

(2) Tax rates

For taxpayers with **limited tax liability**, the same tax rates generally apply as those for taxpayers with unlimited tax liability (described above), 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 2014/48/EU[90], 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 at 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 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 conducted by the corporation. This means that corporations are automatically subject to trade tax solely due to 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 corpora-

[90] Council Directive 2014/48/EU of 24 March 2014 amending Directive 2003/48/EC on taxation of savings income in the form of interest payments (OJ L 111, 15. 4. 2014, p. 50).

tions 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. Accordingly, 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 must 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 the case of the sale** of a shareholding, there is no difference between free float shares (<10%) and shares of more than 10%.

All operating expenses associated with the generation of 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 was 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 approximately 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, there is a locally variable trade tax of around 7% to 19.8%. The nominal overall tax therefore comes to approx. 23% to 36%.

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 approximately 7% to 19.8% is also applicable, so that the nominal overall tax burden will be around 23% to 36%, just like a corporation with unlimited tax liability.

c) New electoral law through the Corporate Modernisation Act

Since 1 January 2022, commercial partnerships **may opt to be treated as corporations** for tax purposes for the first time.

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

By exercising the option, the commercial partnership is subject to trade and corporation tax like a corporation. In order to exercise this option, the partnership **must submit an irrevocable application** for this to the tax office **no later than one month before the beginning of the financial year**.

(2) Tax rates

Opting commercial partnerships are also subject to corporation tax at a standard rate of 15% (plus a solidarity surcharge of 5.5% on the corporation tax) and local trade tax.

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** (*Quellensteuer*). 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[91] applies. As a rule, taxation at source is definitive; there will be no assessment. To this extent, 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 been issued a final exemption certificate 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 above 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

To the extent that 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 two-fifths of the tax if the foreign corporation is a shareholder of the German entity, so that the remaining taxation at source would be 15%.

[91] Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, Official Journal of the European Union L 345/8 of 29.12.2911, p. 8-16.

(2) EU 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 shareholding 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 3. a)) 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 where natural persons are the 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. If the full tax amount was withheld, **a refund can be claimed through another formal procedure**. In both cases, the competent authority will examine whether the strict requirements (see 3. a)) have been met. Essentially, **the foreign company must prove that it pursues a sustainable business** and is not simply used as an 'empty shell' to reduce taxation at source.

In any case, it is important to check which double taxation agreement applies and how it is structured in detail.

4. Taxation of permanent establishments

a) German tax law

The Tax Code (*Abgabenordnung, AO*)[92] defines "**permanent establishment**" (*Betriebsstätte*) as any fixed place of business or facility serving the business of an enterprise. According to the 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

[92] Tax Code (*Abgabenordnung, AO*) in the version of the publication of 1 October 2002 (BGBl. I p. 3866; 2003 I p. 61), last amended by Article 15 of the Law of 18 December 2018 (BGBl. I p. 2639).

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%, if applicable, plus the 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 7% to 19.8%, depending on their location.

Germany has implemented the so-called "authorised OECD approach". As a result, a permanent establishment is treated as a separate and independent enterprise **for the purposes of transfer pricing tax rules**, 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, 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, in as far 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.

5. Taxation of partnerships

a) German tax law

According to German tax law, partnerships **are not treated as separate tax entities**, but are deemed to be transparent in tax terms, with the exception of **trade tax** and **value added tax**. This means that only the partners in the partnership **are subject to income or corporation tax**. Accordingly, the partners 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 (pro rata) taxes to be paid by the individual partners are assessed.

Natural persons have 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 that these amounts are 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 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 trade tax and 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 with an appropriate partnership design**.

As a result, "Under the authorised OECD approach" (see above), partnerships are treated as a separate, independent entity for the purposes of transfer pricing tax rules.

6. Value added Tax (VAT)

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 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 calculate 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. With the single European market (free movement of goods and services) these standards are of great importance and are often the subject of proceedings before 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%. A reduced rate of 7% applies to certain transactions, such as 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, the grant of loans, and medical 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, providing the entrepreneur has received an invoice for the goods or services in question duly made out by the entrepreneur providing the goods or services. 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 at an effective rate of 7% to 19.8%, 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 (*Körperschaftssteuergesetz, KStG*[93]) (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 1.75% to 4.29% 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 approximately 2%. Conversely, the simple administration of properties by companies can, under certain preconditions, be completely exempt from trade tax.

[93] Corporation Tax Act (*Körperschaftssteuergesetz, KStG*) in the version of the publication of 15 October 2002 (BGBl. I p. 4144), last amended by Article 7 of the Law of 11 December 2018 (BGBl. I p. 2338).

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

8. Real estate transfer tax

Real estate transfer tax (*Grunderwerbsteuer*) is charged on various transactions in connection with real estate located in Germany. These include:

- the acquisition of real estate (**asset deal**);
- a change in partnership interests **of 90% or more** in relation to the shares in a partnership within a 5-year period if the partnership's assets include real estate assets in Germany (share deal);
- at least 90% 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 real estate 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 real estate transfer tax as an attempt by the German legislator **to prevent an excessive use of so-called "RETT blocker" structures**. There are still many details to be worked out. This limit **was reduced to 90% as of 1 July 2021**.

The rate of real estate transfer tax is between 3.5% and 6.5%, depending on the respective federal state and, as a 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 'real property 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 real estate transfer tax; in practice, the real estate transfer tax burden is transferred contractually to the purchaser. If at least 90% of the shares in a partnership are transferred (see above, point 2), the partnership itself must pay the real estate 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 and Gift Tax Act (*Erbschaftsteuer- und Schenkungsteuergesetz, ErbStG*)[94]. The provisions of the law have repeatedly been subject to

[94] Inheritance Tax Act (*Erbschaftsteuergeetz, ErbStG*) in the version of the publication of 27 February 1997 (BGBl. I p. 378), last amended by Article 8 of the Law of 16 July 2021 (BGBl. I p. 2947).

review by the Constitutional Court. The latest reform of inheritance law in 2009 was also undertaken as a result of an earlier objection raised by the Constitutional Court. In 2014, the Constitutional Court held that parts of the Inheritance Tax Act were inconsistent with the Basic Law, notably the special rules governing operating assets explained in point e) below. The legislator amended the relevant regulations with the Tax Act of 4 November 2016.

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 (where their domicile or usual place of residence is not in Germany) German citizens who have not remained abroad for longer than 5 years.

If none of the 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 a permanent establishment is 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 (2) of the International Tax Relations Act (*Außensteuergesetz, AStG*))[95];
- **mortgages, land charges or other claims or rights**, if these are secured through domestic property holdings.

b) Tax assessment basis

As a basic rule, for the purpose of determining the tax assessment basisunder the ErbStG, 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 to up to EUR 500,000 for married couples and EUR 400,000 for children. In addition, the transfer of the family home to the married partner or 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 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 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 of EUR 26,000,000 or more over the applicable exempted amount.

e) Special rules

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 2 options, which must each fulfil certain preconditions:

In the case of the transfer fo business assets (e.g., sole proprietorships, shares in commercial partnerships, shares in corporations with a participation of more than 25%), a **further tax exemption can apply under certain conditions** which allows an 85% reduction in the tax base and reduces the tax base by a further 150,000 euros on the basis of a tax write-off model. A prerequisite for the grant of the tax exemption is the existence of beneficiary assets and a maximum quota of assets under management.

In addition, the Inheritance and Gift Tax Act provides for an exemption of 10% for real estate rented out for residential purposes.

As the special rules are quite detailed and complex, each case **must be assessed individually**.

[95] International Tax Relations Act (*Außensteuergesetz, AStG*) in the version of the publication of 8 September 1972 (BGBl. I p. 1713), last amended by Article 5 of the Law of 27 June 2017 (BGBl. I p. 2074).

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

General conditions	Taxes (taxation of holding companies)
• No special restrictions on capital transactions, currency transfers or the repatriation of profits; • Recognised worldwide as politically stable; • Very good logistics and transport infrastructure; • Very good and reliable telecommu nications infrastructure; • Very high level of education and training; • Very high level of technological and scientific expertise; • Largest population within the EU; • Strongest economy within the EU.	• Corporation tax (incl. solidarity surcharge) on all income except dividends: 15.825%; • Trade tax on all income except dividends of approx. 7% to 19.8% (depending on the location of the registered office of the holding company); • 95% of the dividends received from other corporations are exempt from corporation tax and (generally with shareholdings of over 15%) also from trade tax; • For individuals who hold shares as part of their private assets: flat rate withholding tax (incl. solidarity surcharge) 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 more 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 carryforwards; • Loss carryforwards are lost with a shareholding acquisition of over 50% within 5 years; • Double taxation agreements with countries worldwide, including all important business information.

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 (haftungsbeschränkt)*: 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 approx. 20% 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, in large parts based on EU-Law;
	  ◦ Well-trained and qualified em-ployees;
	  ◦ National minimum wage.

Legal form	***Einzelkaufmann*** **Sole trader**	***Gesellschaft bürgerlichen Rechts*** **(GbR, partnership under German law)**	***offene Handels-gesellschaft*** **(OHG, general partnership)**
Proprietor	Entrepreneur (business-man/woman)	Partners	Partners
Minimum number of shareholders (partners)	1	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, private limited partnership)**	***Gesellschaft mit beschränkter Haftung*** **(GmbH, limited liability company, corporate entity)**	***Unternehmer-gesellschaft*** **(UG, entrepreneurial company with limited liability, corporate entity)**	***Aktiengesellschaft*** **(AG, public limited company, 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	1 – 24,999	50,000
General partner	Director(s) (*Geschäftsführer*)	Director(s) (*Geschäftsführer*)	Management board (*Vorstand*)
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

J. Useful addresses for investors in Germany

Contact	Address
Baden-Württemberg International Gesellschaft für internationale wirtschaftliche und wissenschaftliche Zusammenarbeit mbH	Willi-Bleicher-Strasse 19 70174 Stuttgart Phone: +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 Phone: +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 Phone: +49 89 2162-2630 Fax: +49 89 2162-2803 www.invest-in-bavaria.com
Invest in Bavaria bei Bayern International GmbH	Prinzregentenstrasse 22 80538 Munich Phone: +49 89 24210-7500 Fax: +49 89 24210-7557 www.invest-in-bavaria.com
Wirtschaftsförderung Land Brandenburg GmbH (WFBB)	Babelsberger Strasse 21 14473 Potsdam Phone: +49 331 730-6100 Fax: +49 331 730 61-109 www.wfbb.de
WFB Wirtschaftsförderung Bremen GmbH	Kontorhaus am Markt Langenstrasse 2–4 (Eingang Stintbrücke 1) 28195 Bremen Phone: +49 421 9600-10 Fax: +49 421 9600-810 www.wfb-bremen.de
Germany Trade and Invest – Gesellschaft für Außenwirtschaft und Standortmarketing mbH	Friedrichstrasse 60 10117 Berlin Phone: +49 30 200 099-0 Fax: +49 30 200 099-812 www.gtai.com
HIW Hamburg Invest Wirtschafts-förderungsgesellschaft mbH	Wexstrasse 7 20355 Hamburg Phone: +49 40 227019-0 Fax: +49 40 227019-29 www.hamburg-invest.com
HA Hessen Agentur GmbH	Konradinerallee 9 65189 Wiesbaden Phone: +49 611 950 17-80 www.hessen-agentur.de
Hessen Trade & Invest GmbH (Tochtergesellschaft der Hessen Agentur)	Konradinerallee 9 65189 Wiesbaden Phone: +49 611 95017-85 www.htai.de
Invest in Mecklenburg-Vorpommern GmbH	Schlossgartenallee 15 19061 Schwerin Phone: +49 385 592250 Fax: +49 385 5922522 www.invest-in-mv.de
Invest in Niedersachsen – Niedersächsisches Ministerium für Wirtschaft, Arbeit, Verkehr und Digitalisierung	Referat 25 Außenwirtschaft Ansiedlung und Marketing Friedrichswall 1 30159 Hannover Phone: +49 (0)511 120 5578 www.nds.de

Contact	Address
NRW.INVEST GmbH	Völklinger Strasse 4 40219 Duesseldorf Phone: +49 211 13000-0 Fax: +49 211 13000-154 www.nrwinvest.com
Investitions- und Strukturbank Rheinland-Pfalz (ISB)	Holzhofstrasse 4 55116 Mainz Phone: +49 6131 6172-0 Fax: +49 6131 6172-1299 www.isb.rlp.de
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K. Glossary

I. German laws

An English version of many German laws can be found on: https://www.gesetze-im-internet.de/Teilliste_translations.html

German (incl. abbreviation)	English
Abgabenordnung (AO)	Tax Code
Aktiengesetz (AktG)	Stock Corporation Act
Allgemeines Gleichbehandlungsgesetz (AGG)	General Equal Treatment Act
Arbeitsgerichtsgesetz (ArbGG)	Labour Courts Act
Arbeitsschutzgesetz (ArbSchG)	Occupational Health and Safety Act
Arbeitszeitgesetz (ArbZG)	Working Hours Act
Aufenthaltsgenehmigungsgesetz (AufenthaltsG)	Residence Act
Aufenthaltsgesetz (AufenthG)	Law on the Residence, Economic Activity and Integration of Foreigners in die Federal Territory (Residence Act)
Außensteuergesetz (AStG)	International Tax Relations Act
Außenwirtschaftsgesetz (AWG)	Foreign Trade and Payments Act
Außenwirtschaftsverordnung (AWV)	Foreign Trade and Payments Ordinance
Baugesetzbuch (BauGB)	Federal Building Code
Baunutzungsverordnung (BauNVO)	Land Use Ordinance
Berufsbildungsgesetz (BBiG)	Occupational Training Act
Beschäftigungsverordnung (BeschV)	Regulation on the Employment of Foreigners (Employment Regulation)
Betriebsverfassungsgesetz (BetrVG)	Works Council Constitution Act
Bewertungsgesetz (BewG)	Valuation Act
Bundesgesetzblatt (BGBl.)	Federal Law Gazette
Bundesbodenschutzgesetz (BBodSchG)	Federal Soil Protection Act
Bundesurlaubsgesetz (BUrlG)	Federal Holidays Act
Bürgerliches Gesetzbuch (BGB)	Civil Code
Drittelbeteiligungsgesetz (DrittelbG)	One-third Participation Act
Einkommensteuergesetz (EStG)	Income Tax Act
Entgeltfortzahlungsgesetz (EntgFG)	Continued Payment of Wages Act
Erbbaurechtsgesetz (ErbbauRG)	Hereditary Building Right Act
Erbschaftsteuergesetz (ErbStG)	Inheritance Tax Act
Europäische Marktmissbrauchs-verordnung	European Market Abuse Regulation
Gesetz betreffend die Gesellschaften mit beschränkter Haftung (GmbHG)	Limited Liability Companies Act
Gesetz gegen Wettbewerbs-beschränkungen (GWB)	Act against Restraints of Competition

German (incl. abbreviation)	English
Gesetz über die Kontrolle von Kriegswaffen (KrWaffKontrG)	Control of Military Weapons Act
Gesetz zum Schutz vor Gefährdung der Sicherheit der Bundesrepublik Deutschland durch das Verbreiten von hochwertigen Erdfernerkundungsdaten (SatDSiG)	Satellite Data Security Act
Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen (MoMiG)	Law on the Modernisation of the Private Limited Companies Act and the Combating of Misuse
Gewerbeordnung (GewO)	Industrial Code
Grundbuchordnung (GBO)	Land Register Act
Grunderwerbsteuergesetz (GrEStG)	Real Estate Tranfer Tax Law
Grundgesetz (GG)	Constitution
Grundsteuergesetz (GrStG)	Real Estate Tax Law
Handelsgesetzbuch (HGB)	Commercial Code
Insolvenzordnung (InsO)	Insolvency Code
Jugendarbeitsschutzgesetz (JarbSchG)	Protection of Young Persons in the Workplace Act
Kapitalanlagegesetzbuch (KAGB)	Investment Code
Konzessionsvergabeverordnung (KonzVgV)	Ordinance on the Award of Concession Contracts
Körperschaftsteuergesetz (KStG)	Corporation Tax Law
Kreditwesengesetz (KWG)	Banking Act

German (incl. abbreviation)	English
Kündigungsschutzgesetz (KSchG)	Protection of Employment Act
Ladenschlussgesetz (LadSchlG)	Shop Closing Times Act
Landesvergabegesetze	Federal state laws of German federal states governing award procedure
Makler- und Bauträgerverordnung (MaBV)	Ordinance on the obligations of agents, loan and investment brokers, investment advisers, developers and building managers
Mindestlohngesetz (MiLoG)	Minimum Wage Act
Mitgestimmungsgesetz (MitbestG)	Co-determination Act
Montanmitbestimmungsergänzungsgesetz (MontanMitbestGErgG)	Supplementary Mining and Steel Industry Co-determination Act
Montanmitbestimmungsgesetz (MontanMitbestG)	Mining and Steel Industry Co-determination Act
Mutterschutzgesetz (MuSchG)	Maternity Protection Act
Nachweisgesetz (NachwG)	Proof of Substantial Conditions Applicable to the Employment Relationship Act
Schornsteinfeger-Handwerksgesetz (SchfHwG)	Chimney Sweeping Craft Act
Sektorenverordnung (SektVO)	Ordinance on the Award of Public Contracts in Specific Sectors
Sozialgesetzbuch (SGB)	Social Security Code
Sprecherausschussgesetz (SprAuG)	Executives´ Representative Committee Act

German (incl. abbreviation)	English
Tarifvertragsgesetz (TVG)	Collective Bargaining Act
Teilzeit- und Befristungsgesetz (TzBfG)	Part-time and Limited-term Employment Act
Umsatzsteuergesetz (UStG)	Turnover Tax Act
Umwandlungsgesetz (UmwG)	Reorganisation of Companies Act
Unterschwellenvergabeordnung (UvgO)	Award Procedures below Thresholds
Urheberrechtsgesetz (UrhG)	Law on copyright and related property rights (Copyright Act)
Vergabe- und Vertragsordnung für Bauleistungen – Teil A (VOB/A)	Award Procedures for construction services
Vergabe- und Vertragsordnung für Leistungen – Teil A (VOL/A)	Award Procedures for public supplies and services
Vergabeverordnung (VgV)	Ordinance on the Award of Public Contracts
Vergabeverordnung Verteidigung und Sicherheit (VSVgV)	Ordinance on the Award of Public Contracts in the fields of defence and security
Versicherungsvertragsgesetz (VVG)	Insurance Contract Act
Wohnungseigentumsgesetz (WEG)	Law on Condominium and Long-term Right of Tenure
Zivilprozessordnung (ZPO)	Code of Civil Procedure

II. German authorities, courts and institutions

German (incl. abbreviation)	English
Ausländerbehörde	Immigration authority
Bundesagentur für Arbeit	Federal Employment Agency
Bundesanstalt für Finanzdienst-leistungsaufsicht (BaFin)	Federal Financial Supervisory Authority
Bundesarbeitsgericht (BAG)	Federal Labour Court
Bundesanzeiger	Federal Gazette
Bundesgerichtshof (BGH)	Federal Court of Justice
Bundeskartellamt	Federal Cartel Office
Bundesministerium der Justiz und für Verbraucherschutz (BMJV)	Federal Minstry of Justice and Consumer Protection
Bundesministerium für Wirtschaft und Energie (BMWi)	Federal Ministry for Economic Affairs and Energy
Bundesvereinigung der Deutschen Arbeitgeberverbände (BDA)	Confederation of German Employers` Associations
Bürgeramt	Local Residents` Registration Office
Deutscher Gewerkschaftsbund (DGB)	German Trade Union
Einwohnermeldeamt	Local Residents` Registration Office
Frankfurter Börse	Frankfurt Stock Exchange (FSE)
Industrie- und Handelskammer (IHK)	Chamber of Industry and Commerce
Oberlandesgericht	Higher Regional Court
Vergabekammern des Bundes	Federal Public Procurement Tribunal
Vergabekammern der Bundesländer	Public Procurement Tribunal of the federal states
Vereinte Dienstleistungsgewerkschaft (ver.di)	United Service Union

III. German legal terms

German (incl. abbreviation)	English
Abstraktes Schuldanerkenntnis	Abstract acknowledgment
Aktiengesellschaft (AG)	Public limited company
Altlastenkataster	Contamined Land Survey Register
Arbeitslosenversicherung	Unemployment insurance
Auflassung	Agreement for the conveyance of ownership
Aufsichtsrat	Supervisory board
Auszubildende	Person taken on for occupational training
Außenbereich	Outer zone
Baugenehmigung	Planning permission
Baulast	Obligation to construct and maintain or public easement
Beleihungswert	Lending value
Beschränkte persönliche Dienstbarkeit	Easement in gross
Betriebsrat	Works council
Betriebsstätte	Permanent establishment
Betriebsvereinbarung	Works agreement
Bewertungsrichtlinien	Lending guidelines
Börsennotierte Aktiengesellschaft	Listed public limited company
Briefgrundschuld	Certificated land charge
Buchgrundschuld	Uncertificated land charge
Bundesanzeiger (BAnz)	Federal Gazette
Eingetragener Kaufmann (e.K.)	Registered businessman
Einkommensteuer	Income tax
Einzelkaufmann	Sole trader
Erbbaurecht	Hereditary building right
Erbschaftsteuer	Inheritance tax
Erlaubnis zum Daueraufenthalt-EU	EU permit for permanent residence
Ertragswertverfahren	Rental value method
Filiale	Dependent company branch
Flurnummer	Specific title number
Freiverkehr	Open Market
Freiwilliger Aufsichtsrat	Optional supervisory board
Geschäftsführer	Director
Gesellschaft bürgerlichen Rechts (GbR)	Partnership under German civil law
Gesellschafterversammlung	Sharehholders` meeting
Gesellschaft in Gründung (i.G.)	Company being established

German (incl. abbreviation)	English
Gesellschaft mit beschränkter Haftung (GmbH)	Limited liability company
Gewerbesteuer	Trade tax
Grundbuch	Land register
Grunderwerbsteuer	Real estate transfer tax
Grunddienstbarkeit	Easement
Grundschuld	Land charge
Grundschuldbrief	Land charge certificate
Hauptversammlung	General meeting
Hypothek	Mortgage
Innenbereich	Inner zone
Kirchensteuer	Church tax
Kommanditgesellschaft (KG)	Private limited partnership
Körperschaftsteuer	Corporation tax
Krankenversicherung	Health insurance system
Leitende Angestellte	Executive employees
Mitbestimmung	Co-determination
Nebenleistung	Ancillary payment
Niederlassungserlaubnis	Settlement permit
Nießbrauch	Usufruct

German (incl. abbreviation)	English
Offene Handelsgesellschaft (OHG)	General partnership
Pflegeversicherung	Long-term care insurance
Prokura	Power of procuration
Quellensteuer	Withholding tax
Regulierter Markt	Regulated Market
Rentenversicherung	Pension insurance
Sachwertverfahren	Asset value method
Solidaritätszuschlag	Solidarity surchage
Tarifvertrag	Collective bargaining agreement
Umsatzsteuer (USt)	Value added Tax (VAT)
Unfallversicherung	Accident insurance
Unselbständige Niederlassung	Dependent company branch
Unternehmergesellschaft (oder UG) haftungsbeschränkt	Entrepreneurial company with limited liability
Verkehrswert	Market value
Vormerkung	Priority notice of conveyance
Vorrangprüfung	Priority check
Vorstand	Management board
Zinsen	Interests
Zinsschranke	Earnings stripping rule
Zweigniederlassung	Company branch

IV. Keyword Index

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