



Business in Germany

APRIL 2006

With Europe's largest economy and second largest population, Germany is a key member in the continent's economic and political organizations. International business in Germany encompasses a large spectrum. This article sets out a comprehensive legal overview of the same.

Distribution Partners

When a continuing business activity in Germany is established, the type of relationship between the foreign company and its German counterpart becomes crucial. The classic relationships formed are that of the commercial agent (Handelsvertreter) and the distributor (Vertragshändler).

Commercial agents are indispensable to many foreign companies for the purposes of doing business in Germany. The law of commercial agency is regulated by the Commercial Code and extends to commercial agents special protection. The recurring issues in commercial agency revolve around the rights and duties of the principal and agent. Sensitive topics usually include establishment of sales territories, commission structure, type and scope of the agent's authority, and obligations owed by the agent to the customer.

Upon termination of the agency, German law affords the commercial agent the right to be compensated for the customer base which he leaves behind for the principal company. The right of compensation upon termination assumes that the commercial agent has created or expanded a customer base that will benefit the company through future orders. The compensation upon termination must be reasonable, not inequitable and cannot exceed the total amount of commission paid out in one year.

In contrast to the commercial agent, the distributor buys goods and transfers them in his own name. Distributors have to be distinguished from commercial agents because distributors create

a new trade level by purchasing goods in their own name. This activity however does not exclude distributors from obtaining a commission for generated businesses. Distributors can act exclusively for one manufacturer, as is usually the case with commercial agents or they can work with several manufacturers. In contrast with the commercial agent, there are no statutory rules applicable to the distributor in Germany. Case law however tends to apply the rules for a commercial agent by analogy in situations where the distributor is significantly integrated in the distribution organization of the manufacturer and where the manufacturer is entitled to use customer information owned by the distributor after the termination of the contract.

Corporate Structures

When foreign business reaches a certain extent, they will be conducted through majority-owned subsidiaries and no longer through distribution partners. Business can be conducted through dependent entities such as a representative office or a branch, as well through legally independent subsidiaries. The common corporate structures of doing business in Germany are the following:

Sole proprietorship

Dependent entities:

- representative office
- branch

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Partnership forms:

- partnership under civil law (Gesellschaft des bürgerlichen Rechts or GbR)
- partnership under the 1994 statute on partnerships (Partnergesellschaft)
- European Economic Interest Grouping (EEIG)
- commercial general partnership (offene Handelsgesellschaft or OHG)
- limited partnership (Kommanditgesellschaft or KG)
- limited partnership together with private limited liability company or public company as general partner (GmbH & Co KG or AG & Co KG)
- silent partnership (Stille Gesellschaft)

Corporate forms:

- the private limited liability company (GmbH)
- the public company (AG)
- the European Company (Societas Europaeae)
- the partnership limited by shares (Kommanditgesellschaft auf Aktien or KGaA).

The basic distinctions among the abovementioned structures involve two issues: firstly, the status and accompanying rights and duties of the business structures and secondly, the existence of personal liability of the owners beyond their investment. The corporate forms (GmbH, AG) confer status as a separate legal entity with the ability to sue and be sued in its own name while the partnerships are only partially recognised as a separate legal entity. Partnerships can sue and be sued but in tax matters function only as a conduit, by which the partners are taxed on their share of the partnership income or losses. While personal liability does not exist generally in the corporate forms, this is in contrast imposed on at least one of the owners (the general partner) in all forms of the partnership (OHG, KG).

The GmbH is by far the most popular corporate form with some 850,000 such companies registered with the district courts. A GmbH is the usual form utilised by small and medium-sized enterprises. The GmbH structure can be used for commercial, non-profit, as well as political purposes. A GmbH is distinguished from the public company (AG) by its private structure. The relationship of the shareholders with each other as well as with the GmbH is defined in the articles of association (Satzung). It is mandatory that the articles of association contain certain minimum provisions. Once these minimum standards are complied with, the GmbH Law allows for flexibility in content. A GmbH can have one or more shareholders, who may be natural persons or legal entities. The minimum capital

stock is EUR 25,000. There are no particular restrictions for foreign investors. The limited liability company is represented and managed by one or more managing directors. The nationality, place of residence or address of a managing director is in principle of no relevance.

Employment

Management and labour relations in Germany are characterized by low levels of industrial action, regulated labour market, social cohesion based on institutionalized employee participation at the plant and company levels, and extensive social benefit entitlements. The major sources of labour law are Federal legislation, collective agreements, work agreements and case law. Germany does not have a consolidated Labour Code; minimum labour standards are laid down in separate Acts on various labour-related issues, which are supplemented by the government's ordinances. Labour legislation is interpreted by labour courts.

When concluding a labour contract, the parties usually agree on a probation period of up to 6 months. This will be changed in summer 2006. The probationary period can thereafter be extended for up to 2 years. During this period, the employee can be dismissed with 2-week notice.

Although the employment contract is not required to contain specific terms, it usually includes the following: a description work scope, the calculation and amount of remuneration, a reference to applicable collective agreements, the normal working time and annual vacation, and the place and start of employment. Employment contracts are presumed to be created for an indefinite period. The employment contract can also be for a fixed period, but only when it is expressly related to a certain event or purpose. If a fixed term employment contract is entered into for the first time, a limited period without reference to any particular justification is permitted, provided that the total length does not exceed two years.

German labour law distinguishes between ordinary and extraordinary dismissals. The ordinary dismissal, which must be preceded by notice, can occur due to misbehaviour of the employee, personal inability which the employee may possess, or commercial grounds, due to which the company may choose not to continue the employment.

The good news for employers is that there is a very short period for the employee to contest a dismissal. An employee wishing to challenge a dismissal must file a complaint in the labour court

within three weeks after receipt of the dismissal notice, seeking a declaration that the dismissal is unjustified and for an order reinstating the employment.

A notice of dismissal is not necessary in the case of extraordinary dismissals. A compelling ground, making the continuation of the employment relationship, taking into interest of both parties involved, unreasonable, must however exist.

Businesses in Germany are required to include employees on their supervisory board under certain conditions. Companies organized in a non-partnership form and employing usually more than 500 employees must establish a supervisory board and allow a minimal one third employee representation on the board (Drittelbeteiligungsgesetz). The Codetermination Law (Mitbestimmungsgesetz) provides for parity representation on the supervisory board by employees for companies with more than 2,000 employees. There are some exceptions for a company organized as a GmbH & Co KG.

Employees in workplaces with at least five permanent employees, of which three are be eligible to serve as employee representatives, are entitled to establish a labour council (Betriebsrat). Managerial employees are not represented in the council but have their own committee. The council in a work-place with more than twenty employees, for example, has the right to be informed and consulted about intended closure or partial closure of business, transfer or merger of business, essential changes in work organization or equipment, and introduction of fundamentally new work methods and production procedures.

Property

The acquisition of real property in Germany requires formalities to ensure protection of the parties. Property charts are maintained by the land surveyors' office (Katasterämter) and land registries at the district courts (Grundbuchamt), respectively. Transfer of real property requires the executed purchase contract to be duly notarised and an actual transfer of possession. One will be only able to obtain compensation in the form of damages for actual expenses expended in reliance of the transaction for contracts which have not been properly notarised. The notarized contract should incorporate the entire agreement, because partially oral or parts of written

agreements that are not notarised make the entire agreement invalid. Property is transferred upon due record of the same in the land registry book. The transfer of property (Auflassung) is usually part of the purchase contract and is registered by the notary with the land registry office only after certain conditions are fulfilled (for example, payment of the purchase price). The buyer should arrange for a notice of priority to be filed in the land registry to prevent the seller from selling the property again before the record of the transfer. The purchase price should only be paid after the filing of such notice.

It costs an estimate of 4-5% of the buying price to purchase landed property. The costs comprise of the transfer tax of 3.5% and notary fee of about 1 %. The Real Estate Agents fees amount to 3-6% and would ordinarily be shared by the buyer and seller. Property tax, which is charged for the provision of local services, is rated usually below the current market value and is approximately 1% of the rateable value.

Taxation

Tax obligations arising from business conducted in Germany depends on various factors, including the business structure. Taxes can be classified into four basic groups:

- income or revenue taxes (wage tax, personal income tax, corporate income tax and trade tax),
- transactional-based taxes (for example, property acquisition tax, value added tax),
- consumption taxes (gasoline excise tax, liquor excise tax, etc.),
- asset-based taxes.

Tax law in Germany is based on the Tax Regulation (Abgabenordnung or AO), pursuant to which the so-called world income principle applies. According to the world income principle, all legal persons are subject German taxation both on their domestic as well as foreign income. Persons abroad can come under the German tax jurisdiction if they derive income from Germany, for example, from capital investments, ownership of real property or commercial activity. For foreign income, relevant double taxation treaties may apply.

Personal income tax (Einkommenssteuer) is levied on individuals and partnerships of all kinds including mixed partnership forms such as the GmbH & Co KG. The partnership itself is neither subject to personal income tax nor to corpora-

te income tax; the tax liability passes instead through the partnership entity to the partners themselves.

Corporate entities such as private and public companies are subject to corporate income tax (Körperschaftsteuer). The corporate income tax is essentially 25%. It is imposed on distributed as well as undistributed net income. The former practice of favouring distributed profits by exempting them from corporate income tax has since been abolished.

Pursuant to the Trade Tax Law (Gewerbsteuergesetz), all commercial companies are subject to trade tax without regard to their legal structure. Income from professional services, e.g., income derived from the provision of accounting, tax or legal advice is not subject to trade tax unless the service provider is organized in the form of a private limited or public company. Each state has the right to fix its own trade tax rate. The rate of the trade income tax thus varies in each German state and ranges between 10% and 20% of the taxable corporate income. In light of the fact that total tax burden for companies cannot exceed 37 %, trade tax is credited against the income tax.

Investor factors

Commercial projects are generally financed by commercial banks. The German banking system is based on the principle of unified or universal banking, which enables the banks to pursue basically every type of financial services such as bank loans, mortgage loans, current account loans, leasing and factoring. Business investments in Germany are also increasingly financed by private investors (private equity). The type and amount of investment is dependent on the business entity as well as the sector in which the company is active. In addition to private finance, there are also various types of public programs available to attain specific economic goals such as economic development of a region and improvement of the job market situation. These public programmes are funded by the federal, state or local governments and are frequently administered by banks or trust companies.

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