### Contents

1. Limited Liability Company – GmbH  
   2
2. Stock Corporation – AG  
   5
3. Partnership Limited by Shares – KGaA  
   8
4. GmbH & Co. KG  
   9
5. Branch offices  
   11
6. Developments in European Law  
   12
7. Relevant German tax law  
   14
FURTHER INFORMATION

Should you require further information on any aspect of Doing Business in Germany, please contact one of the persons mentioned below or the person with whom you usually deal.

Contact

Düsseldorf
Dr. Christoph Louven
christoph.louven@hoganlovells.com

Frankfurt
Dr. Tim Oliver Brandi
tim.brandi@hoganlovells.com

Hamburg
Dr. Andreas H. Meyer
andreas.meyer@hoganlovells.com

Munich
Dr. Michael Rose
michael.rose@hoganlovells.com

Tax
Dr. Ingmar Dörr
ingmar.doerr@hoganlovells.com

This note is written as a general guide only. It should not be relied upon as a substitute for specific legal advice.
German law offers a number of legal vehicles for the carrying on of entrepreneurial business activities. The available corporate legal forms are defined in German statutory regulations which can to a greater or lesser extent be tailored using contractual provisions.

This brochure gives an overview of the various legal frameworks within which businesses can operate in Germany and outlines the main characteristics of the different legal forms and their differences, the requirements for formation and management, and the liability regime of the respective corporate entities. It first addresses the German limited liability company (GmbH) which is the most common form of incorporation in Germany and then deals in turn with the German stock corporation (AG) whose shares may be traded on a stock exchange, the partnership limited by shares (KGaA) and the limited liability partnership (GmbH & Co. KG).

The establishment of branch offices of foreign companies is then dealt with briefly followed by an overview of European corporate law developments. The brochure concludes with an examination of the various German tax law issues applicable to businesses.

Please regard this client note as a brief summary provided merely to give an initial overview of the various possible entrepreneurial models in Germany. Given the complexity of company law, it cannot serve as a substitute for legal advice which our German offices will gladly provide to you as necessary.
1. **Limited Liability Company – GmbH**

1.1 **Description and legal characteristics**

The German limited liability company (*Gesellschaft mit beschränkter Haftung, GmbH*) is a commercial company with a separate legal personality which can be established for any legally permissible purpose. The shareholders (*Gesellschafter*) participate in the company through ownership of one or more shares (*Geschäftsanteile*) in the company’s share capital. As a result of its separate legal personality, when the company enters into transactions with third parties, its shareholders are not personally liable towards those third parties.

The German Limited Liability Companies Act (*GmbHG*) is the primary legal source governing the GmbH which was amended significantly in 2008 in order to simplify and accelerate its formation and enhance its overall attractiveness in comparison to foreign limited liability companies.

1.2 **Formation**

A GmbH can be established by one or more persons. Any natural or legal person or partnership in terms of private or public law (domestic or foreign) may participate in a GmbH.

The valid creation of a GmbH takes place in two steps: first the establishment of the company by a notarised agreement between the shareholders (or by a notarised model protocol as attached to the GmbHG (*Musterprotokoll*)) which embodies the company’s articles of association, and secondly its registration and entry in the competent commercial register.

The company’s articles of association (*Gesellschaftsvertrag, or Satzung as it is often referred to in practice*) set forth in detail the specific characteristics of the particular GmbH, such as its organisation (in particular the name and registered office of the company, the object of the enterprise as well as the aggregate amount of the registered share capital) and the relationship between the company and its shareholders. The articles of association constitute the instrument by which the company is established and incorporated and contain the founding shareholders’ undertaking to make an agreed initial contribution to its registered share capital.

The shareholders can stipulate further provisions in the articles such as a limitation of the life of the company to a certain period of time, the release of the shareholders from non-compete covenants or the obligation to make additional contributions.

For a GmbH to be validly constituted, it must be registered with the competent commercial register. The managing directors and shareholders should wait until registration is completed before entering into transactions on behalf of the GmbH in order to avoid running the risk of incurring personal liability.

**Name and registered office**

There are no restrictions on the name given to a GmbH provided that the name:

- clearly distinguishes the GmbH from other businesses in the same location;
- is not misleading; and
- contains a reference to its limited liability.

A GmbH’s registered office (as stipulated in the articles of association) must be located in Germany. This location can differ from the location of the company’s operational facilities, the company’s management, and the company’s administration. Unlike the registered office, the seat of management or administration (*Verwaltungssitz*) of a GmbH can be located outside Germany (at least in another EU country or the US; in other countries this may depend on their respective corporate laws).

**Registered share capital**

In terms of German law, the registered share capital (*Stammkapital*) of a GmbH cannot be less than Euro 25,000. The shareholders are free to stipulate for any amount of the registered share capital above Euro 25,000, provided it is in whole units of Euro. Each shareholder can hold as many shares (*Geschäftsanteile*) as desired provided that the aggregate of all the shares subscribed equals the company’s registered share capital.

The list of shareholders includes consecutive numbering of the shares and only those shareholders shown in the list are recognised legally as shareholders of the company. The list, therefore, forms the basis for the acquisition of shares in good faith.
Contributions towards the capital of the company can be made in cash or in kind.

Contributions in kind must always be made in full, whereas payment of one quarter of the subscribed contribution suffices in the case of cash contributions. However, the total of all cash contributions and contributions in kind must amount to at least half of the registered share capital.

Contributions in kind are only permissible if expressly provided for in the articles of association and include all non-cash contributions, for instance contributions of assets. The relevant asset must have an ascertainable economic value. Typically, assets contributed in kind include movable and immovable property, rights in intangibles, membership rights (such as shares), receivables, goodwill, customers and know-how. Services (e.g. consulting services) cannot be provided as a contribution in kind. To minimise the risk of the value of the contribution in kind falling short of the required amount of the initial contribution subscribed and the consequent risk to the company’s creditors and co-shareholders, German law requires all shareholders to draw up a written and personally signed “report on formation by contributions in kind” (Sachgründungsbericht). This report must detail an intelligible summary of the methods used to value the non-cash assets. As a rule, the competent court also requests an expert opinion by a certified public accountant (Werthaltigkeitsgutachten).

1.3 Management structure and organisation

As a legal person, the GmbH can only act through its representatives. The only management bodies prescribed by German law for every GmbH are the managing director(s) and the shareholders. German legislation regarding employee participation or, alternatively, the GmbH’s articles may require a supervisory board or an advisory board to be formed as a further management body.

Managing directors

Typically a GmbH acts through one or more managing directors (Geschäftsführer) as its legal representative. Managing directors can be, but do not have to be, shareholders of the GmbH. Any natural person of full legal capacity can be appointed as a managing director. Non-German nationals can also be appointed as managing director. However, the courts sometimes require that foreign managing directors be able to freely enter Germany at any time. The appointment to office is normally made by a resolution adopted by simple majority of the competent body – typically the shareholders’ meeting. A managing director may be removed from office at any time (also by a shareholders’ resolution adopted by simple majority). The appointment and removal of managing directors takes effect as soon as the resolution is adopted (or on the date specified in the resolution) and such resolution is entered in the commercial register.

Generally, a managing director’s service contract (Dienstvertrag) sets out his/her contractual duties to the company and is usually concluded at the time of his/her appointment. However, the two legal relationships are not necessarily linked to each other (e.g. a managing director’s service contract is not, in principle, affected by his/her dismissal).

Normally, managing directors are appointed to represent the company jointly. However, the articles of association can provide that either a managing director acting alone or two managing directors acting jointly can represent the company. It is also possible to appoint other representatives, (eg authorised representatives (Prokuristen)) and to link their power of representation to the managing directors’ and vice versa. Outside parties may generally rely on the information provided by the commercial register regarding the representatives of the company.

The managing directors are responsible for the management of the company, for internal decision making within the company – outside of the shareholders’ meeting – and for managing the business, including hiring, management and supervision of the employees.

Managing directors can become liable to the company if they do not comply with the standard of “due care of a prudent businessman” and, in mostly rare cases, managing directors can be held liable to third parties.

Shareholders’ meeting

The shareholders’ meeting is the GmbH’s highest authority/decision making body. Shareholders enjoy the rights and must perform the obligations as set out in the articles of association as well as those granted/imposed by law. Typically these include the appointment and dismissal of managing directors, the formal approval of managing directors’ actions, the adoption of the annual financial statements and the appropriation of profits, and the monitoring and review of the management.

Some rights and obligations are reserved to the shareholders’ meeting. These include amending the articles of association, calling in additional contributions, capital measures, dissolution of the company, certain measures resulting in the formation of a corporate group, and the restructuring measures pursuant to the German Reorganisation of Companies Act (Umwandlungs-gesetz, UmwG) (e.g. merger or change of form).

Except for the conclusion, amendment and termination of a managing director’s service contract, the share-
holders’ meeting is generally not authorised to represent the company vis-à-vis third parties. However, the shareholders’ meeting has an unfettered right to intervene directly in the management of the company by giving binding instructions to the managing director(s).

**Supervisory board**

Generally speaking, a supervisory board is not a requirement for a GmbH. However, if a GmbH’s domestic operations regularly employ more than 500 employees, German legislation on co-determination requires the formation of a supervisory board with employee representation. One third of the members of the supervisory board must be employee representatives for companies regularly employing more than 500 employees in Germany, and one half in companies which have more than 2,000 employees in Germany (under certain circumstances subsidiaries need to be included in this calculation). A mandatory supervisory board is required by the Investment Companies Act (*Investmentgesetz, InvG*) for investment companies which have the legal form of a GmbH. In addition, the articles of association may voluntarily prescribe the establishment of a supervisory board to assist the shareholders and monitor management.

**1.4 Shareholder’s rights**

A shareholder’s membership in the GmbH derives from the ownership of a share in the company which confers ownership rights and rights of participation.

**Ownership rights**

The most important ownership right is the entitlement to a share of the profits which, as a rule, are distributed among the shareholders according to the proportion of shares they hold. Any alternative provisions are usually stipulated in the articles of association, for example, a different profit sharing mechanism or the allocation of reserves.

**Right of participation**

The shareholders must be granted reasonable participation rights in the decision-making process, in particular, a minority of shareholders can request the convening of a shareholders’ meeting. Moreover, each shareholder has a right to information and a right to inspect the business accounts. Such information or inspection may be refused if, for example, information might be provided to a competitor.

A shareholder is generally free to dispose of his/her share(s) unless – as it is often the case – the articles of association stipulate otherwise (e.g. requirement for approval by the company, transfer only to co-shareholders). The shareholder’s right of disposition includes the right to transfer and encumber his/her share. A notarised contract is required for the valid disposition of a share. In Germany, the costs of notarisation can be considerable depending on the value of the share to be transferred.

GmbH shares cannot be traded on a stock exchange.

**1.5 Liability regime**

GmbH shareholders are not personally liable for the obligations of the company. The shareholders’ primary obligation to the company is to pay their contribution when the company is established or when they participate in a capital increase. An overvaluation of a contribution in kind results in what is referred to as a ‘differential liability’ (*Differenzhaftung*) – the obligation to pay the difference between the nominal amount of the initial contribution subscribed and the (actual) value of the contribution.

As a protective provision for company creditors, the GmbH is subject to certain capital preservation rules prohibiting the distribution to shareholders of the capital required to maintain the company’s registered share capital. In general, distributions and other payments to shareholders are disallowed if such distribution or payment causes or exacerbates an “adverse balance” (*Unterbilanz*), i.e. a negative difference between the net assets and the registered share capital of the company. In this context, however, it is generally possible to grant upstream loans to shareholders, as long as the claim against those shareholders is fully recoverable.

Shareholder loans are always subordinated against all other liabilities if the company becomes insolvent. Any payments on shareholder loans within one year prior to the filing for insolvency are voidable and can be clawed back by the insolvency administrator. The same applies to securities for shareholder loans granted within a period of 10 years prior to the filing for insolvency.
2. Stock Corporation – AG

2.1 Description and legal characteristics

A German stock corporation (Aktiengesellschaft, AG) has a legal personality separate from its shareholders (Aktionäre). The shareholders are not liable to third parties for acts of the company.

The German Stock Corporation Act (Aktiengesetz, AktG) is the primary legal source governing the AG and its rules are generally less flexible than the rules for limited liability companies. The shareholders participate in the company by holding shares (Aktien) and it is possible for the shares to be listed on a stock exchange. Trading in the shares of listed German stock corporations is regulated by the Stock Exchange Act (Börsengesetz, BörsG) and the procedural rules of the relevant stock exchanges.

Other laws apply to publicly listed stock corporations, such as the Securities Trading Act (Wertpapierhandelsgesetz, WpHG) and the Securities Acquisition and Takeover Act (Wertpapierrechts- und Übernahmegesetz, WpÜG). These laws regulate the rights, obligations and duties relating to the capital market.

2.2 Formation

An AG can be established by one or more persons for any permissible purpose, and can have as its shareholders any natural or legal person (including non-German ‘persons’) or partnerships existing by virtue of public or private law.

The articles of association of an AG must be notarised and must contain certain mandatory information (e.g. the name, registered office and object of the enterprise and its registered share capital).

Other procedures for the valid formation of the company involve, inter alia, the appointment of the members of the management and the supervisory board. On registration with the commercial register, the AG obtains legal personality before which the AG should not be used in order to conduct any business vis-à-vis third parties.

Name and registered office

The provisions regarding the name and registered office of the GmbH also apply to the AG.

Registered share capital

The AG’s registered share capital (Grundkapital) must amount to at least Euro 50,000, divided into shares. These can be either par-value shares (in whole units of Euro) or no-par-value shares which do not have a specific nominal value but represent a pro rata amount of the registered share capital and which cannot be less than Euro 1 per share. Issuance of shares for an amount below their par value or below the pro rata amount of the registered share capital attributable to the individual no-par-value share is prohibited. However, it is possible to issue shares at a higher amount or at a premium (Agio).

German law distinguishes between two types of contributions to the capital of an AG: cash contributions and contributions in kind. Basically, the regulations governing these methods of contributions are similar to the regulations governing the GmbH.

Before applying to register the company, the founding shareholders must pay their contributions. In the case of cash contributions, at least one quarter of the lowest issue price of the shares subscribed must be paid plus any premium in the case of an over-par issue.

2.3 Management structure and organisation

The AG has three corporate bodies: the management board (Vorstand), the supervisory board (Aufsichtsrat) and the shareholders acting in general meeting (Hauptversammlung).

Management board

The management board may comprise one or more persons. Members of the management board do not have to be shareholders. Where an AG has more than 2,000 employees, the management board must be made up of at least two persons since a “works director” (Arbeitsdirektor) must be appointed to deal with labour and socio-political issues. Members of the man-
agement board are appointed by the supervisory board for periods of up to five years at which point the term can be renewed.

The management board is authorised to manage day-to-day business, to represent the company vis-à-vis third parties and to define the guiding principles of company policy and strategy.

The tasks of the management board can be split among the individual board members, for example, by appointing a CEO, a CFO etc. Nevertheless, each board member remains responsible for the actions of the management board. Fundamental matters/issues need to be submitted to the entire board. Regarding the representation of the AG by the management board, the articles of association can provide for various mechanisms, such as joint representation by all board members or individual representation by each board member or, alternatively, representation by specific board members.

In principle, the management board is not bound by instructions from other persons and, in particular, not by those of the supervisory board or the general meeting. However, the articles of association or the supervisory board can stipulate that certain measures or transactions may only be performed with the approval of the supervisory board or by a general meeting of the shareholders.

**Supervisory board**

The supervisory board is a controlling corporate body responsible for the appointment and removal of members of the management board, supervision of the management of the company, as well as for representing the company in and out of court vis-à-vis the members of the management board. Unless otherwise required, the supervisory board, which represents the shareholders, is elected in a general meeting of shareholders. The articles of association can confer on certain shareholders (or on holders of certain classes of shares) rights of appointment, but only up to a maximum of one third of the supervisory board members to be elected by all shareholders. Election by the shareholders is excluded if and to the extent employee representatives are appointed to the supervisory board pursuant to German legislation governing employee co-determination. In companies regularly employing more than 500 employees in Germany, a third of the members of the supervisory board must be made up of employee representatives, and for companies with more than 2,000 employees in Germany, one half. In the latter case, however, the chairman of the supervisory board, who is designated by the shareholders' representatives in the supervisory board, is entitled to vote twice when there is a tied vote.

**General meeting**

The general meeting is the forum in which the shareholders exercise their rights. However, their responsibility is generally limited to those decisions listed in the AktG or the company's articles of association. The general meeting decides mainly on the basic issues of the corporation.

Under the statutory regulations, the general meeting decides on the appointment and removal of the shareholder representatives on the supervisory board, appropriation of the balance sheet profit, formal acceptance of the actions of the members of the management board and the supervisory board, appointment of the statutory auditor, amendments to the articles of association, measures for raising or reducing capital, appointment of auditors for the examination of procedures relating to the formation or management of the company, decisions on transformation measures (such as merger or change in form), approval of intercompany agreements and resolving on the company's dissolution.

Each year, an annual (ordinary) general meeting of the company is held to resolve on the appropriation of profits, the discharge of the management board and advisory board and the appointment of the statutory auditor.

The general meeting may only resolve on matters relating to the management of the company if requested to do so by the management board. However, Germany's Federal High Court of Justice has conferred on the general meeting a right of approval of measures which, though formally within the power of the management board, nonetheless affect the property rights resulting from the ownership of shares in a company to such extent that the management board cannot reasonably expect to resolve on these matters without involving the general meeting.

**2.4 Shareholder's rights**

The rights conferred on shareholders by membership are generally divided into rights of co-administration and ownership rights.

**Co-administration rights**

Co-administration rights refer to the exercise of influence on the company's decision-making. These rights first and foremost include the right to attend and speak at the general meeting, the right to information, voting rights and the right to contest resolutions of the general meeting.
**Ownership rights**

The ownership rights of shareholders are primarily the right to a dividend, the right of subscription in respect of capital increases, the right to repayment in respect of capital reductions and the right to participate in the proceeds of liquidation. Further ownership rights of the shareholders are the right to compensation and consideration in numerous cases of merger, division, change in form and other matters under the law relating to corporate groups.

A dividend may only be distributed out of the distributable profits as accounted in the annual financial statements. The company’s remaining assets are non-distributable and may not be paid out to the shareholders. This strict protection of capital is in contrast to a GmbH in which only the assets maintaining the registered share capital are protected.

In principle, shares in an AG can be freely transferred. However, in the case of registered shares, the articles of association may make transfer conditional upon company approval. To the extent that share certificates are issued, the transfer is subject to the regulations under applicable securities laws. If no share certificate is issued, the shares can be transferred by assignment.

### 2.5 Liability regime

Only the company and not the shareholders are liable towards the company’s creditors. The shareholders’ duties towards the AG are basically limited to paying their agreed contributions.

Members of the management board who breach their duties have an obligation as joint and several debtors to pay compensation to the AG for any resulting damage. This also applies to members of the supervisory board.

Only in exceptional cases creditors are entitled to assert claims for breach of duty by members of the management board and the supervisory board directly. In the case of a particularly serious breach of duty by members of the management body, the creditors are, however, entitled to assert claims against the members of the management bodies directly if and to the extent they are unable to realise compensation from the company.
3. **Partnership Limited by Shares – KGaA**

### 3.1 Description and legal characteristics

In partnerships limited by shares (*Kommanditgesellschaft auf Aktien, KGaA*), at least one partner must have unlimited liability towards the creditors of the company (the general partner, *Komplementär*). The limited shareholders (*Kommanditaktionäre*) participate in the registered share capital of the partnership in the same way as shareholders in an AG, without being personally liable for the liabilities of the company. The KGaA is a variant of the AG (special provisions on this legal form are found in the AktG). Since any legal person (including a GmbH or AG) may be the general partner, this legal form makes it possible to limit the personal liability of the investors. However, there are far fewer KGaAs than GmbHs or AGs in Germany.

### 3.2 Formation

The formation procedure for a KGaA largely mirrors that of an AG. In the articles of association, the limited liability shareholders must subscribe for all the shares. The general partners may also participate in the registered share capital, which is divided into shares, in which case they also become limited liability shareholders.

The general partner, however, has no obligation to participate in raising the registered share capital or to make any other contribution of assets. His shareholder contribution can be limited to his/her activity as a corporate body of the KGaA and the liability risk assumed as general partner.

Formation of the KGaA is completed with the full subscription of shares and, like the other forms of corporation, the registration and entry in the commercial register. Until then, it exists only as a pre-incorporation entity to which the regulations governing the KGaA for the most part apply.

### 3.3 Management structure and organisation

A KGaA has registered share capital (*Grundkapital*) divided into shares (*Aktien*). As with an AG, this registered share capital must amount to at least Euro 50,000 and is bound by the same restrictions as the registered share capital of an AG.

The law governing the general partners states that they are each authorised to manage and represent the company individually. As regards third parties, their power of representation is in principle unrestricted. Internally, however, for extraordinary business transactions the general partners require the consent of the limited liability shareholders by a resolution of the shareholders’ meeting. The position of the general partners as a management body within the company is similar to that of the management board of an AG. However, since their powers result from their position as partners, they cannot be removed in the same way as management board members. Their powers of management and representation may only be revoked by way of judicial decision for cause.

The limited shareholders have essentially the same rights and obligations as shareholders of an AG. They have a claim to a share in the distributable profits (dividend), the right to attend, speak and cast a vote at the general meeting, and the right to request information on any affairs relating to the company.

A KGaA must have a supervisory board. The appointment of its members and its working procedures are generally subject to the regulations which apply to stock corporations, but its duties are essentially limited to monitoring the general partners. By law, general partners may not become members of the supervisory board. The supervisory board ensures the implementation of the limited shareholders’ resolutions.
4. **GmbH & Co. KG**

4.1 **Description and legal characteristics**

A GmbH & Co. KG is a special form of limited partnership (*Kommanditgesellschaft, KG*), in which a limited liability company participates as the personally liable partner (general partner, *Komplementär*). The flexibility of the GmbH & Co. KG as a legal form, especially for medium-sized companies and family businesses, stems from the special combination of the corporate and tax law advantages of partnerships with the limited liability and organisational advantages of corporations.

4.2 **Legal forms**

In a typical GmbH & Co. KG, the shareholders of the general partner GmbH (*Komplementär-GmbH*) are identical to the limited partners of the KG and have the same participating interest in both, the GmbH and the KG.

There are also forms of a GmbH & Co. KG in which the shareholders of the GmbH and the limited partners are not identical – for example, the *Publikums-GmbH & Co. KG*, which is usually formed by only a few persons, but is geared from the outset towards a large number of limited partners as capital providers.

4.3 **Formation**

A GmbH & Co. KG comes into existence when the partnership agreement (*Gesellschaftsvertrag*) is concluded between the general partner GmbH and the limited partners. An application must be filed for the GmbH & Co. KG to be entered in the commercial register. The partnership agreement does not require any special form and can be drawn up according to the partner’s needs. Here the parties enjoy freedom of contract. Notably, the partnership agreement itself does not have to be filed with the commercial register and is thus not available for inspection by the public. The limited partners may be natural and legal persons as well as partnerships.
There are no restrictions on the possible names of the GmbH & Co. KG provided the name is clearly distinctive and not misleading and contains the description "GmbH & Co. KG".

4.4 Management structure and organisation

Management and representative power in a GmbH & Co. KG vests with the general partner GmbH. The latter in turn acts through its managing directors who conduct the business of the GmbH directly and that of the KG indirectly. For details on the management and representation of a GmbH, please refer to the section dealing with the GmbH.

In principle, the limited partners are excluded from management and representation of the company. However, matters which are beyond the normal scope/course of business require the approval of the limited partners. The partnership agreement may grant the limited partners participation rights or rights to issue instructions vis-à-vis the general partner GmbH, or even authority to be the sole manager of the company. However, the partnership agreement may also reduce the limited partners’ statutory participation rights. Decisions relating to matters of fundamental importance to the company are taken by all the partners. The partners’ decisions are normally made by resolution in general meetings.

4.5 Limited partners' rights

Whereas the general partner GmbH does not normally participate in the assets of the KG, the payment of a contribution (either in cash or in kind) is mandatory for the limited partners. Unlike the personally liable general partner, who has a statutory drawing right which is not linked to the company’s profits (and is normally only as consideration for the assumption of liability as the personally liable partner), the limited partners, as a general rule, have a right to the payment of their profit share.

In addition to their general right to information, the limited partners enjoy other control and information rights conferred by law. For instance, the limited partner may request a copy of the annual audited financial statements in order to examine these statements and may inspect all books and documents which provide information on the business transactions of the company relevant to the annual financial statements.

4.6 Liability regime

The general partner GmbH has unlimited liability for the obligations of the GmbH & Co. KG. It is the limited partners, however, who are required to make the initial contribution (Einlage) pursuant to the partnership agreement. As soon as the initial paid contribution equals the maximum liability amount (Haftsumme) in accordance with the partnership agreement and is entered in the commercial register, the personal liability of the limited partners ceases. At this stage, the company’s creditors only have potential recourse to the corporate assets of the GmbH & Co. KG or to the assets of its general partner. The liability of the limited partners revives when a limited partner’s initial contribution is repaid.
A branch office is a business undertaking located in a different location from the principal business undertaking. Any company that has its registered office abroad and exists as a legal person (according to the law of the country of its principal place of business) is entitled to establish a branch office in Germany. It must have a certain degree of organisational and management independence and it must have more than merely a temporary purpose.

The branch office of a foreign company must be registered in the local commercial register in Germany. The registration must be filed in German, comply with various formal requirements and contain significant information regarding the foreign parent company, such as particulars regarding the legal nature of the foreign company. Any and all changes at the branch office, such as new managing directors or permanent representatives, changes in their power of representation or closure of the branch office, must be notified to the commercial register; any other changes to the foreign company must also be updated in the commercial register. Consequently, the establishment and on-going maintenance a branch office involves considerable administrative effort.

A branch office remains a part of the principal business and does not have its own legal personality. Therefore, it cannot have any rights and obligations of its own and the principal business is liable for actions carried out through the branch office.
6. Developments in European Law

6.1 European Court of Justice decisions

For some years, the European Court of Justice (ECJ) has been the main driving force behind the integration process in the European Union in the area of corporate law. In the context of freedom of establishment and the creation of a single market within the European Union, the court’s numerous rulings have resulted in greater harmonisation within the European legal systems.

Since the ECJ’s “Überseering” decision in 2002, reinforced by the 2003 “Inspire Art” decision, foreign companies from other member states of the European Union must be acknowledged as such in Germany. They may pursue their business activity in Germany as a company incorporated abroad, while the regime of their domestic law of incorporation remains applicable to them.

In its 2012 “Vale” decision, the ECJ ruled that national legislation that enables national companies to convert but does not allow, in a general manner, companies governed by the law of other member states to do so amounts an unjustified restriction of the freedom of establishment. However, the host state remains competent determining the national law applicable to cross-border conversions as long as these provisions are applied to national and non-national companies in compliance with the principle of equivalence and effectiveness.

6.2 The European Public Limited Company

Since 2004, it is possible to establish a new form of legal entity in all member states of the European Union and the European Economic Area (EEA) – the European public limited company (Societas Europaea, SE). With the advent of the SE, companies focused on the European market are offered legal options they have previously been denied while operating under national legal forms. This includes, in particular, the facilitation of cross-border restructuring as well as the choice between one-tier and two-tier management systems. The SE is thus aimed at creating the basis for a uniform EU legal framework within which companies and groups can pursue their operations with greater flexibility.

An SE can be established in different ways: by merger, by formation of a holding SE, by formation of a (joint) subsidiary SE, or by conversion of an existing public limited company into an SE. A principal characteristic of each of these incorporation forms of a SE is the notion of trans-nationality; that is, the promoting companies are subject to the laws of different member states (or at least have subsidiaries in different member states). Beyond this, an existing SE may itself set up one or more subsidiary SEs.

The SE is, in principle, structured like a public limited company (Aktiengesellschaft) being subject to the laws of its incorporation. For SEs registered in Germany, laws applicable to German stock corporations consequently apply (AktG, HGB, UmwG, WpHG, WpÜG, etc.).

The SE gives German companies the option of adopting either the corporate governance of a two-tier system of management board (Vorstand) and supervisory board (Aufsichtsrat) or what is referred to as the one-tier system of corporate management akin to the board system in the Anglo-Saxon world. Under the one-tier system, no distinction is made between the executive board and the supervisory board, but instead there is one single management body responsible for both managing and monitoring the company.

The level of employee participation (Arbeitnehmerbeteiligung) both in the works council and in the supervisory board/administrative board of the SE is, within certain boundaries, freely negotiable. Some SE companies in Germany have already reduced the overall number of supervisory board members (e.g. Allianz SE from twenty to twelve members) to make the board more flexible.
6.3 European Private Company

There have been various initiatives to provide for the legal entity of a European private limited company (Societas Privata Europaea, SPE) in order to meet the needs of small and medium sized enterprises on a European level since the 1990s. However, until today the European member states could not agree upon the provisions that would govern the SPE.

6.4 Cross-border mergers

In December 2005, the ECJ ruled in its “SEVIC Systems” decision, that the application of the German Re-organisation Act (Umwandlungsgesetz, UmwG) to German corporate forms only was a contravention of European community law. According to this decision, cross-border mergers of companies from different member states must be possible in principle.

In 2005 the Council Directive 2005/56/EG concerning cross-border mergers became effective. The directive allows corporations from different member states to conduct cross-border mergers. To this end, the German legislator has passed laws governing the consequences on employee representation and the tax treatment of cross-border mergers.
7. Relevant German tax law

7.1 Taxation of corporations

Corporate income tax

As legal persons, corporations (SEs, GmbHs, AGs and KGaAs) are subject to unrestricted corporate income tax liability if they have their place of management or their statutory seat in Germany. This unrestricted tax liability covers all domestic and global income which for corporations is always regarded as income from trading operations (gewerbliche Einkünfte). Taxable income of corporations in Germany is currently subject to a corporate income tax rate of 15.0% plus a solidarity surcharge of 5.5% on the corporate income tax, resulting in an aggregate rate of 15.825%. The uniform corporate income tax rate plus solidarity surcharge is applied to both distributed and retained profits of the corporation.

The determination of the taxable income is generally based on the financial statements prepared in accordance with German commercial law, but the profit disclosed in these financial statements is then adjusted pursuant to tax law regulations. Notably, these include regulations on the treatment of constructive dividends (verdeckte Gewinnausschüttungen) and restrictions on the deductibility of business expenses, particularly with regard to debt financing expenditures.

The deductibility of financing costs is restricted to prevent an excessive level of debt financing since interest expenditure is tax-deductible as a business expense. As a general rule, interest expenditure is tax-deductible up to the level of the interest income in any given tax year. The net interest expenditure (= interest expenditure minus interest revenues – Nettozinsaufwand) is only deductible up to an amount of Euro 3 million in any given tax year. Any amount in excess of this exemption limit triggers the interest deduction limitation for the entire net interest expenditure amount. In this case, the net interest expenditure in a given tax year is tax-deductible only up to 30% of the EBITDA (earnings before interest, taxes, depreciation and amortisation) determined according to German tax law. Any remaining “excess” net interest expenditure that is not tax deductible in a given tax year is carried forward to a new account (Zinsvortrag) and can be deducted in future years under the afore-discussed prerequisites. In 2009, EBITDA carryforward (EBITDA-Vortrag) was introduced retroactively to provide relief for financial years ending after 31 December 2009. An EBITDA carryforward is generated if a taxpayer in a given year has net interest expenditure lower than 30% of the EBITDA for tax purposes. The excess EBITDA would then be carried forward and could be used in the following five years when the net interest expenditure exceeds 30% of the current EBITDA. The interest deduction restriction does not apply to companies who do not belong to a group of companies (stand-alone-clause) if the company is not a corporation which pays more than 10% of its net interest expenditure to major shareholders (shareholders with a participating interest greater than 25%), associated persons or third parties with a right of recourse. A company which belongs to a group of companies can deactivate the interest deduction restriction by using the “escape-clause”. For this purpose, the equity-to-assets ratio of the respective company must not be less than two percentage points below the equity-to-assets ratio of the group of companies. In principle, this comparison has to be made according to IFRS, or alternatively according to HGB or US-GAAP. For corporations, the escape clause only applies if not more than 10% of the net interest expenditure on debts reported in the consolidated financial statements is paid to major shareholders (shareholders with a participating interest of more than 25%), associated persons or third parties with a right of recourse against major shareholders which are not part of the group of companies or persons related to such shareholders.

As a rule, a corporation’s losses can be utilized only by that corporation and not by its shareholders. A loss carryback is limited to the immediately preceding year and to Euro 1 million as from 2014 (before only Euro 511,500). No time limit applies to the utilization of a loss carryforward, but the annual utilization is limited in its amount: after the deduction of Euro 1 million from the taxable income, the loss carryforward can only be set off against 60% of the remaining taxable income, whilst the remaining 40% of the income of the respective year is taxed. Unutilized loss carry-forwards for tax purposes can, in principle, be carried forward without any restriction on time and can be deducted under the described rule from future taxable corporate income or taxable trade income. However, if, within five years, either directly or indirectly more than 25% of a corporation’s stated capital or shares or voting shares are
transferred to one purchaser or to affiliated persons or to a group of purchasers that have aligned their interests (harmful share acquisition, schädlicher Beteiligungsverwerb), the corporation’s net operating losses and loss and/or interest carry-forwards are proportionately reduced. If, within such period, more than 50% of the shares are directly or indirectly transferred in a harmful share acquisition, the corporation’s net operating losses and loss and/or interest carry-forwards are forfeited entirely. The same applies if the shares are transferred to any such person or persons as a result of a share capital increase with a change of the shareholding quota. Whether or not the change-in-ownership rule will apply to share transfers from 1 January 2008 that were made for the purpose of a financial reorganization (Sanierung), i.e. to avoid or overcome a threatened or existing insolvency or over-indebtedness of the corporation having a loss and/or interest carry-forwards and, at the same time, to maintain its relevant business organization is currently a pending case before the European Court of Justice: This is because the exception for financial restructurings was claimed to be in breach of the European state aid rules by the European Commission. Furthermore, the change-in-ownership rule will not apply to share transfers which are conducted as part of an intra-group restructuring. This requires that both the purchasing and the transferring entity are wholly-owned subsidiaries of the same legal entity. Lastly, a harmful share acquisition does not affect net operating losses and loss carry-forwards up to the extent of the company’s hidden reserves (stille Reserven), as far as they are subject to tax in Germany.

It is possible for a corporation to establish a consolidated tax group (Organschaft) which generally allows loss offsetting between two independently taxable corporations. However, the formation of a consolidated tax group is generally limited to corporations which have at least a permanent establishment in Germany. Foreign corporations who have neither their place of management nor their registered office in Germany are subject to German corporate income tax on their German income as corporations with limited tax liability.

Trade tax

Corporations are subject to German trade tax (Gewerbesteuer) which accrues to the municipality in which the company has a permanent establishment. The calculation of trade tax is based on the taxable income of the corporation which is subject to add-backs and reductions. The amount (taxable trade earnings, Gewerbeertrag) is then multiplied by the basic federal rate (Steuermesszahl) of 3.5%, resulting in the base value (Gewerbesteuermessbetrag) to which the trade-tax municipal multiplier (Gewerbesteuerhebesatz) set by the municipalities is applied. This municipal multiplier differs from one municipality to another with a statutory minimum of 200%, resulting in a trade tax rate of 7%. The aggregate tax rate, including corporate income tax, solidarity surcharge and trade tax thus currently averages around 29.8%.

7.2 Taxation of shareholders of a corporation

Where dividends are distributed to shareholders of a corporation or profits are generated by the sale of shares, a distinction must be made as to whether the shareholder is a corporation or a natural person and whether the taxable entity or person is subject to tax on its global income (unlimited tax liability) or to tax on its domestic income only (limited tax liability).

Corporate shareholders

Dividends distributed by a company to a corporation with its seat or place of management in Germany and which has a shareholding of at least 10% in the distributing company, and capital gains from the sale of domestic or foreign shares in corporations are, as a rule, 95% tax-exempt at the level of the shareholder. The remaining 5% of the dividends or capital gains are treated as non-deductible business expenses and subject to corporate income tax and trade tax. Actual business expenses which are economically related to the dividend income or the capital gains are, as a rule, fully tax deductible, provided such expenditure exceeds 5% of the respective income. This applies in particular to the shareholders’ financing cost of acquiring the holding.

The company paying the dividends must withhold 25% plus solidarity surcharge of 5.5% thereon, totalling 26.375%. For foreign shareholders this collection at source is, as a rule, absolute. However, the foreign shareholder’s national tax legislation usually provides for (at least partial) relief by crediting the German tax. The withholding tax on dividends is often reduced by an applicable German Double Taxation Treaty or, in the case of European groups of companies (10% minimum shareholding with a minimum holding period of 12 months), can be excluded completely, in each case, on application by the foreign shareholder.

Capital gains taxable in Germany of (foreign) corporations with limited tax liability from the sale of shares in domestic corporations are tax-exempt as to 95% of the capital gain. Nevertheless, most German Double Taxation Treaties do not generally provide for a German right of taxation regarding the capital gain, meaning that the latter can only be taxed in the country of residence of the shareholder. Dividend payments from domestic corporations to foreign shareholders are subject to withholding tax as described in more detail below.
**Individual shareholders**

A distinction has to be made for shareholdings held by individuals as a private asset or as a business asset:

From 1 January 2009 onwards, a flat rate withholding tax (*Abgeltungssteuer*) was established for dividends and other capital income as well as capital gains received as income from private investments by a natural person. The company paying the dividends must withhold 25% plus solidarity surcharge of 5.5% thereon, totalling 26.375%, plus church tax if any.

Dividends and other capital income derived from domestic business assets and received by a natural person are subject to the partial income procedure and are therefore taxed on 60% (due to the tax exemption of 40%). Expenses which are related to such income are likewise only tax deductible up to 60%. Withholding tax is credited to later tax assessments. A domestic business exists if a permanent establishment is maintained in Germany or if a permanent representative is appointed for the business in Germany.

Capital gains from the sale of shares accrued from private investments which were acquired prior to or on 31 December 2008 are, as a rule, fully tax-exempt if the holding period exceeds 12 months (*Spekulationsgeschäft*) or if the shareholder at any time during a period of five years preceding the sale held a direct or indirect participation in the company of at least 1% (*wesentliche Beteiligung*). If subsequently taxable, the half-income procedure applies to the taxation of capital gains received prior to or on 31 December 2008 which are therefore taxed up to 50% (due to the tax exemption of 50%). Similarly, expenses which are related to such income are only tax deductible up to 50%.

Capital gains received from 1 January 2009 onwards and accrued from shareholdings held as business assets are taxed according to the 60% partial income procedure as described above. The same applies to capital gains from the sale of shares from private investments if the shareholder at any time during a period of five years preceding the sale held a direct or indirect participation in the company of at least 1% (*wesentliche Beteiligung*).

Taxable capital gains from the sale of shares which were acquired prior to or on 31 December 2008 are not subject to the withholding tax. Capital gains from the sale of shares which were acquired after 1 January 2009 are, in principle, subject in full to the flat rate withholding tax. The domestic financial institution which maintains the account of the individual shareholder in which the shares are booked and effects the sale thereof and pays the dividends withholds the flat rate withholding tax on behalf of the shareholder.

Income tax depends on the amount of taxable income of the taxpayer. The basic tax-free personal allowance is Euro 8,354. The income tax rate on individuals varies between 14% (bottom rate) and 45% (top rate) plus 5.5% solidarity surcharge thereon, resulting in an aggregate rate of between 14.77% and 47.475% respectively plus church tax, if applicable.

The tax-free allowance for income from savings amounts to Euro 801 (1,602 for spouses jointly assessed for taxation) and applies to dividends and capital gains from the sale of shares accrued from private investments unless the shareholder, at any time during a period of five years preceding the sale, held a direct or indirect participation in the company of at least 1% (*wesentliche Beteiligung*). Income tax is in principle settled by the payment of withholding tax.

Natural persons who are not tax resident in Germany are only subject to limited income tax liability as regards their income from German sources.

### 7.3 Taxation of partnerships

Partnerships themselves are not subject to income or corporate income tax. Instead, income tax or corporate income tax is levied on the partners of the partnership (transparency principle). Income from their participation in the partnership is determined "uniformly and separately" for all partners. However, the interest expense situation at the level the partnership is, in principle, relevant for the application of the interest deduction limitation. The afore-discussed counter-exceptions of the stand-alone clause and the escape clause also apply to partnerships which are held by corporations.

A partnership is, however, itself subject to trade tax if its activity is determined as a trade within the meaning of German tax law. This does not apply to the majority of pure asset managing partnerships. However, the activity of a classical GmbH & Co. KG is usually determined as a trade, because no natural person has unlimited personal liability for the obligations of the KG, resulting in it being subject to trade tax. With regard to trade tax, previous statements made in connection with corporations apply except that (i) the starting point for calculating taxable trade earnings is the profit of the partnership calculated pursuant to the German Income Tax Act (*Einkommensteuergesetz, EStG*) and (ii) an exempt amount of Euro 24,500 is granted for trade tax purposes. As a rule, losses of a partnership for trade tax purposes can be utilized only by that partnership and not by the shareholders/partners. A loss carryback is not possible. No time limit applies to the utilization of a loss carryforward, but the annual utilization is limited in its amount: after the deduction of Euro 1 million from the taxable income, the loss carryforward can only be set...
off against 60% of the remaining trade taxable income, whilst the remaining 40% of the income of the respective year is subject to trade tax.

### 7.4 Taxation of partners

Foreign partners of a partnership are subject to either limited income tax liability as natural non-resident persons or to limited corporate income tax liability as non-resident corporations in respect of their income from trade and business in Germany. The profit (or loss) of the partnership is attributed to the partners regardless of whether profit is paid out or retained, and is taxable in the hands of the partners. For the partners, their share in a commercial partnership’s profit is classified as income from trade and business which is not subject to withholding tax in Germany. The income tax is levied by the tax authorities on the basis of a tax assessment.

In accordance with the agreed profit distribution arrangement, each partner receives his/her share in the total profit of the partnership. Remuneration received by the partner from the partnership for his work in the partnership or for loans to the partnership or for the use of assets by the partnership is subject to tax on the partner as income from trade and business. Personal expenditure incurred by the partner through his/her partnership interest is deemed as business expenses and is deductible from his trade and business income. This also applies to partners with limited tax liability.

Regarding the income of partners subject to German trade tax, German income tax law provides for an income tax reduction relating to the trade tax burden. This income tax reduction at the level of the partners credits the trade tax burden incurred by the partnership. It does not apply to partners subject to corporate income tax.

Taxation on accumulated profits of partnerships which prepare financial statements for tax purposes is similar to the taxation of corporations. On request, accumulated profits are taxed at a rate of 28.25% (plus 5.5% solidarity surcharge thereon). Deferred taxation with a definitive withholding tax of 25% applies on the amount by which the withdrawals of the shareholder exceed his/her share of the profits and his/her capital contributions.

Losses of the partnership (other than trade tax losses) are attributed to and can, in principle, be utilized by the partners for corporate or personal income tax purposes. The loss carryback is limited to the immediately preceding year and to an amount of Euro 1 million as from 2014 (before only Euro 511,500). A loss carryforward may be retained for an unlimited period, but its annual utilization is limited in its amount: after the deduction of Euro 1 million from the taxable income, the loss carryforward can be offset against only 60% of the remaining taxable income, whilst the remaining 40% of the income of the respective year is subject to tax. Further special provisions exist, for example, where limited partners of a KG (or GmbH & Co. KG) suffer losses as a result of their participation and which result in a negative capital account or an increase in an already existing negative balance. As a result of these provisions it is not possible to recover losses using other positive income but only by utilizing profits resulting from the participation in the partnership.

### 7.5 Branch office of a foreign company

Income earned in Germany by a foreign corporation which has a branch office in Germany qualifying as a permanent establishment is treated as domestic income from trade or business. In respect of this income, the non-resident company is subject to corporate income tax, solidarity surcharge and trade tax at the current tax rates. In accordance with Article 7 (1) of the OECD Model Convention for the avoidance of Double Taxation and the corresponding German Double Taxation Treaties, Germany has the right to tax the income attributable to the permanent establishment.
Hogan Lovells has offices in:

<table>
<thead>
<tr>
<th>Alicante</th>
<th>Dusseldorf</th>
<th>London</th>
<th>Paris</th>
<th>Tokyo</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amsterdam</td>
<td>Frankfurt</td>
<td>Los Angeles</td>
<td>Philadelphia</td>
<td>Ulaanbaatar</td>
</tr>
<tr>
<td>Baltimore</td>
<td>Hamburg</td>
<td>Luxembourg</td>
<td>Rio de Janeiro</td>
<td>Warsaw</td>
</tr>
<tr>
<td>Beijing</td>
<td>Hanoi</td>
<td>Madrid</td>
<td>Rome</td>
<td>Washington DC</td>
</tr>
<tr>
<td>Brussels</td>
<td>Ho Chi Minh City</td>
<td>Miami</td>
<td>San Francisco</td>
<td></td>
</tr>
<tr>
<td>Budapest*</td>
<td>Hong Kong</td>
<td>Milan</td>
<td>São Paulo</td>
<td></td>
</tr>
<tr>
<td>Caracas</td>
<td>Houston</td>
<td>Moscow</td>
<td>Shanghai</td>
<td></td>
</tr>
<tr>
<td>Colorado Springs</td>
<td>Jakarta*</td>
<td>Munich</td>
<td>Silicon Valley</td>
<td></td>
</tr>
<tr>
<td>Denver</td>
<td>Jeddah*</td>
<td>New York</td>
<td>Singapore</td>
<td></td>
</tr>
<tr>
<td>Dubai</td>
<td>Johannesburg</td>
<td>Northern Virginia</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Associated offices

"Hogan Lovells" or the "firm" is an international legal practice that includes Hogan Lovells International LLP, Hogan Lovells US LLP and their affiliated businesses. The word "partner" is used to describe a partner or member of Hogan Lovells International LLP, Hogan Lovells US LLP or any of their affiliated entities or any employee or consultant with equivalent standing. Certain individuals, who are designated as partners, but who are not members of Hogan Lovells International LLP, do not hold qualifications equivalent to members.

For more information about Hogan Lovells, the partners and their qualifications, see www.hoganlovells.com.

Where case studies are included, results achieved do not guarantee similar outcomes for other clients. Attorney Advertising.

©Hogan Lovells 2014. All rights reserved. #614585