Doing Business in Germany

2010

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1. Introduction

UHY is an international organisation providing accountancy, business management and consultancy services through financial business centres in over 70 countries throughout the world. Business partners work together through the network to conduct trans-national operations for clients as well as offering specialist knowledge and experience within their own national borders. Global specialists in various industry and market sectors are also available for consultation.

This publication is current at September 2010.

Every effort has been made to ensure that the facts in this booklet are correct at the time of going to press. However, no responsibility for loss incurred by any person acting or refraining from acting as a result of any material in this publication can be accepted.

This detailed report providing key issues and information for investors considering business operations in Germany has been provided by the office of UHY representatives:

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We look forward to helping you to do business in Germany.

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2. Business environment

2.1 The German geography, climate, constitution and government

Germany is located in the centre of Europe. It is one of the largest countries in Europe. Neighbour countries are Poland, the Czech Republic, Austria, Switzerland, France, Luxembourg, Belgium, the Netherlands and Denmark.

The capital of Germany is Berlin. However, the main business areas are Hamburg, North-Rhine Westphalia (Cologne, Düsseldorf), Frankfurt, Stuttgart and Munich. International airports are located in all these cities. Furthermore, Germany has access to the North Sea and the Baltic Sea. The Port of Hamburg is one of the largest container transhipment centres in Europe.

Germany belongs to the temperate climate zone of Central Europe. Therefore, the climate is mild. In principle, summers are not too hot and in winter the temperatures are around freezing with rare snowfalls. The average annual rainfall is 700 mm; the average annual temperature is 10°C.

Germany is a parliamentary democracy with a very pronounced federal structure. The legislative and executive powers are divided between the federation and the 16 federal states, namely Baden-Württemberg, Bavaria, Saarland, Rhineland-Palatinate, Hessen, Thuringia, Saxony, Saxony-Anhalt, North-Rhine Westphalia, Lower Saxony, Berlin, Brandenburg, Bremen, Hamburg, Schleswig-Holstein, Mecklenburg-Vorpommern. The federal parliament has responsibility for national matters such as international affairs, defence and economic policy and taxation. The legislatures of the 16 federal states are responsible for issues such as education and property.

On the federal level, the most important legislative institutions are the Bundestag (federal parliament) and the Bundesrat (the upper house representing the federal states). Whilst the power of the German president is limited to representation, the position of the chancellor is fairly pronounced.

The country's constitution is based on the Basic Law that was passed in 1949. Upon reunification in 1990 its applicability was extended to the states of the ex-GDR.

German legislation is modelled on the old Roman system and has no resemblance to the Anglo-Saxon legal system.

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2.2 Population, Size and Language

Population: 81.8 million inhabitants

Area: 357,112 sq. km; measuring 885 km from north to south and 595 km from east to west.

Population density: 229 inhabitants per square kilometre.

Currency: Euro (EUR)

Language: Official language is German.

2.3 The economy

Germany is a founding member of the European Union. Furthermore, Germany is part of the United Nations, the OECD, the NATO, G 8 and G 20 and the EMU.

Based on the nominal Gross Domestic Product Germany is the 3rd largest political economy and the second largest export nation. The German Gross Domestic Product was 2,404 billion EUR in 2009.

The service sector accounted for 72.4% of total employment in 2009 compared to agriculture with 2.1% (2009). Industrial production counts for 19.4% (2009).

Unemployment figures vary every year. However, inspite of the financial crisis in 2009 the rates are better than in the years 2005, 2006 and 2007; the average rate of unemployment during 2009 was 8.2% (2008: 7.8%, 2007: 10.1%, 2006: 12.0%, 2005: 11.7%). In July 2010 the rate of unemployment was 7.6%.

The annual average inflation rate was around 0.4% in 2009, in June 2010 this index was 0.9% (2008: 2.6%, 2007: 2.2%, 2006: 1.7%, and 2005: 2.0%).

The German economic model is to be a functioning social market economy, in which free market economics are blended with solidarity and social compromise.

2.4 Prices and interest rates

As Germany is part of the European Monetary Union (EMU), the monetary policy is managed by the European System of Central Banks. The European Central Bank (ECB) based in Frankfurt is the common monetary authority of all member states of the European Monetary Union and is among others responsible for the supervision of the banking system and the regulation of the money supply. Its two biggest aims are the stability of the price level and to have a compensated economic development. One of the instruments to pursue these aims is the regulation of the price for lent money by the prime interest rates.

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The prime interest rates influence the business between the ECB and the other banks and the exchange rate of the Euro against other currencies. The world banking crisis of 2009 led to low interest rates. Since January 1, 2010 the basic interest rate has been app. 0.12%.

2.5 Foreign trade and the balance of payments

Germany is one of the world's most active trading countries with a significant surplus. In 2009 the volume of export was 803, 2 billion Euros, while the volume of import amounted 667, 1 billion Euros. The foreign trade balance in 2009 reached a surplus of 136.1 billion Euros. In 2008 the surplus amounted to 178.3 billion Euros.

About three-quarters of the exports of German goods are delivered to European countries. Germany′s highest trade surplus resulted in 2009 from its trade with France (total exports 81, 9 billion Euros). Other important trade partners are the Netherlands (54, 1 billion Euros in 2009), the U.S. (53, 8 billion Euros), the United Kingdom (53, 2 billion Euros) and Italy (51, 1 billion Euros).

Germany′s main exported goods are manufactured products (87% of the total), e.g. machinery, automobiles and car parts and chemical products. One of four jobs in the German industry depends on exports.

The German industry has increased its competitiveness considerably in the recent years and has maintained and expanded its leading market position on the German, European and international markets.

2.6 The financial and banking system

The German banking system and the German financial services industry are stable and well developed. Frankfurt is the financial centre of Germany. It is the seat of the European Central Bank and the most important Stock Exchange of the country and the Eurex (the German futures and options exchange).

The German financial system consists of the following actors:

- banks
- insurances
- investment companies
- operators of stock exchanges and equity markets
- operators of payment systems
- central banks
- trade markets

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The aim of a financial system is to *allocate deposits*, to transform it into loans and to make it available for investments. This ensures a significant input to the German economical growth.

All available banking transactions and financing options are carried out in Germany. Many forms of debt financing are possible. Short-term arrangements include bank loans, trade credit from suppliers, commercial and financial paper, factoring of receivables etc.

Forms of long-term financing include open market borrowings (bonds, notes, etc.) and direct borrowings (mortgages and term loans) from financial institutions. Leasing arrangements represent a further option of long-term financing.

The capital market in Germany has grown in importance over recent years. As a consequence, all major new capital instruments of financing or risk hedging such as derivatives, swaps, etc are available.

In addition, the following banking transactions can be carried out:

- deposits
- discount business
- portfolio & investment management
- guarantee business
- giro business (cashless payments and clearings)
- electronic banking.

Banking transactions in Germany are facilitated by an extensive branch network of German banks and credit institutions, as well as extensive international linkages and a sophisticated technical infrastructure.

In principle, the German banking industry is national, dominated by several large banks. All German banks are federally chartered. The German banking system is characterised by "universal" banks, on the one hand, and "niche" players, on the other.

The universal banks offer the full range of banking and financial services. They are dominated by internationally known names. The advantage of the universal bank system is that companies can establish long-term relationships with their respective bank, thereby avoiding the short-term view present in the Anglo-Saxon financial markets system.

The "niche" players are smaller financial institutions that have succeeded in offering specialised services.

The German financial institutions system comprises all major forms such as private credit institutions, savings banks, co-operative credit institutions, security houses, mortgage houses, trust companies, credit unions etc. The responsibilities range from capital and credit for private

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persons and commercial enterprises, provision of payment solutions to wide-ranging possibilities of investment of assets.

Foreign banks are permitted to establish German subsidiary operations. They tend, however, to have few branches and to focus on the business market, rather than the full-service banking market. EU legislation on bank licences has been fully implemented in Germany.

2.7 Working and living conditions

2.7.1 Visa / Residence title / Work permit

Generally speaking, all foreigners which are non-EU and non-EEA nationals require a visa / a residence title for stays in Germany. Nationals from EU and EEA member states and citizens of Switzerland do not need a visa / a residence title to enter or to reside in Germany. After arrival they just need to register with the appropriate authoritiy of their residence in Germany.

A short-term visa (so-called Schengen visa) is sufficient for a stay up to 90 days. For several foreigners a visa is not required for a stay up to three months within a six months period, provided that they do not take up gainful employment requiring a work permit in Germany (e.g. Nationals of Australia, Canada, Israel, Japan, New Zealand, South Korea and the United States, etc.). However, it has to be considered that also these foreigners can only enter Germany if they have valid identity papers. On the planned date of departure from Germany, the papers should have at least three months validity.

For stays for more than three months or in case the foreigners intend to take up employment, a national visa and / or a work permit is required. In principle, Nationals from EU and EEA member states and citizens of Switzerland do not require a work permit. However, for some new member states of the EU (countries which acceded to the EU on 1 May 2004 and 1 January 2007) other regulations are applicable during a transitional period. All foreigners from outside the EU and outside the EEA require a work permit in addition to the residence permit in case they want to take up gainful employment. In principle, this work permit is required before entering Germany. Nationals of Australia, Canada, Israel, Japan, New Zealand, South Korea and the United States may apply for the respective permit after arrival in Germany.

Under German law the consulates and embassies issue visas of the Federal Republic of Germany. Visas are issued by the mission responsible

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for the area in which the applicant has his/her ordinary residence or domicile. For work permits other authorities, as the foreign authority in the place where the activity in Germany is to be commenced has to grant its approval. The Federal Employment Office must also approve the issuance of the visa if the foreigner intends to take up gainful employment.

2.7.2 Cost of living and housing

The standard of living is high in Germany. However, the costs of living vary broadly and depend mainly on the general cost of living and the place of residence. Munich, for example, is one of the most expensive cities in Germany.

The average costs for housing vary between 7.50 and 12.50 EUR/m² (base rent per month). The average cost for office spaces in the big cities vary between 15 and 30 EUR/m² for down-town locations, 10 – 20 EUR/m² for suburban areas.

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3. Foreign investment

In principle, there are no substantial restrictions on foreign investment in Germany. Foreign investors are generally subject to the same conditions as German investors. There are no permanent currency or administrative controls. However it has to be double-checked for every individual case whether there exist considerable bureaucratic registration and permit regulations (e.g. special licences for risky business practices as Insurance, Commercial Banking, Brokers and Agents, etc. or special business permits with regard to the environmental regulation pursuant to the Federal Pollution Control Act (Bundesimmissionsschutzgesetz)). Furthermore, the detailed registration regulations at the local administration and tax authorities have to be obeyed.

Germany is appreciated by foreign investors as a location for manufacturing, research and development and establishing their company headquarters. Even in the crisis year of 2009, Germany has asserted internationally as an investment place. Germany ranks in fifth place of the world's most attractive investment places (behind the USA, China, the U.K. and India).

Especially the services sector recorded a strong interest of investors. The sectors of renewable energies, mechanics and electronics, chemicals and health prove to be attractive. Germany is appreciated by international investors as reliable and competitive; this applies to the full range of high technologies and services.

The investing companies are mainly from Europe, Asia and North America. But there has been a notable shift of interests towards Asia. Especially Indian and Chinese companies strengthened their commitment in Germany. Also noticeable is the interest of Israeli and Turkish companies to invest in Germany. Especially in the high technology sector, such as in medical technology, health care industry and nanotechnology, Germany has obviously become more attractive for Israeli investors. In the consumer goods sector, mainly in the textiles and home ware products area, Turkish companies intensified their commitments.

10 reasons for an investment in Germany:

Large Market

With 82 million inhabitants, Germany is the European Union's most populous country and therefore also the largest market within the EU. With a gross domestic product of more than 2.4 trillion EUR, Germany is

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the largest economy in Europe and the third strongest economy in the world.

Central Location

Germany's central location in Europe makes it a hub for goods and services. Germany is especially benefiting from EU enlargement. As a result, it is the only country among the seven most important industrialized nations to increase its share of world trade since 1995.

Open Market

Germany is an open market and warmly welcomes foreign investors. That is demonstrated by the 22,000 foreign enterprises that have established businesses in Germany and now employ more than 2.7 million people. The German market is open to entrepreneurial investment in practically all areas. There are no longer any state-controlled industries. Germany is receiving increasing attention from private equity firms and hedge funds due to its highly attractive companies and favorable investment conditions.

International Location

More than 7 million foreigners live in Germany. Several metropolitan regions have prominent foreign communities with their own schools, churches, shops and restaurants. For example, a large number of Japanese live in the Düsseldorf region, many Koreans in and around Frankfurt and many Chinese in Hamburg. Approximately 70% of German blue- and white-collar workers speak English.

Qualified Personnel

Germany offers an exceptionally well-qualified, motivated and conscientious workforce. German employees' high standard of knowledge and skills is internationally recognized.

High Level of Innovation

Statistically, Germany has 277 international patents per one million inhabitants – more than anywhere else in the world. The close cooperation between industry and world-famous research institutions like the Max Planck and Fraunhofer Institutes swiftly transforms new ideas into products for the world market.

Highly Developed Infrastructure

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Germany has a closely knit network of roads, railways and international airports. That guarantees swift connections.

Legal Security

Germany is a modern constitutional state with transparent and reasonable laws. The advantages are internationally recognized. Among all countries, Germany ranks fourth in terms of legal security.

Strong Mittelstand

The German economy is characterized by privately owned small and medium-sized firms, the Mittelstand. 85% of all businesses are small or medium-sized. This makes German industry very flexible, multifaceted and competitive. Many of these highly specialized firms are world market leaders in their field.

World-Famous Trademark

Products with the "Made in Germany" seal stand for highest quality worldwide. This has played a significant role in maintaining Germany's position as world export champion for many years. The automobile, mechanical engineering, electrical engineering and chemical sectors are particularly strong. Industries of the future such as environmentally friendly energy production and nanotechnology, in which the number of patent applications is doubling every two years, are steadily gaining in importance.

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4. Setting up a business

As a foreign investor there are two avenues available to set up a business in Germany:

- Legally dependent branch of a foreign company
- Legally distinct subsidiary.

For natural persons a sole proprietorship may be the easiest way to establish a business in Germany.

There are also the following below opportunities open to establish a business :

- an independent sales agent
- an independent distributor
- a representative office.

4.1 Branch

All foreign investors are able to open a branch of their existing business abroad (individual entrepreneurs, corporations or partnerships). Part of the process does however require the foreign investor to register the branch of their existing business at the local Court and municipality. While such a branch is an unincorporated body it is entitled to act as a legally binding entity in its own name.

4.2 Subsidiary

There are various different structures of subsidiaries open to foreign investors when they decide to set up a business in Germany. The German Commercial and Company Law distinguishes between unincorporated companies and corporations.

In deciding what structure is best in the circumstances thought should be given to what the liability of the structure will be of the subsidiary. For example, a corporation is a legal entity and is liable itself, limited to the value of its assets, for any debt. In comparison to this, in an unincorporated company the partner is personally liable for any debt.
The following gives a brief overview of the most common ways to open a subsidiary in Germany:

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4.2.1. Unincorporated Companies

4.2.1.1 General Partnership (German: Offene Handelsgesellschaft)

A general partnership may be formed by two or more persons (German or foreign corporations, other partnerships of natural persons).

A general partnership may be created by agreement and must be registered. In a partnership it is the partners who are personally liable, jointly or severally, for all obligations of the partnership. A general partnership is however a legal entity and can acquire rights, create obligations, acquire ownership and has other legal rights, for example can sue. Fiscally a partnership is seen as a transparent vehicle. The partners contribute capital and efforts and therefore reap the fruit of their labour as agreed upon in the partnership's agreement. Without contrary consent in the partnership's agreement all partners are entitled to manage and represent the general partnership.

4.2.1.2 Limited Partnership (German: Kommanditgesellschaft)

As with a general partnership, a limited partnership may be formed by two or more persons (German or foreign corporations, other partnerships of natural persons). A limited partnership may be created by agreement and must be registered. In comparison with a general partnership, in a limited partnership there are 'general' partners with unlimited liability and also limited partners. A limited partner's liability is restricted to their contributions to the partnership. This restriction however only becomes effective after registration at the local court. Unless otherwise agreed upon limited partners do not participate in the management and cannot represent the limited partnership.

A GmbH & Co. KG is an example of a limited partnership with a sole general partner being a private limited liability company(German: Gesellschaft mit beschränkter Haftung, GmbH). The main characteristics of a GmbH & Co. KG are:

- limited liability of the general partner
- partnership owns the company's assets
- partnership runs the actual business under administration, management and representation of the general partner.

4.2.1.3 Dormant Partnership (German: Stille Gesellschaft)

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A dormant partnership may be created by a contribution to an already existing enterprise (partnership, company, etc). A dormant partnership is not a legal entity but a financial participation on a contractual basis. Dormant partners do not participate in the management of the enterprise and cannot represent the dormant partnership and the contribution of the dormant partner can be simply seen as an investment. The dormant partner shares in the enterprise's profits and losses. As a special feature of the dormant partnership the dormant partner is not discernable externally.

4.2.1.4 Civil Law Association (German: Gesellschaft bürgerlichen Rechts)

A civil law association may be formed by two or more persons and it is created in agreement by the founders in order to achieve any common purpose. Although a civil law association is not a legal entity a civil law association itself is legally responsible. Property can be acquired by the association and can be owned by the partners in joint tenancy. Each partner is liable without restriction for the association's obligations. They also manage and represent the association as a joint venture and all decision require the consent of every partner.

This form of incorporated company is commonly used by small entrepreneurs, self employed persons and other short term projects of larger enterprises or joint ventures (e.g. large construction projects).
A civil law association is not registered.

4.2.1.5 Professional partnership (German: Partnerschaftgesellschaft)

A professional partnership is a company of freelance professions for example architects, engineers, consultants, lawyers and auditors.A professional partnership may be established by written agreement of the partners and must be registered. A professional partnership may create rights and obligations, acquire and own property and sue or be sued. It is however, not a legal entity. The partners are jointly and severally liable. In a situation where only a number of partners cause a liability to the partnership due to their misconduct, then only these partners are liable. Partners are entitled to manage and represent the partnership as desired unless otherwise agreed upon in the Partnership Agreement.

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4.2.2 Corporations

There are a number of different forms of corporations. In Germany, unlike unincorporated bodies, a corporation is regarded as a separate legal entity. The shareholder's liability is restricted to the value of their assets. Corporations do not depend on a certain number of shareholders and may be formed by one or more persons including corporations, partnerships or individuals, regardless of their nationality or place of residence.

The setting up of a corporation and its maintenance is more expensive in comparison with partnerships or proprietorships. Corporations are more regulated by German Business and Company Law and require more review and information.

In Germany, corporations can be traded both privately or publicly. In the case of a private corporation shares may not be sold to the general public. Public corporations are subject to various disclosure and reporting requirements and have to file prospectuses with the relevant securities commission before offering shares to the general public.

4.2.2.1 Stock Corporation (German: Aktiengesellschaft)

In Germany, a stock corporation is one of the two most frequent forms of a corporation. Stock corporations are a popular structure for commercial enterprises that have large capital needs. Generally speaking the major difference between a limited liability company and a stock corporation is that a stock corporation can trade its shares on the stock exchange. A stock corporation may be both; quoted on one of the German stock exchange, e.g. on the largest one in Frankfurt, or be held as long-term participations without being quoted. A stock corporation may deal its shares by contracts of sale other than a limited liability company which contracts of sale need to be notarized.

A stock corporation has a management and supervisory board. A shareholder of a stock corporation may be a member of one of the aforementioned boards but cannot direct the managers on how to conduct the business of the corporation.

As a precondition for its formation a stock corporation must be registered and present a share capital of EUR 50,000,00.

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4.2.2.2 Limited Liability Company (German: Gesellschaft mit beschränkter Haftung)

A limited liability company is the other very common type of corporation in Germany. This form of corporation is especially used by both, German medium-sized businesses (these are very often family-owned and owner-managed businesses), and subsidiaries of foreign companies in Germany. The associated handling and administrative efforts are less formal and complex in comparison to a stock corporation.

Under German law a limited liability company must register itself with a share capital of at least EUR 25,000. The founding act and the articles of association have to be notarized and the corporation does not exist before completion of registration.

A limited liability company is managed and represented by the managing directors that are chosen by the shareholders. A shareholder can also be a managing director. A managing director can be directed by the shareholders resolution.

Under the relevant legislation a limited liability company's office can be registered in a different locality then the place of its actual business activity. Under German legislation the limited liability company's existence does not even depend on the place of business activity and this may be abroad however, the limited liability company must have a German postal address.

4.2.2.3 Business Company (German: Unternehmergesellschaft, haftungsbeschränkt)

A business company is another type of a limited liability company and may be founded under similar conditions. However, in opposite to a limited liability company the amount of share capital of a business company may be appointed in the articles of association. The minimum amount of share capital is EUR 1.

Due to the limited liability and the little amount of share capital a business company does not have a good credit.

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4.2.2.4 Real Estate Investment Trust

Effective from 1 January 2007, Germany introduced the Real Estate Investment Trust (REIT) which is a tax-exempt legal entity. Under German law, a REIT is a listed stock corporation and must meet the following conditions:

- German registered office and place of business;
- Shares must be registered for trading on a public exchange in a member state of the EU or EEA;

  Free float (volume of shares traded on the stock exchange) at the time of listing at least 25%;
- Its real estate assets account for at least 75% of its gross assets;
- Rental income from real estate accounts for at least 75% of its total income; and
- Ninety percent of its income is distributed to its shareholders.

Although corporations that meet the above requirements are exempted from income tax, trade tax and solidarity surcharge, REIT is not a very popular company structure in Germany.

4.2.2.5 Limited Partnership with Share Capital (German: Kommandit-gesellschaft auf Aktien)

A limited partnership with share capital is comparable with a stock corporation. However, at least one general partner is personally liable for the company's debts. This form of corporation is also not very popular in Germany.

4.2.2.6 Societas Europaea (SE)

A SE is a corporation based on law of the European Union (EU). A SE may be registered in any member state of the EU whereby its company domicile can be easily relocated to another state of the EU. A SE has its own legal entity and must present share capital to the amount of EUR 120,000. It may be founded by a merger of stock corporations from at least two different states of the EU or by conversion.

4.2.2.7 Foreign Companies

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As a result of the right of free movement of business within the EU, companies regulated by the jurisdiction of another state of the EU may move their company domicile to Germany. In this case German courts must observe the legal characteristics of such a company and must not only apply German law.

4.3 Sole Proprietorship (German: Einzelkaufmann)

A sole proprietorship is the simplest form of a way to run a business under German law. A sole proprietorship is not a legal entity but the business of a natural person with full liability. This structure is especially popular with small businesses. It requires no formal filing and reporting over and above maintaining proper records and obtaining the necessary local permits. The liable proprietor is subject to taxation and must register the business.

4.4 Independent Sales Agent/Distributor and Representative Office

If a foreign investor does not intend to have any staff based in Germany then the easiest way to set up a business relationship is through independent sales agents and independent distributors. It is very often common practice to use sales agents or independent distributors to sell a foreign company's goods in Germany. A representative office in Germany is not subject to all the requirements of opening a branch of a subsidiary.
In any case the decision on what is the most sensible form of investment, or structure for doing business in Germany, really comes down to the individual circumstances of the business.

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5. Labour

Employment contracts

The employment contract forms the basis of the relationship between employee and employer. The terms of the contract can be freely negotiated by both parties subject to existing legislation, collective agreements (if applicable, see below) and bargaining agreements with a potential works council (if applicable, see below).

Every employment contract has to comply with the current legislation and the labour-law based on the jurisdiction of the Federal Labour Court.

Most of the basic rights and duties of the employer and the employee are settled in labour protection laws such as for example:

i. German Civil Code

ii. act concerning continued remuneration during sickness

iii. act concerning vacation paid

iv. working-time act

vii. act against unfair dismissal

v. acts concerning maternity protection and parental leave

vi. act concerning severely disabled employees

v. act concerning trainees

This legislation has to be regarded already in the contracts as well as during the ongoing employment relationship

Collective agreements

According to German Law, employer associations and trade unions are able and entitled to negotiate wage settlements and working conditions in collective agreements among themselves without interference from government bodies. Wage bargaining represents a collective process during which working conditions and wage settlements are negotiated for entire occupational groups in various industries.

However, a collective agreement is valid for the employment relationship if the employer is member of the employers` association and the employee is member of the labour union. The membership is voluntary. Employers who are member of the employers′ association frequently

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declare the collective agreements as applicable in the employment contract in order to equally treat the organised and non organised employees. In particular in smaller Companies without a membership in the employer's association mostly no collective agreement is declared as applicable.

In some industries there exist collective agreements which were declared as applicable for all employees in that industry by the Government disregarding of any memberships.

Bargaining agreements

Working conditions can also be settled by the employer and the works council binding for all employees of that Company. German Companies are not obliged to have a works council. It is up to the employees themselves to found one. If a works council exists it has a lot of rights of co-determination and rights to information based on the works council constitution act.

Especially in case of dismissal the works council must be informed and interviewed in advance. Otherwise the termination is invalid.

Termination of employment contracts

Every employer and every employee can at any time terminate the employment contract extraordinarily based on severe cause, such as criminal behaviour of the employee, not-paying of the salary or discrimination by the employer and so on without a notice period.

In case of an ordinary termination both parties have to keep the relevant notice period out of the German Civil Code, the labour contract and/or collective agreements.

In small Companies, usually with not more than 10 employees, the employer regularly does not need a special reason for an ordinary dismissal and regularly does not have to pay a compensation.

In bigger Companies usually with 10 or more employees the employer needs a reason for the dismissal according to the act against unfair dismissal. There are detailed requirements for a termination which can be based on the behaviour of the employee, personal or operational reasons. The employees can file for unfair dismissal at the Labour Court with the aim of continuing the employment relationship. These cases are often settled by an agreement which contents the termination of the employment and a compensation payment.

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Works councils have several rights regarding the dismissal by the employer.

Social insurance

Social insurance coverage in Germany is statutory for all employees. The compulsory insurance plan serves to protect people from hardships due to sickness, nursing, work-related accidents and unemployment. Moreover, statutory pension insurance is compulsory for all employees.

The social insurance contributions are to be paid nearly half by the employer and half by the employee. They are paid to the authorities directly by the employer. The gross payment the parties agree upon does not include the part of the social insurance contributions to be paid by the employer (nearly half of the rates mentioned below).

Rates

Social security contribution rates for 2010

	rate %
health insurance (average)	14.9
nursing insurance	1.95
pension insurance	19.9
unemployment insurance	2.8

Income thresholds (monthly, upper limit) for 2010

Salaries higher than the following do not contribute above the thresholds.

Employees earning above the mentioned limit of health insurance are free to join the health insurance system at all.

	Old federal states EUR pa.	New federal states EUR pa.
health & nursing insurance	3,750	3,750
pension insurance	5,500	4,650

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6. Taxation

The taxation of commercial activities in Germany depends on the particular form of business organisation chosen. The main aspect to be considered in this context is that unincorporated companies are not taxable entities with regard to income or corporate income tax purposes. They are only subject to trade tax. Therefore, the income of unincorporated companies is taxed at the level of the shareholders, while a corporation represents an independently taxable entity for all kind of taxes (transparent taxation).

For general information on taxation please see:
http://www.bundesfinanzministerium.de

6.1 Unincorporated companies and individuals

6.1.1 Income taxation

6.1.1.1 Taxable persons

In principle, German residents are liable to income tax on their worldwide income. Non-residents are generally liable to the tax on certain German-source income. An individual is a German resident if his domicile or habitual place of abode is in Germany. A domicile is a home at the disposal of the taxpayer which he maintains for a long term. A habitual place of abode is a location where an individual is physically present for a continuous period of more than six months.

As partnerships – such as OHG, KG, GbR, professional partnerships – and sole proprietorships are not really separate legal entities. The partners themselves are generally subject to all rights and obligations. Accordingly, partnerships are not subject to income or to corporate income tax, but only to trade tax. The income determined at the level of the partnership is allocated to the partners and at the level of the partners subject to income tax (in case of an individual), in principle with the individual tax rate applicable to each partner, or corporate income tax (in case of a corporation).

In order to achieve a tax burden neutrality between partnerships and corporations, individuals have the possibility to choose the reduced income tax rate applicable to retained earnings (thesaurierte Gewinne) of a partnership amounting to 28.25% plus solidarity surcharge (in total 29.8%). After offsetting personal income tax against trade tax payments, retained earnings of a partnership will therefore be subject to an average tax burden similar to that of a corporation under the corporate income

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taxation. In case of distribution to the partners, the distributed earnings are subject to a subsequent taxation of 25% plus solidarity surcharge (in total 26.35%), provided and insofar as the annual balance between a partner's capital contribution and withdrawals exceeds the annual profits of the company or the partner's share in the company ("excess withdrawals"). Germany has entered into a large number of agreements for the avoidance of double taxation with other countries. Most treaties make provisions for the situation that an individual is resident in two different countries.

The terms of agreements for the avoidance of double taxation override German tax law and, if an individual is deemed to be a resident of a foreign country under the agreement, his German tax liability will then be computed in accordance with other provisions of the agreements for the avoidance of double taxation treaty.

6.1.1.2 Taxable income

Taxable income comprises the entire annual income from the following sources:

- Agriculture & forestry
- Business establishments (trade)
- Independent professional services
- Employment
- Capital investment
- rental income from immovable property and certain tangible movable property and income from royalties and
- Other income (gains from private transactions, alimony, annuities, etc.).

Income tax is computed on a progressive scale. German legislation allows for the deduction of certain expenses that are economically linked with the various sources of income. Relief can be granted for itemised expenses. In some cases relief can be granted on the basis of standard allowances.

There are two different methods to compute taxable income – the net worth comparison method and the net income method. The income from agriculture and forestry and from business establishments or trade is calculated on the basis of the net worth comparison method. For employment, capital investment, rental income and other income the net income method applies. In case of income from independent professional services the net worth comparison method applies if it is chosen by the

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tax payer. Income from capital investment, which includes dividends, interest, royalties, income from typical silent partnerships, in principle capital gains from the sale of shares (provided a participation in the corporation of which the shares are sold of less than 1%) and financial instruments, is generally subject to a flat withholding tax of 25% plus solidarity surcharge (in total 26.35%). For this income an allowance of up to EUR 801 per year is granted. Expenses economically connected to the investment income are not deductible. However, in case the tax burden by the flat withholding tax exceeds the marginal income tax rate of the taxpayer, the taxpayer can opt for an assessment. Furthermore, there exist some other exemptions of the flat withholding tax.

6.1.1.3 Losses

In principle, losses can be fully set off against income of the same year. However, some restrictions apply, e.g. with regard to capital losses from capital investments or from the sale of shares or from private transactions.

In general, losses up to EUR 511,500 can minimize the profit of the preceding year. Further losses can be carried forward for use in the following years, but considering the so called "minimum taxation rules" (offset up to EUR 1,000,000 of net income without restrictions; exceeding losses may be set of against up to 60% of the net income exceeding EUR 1,000,000).

6.1.1.4 Tax rates

In 2010 individuals are subject to federal rates of taxation as follows (rough overview):

	single EUR	married EUR	tax rate %
Basic personal allowance	8,004	16,008	0
Progressive rates of	8,005 – 52,881	16,009 – 105,763	14.0-42.0
Tax rate as of	52,882 – 250,730	105,764 – 501,461	42.0
Highest tax rate as of	250,731	501,462	45.0

The 5.5% solidarity surcharge is levied on the amount of tax computed according to the above shown table.

Taxes on income from employment are based on the employee's monthly salary (PAYE). It is the employer's duty to deduct tax and to forward it to

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the fiscal authorities. At the end of the year the tax amount withheld throughout the year will be certified on the employee's wage tax card in order to be taken into account in the final income tax assessment.

6.1.2 Trade taxation

6.1.2.1 Taxable persons

Individuals and unincorporated companies carrying on a trade or business in Germany are subject to trade tax. Trade tax is collected by the municipalities.

6.1.2.2 Tax calculation and tax rate

The basis for trade tax computation is a the income for income tax purposes, subject to certain adjustments. Some expenses that can be deducted for income tax purposes are non-deductible for trade tax purposes and vice versa. In 2010 the major adjustments include a 25% non-deductibility of the sum consisting of interest payments for debts , annuities and permanent charges, profits of a silent partner, 20% of lease payments for movable assets and 50% of lease payments for immovable assets and 25% of licence payments, in case of exceeding a threshold of EUR 100,000.

The income for trade tax purposes of individuals and unincorporated companies is minimized by an allowance of EUR 24,500.

The trade tax rate varies from one municipality to another, as they have a degree of discretion on fixing the multiplier on this tax which is one part of the effective trade tax rate. The other part of the effective trade tax rate is a federal base rate of 3.5%. The system of computation is fairly complicated, but the average trade tax rate is app. 14% (provided a multiplier of 400%). In case of a higher multiplier the trade tax rate increases; for example, Berlin has a multiplier of 410%, Cologne 450%, Dusseldorf 440%, Frankfurt aM 460%, Hamburg 470% and Munich 490%.

In case a firm has permanent establishments spread over several municipalities, the tax will be distributed amongst the municipalities according to a key based on the size of the payroll.

Due to the 2008 Business Tax Reform trade tax has to be considered as a non deductible tax expense for income and trade tax purposes from 2008 onwards. However, a part of the trade tax (weighting factor of 3.8 on income for trade tax purposes multiplied with the federal base rate) can

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be deducted from the personal income tax burden of individuals / partners of a partnership.

6.1.2.3 Losses

Trade losses can not be carried back, but only carried forward without limitations in time under consideration of the "minimum taxation rules" (see above).

6.1.3 Example – Calculation of income tax and trade tax for unincorporated companies

Trade tax:		
Taxable income for trade tax purposes:	1,000,000	1,000,000
Amount of deduction:	24,500	
	975,500	
Assessment base (base rate 3.5%):	34,143	
Trade tax (multiplier 400%):	136,570	136,570
Income tax:		
Taxable income before taxes:	1,000,000	
Tax rate pursuant to § 32a Abs. 1 S. 2 Nr. 5 German Income Tax Act		
Income tax:	434,306	
Deduction of trade tax pursuant to § 35 German Income Tax Act (trade tax assessment base x 3.8)	129,742	
Final income tax:	304,565	304,565
Solidarity Surcharge 5.5%	16,751	16,751
Net income:		542,114

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6.2 Corporations

6.2.1 Corporate income taxation

6.2.1.1 Taxable persons

Corporations, as stock corporations, limited liability companies, etc., are subject to corporate income tax and solidarity surcharge.

Corporations which have its legal seat or its place of management in Germany are unlimited tax liable in Germany with its worldwide income. All income of resident corporations constitutes business income, irrespective of its source.

In case a corporation does not have its legal seat or its place of management in Germany it is tax liable in Germany only with its income deriving from German sources, which includes among others income derived from a permanent establishment or a permanent representative in Germany, in principle gains from the sale of shares in a German corporation, rental income and investment income. The tax treatment depends on whether the tax is levied via a filing and assessment procedure (e.g. business income derived from a permanent establishment) or via a withholding tax procedure (e.g. dividends, interest, rental income from movable assets, and royalties).

6.2.1.2 Tax bases and rates

Since 2008 the corporate income tax is payable for income and capital gains of resident corporations at a rate of 15% of taxable income, regardless whether the income is distributed or not.

A 5.5% solidarity surcharge is imposed on the corporate income tax, resulting in an effective tax rate of 15.825%

The corporate income tax is levied on the total amount of income of a corporation after deduction of business expenses. It has to be considered that there exist some restriction with regard to the deductibility of business expenses, e.g. with regard to personal expenses, taxes, interest and dividends. Furthermore, depreciation and amortization rules have to be considered.

Withholding taxes have to be paid on dividends and interest payments to resident corporations at a rate of 25% plus solidarity surcharge of 5.5%, in total 26.375%. These withholding taxes are creditable against the tax liability of the recipient.

For non-resident corporations in principle the same rates apply. However, the withholding tax rate for dividends and interest payments to these non-resident corporations could be minimized by regulations of

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double tax treaties or EU Directives. Furthermore, there exist additional withholding tax regulations for income which is subject to the withholding tax procedure.

6.2.1.3 Tax system

As corporations are separate legal entities which are taxed themselves and independently from its shareholders the risk of a double taxation exists in case of profit distributions to the shareholders since taxes are levied at the level of the corporation and at the level of the shareholders. The basic idea of the corporate income tax system is to avoid or to reduce this double taxation.

Today, in Germany, a double taxation system applies which considers the risk of double taxation insofar as corporate profits are taxed at the level of the corporation at the corporate income tax rate and dividends are taxed at the level of the shareholders by not considering the total dividend payments.

It has to be considered that the former so-called imputation system respectively split-rate system which granted a full imputation credit to resident shareholders was applicable in 2001 for the last time, but transitional regulations were arranged. From 2002 to 2008 the "half-income-system" applied at the level of the shareholders. From 2009 onwards the “half-income-system” was replaced by the “partial-income-system. Furthermore, a difference is made between private shareholders and shares which are held as business assets.

In case of private shareholders a flat withholding tax on dividends at a rate of 25% and solidarity surcharge of 5.5%, in total 26.375% applies in principle. However, some restrictions have to be considered. In case of business income of shareholders 60% of the dividends are taxable at their level, i.e. included in the shareholders personal income tax base, and 40% are tax-exempt. On the other hand, shareholder expenses related to distributed profits are deductible by 60%.

If the shareholder is a corporation, in principle the distributed profits are exempt from taxation. However, an amount equivalent to 5% of a corporation′s dividend is treated as non-deductible business expense. Hence, in principle 95% of the dividend income is tax-exempt at the level of the shareholder. Expenses actually incurred related to such income are fully deductible for corporate tax purposes.

In every case, the corporation paying the dividend has to deduct withholding taxes at a rate of 25%. These withholding taxes are creditable against the tax liability of the recipient.

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Payments of certain amounts to non-residents are subject to withholding taxes. These include payments such as royalties and license fees, interest and management fees.

6.2.1.4 Capital gains

Capital gains resulting from a sale of shares held by a corporation are, in principle, fully exempt from corporate income tax. However, an amount equivalent to 5% of the capital gain is treated as non-deductible business expense. Hence, in principle 95% of the capital gain is tax-exempt. There is no minimum participation requirement, nor any minimum holding period, except in case of some restructuring situations where a seven years holding period is required. In case the value of the shares has been written down tax-efficiently and has not been revalued before the sale of the shares, the capital gain is not tax-exempt to the extent of the write-down.

It has to be considered that at the present time, write-downs due to impaired value are not tax deductible.

All other capital gains are in general subject to corporate income tax respectively withholding taxes. However, up to 100% of the capital gains resulting from the sale of real estate and buildings may be offset against the costs of similar assets aquired in the same year, the preceding year or in the following four years.

6.2.1.5 Losses

Losses are in principle deductible. Losses up to EUR 511,500 may be carried back to the preceding year. The exceeding losses may be carried forward for use in the following years under consideration of the minimum taxation rules.

However, the loss carry forward will be erased in case of reorganizations and in case change-of-control-rules apply. In principle, the transfer of more than 25% and less than 50% of a corporation′s shares within a five year period to one person or parties related thereto results in pro rata forfeiture of losses; in case of transfer of more than 50% of the shares the losses will be erased in total.

Losses resulting of the sale of shares are not tax deductible.

Furthermore, restrictions apply to the set-off of losses derived from foreign operations.

6.2.1.6 *Earnings stripping rules*

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The earnings stripping rules replaced the former thin-capitalization rules due to the 2008 Business Tax Reform. Now, a general limitation on the deduction of interest payments is given, which applies in general to all kinds of debt financing. According to the earnings stripping rules interest expense if fully deductible in case it does not exceed the interest income. The exceeding net interest expense is also deductible in case it does not exceed three million EUR. In case of net interest expense of more than three million EUR, such interest expense is only deductible up to 30% of the EBITDA (earnings before interest, taxes, depreciation and amortization).

However, the limitation rule does not apply if any of the following conditions is satisfied:

- The company is not a member of a consolidated group (a group of companies that can be consolidated under International Financial Reporting Standards [IFRS]); or
- The equity ratio of the German subgroup is equal to or higher than the equity ratio for the group as a whole, as shown on the balance sheet of the preceding fiscal year (so-called "escape clause"). A deviation up to 1% downwards is not harmful. A "group" is defined as a group of entities that could be considered under IFRS, regardless of whether a consolidation has been actually carried out. The escape clause does not apply if any entity in the worldwide group has received loans from a substantial shareholder (more than 25%) or related party not included in the group and if the interest paid on such debt exceeds 10% of the net interest expense.

6.2.2 Trade taxation

6.2.2.1 Taxable persons

All corporations carrying on a business in Germany are subject to trade tax.

6.2.2.2 Tax calculation and rates

In principle, the rules and regulations applicable to the computation of trade tax for corporations correspond to those applicable to unincorporated businesses. However, the allowance of EUR 24,500 does not apply for corporations.

Furthermore, dividends received from shareholdings in resident or non-resident companies are subject to trade tax in case the participation is less than 15% at the beginning of its fiscal year although these dividends are tax-exempt with regard to corporate income tax (see above).

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6.2.3 Example (for 2010)

Corporation

Trade tax:	EUR	EUR
Taxable income for trade tax purposes:	1,000,000	1,000,000
amount of deduction:	0	
	1,000,000	
assessment base (base rate 3.5%):	35,000	
trade tax (multiplier 400%):	140,000	140,000
Corporate income tax:		
Taxable income before taxes:	1,000,000	
Tax rate pursuant to § 23 sec. 1 German Corporate Income Tax Act (15%)		
Corporate income tax:	150,000	150,000
Solidarity Surcharge 5.5%	8,250	8,250
Net income:		701,750

Shareholder	EUR private (flat with-holding tax)	EUR business (partial income system)
Dividend from corporation	701,750	701,750
Withholding tax (25%)		175,438
Flat withholding tax (25%)	175,438	
Solidarity Surcharge (5.5%)	9,649	9,649
Cash dividend:	516,663	516,663

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Taxable income of shareholder (60% of 701,750)		421,050
Income tax (on 421,050) Tax rate pursuant to § 32a Abs. 1 S. 2 Nr. 5 German Income Tax Act		
Income tax:		173,779
Solidarity surcharge (5.5%)		9,558
Net income: (Creditable withholding tax and solidarity surcharge have been considered; Church tax has not been considered)	516,663	518,414

Comparison: Incorporated and Unincorporated companies

	corporation	Unincorporated companies:
Profit before tax	1,000,000	1,000,000
Trade tax (multiplier 400%)	140,000	136,570
Corporation tax + solidarity surcharge	158,250	-
Income tax + solidarity surcharge in case of full distribution		321,316
Net income	701,750	542,114

6.3 Taxation of permanent establishments in Germany

According to German tax law, a permanent establishment is defined as an operational facility (representation office, plant, sales office, etc.) that serves to carry out business activities in Germany.

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Commercial activities include all sorts of business transactions that exceed the mere preparation of business contacts or other auxiliary services. The permanent establishment has its own internal organisation and bookkeeping and could, therefore, exist as an independent commercial entity without major restructuring efforts.

Because there are different national definitions of the term "permanent establishment", the tax committee of the Organisation for Economic Co-operation and Development (OECD) has come up with a uniform definition (*cf. article 5 OECD sample convention*).

The right of taxation is usually regulated by means of Treaties for the Avoidance of Double Taxation between Germany and the other country. In most cases taxation takes place in Germany in line with the international principle of place of operations. The other country, therefore, does not levy taxes on the profits of the permanent establishments.

If the foreign parent company is an unincorporated partnership, then the profits of the permanent establishment located in Germany are usually subject to German income tax.

The profits are, as a consequence, exempt from further taxation in the country of domicile of the parent company. Losses of the permanent establishment can only be offset against positive income within the scope of the limited liability to pay taxes in Germany. Both a loss carry-back and a loss carry-forward is possible for the income of a permanent establishment.

If the "parent company" is a corporation, the profits of the permanent establishment will be subject to corporation tax and trade tax.

6.4 Solidarity surcharge

A solidarity surcharge on income and corporation tax has been introduced to raise additional funds for the German reunification.

The solidarity surcharge amounts to 5.5% of the respective income or corporation tax burden assessed for the fiscal year.

The surcharge applies to individuals as well as corporations, associations and conglomerations of property with limited or unlimited tax liability located in any part of Germany.

The solidarity surcharge has been introduced only as a temporary tax burden. It is to be phased out eventually although no definite time has been set by legislation.

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6.5 VAT

The German value added tax is a general tax on consumption of goods and services in Germany. In principle, all entrepreneurs, corporations or individuals are subject to VAT. This applies also for non resident entrepreneurs who perform supplies and services in Germany.

For the question as to whether a supply or service is subject to German VAT several regulations exist. The German VAT Act complies predominantly with the

The VAT liability can fall under one of three main headings:

- "taxable" at the standard rate of currently 19 % or at the reduced rate of 7 %
- “exempt"
- "outside the scope" of Germany.

In Germany for some kind of services and supplies the reverse-charge-system is applicable.

6.6 Church Tax

Residents in Germany who have chosen officially register themselves as members of the Roman Catholic or Protestant-Lutheran churches are liable to church tax. Church tax is not a subcategory of personal income tax. However, the amount of church tax depends on the personal income tax liability.

Depending on the federal state, church tax amounts between 8% and 9% of an individual’s personal income tax burden. Church tax is collected by the tax authorities and distributed among the churches.

Secular persons or members of other religious affiliations are not liable to pay a church tax.

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7. Accounting & reporting

Accounting and corporate recordkeeping

Adequate financial records must be kept by all businesses operating in Germany. The books must show clearly all commercial transactions and the financial position pursuant to generally accepted accounting principles. The bookkeeping must be maintained in such a way that an outside expert can derive from it within a reasonable time an overview of the business operations and the position of the firm. The business operations need to be comprehensible from their origins through to completion.

At the end of each financial year, both unincorporated and incorporated firms must prepare their annual financial statements including a balance sheet as well as an income statement.

In addition, corporations must prepare notes to the financial statement and a management report. The latter must make reference to the development of the company's main business activities. Furthermore, an assessment of the present situation and future developments must be made. The notes to the financial statement must include details as prescribed by statute and by law. These details need to give further explanation to individual items in the balance sheet and income statement respectively.

German legislation has incorporated the rules and regulations of the EEC Fourth Directive on accounting and reporting issues, the EEC Seventh Directive on consolidated accounts, and the EEC Eighth Directive on account control and external auditing requirements. The last modification was made with the implementation of the EU-Fair-Value-Directive and the EU-Modernisation-Directive.

The required statutory corporate records generally include:

- The documents of incorporation
- The company articles
- All minutes of shareholders' meetings
- A register of shareholders and directors
- Prescribed accounting documents

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The prescribed accounting documents include the following:

- Commercial business records, inventories, opening balance sheets, annual financial statements, management reports, procedural instructions and other organisational documents necessary for interpreting such documents
- Incoming business correspondence
- Copies of mailed business correspondence.

The records need to be kept regularly for ten years. If the documents are needed for tax purposes, a longer period of keeping may become effective.

The German Commercial Code (HGB) also prescribes the preparation of inventories for the end of every business year. The inventory must be taken within a period consistent with orderly business practice. Certain procedures for simplifying the keeping of an inventory are allowed if they are in accordance with generally accepted accounting principles. The informational value of the inventory prepared by these methods must match the informational value of an inventory prepared on the basis of a physical count.

Audit requirements

Unincorporated companies are generally not obliged to appoint an external auditor. The audit and disclosure requirements do, however, take effect when certain size criteria are met. These are currently set at:

- A balance sheet total exceeding EUR 65 million
- An annual turnover exceeding EUR 130 million
- An annual average of more than 5,000 employees.

At least two of the above thresholds must be exceeded on three successive balance sheet dates.

The audit requirements for corporations and for the special limited partnership (GmbH & Co. KG, see above) are contained in the German Commercial Code which groups corporations into three class sizes effective 2009:

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	small		medium	
Balance sheet total	≤ EUR	4,840,000	≤ EUR	19,250,000
Turnover	≤ EUR	9,680,000	≤ EUR	38,500,000
Employees		≤ 50		≤ 250

Small corporations are those that do not exceed at least two of the aforementioned criteria. Medium-sized corporations are those that exceed at least two of the criteria in column one but, at any given time, do not exceed at least two of the criteria in column two. Corporations that exceed two of the criteria in column two are classified as large. The respective characteristics need to be met on two successive balance sheet dates. Companies listed on the stock exchange, banks, insurance companies and other companies acting in the financial sector are always classified as large corporations.

The annual financial statement and the management report of companies which are not small according to the aforementioned definition must be examined by an external auditor. Only the audited annual financial statements can be adopted.

The legally required consolidated financial statement and consolidated management report of companies always need to be examined by an external auditor.

Disclosure requirements

The legal representatives of companies must file at the electronic commercial register the annual financial statement without undue delay after its presentation to the shareholders, but no later than nine months (small corporations: 12 months) of the following business year after the closing day. The law distinguishes again between the different class sizes:

	small	medium	large
disclosure of balance sheet	CR	CR	FG
income statement	-	CR	FG
notes to the financial statement	CR	CR	FG
management report	-	CR	FG

CR = Commercial Register
FG = Federal Gazette *)

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Large corporations are also subject to disclosure of their annual financial statements and of the management report in the Electronic Federal Gazette.

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9. UHY offices worldwide

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