Successful penetration of foreign markets – Part 2

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Carl Müller intends to expand his "Müller Transformatoren AG" to Poland. He already sells a large number of his transformers in Poland/Eastern Europe; it thus seems reasonable to expand to Eastern Europe by transferring production to Poland. The first part of the series dealt with the basic considerations of a transfer abroad. The general political and legal conditions in Poland were also already presented in part 1. Carl Müller now wants to know which opportunities of expansion would present themselves under company law and from an organizational point of view.

A. Fundamentals

Part 1 outlined the fundamentals of the Polish company law. It is similar to the German company law and distinguishes between partnerships (civil-law association, spólka cywilna; general partnership, spólka jwana; limited partnership, spólka komandytowa; etc.) and corporations (limited liability company, spólka z organziczoną odpowiedzialnością and joint stock company, spólka akcyjna).

Of course, the Polish company law also systematically distinguishes between the two company types. With partnerships, the partners are liable for the company's liabilities. With a limited partnership, the limited partners' liability is limited to the specific amount of their contribution, whereas the general partner is fully and personally liable. The limited liability company, by contrast, completely shields the shareholders from any liability claims.

B. Matters of course and characteristics of the Polish company law

The use of foreign legal forms requires knowledge of the legal framework to ensure that the owner (Carl Müller) be protected against unpleasant surprises regarding the fate/ the business of his foreign companies. On the other hand, the local decision-makers must be given enough leeway and unnecessary (communication) expenditure must be avoided. Carl Müller thus has to know which regulations are compulsory and which ones can be modified by contract or by partner (or shareholder) resolution.

The Polish limited partnership is represented by its general partners. According to legal provisions, only the general partners have managing authority. An exception to this rule is only possible if the partnership expressly gives the limited partners power of representation and managing authority. The general partner, however, requires the limited partners' consent when entering into transactions that exceed the usual scope. However, this requirement of consent can be restricted or abolished by the articles of partnership.

The agents of the Polish limited liability company are the board of management and the shareholders' meeting. The board of management represents the company in and out of court. If several boards of management have been appointed, at least two have to act together or one has to act together with a "Prokurist" (holder of a general commercial power of attorney). An

exception to this rule is only possible if the shareholders' meeting gives the respective board of management power of sole representation. The shareholders' meeting is the top decision-making body of the company and has most competences. Some competences can be transferred to the board of management. Due to legal provisions the "important" decisions, however, must be left to the shareholders' meeting (e.g. formal approval of the actions of the board of management, decision on recourse claims against the board of management). The decision on the acquisition and sale of real estate has to be approved by the shareholders' meeting; however, it can be laid down in the partnership agreement that this requirement of approval be dispensable.

Like under the German company law, certain provisions have to be observed in the case of participation of different companies in one another.

Control relationships or related companies are notifiable. Control of a company may be the case due to a large number of conditions. Apart from other conditions, it is the case if a company directly or indirectly has the majority of votes in another corporation or partnership. Corporations that have at least 20 per cent of the votes in the shareholders' meeting or 20 per cent of the shares in the other corporation are considered related companies. Controlling enterprises have to give notice of the control relationship with the controlled company within a certain period. If this notification is omitted, voting will be restricted. If the worst comes to the worst, this may lead to ineffectiveness of the controlled company's resolutions.

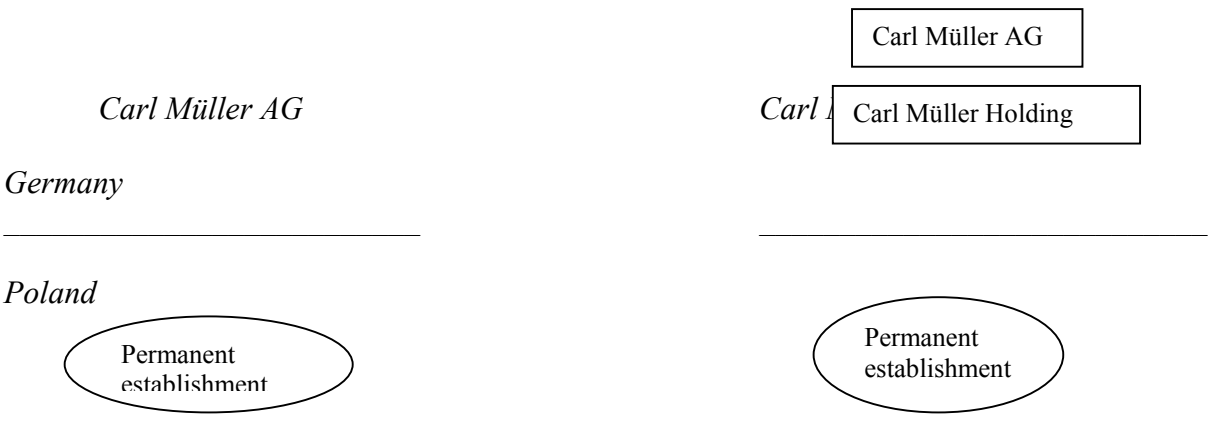
Excerpts of profit transfer agreements between companies have to be submitted to the registration court.

It is important for the long-term planning of the group structure that merger, partition and transformation are possible under the Polish company law.

C. Options

The cross-border expansion can be carried out by means of various company law models. The focus is here on the possibilities under company law; the tax consequences will be considered in the next step, although the two models naturally interact with each other.
The basic model would be the formation of a permanent establishment in Poland. Traditionally, however, such a permanent establishment would be run by a separate German corporation.

Fig. 1+2:



Instead of maintaining only a permanent establishment in Poland, the formation of a Polish partnership or corporation suggests itself. The choice of these models will certainly be governed by the aspect of how the economic success in Poland is calculated: are immediate profits/ distributions to the parent company expected or will the company face initial losses for some years? Here the taxation of possible profits or the possibility of loss offsetting plays a crucial role. In this connection, Poland's membership in the EU has made things easier but it has also led to some "uncertainty". A new decision of the European Court of Justice on group-wide, cross-border transfer of losses was passed (Marks & Spencer, Case C-446/03). This decision declares many restrictions concerning this null and void.

Especially in order to utilize further tax benefits, it may be advisable to run the foreign company via a holding company which is located either in Germany, in Poland or in a European third country.

Fig. 3+4:

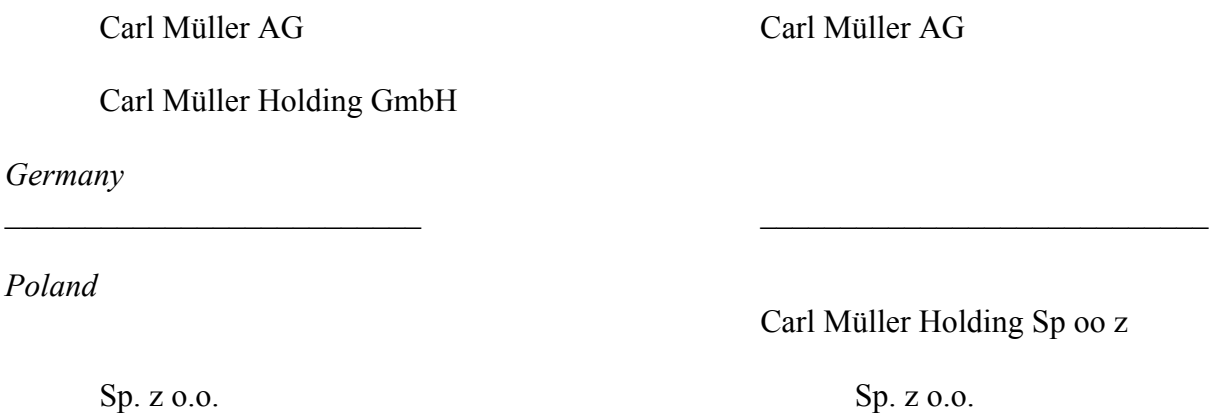


Fig. 5

D. Pros and cons

As described above, the Polish company law offers the internationally usual possibilities. Therefore the focus will rather be on other considerations, in particular tax considerations. There are numerous possibilities of tax optimization and each of the aforementioned group structures holds its own advantages. For this reason only some possibilities/ problem areas will be broached.

In some cases the formation of a foreign partnership is recommended for tax reasons. In some cases, however, the "risks" of partnerships are underestimated. With regard to Poland it has to be borne in mind that the new double taxation agreement between Germany and Poland came into force on 1 January 2005. This agreement superseded the old double taxation agreement of 1972 and has led to major changes of the tax situation in some areas. However, this aspect is to be examined in a separate article.

Apart from tax considerations, the choice of the group structure is also governed by the aspect of how far the expansion is to be driven forward. Is a rather "organic" development intended, that means ranging from employee secondment to the permanent establishment to the legally independent foreign subsidiary corporation, or is a structure to be developed immediately that is to serve as a solid basis for speed-up expansion? In the latter case it is advisable to opt for a variant that is optimized with regard to company law and tax law right from the start even if that initially involves greater expense.

Especially the accession of Poland to the EU has opened up many tax benefits/ options, which are to be utilized. For instance, the parent/ subsidiary directive applies, which allows tax-free distribution of dividends between corporations. In some sub-areas this relief now also applies to "intransparent" partnerships, which, in turn, increases the attractiveness of these legal forms of commercial entities.

With the Polish limited liability company, for example, it has to be borne in mind that Poland does not grant loss deduction for an indefinite period of time, but that it is limited to five years. As a result, one possibly has to try to transfer the losses to other/ German companies. However, regarding this aspect a change may occur as the European Court of Justice has decided on the admissibility of the limitation of loss offsetting under European Community Law.

On the other hand, some other Eastern European acceding countries allow "step-ups" as they are called, which enable entrepreneurs to depreciate the book value contained in the acquired goodwill. In Carl Müller's case this would be of interest if a holding company is to be established in a third country, which acquires shares in other subsidiaries from the Carl Müller AG.

Second summary:

The Polish company law provides optimum conditions for Carl Müller's plans. There are several options under company law possible. First and foremost the concrete implementation will therefore be oriented towards the tax benefits.

The main consideration of tax planning yet to be carried out should be given to utilizing the low foreign tax rates and at the same time avoiding "supplementary taxation" of profits in Germany. In a second step it must be considered how the tax burden can be further reduced in the foreign country itself.

To be continued ....