

A foreign company's way to Germany

-Part 1-

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The English company Smith Ltd. is the subsidiary of an Asian electronics groups. So far, the Smith Ltd. has seen to business activities in the EU area, with the focus being on final assembly and the sale of electronic products. Now expansion is to be further boosted. In the principal EU markets, among them also in Germany, business is now to be conducted by local companies (branches or independent companies). The Smith Ltd. is undecided as to which legal form to choose for their business activities in Germany and therefore asks for a presentation of the possibilities. In another step, the Smith Ltd. wants the disadvantages and advantages involved with regard to company law, tax law and labour law to be outlined. Besides, the Asian parent company is interested to know which is the best way to combine its different European subsidiaries now to be established.

When deciding on the optimum structuring of business operations in Germany, the Smith Ltd. can basically choose between three different legal forms under company law: (A) the formation of a permanent establishment (dependent agent, as it is termed) or the formation of an independent branch establishment, (B) the formation of a German partnership (OHG, KG, GmbH & Co. KG) as the Smith Ltd.'s subsidiary and finally (C) the formation of a corporation as the Smith Ltd.'s subsidiary. Apart from the German forms of corporations (GmbH, AG), it is also possible according to recent rulings of the European Court of Justice (ECJ) to use corporations from other European Member States. Especially the English Limited Company (Ltd.) is very popular in practice; more than 30,000 Limited Companies are said to already exist in Germany.

A. Establishments

I. Permanent establishment

The permanent establishment as a dependent agent is probably the simplest way for a foreign company to conduct business in Germany; the term "branch" describes this form of organisation best. A branch is dependent on the company headquarters (the Smith Ltd.) in every respect: the name of the permanent establishment, for example, must be the same as that of the principal establishment, and invoices are made out in the name of the principal establishment. Due to its dependence on the principal establishment, a permanent establishment is not entered in the commercial register, but must merely be registered with the office for the registration and supervision of trades. The permanent establishment's profits are taxed in Germany; as the Smith Ltd. is a corporation (constituted under the law of a foreign state), the permanent establishment's profits are subject to corporation tax like that of a German corporation. Furthermore, the permanent establishment is subject to turnover tax and trade tax in Germany.

II. Branch establishment

A branch establishment is an additional focus of the company intended to exist for a long time, which independently conducts business that is typical of the whole company. Unlike a permanent establishment, a branch establishment is to some degree independent of the principal establishment, by having its own management with its own authority to act, by having separate accounting systems, its own balance sheet and its own working capital allocated to it by the headquarters. The branch establishment is not an independent legal entity like for example a limited liability company (GmbH), but only a constituent part of the legally independent company, in our example of the Smith Ltd. Unlike a permanent establishment, the independent branch establishment must be entered in the German commercial register at the relevant local court; in addition, an application for registration of a trade or business has to be filed. The domestic branch establishment of the Smith Ltd. is taxed similarly to a permanent establishment, which means that profits are taxed in Germany under the Corporation Income Tax Act; besides, the branch establishment is subject to turnover tax and trade tax.

B. Partnerships

Permanent establishment and branch establishment aren't independent legal entities. They are merely establishments of the company headquarters and thus have the same legal classification.

Basic forms of independent legal entities in Germany are the civil-law association (GbR) and the general partnership (OHG). However, natural persons are primarily intended as partners of these legal forms. Besides, these partnerships are not very attractive as the liability of these partnerships and of their members is unlimited.

A subgroup of these partnerships is the limited partnership (KG), which is characterized by the fact that only one partner is fully personally liable (general partner), whereas the other partners' liability is limited to the specific amount of their contributions (limited partners). It is very popular to have a corporation take the place of the general partner, e.g. GmbH & Co. KG or Ltd. & Co. KG. As the limited partnership is not subject to any minimum capital requirements, it can be very quickly and easily set up, however, a notary public has to be called in and the company has to be entered in the commercial register. With partnerships, the profits are determined at company level and assigned to each partner according to their contribution. Each partner then pays income tax on the profits assigned to them.

C. Corporations

First and foremost only the German corporations or the European Company may suit the Smith Ltd.'s purposes. Among these corporations, the limited liability company (GmbH) ranks first.

I. Limited liability company (GmbH)

The limited liability company is the most common form of incorporated company in Germany. The minimum capital stipulated by law is € 25,000.00. The Federal Government, however, is planning to amend the law and to reduce the statutory minimum capital requirement to probably € 10,000.00. The company's liability is limited to the share capital. With some exceptions, the shareholders are not personally liable for the company's liabilities. A limited liability company is formed by notarized deed of incorporation. For some years now, the formation of a one-man limited liability company (Ein-Mann-GmbH) has been admissible. The limited liability company is liable to pay corporation tax on its annual surplus; in addition, it is subject to local trade tax. The shareholders of the limited liability company pay income tax on the receipt of dividends. However, the corporation tax paid by the limited liability company is no longer credited against the shareholders' personal income tax – the half-income system, as it is termed, applies.

II. Joint stock company (AG)

The German joint stock company has advantages and disadvantages similar to those of comparable international joint stock companies. In Germany, a joint stock corporation requires a minimum capital of € 50,000.00. Of some interest may be the "small" joint stock company, as it is termed, which enables the formation of one-man joint stock companies (Ein-Mann-AG) and provides less stringent regulations. However, a notarized deed of incorporation is mandatory for formation. The joint stock company is subject to German corporation tax and local trade tax. In the case of dividend payouts, the half-income system shall apply.

III. European Company (SE)

Since 2004, companies have been able to set up a European Company (SE) as an alternative to a German public limited company. An SE is a supranational European corporate entity which may be formed in any one of the EU Member States and largely corresponds to a joint stock company constituted under national law. However, one prerequisite for formation is that there must always be a cross-border element involved; that means that it must basically be a merger of at least two companies from different EU Member States. In certain cases, it is sufficient if there are subsidiaries or branch establishments in another Member State. In tax matters, the SE is basically treated the same as a national public limited company; i.e. it is subject to the tax regime of the applicable national legislation.

IV. English Limited Company (Ltd.) – private company limited by shares

Apart from the above-described German corporate forms, also the formation of an English subsidiary limited company and the transfer of this Ltd.'s registered office to Germany suggest themselves because of the ECJ rulings. The corporate form of the Limited Company is the English equivalent of the German GmbH, but can even be established with a minimum capital of £1 and at lower costs, which is why it is very popular with start-up entrepreneurs in Germany. Unlike the Smith Ltd., the newly established Limited Company (in the following referred to as Smith Subsidiary Ltd.) would not conduct business in its state of incorporation Great Britain, but only in Germany. In Great Britain, however, the Smith Subsidiary Ltd. is merely entered in the local commercial register (Companies House) and must formally register its office there, which is why such companies used to be called "letter-box companies". Except for the rules of company law, the Smith Subsidiary Ltd. is largely subject to German law, for example, with regard to obligations under public law. As the Smith Subsidiary Ltd. does not conduct business in Great Britain, it is liable to tax (corporation, turnover and trade tax) in Germany only. For disclosure reasons, the Smith Subsidiary Ltd. must be entered in the commercial register like a "branch establishment".

After this short survey, the Smith Ltd. will decide which corporate structure suits its purposes best and which additional information is still needed.

To be continued ...