

Buying a German business is easier than one may think



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Germany has the biggest economy in Europe, and one of the strongest. Mid-sized firms, often family owned, are the backbone of Germany's economy, and many are open to expansion through investment. So, what are the crucial points when thinking of investment in German companies?

In general, foreign investors who intend to buy a German company face no limitations and there is no requirement for any public authority to approve a transaction. The typical acquisition routine involves due diligence followed by a letter of intent and detailed deal negotiations. The results are laid down in a term sheet, which lawyers later put into the legal documentation. With respect to purchase price the discounted cash-flow approach is fairly standard.

Finding a suitable target may be a challenge but specialist consultants are available and chambers of commerce and banks are often helpful contacts.

Legal aspects

German law distinguishes between a purchase agreement and the acquisition. The agreement stipulates the terms and conditions of the transfer of the ownership of the shares or assets in question and so determines an obligation, whereas the transfer requires a second act. However, both aspects may be combined in one document.

Purchases of companies are usually made as asset deals or share deals. No German statute explicitly deals with the sale of companies. From a legal point of view, the sale of a company is treated similar to the sale of a banana. No surprise, most investors prefer complex guarantee provisions in the purchase agreement instead of relying on the

standard warranty obligations provided by the Civil Code.

The principle of *caveat emptor* – the buyer bears the risk – applies in Germany. However, due diligence is not as common as in other countries. The failure to conduct due diligence is not automatically seen as negligence and does not bar claims against the seller.

Although most transactions can be made in simple written form or even orally, the sale of shares of a GmbH (limited company) is subject to notarization. The management of a GmbH also has to file an updated list of shareholders with the commercial register. That list, together with other publicly available data, is online for anyone to see.

With asset deals, usually all the assets of an enterprise along with the business are transferred into a new entity. By law this includes the employment contracts. Dismissing employees in Germany is a burdensome and expensive undertaking.

Indian staff require a work permit and a valid visa. In general, one needs to demonstrate that the specific position requires an Indian person and cannot be done by an EU person.

Tax aspects

Tax aspects may be important when setting the purchase price. The sale of a business, part of a business or assets by an individual or a tax transparent entity (e.g. partnership) is subject to income tax at the individual tax rate (up to 47.48%). Trade tax will also become due (about 15%, depending on the location of the business) but can be deducted from income tax.

If an individual sells shares that are held as business assets 60% of the profit is subject to income and trade tax. If the shares are held as private

assets a flat 25% income tax applies and trade tax is not applicable.

If a company sells a business, part of a business or assets, any gain will be subject to corporate tax and trade tax. Profit from the sale of shares, however, is to the extent of 95% exempt from tax.

For the investor, tax claims arising later may frustrate an initially successful purchase. To avoid this, a purchaser should check the documentation of the last tax inspection and ascertain how many years are "open" for tax changes. Usually tax claims are barred if based on facts that are more than four full years old. A change in ownership may lead to the loss of all or part of any tax loss carry-forward.

In case of an asset deal the purchase price is split pro rata over the assets bought and the new value serves as base for further depreciation. So, tax refunds may help to refinance the acquisition. Since shares are not subject to wear and tear there is no depreciation in a share deal. The price only becomes tax relevant when the company is sold later and the capital gain is defined.

The double tax treaty between Germany and India provides for German withholding of 10% on any dividends transferred to an Indian shareholder. The acquisition of a business in whole or in part and share purchases are exempt from value-added tax.

So, not rocket science. Access to one of the most powerful markets is nothing to be scared of.

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