

Doing Business Guide

Germany

2nd Edition



Morison Germany



An independent member of
Morison International

About This Booklet

This booklet has been produced by Morison International's German member firms for the benefit of their clients and associate offices worldwide who are interested in doing business in Germany.

Its main purpose is to provide a broad overview of the various things that should be taken into account by organisations considering setting up business in Germany.

The information provided is not exhaustive and – as underlying legislation and regulations are subject to frequent changes – we recommend that anyone considering doing business in Germany or looking to the area as an opportunity for expansion should seek professional advice before making any business or investment decision.

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Introduction and Background

Geography and population

Germany covers an area of about 357,000 km² (138,000 square miles) in Central Europe. The country borders on Denmark, Poland, the Czech Republic, Austria, Switzerland, France, Luxembourg, Belgium and the Netherlands, and on the North Sea and the Baltic Sea.

The German population is currently estimated at 82 million. In contrast to other Central and Western European countries, the population has risen over the past decade due to immigration, which up to now has generally more than compensated for the excess of deaths over births. However, this trend has now ceased and official estimates suggest that the population will fall to between 65 and 70 million by 2060 – depending on immigration levels and birth trends.

The German population does not have a tradition of mobility within the country. Movement is hampered by cultural differences and by other factors, such as the decentralised education system.

The official language is German. English is by far the best-known foreign language and is generally accepted as the common medium for all forms of communication abroad. It is also quite usual for educated Germans to have a good command of at least one other foreign language, the most widespread being French, Italian, Spanish and the various Slavic languages.

Law

The ultimate source of all law is the constitution or basic law (*Grundgesetz*). Acts of either the Federal Parliament (*Bundestag*) or a federal state parliament are void if they conflict with the constitution or are passed in an unconstitutional manner. Similarly, all acts of the federal state parliaments must be in accordance with the provisions of the constitution of the relevant federal state.

The government, individual ministries and other authorities have the power to issue guidelines, decrees and other pronouncements. These ordinances are of varying degrees of authority and require the approval of differing levels of government. Tax guidelines, for example, but not decrees, require the consent of the Bundesrat (Federal Council of Germany).

The German court system is decentralised. Initially, cases are held locally and appeals are made to a higher court responsible for a wider geographic area. The courts are divided into a number of different streams, each specialising in its own field of law. There are therefore separate courts to try tax, commercial and labour law suits. At the head of each stream is a single, federal supreme court to which appeals can be made by either side on points of law, but not of fact. The ultimate arbiter is the Federal Constitutional Court (*Bundesverfassungsgericht*) in Karlsruhe to which a final appeal can be made, although only on the grounds of conflict with the constitution.

The decisions of the Federal Constitutional Court are binding on all other courts. The decisions of all other courts, including the supreme court of each stream, are only binding in respect of the case tried and do not set binding precedents for other cases of a similar nature. They may, however, give guidance to other courts, especially to lower courts of the same stream, although even a lower court is free to depart from an established precedent if it feels that circumstances warrant a change.

Economy

Germany is a founding member of the European Union (EU) and takes an active part in the activities of all subordinate institutions of the EU.

Almost all sectors of industry are represented within the broad-based German economy. As befits a country with high employment costs but with a well-educated population and a well-trained workforce, the most exciting prospects today are offered by industries at the forefront of technology and by the providers of sophisticated technical, commercial and financial services. Agriculture and tourism are less significant, although they are of social and cultural importance, especially for the preservation of living and recreational standards.

Traditionally, the German economy is oriented towards manufacturing. This extends to the service sector, where there are many companies developing and applying leading-edge technologies for industrial use. For decades, manufacturing output has exceeded the consumption requirements of the domestic economy; in effect, Germany is and remains a major exporting nation in order to maintain domestic employment. In keeping with this tradition, Germany's recovery from the economic crisis was led by exports. The unemployment rate had fallen to 5.0% in January 2014, according to Eurostat.

Germany is one of the largest trading nations. In 2013, the total amount of exports was €1,093 billion and the imports reached €895 billion, resulting in an export surplus of €198 billion according to the Federal Statistical Office (Destatis). In 2013, Germany was the third largest exporting country in the world.

The typical business in Germany is a small family-owned unit. Any outside shareholders are usually long-term employees or others with long-standing personal relations with the original family. Most large businesses are publicly held corporations with many shareholders. However, the original family owners often retain a significant minority holding and there are still a few large businesses closely held by only a few individuals. Many medium-sized corporations that are publicly listed issue a different class of shares to the public (quite frequently non-voting preferred stock) in order to give the original owners a greater degree of control and influence than warranted by their investment.

Banking and Finance

Currency

Germany no longer maintains its own currency, having adopted the Euro on 1 January 1999. The Euro is managed by the European Central Bank in Frankfurt led by a multinational board of delegates from the central banks of the participating countries. Participation is obligatory for EU member states once they meet certain economic criteria for stability and solvency for a 2 to 3-year period, although Denmark, Great Britain and Sweden have an option not to join. The current members are Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain.

The German central bank (*Deutsche Bundesbank*) is responsible for minting the German Euro coins currently in circulation. It also sends representatives to sit on the board of the European Central Bank. Within Germany, it exercises various supervisory functions over the banking system, in consort with the Federal Financial Supervisory Authority.

Banking system

Banking services are offered to the public, both to businesses and to private households, by a variety of financial institutions. The business banks offer the most comprehensive services, but there is also a range of savings banks, similar institutions and building societies. The business banks, which in Germany are often referred to as 'universal banks', offer a full range of services, retail and wholesale, including all forms of investment banking, corporate finance and related consultancy. They are also the traditional doorway to the stock exchange for German business and for the investing public.

Traditionally, no fundamental distinction is drawn between the various types of business banks. The banking business itself is broken down into different categories by the Banking Act, but this merely serves to restrict banking licenses to specified activities, so that each bank needs only to adhere to the specific conditions and control requirements relevant to its own particular sphere. However, the larger German banks are active in all fields, although there is still plenty of scope for the smaller institution specialising in a particular activity or market.

The German financial and money markets are almost entirely free of exchange controls. Indeed, transactions within the Euro Zone are for almost all practical purposes identical to domestic transactions (bank charges and statistical reporting requirements are the two exceptions). Both local business and foreign entities may deposit or borrow funds freely through the German banking system; thus, for example, it is usually possible for a foreign investor to choose the financing source for a German investment from competing offers from different countries. The choice can be based on taxation and other business considerations of real, as opposed to formal, importance.

Capital markets

Germany operates a flourishing money market and stock exchange. Its bond market is the third largest in the world, after New York and London, and its stock market is the fourth, after New York, London and Tokyo. There are nine German stock exchanges, although they are all linked to the Frankfurt Stock Exchange, the center of the German money market and the seat of the various bodies that ensure the smooth control and completion of transactions.

Companies seeking a quote on the German stock market do so through a listing partner. All major banks and most of the larger accounting and legal firms have been granted recognition as listing partners. Basically, a quote is available to any company with shares open to public trading. Trading takes place on the regulated market and on the unregulated (or open) market. Issuers on the regulated market are required to meet either the general or the prime standard of transparency and governance. The two standards are not dissimilar, though the prime standard sets additional reporting requirements. The minimum equity capital for both is €1.25 million.

The unregulated market is open to issuers with equity capital of at least €250,000. The publication and reporting requirements are less arduous than those for regulated market quote holders. Issuers fall into two categories, i.e. first and second quotations. Applicants for a first quotation must publish a prospectus meeting EU standards and otherwise satisfy the requirements of the stock exchange (and of the Federal Financial Supervisory Authority) as to the financial standing and past history of the company. Companies with an existing quote on another stock exchange automatically fall into the second category. In this case, there is no need for a further prospectus, and the compliance requirements are greatly eased with the acceptance by the German authorities of an effective supervision in the company's home country. This acceptance is automatic where the first quote is on a recognised market within the EU and is largely a formality where the first quote is in the United States or Japan. However, first quote holders from other countries will need to satisfy the German stock exchange that they meet standards of transparency and governance in their home countries that are at least as rigorous as those of the EU.

Foreign companies may meet all stock market filing and publication requirements in English. Financial statements and disclosures may follow IFRS or US GAAP.

Money laundering

In concert with other EU members, Germany has equipped itself with an impressive arsenal of rules and institutional procedures designed to prevent money laundering, or at least to make it more difficult. The same goes for the fight against the misuse of German financial institutions for organised crime, drug trafficking, terrorism and other serious offences. Most of the rules are impositions on the service providers at risk of being abused, such as banks and other financial institutions, investment consultants and agents, lawyers, accountants and all businesses handling large amounts of cash. The customer's main awareness of these procedures generally comes from requests for positive identification and being asked to explain the circumstances of particular transactions in rather more detail than might seem strictly necessary for smooth processing.

Labour and Personnel

Workforce in Germany and immigration

Out of a population of about 82 million, over 41 million people were economically active in January 2014. The German workforce is well trained and well educated, and is accustomed to high standards of efficiency and of organisation. It is also used to high standards of protection and to generous fringe benefits and remuneration.

The employment of foreigners in Germany is subject to a permit of residence for the means of employment, which comprises the employment authorisation. The conditions under which such a permit of residence is granted will depend on the particular home country:

- Citizens of Switzerland, countries in the EU and European economic areas principally do not need either a permit of residence or an employment authorisation
- Third-country citizens generally need a permit of residence for the means of employment before entering Germany, which in most cases requires acceptance by the German Federal Employment Agency (*Bundesagentur für Arbeit*). This acceptance will depend on the employee's qualification and the aspired place of employment. Special regulations apply to physicians, to mechanical and electrical engineers and to other highly qualified professionals from third countries in order to encourage their coming to Germany. Citizens of Australia, New Zealand, the United States of America, Canada, Israel, Japan and Korea can apply for a permit of residence after their arrival in Germany.

Further information, including advice on the recognition of qualifications, is available on the website of the International Placement Services (ZAV) of the Federal Employment Agency (www.zav-auslandsvermittlung.de/deutschland), the website of the Federal Employment Agency (www.arbeitsagentur.de) and the website of the European Employment Services (<http://ec.europa.eu/eures>).

Statutory working conditions

Many working conditions can be negotiated directly between the employer and the employee, or are laid down in collective agreements between the employer and the work council or between the employer or an employers' association and a labour union. Nevertheless, some working conditions are mandatory in the way that individual negotiations can only be amended in favour of the employee:

Working hours

In principle, the maximum working time is 8 hours per day, Sunday excluded. Individual and collective agreements on part-time employment and/or flexible working hours are quite common.

Minimum wage

A general minimum wage has not yet been enacted by law. However, the present German

government intends to introduce an overall statutory minimum wage of €8.50 with effect from 1 January 2015. As the law has not yet been passed, there are still ongoing discussions on if there will be any exceptions to the statutory minimum wage and what the exceptions will be.

Regardless of this potential statutory minimum wage, for some industries (such as the building, industrial cleaning, care and temporary employment sectors), collectively agreed minimum wages already apply, leading to generally binding minimum wages from €6.50 to €13.95 per hour in May 2014. These minimum wages are regularly updated by mutual agreements between trade unions and employers' associations.

Sick leave

In the case of illness, the employer pays the full salary for a period of 6 weeks, provided the employee was employed at least 4 weeks prior to the illness.

Maternity leave and parental leave

Female employees are entitled to a maternity leave of 6 weeks before and 8 weeks after childbirth. During this period, the employer pays the salary less the amount of maternity allowance paid by health insurance.

Until a child's third birthday, both parents are entitled to parental leave. If the employee makes use of this possibility, s/he cannot claim wages for this time, but is granted a parental allowance for up to 14 months.

Annual leave

Every employee is entitled to a minimum of 24 days of annual leave after 6 months of employment.

Employee participation

In enterprises with at least five employees, the employees are entitled to elect a works council that represents their interests. A works council has to be informed and heard in various matters, especially prior to dismissals. Further, approval of the works council is necessary in some matters, like issues of safety at work.

The employer and the works council can enter into collective agreements that are binding on all employees of the enterprise.

Dismissal

The statutory period of notice will depend on both the party terminating the contract and the duration of employment. Generally, the period of notice is 4 weeks to the 15th or to the end of the month. After 2 years of employment, longer periods of termination – up to 7 months, after 20 years of employment – apply if it is the employer who terminates the contract.

In enterprises with more than five employees, any dismissal is valid only if there is a cause;

this cause may be operational or based on the person or the behaviour of the employee.

If a works council exists in the enterprise, any dismissal is invalid if the works council has not been properly informed.

In some situations, an employee may not be dismissed at all, or only subject to further conditions. This applies to disabled employees, members of the works council, employees on parental leave, pregnant employees, and young mothers.

Social security

In general, every employee is affiliated to the German social security system, which includes insurance for health, long-term care, pensions, unemployment, accidents and maternity leave.

For most branches of the social security system, the contributions to be paid will depend on the individual salary, and amount to the following:

- Health insurance: 14.9% or 15.5% of the gross salary, limited to €48,600 per year
- Long-term care insurance: 2.05% or 2.3% of the gross salary, limited to €48,600 per year
- Pension insurance: 18.9% of the gross salary, limited to €71,400 (western part of Germany) or €60,000 (eastern part of Germany) per year
- Unemployment insurance: 3.0% of the gross salary, limited to €71,400 (western part of Germany) or €60,000 (eastern part of Germany) per year.

The employer pays 50% of these contributions, except for the health insurance where the employer's contribution is a little smaller. The remainder must be withheld from the employee's salary; otherwise the employer may be held liable.

An employee whose annual gross salary exceeds €53,550 may choose to be affiliated to the statutory health insurance or to contract a private health insurance. The choice makes a difference as to the amount of contributions and the services insured.

Besides the statutory pension insurance, many employers offer corporate pension schemes, and many employees choose to contribute to additional retirement provisions, such as the government-funded *Riester-Rente* (Riester pension).

As for the accident insurance and the maternity leave insurance, the employer pays 100% of the contributions, with the amount depending, among other things, on the risk level of the enterprise: in general, contributions amount to 1–2% of the aggregate gross wages paid by the enterprise.

Self-employed persons have to contract private insurances, as they are not part of the statutory social security system. In particular, they are not entitled to be a member of a statutory health or pension insurance, but must make their own private provisions.

Legal Structure of Business Organisations

Overview

Any foreign investor may

- directly supply goods or services to German customers (direct investment)
- establish a branch office of a foreign business organisation in Germany
- set up a separate business organisation in Germany.

Criteria of choice should primarily be the intended type of business and its duration, the risks attached to it, the role of the entrepreneur within the organisation, and taxation.

The German law provides for three main types of domestic business organisation: corporation limited by shares, partnership, and sole proprietorship.

The main forms of corporations limited by shares are

- Private limited corporation (*Gesellschaft mit beschränkter Haftung/GmbH*)
- Public limited corporation or stock corporation (*Aktiengesellschaft/AG*).

The main forms of partnerships are

- Unlimited partnership under civil law (*Gesellschaft bürgerlichen Rechts/GbR*)
- General partnership under commercial law (*Offene Handelsgesellschaft/oHG*)
- Private limited partnership (*Kommanditgesellschaft/KG*).

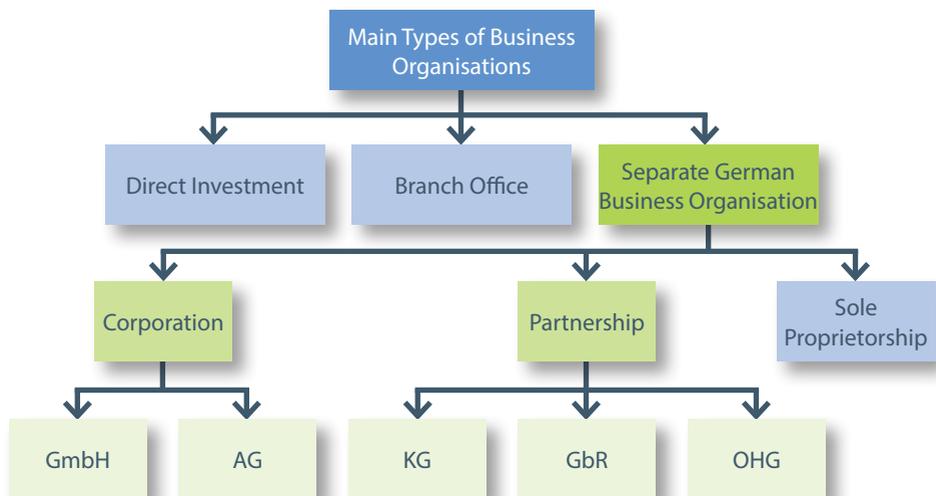


Figure 1: Types of Business Organisations in Germany

Entrepreneurs may freely choose the most suitable type of organisation for their business.

However, prior to activities, any business organisation must give notification to the respective local administration and tax authorities. Further, special licences are required for certain activities, such as banking and insurance, real estate agencies, security, and gambling, as well as many crafts, and polluting activities.

Moreover, foreign legal forms, such as the English limited company (Ltd) or the English limited liability partnership (LLP), are permitted in Germany. Due to the decisions of the European Court companies incorporated in any member state of the European Union may transfer their domicile to another member state.

Corporations limited by shares

Private limited corporation (*Gesellschaft mit beschränkter Haftung/GmbH*)

Many small and medium-sized enterprises (SME) choose to organise as a private limited corporation (GmbH), which offers considerable flexibility, combined with the possibility for shareholders to exert influence on the management of the GmbH.

The GmbH must have at least one shareholder. Any shareholder may be an individual or a corporation, and may be either domestic or foreign. The liability of the shareholders for the debts of the GmbH is limited to their contributions, in total to the amount of the share capital.

The articles of association of a GmbH may, to a wide extent, be tailored to the individual requirements of the shareholders. They must contain at least:

- the company name
- the registered office of the corporation
- the purpose of its business
- the amount of the share capital
- the number and amount of the shares subscribed by each shareholder.

The articles of association and the deed of incorporation must be notarised by a German public notary.

The GmbH as a separate entity is legally established by its registration in the commercial register kept by the competent local court. However, during the period between the notarisation of the articles of association and the deed of incorporation and the registration in the commercial register, the 'GmbH in formation' is already considered an entity able to act with legal effect towards third parties.

The minimum share capital of the GmbH amounts to €25,000. The share capital must be fully subscribed. Contributions may be made in cash or in kind; contributions in kind may not consist of services. In case of cash contributions, the shareholders must pay an amount of at least one-quarter of the nominal value of each share subscribed and of the total minimum amount of €12,500, to be freely disposed of by the management of the GmbH, before filing the application for registration of the GmbH in the commercial register. Contributions in kind must be made in total before such filing.

Shares of a GmbH may be freely transferred, but the shareholders may limit the transferability of the shares in the articles of association. The shares of a GmbH may not be listed at a stock exchange. Any contract by which shares are transferred must be notarised.

The shareholders appoint one or more managing director(s) of the GmbH to represent the GmbH towards third parties. The managing directors must be individuals. It is possible to appoint foreign individuals, even if they reside outside of Germany. The managing directors may be shareholders of the GmbH, but individuals who do not hold shares may also be appointed. The shareholders are at any time entitled to give explicit instructions to the managing directors on how to conduct specific areas of business or specific transactions. However, these instructions do not limit the managing directors' power of representation: in principle, any transaction with third parties concluded in disregard of shareholder instructions will be valid but the managing directors will be liable, towards the GmbH, for any damage arising out of the transaction. Further, the shareholders are free to remove managing directors from office at any time.

A supervisory board is only mandatory if the GmbH employs more than 500 persons. If it has fewer employees, the shareholders are free to install a supervisory board and to define its functions at any time.

Since 2008, a new variation of the GmbH exists: the *Unternehmergesellschaft* (UG) may be incorporated with a minimum share capital of €1. During its existence, profits may not be fully distributed until the nominal share capital is increased to at least €25,000.

Public limited corporation or stock corporation (*Aktiengesellschaft/AG*)

The AG is a form of business organisation that is usually chosen for large businesses, as shares of an AG may be freely transferred, and as AGs may be listed at a stock exchange. Stock exchanges in Germany are located in Berlin, Dusseldorf, Frankfurt, Hamburg, Hanover, Munich and Stuttgart. As shareholders may also limit the transferability of the shares, this form of organisation can be attractive to medium-sized family-owned companies as well, especially if the shareholders wish to establish an independent management of the corporation.

The AG must have at least one shareholder. Any (foreign) individual or (foreign) corporation may be a shareholder. The liability of the shareholders for the debts of the AG is limited to their contributions.

The articles of association of an AG must contain at least:

- the company name
- the registered office of the corporation
- the purpose of its business
- the amount of the share capital
- its split-up in par-value shares or in no-par shares (in case of par-value shares, their par-value and their number; in case of no-par shares, their number; in case of the existence of several classes of shares – common shares and preference shares – their class and the number of shares of each class)

- information on whether the shares are bearer shares or nominal shares
- the number of the members of the directing board or the dispositions that determine this number.

Further, the German Stock Corporation Law contains many dispositions that cannot be amended by the articles of association of an AG. The articles of association must be notarised by a German public notary.

The AG as a separate entity is legally established by its registration in the commercial register kept by the competent local court. During the period between the notarisation of the articles of association and the deed of incorporation and the registration in the commercial register, the 'AG in formation' is already considered an entity able to act even with legal effect towards third parties.

The minimum share capital of the AG amounts to €50,000. The share capital must be fully subscribed. Contributions may be made in cash or in kind; contribution in kind cannot consist of services. In case of cash contributions, the shareholders must pay an amount of at least one-quarter of the nominal value of each share subscribed and of the total minimum amount of €12,500, to be freely disposed of by the management of the AG, before filing the application for registration of the AG in the commercial register. Contributions in kind must, in principle, have been made in total before such filing; only if the contribution in kind consists of the obligation to transfer goods to the AG, this transfer may be done within 5 years from the registration in the commercial register.

During the establishment of an AG, the founders appoint the first auditors of the AG as well as the members of the supervisory board of the AG. The supervisory board must have at least three members. The supervisory board appoints the chair and the members of the executive board of the AG. The members of the supervisory board, the chair and the members of the executive board must be individuals. It is possible to appoint foreign individuals, as well as to appoint individuals who are shareholders of the AG or individuals who are not shareholders. But no member of the supervisory board may act as chair or member of the executive board, and vice versa.

The chair of the executive board represents the AG towards third parties. Neither the shareholders nor the supervisory board of an AG are entitled to give explicit instructions to the chair or the executive board on how to conduct specific areas of business or transactions. Only the supervisory board may subject certain transactions of the chair, director or executive board to the supervisory board's prior approval. The chair or the members of the executive board are appointed for a fixed period of up to 5 years and may be removed from office only for a legitimate cause. Re-election is permissible.

Partnerships

Private limited partnership (*Kommanditgesellschaft/KG*)

Primarily for tax reasons, a lot of small and medium-sized businesses are not organised as a GmbH but as a GmbH & Co. KG, which is a private limited partnership with a private limited corporation as the general partner.

Private limited partnerships have two classes of partners: at least one general partner, whose liability for the partnership's debts is unlimited; and one or more limited partners, whose liability

for the debts of the partnership is limited to their contributions to the partnership. The general partner represents and manages the partnership, while limited partners generally only have rights of control.

The general partner may be a private limited corporation (GmbH) resulting in a GmbH & Co. KG. The GmbH & Co. KG has the advantage that the liability of the person(s) behind the partnership – the shareholder(s) of the GmbH and the limited partner(s) to the KG – for the partnership's debts is limited at last. Legally, such a partnership is treated like a corporation in many aspects.

For the purpose of establishing a private limited partnership, at least two partners enter into a partnership agreement. The general partner(s) and the limited partner(s) as well may be individuals, partnerships or corporations, either domestic or foreign. No minimum share capital is legally required for the private limited partnership.

The partnership agreement does not need to be notarised, except for special obligations contained in it, such as the transfer of real estate. The KG must be registered in the commercial register.

Unlimited partnership under civil law (*Gesellschaft bürgerlichen Rechts/GbR*) / General partnership under commercial law (*Offene Handelsgesellschaft/oHG*)

The unlimited partnership under civil law is often used for the joint administration of assets, especially real estate.

A GbR is established by an agreement between at least two partners. These partners may be (domestic or foreign) individuals, partnerships or corporations. The liability of every partner for the debts of the partnership is unlimited. No minimum share capital is required.

A GbR cannot be registered by the commercial register, as it is not a legal entity; but it can nevertheless sue and be sued in its own name if it enters into legal relations. As the GbR has no separate legal personality, the members act on its behalf.

If a GbR runs a commercial business, it automatically becomes an oHG. The same rules apply as for the GbR, completed by some specific rules. For example, the oHG must be registered in the competent commercial register.

Sole proprietorship

If an individual wishes to conduct business activities on their own without establishing a corporation, this individual can act as a sole proprietor (*Einzelkaufmann*). The individual is liable for all debts incurred as a sole proprietor.

The sole proprietorship has to be registered in the commercial register kept by the competent local court.

Branch offices, especially of foreign businesses

If a foreign business does not wish to incorporate a new subsidiary in Germany, it can still consider establishing a branch office. This branch office is a mere extension of the foreign business entity, and is therefore no separate legal entity. The branch office has to be registered in the commercial register kept by the competent local court.

Accounting and Reporting

Statutory requirements/accounting records

The German Commercial Code (*Handelsgesetzbuch*, HGB) requires all businesses to keep proper books of accounts. The books must conform to a generally accepted standard of record keeping, must provide a complete record of all transactions, and must be supported by a complete set of vouchers and other documentation. They must be kept in euro and must be written up in a living language. If they are not in German, the tax authorities have the right to demand a translation.

The tax acts also contain provisions affecting the accounting records. Foremost among these are the 'principles of orderly computerised accounting systems' and a formal requirement that the books be prepared and retained in Germany at all times, unless the responsible tax office grants a specific exemption. If this requirement is ignored, the tax auditors might regard the company's books as 'disorderly'. This could lead to difficulties in respect of aspects of taxation (including VAT), dependent upon the accounting records. However, there is a procedure for applying for tax office permission to keep (electronic) books and records in another country. In principle, approval will be granted where the tax office is satisfied that its right to audit will not be compromised.

Accounting principles

All German statutory financial statements must agree with the underlying accounting records and must follow the historical cost convention. They must be complete and accurate and be drawn up within 3 months of the company's year-end. This period is extended to 6 months for small companies, but only on the condition that the delay can still be seen as being within the confines of an 'orderly manner of doing business'.

The financial statements must follow the accrual accounting principle of taking up all expenses as incurred, but deferring income until realised. Consistency and prudence are emphasised as principles; there is less apparent importance attached to matching income with its related expense, although there is the requirement that all transactions be taken up in the year to which they belong.

Financial statements must be drawn up under the assumption of a going concern, which means that the company will continue its business operations in the foreseeable future, unless a specific decision to the contrary has already been taken. Appropriate depreciation of fixed assets must be recorded, liabilities must be taken up at their anticipated repayment amounts, and provision must be made for all losses as soon as they become apparent.

Audit of accounts

The Commercial Code also contains additional requirements for the audit and publication of financial statements of limited companies and partnerships in which no natural person ultimately has unlimited liability. Thus, the GmbH & Co. KG in which the unlimited general partner's share is held by a GmbH is subject to an audit and publication requirement. These

rules also describe in more detail the accounting principles to be applied.

From the point of view of the audit and publication of financial statements, companies are categorised as micro, small, medium-sized or large.

A micro company does not exceed any two of the three following criteria:

- Annual sales of €700,000
- Balance sheet total of €350,000 (after deduction of a capital loss disclosed as asset)
- 10 employees.

A small company is one not exceeding any two of the three following criteria:

- Annual sales of €9,680,000
- Balance sheet total of €4,840,000
- 50 employees.

A medium-sized company does not exceed any two of the following three criteria:

- Annual sales of €38,500,000
- Balance sheet total of €19,250,000
- 250 employees.

A company will change its status with effect for the third year where it has met or fallen below the respective criteria for the second consecutive year.

Micro companies are not subject to any audit requirement and may satisfy the publication requirement by filing the abridged balance sheet with the electronic trade register (without publication). Further reliefs are applicable to the preparation of the financial statements (e.g.: waiver of notes to the financial statements for the information given below the bottom line of the balance sheet).

Small companies are not subject to an audit requirement and may satisfy the publication requirement by publishing a condensed balance sheet and notes thereto, but without a profit and loss account, with the electronic Federal Gazette (*elektronischer Bundesanzeiger*).

Medium-sized and large companies must have their financial statements audited and published within the electronic Federal Gazette, but the publication requirements for medium-sized companies are easier to meet, and these companies are exempt from various disclosures otherwise required.

Large companies are subject to the full publication requirement, i.e., publishing their full annual report in the electronic Federal Gazette

Financial statements and annual general meeting

The basic German financial statements consist of a balance sheet and a profit and loss account. The notes thereto are the subject of an *Anhang* (appendix). The financial statements

are accompanied in the annual report by the auditor's report and the proposal for, or resolution on, the appropriation of profits. Finally, the annual report includes the directors' report (called business report). The directors' report discusses the business situation of the company and also specifically mentions any important subsequent events, anticipated development of the company's business, R&D activities and branches it maintains.

Listed companies must also publish a cash flow statement and a declaration of compliance with the Code of Corporate Governance. Instances of non-compliance must be explained.

Unless otherwise provided in the articles of association, the shareholders decide in the annual meeting on the approval of financial statements, the appropriation of profits and the amendments to the articles of association. For an AG, the annual meeting must be held within 8 months of the end of the financial year.



Institutions Providing Assistance to Enterprises

Federal Ministry of Economics and Technology

The political objective of the Federal Ministry of Economics and Technology (BMWi) is the increase of prosperity and the expansion of the business network in the economic realm of Germany. The BMWi's aid programmes and advisory services are increasingly available to small and medium-sized enterprises and up-and-coming companies, which are considered to be "*das Rückgrat der deutschen Wirtschaft*" ("the backbone of the German economy"). For more information, see:

- <http://www.bmwi.de>
(Homepage of the Federal Ministry of Economics and Technology)
- <http://www.bmwi.de/DE/Themen/mittelstand.html>
(Information for small and medium-sized enterprises)
- <http://www.bmwi.de/DE/Themen/Mittelstand/Gruendungen-und-Unternehmensnachfolge/existenzgruendung.html>
(Information for entrepreneurs).

Local trade offices

The local trade offices are responsible for registering basic data on the business operations at a local level. A business notification forms the basis for the subsequent official and regulatory trade inspection; see <http://www.gewerbeamt.de/default.aspx>.

Federal Ministry of Finance

The Federal Ministry of Finance (BMF) is responsible for the public financial administration on a federal level. The core tasks of the BMF are, in addition to the regulation of the monetary and credit system, the regulation of the banking, stock exchange and insurance sector. Further major functions include the provision of different services and information for enterprises and businesses. More information is available at <http://www.bundesfinanzministerium.de/Web/DE/Home/home.html>.

Tax offices

At the level of the German federal states, the tax offices are responsible for the executive functions of the local fiscal administration. Tax offices also publish specific information related to tax effects and requirements; see http://www.steuerliches-info-center.de/DE/FinanzverwaltungDerLaender/finanzverwaltungderlaender_node.html.

Kreditanstalt für Wiederaufbau (KfW)

KfW (<http://www.kfw.de/>) a German government-owned development bank, firstly facilitates and promotes low-interest loans for private purposes and secondly provides assistance for

the establishment and development of enterprises in Germany – offering not only financial aid, but also providing advisory services to founders and start-ups.

Association of German Chambers of Industry and Commerce (DIHK)/Chambers of Industry and Commerce

The Association of German Chambers of Industry and Commerce (DIHK; <http://www.dihk.de/>) is the umbrella organisation of the Chambers of Industry and Commerce, being in charge of the political representation of German businesses and acting in both national and international politics.

The Chambers of Industry and Commerce (<http://www.dihk.de/ihk-finder>) act as regional representatives of the German industrial and trading companies. In addition, they act as points of contacts for economic and industrial questions. As an institution, the individual Chambers of Industry and Commerce consist of their members (local businesses).

German Confederation of Skilled Crafts (ZDH)/Chambers of Handicrafts

The German Confederation of Skilled Crafts (ZDH; <http://www.zdh.de/>) acts as an institutional representative of the skilled crafts in Germany (Chambers of Handicrafts, etc.). As an institution, the ZDH represents the common interests of the skilled crafts in concerted action on a political level.

The individual Chambers of Handicrafts (HWKs; <http://www.zdh.de/handwerksorganisationen/handwerkskammern/deutschlandkarte.html>) act both as regional lobbyists of the skilled crafts and as points of contact for different issues and questions in connection with skilled crafts.

Business Taxation

Preface

In Germany, the tax authorities make a distinction between resident and non-resident companies. Resident companies are incorporated in the commercial register and are subject to German taxation on their worldwide income. Non-resident is a non-domestic company and will be taxed only on its German-sourced income.

The standard fiscal year is the calendar year. A company may apply for a different fiscal year with the German tax authorities. Tax returns must be filed for every fiscal year by 31 May of the following year. This deadline is automatically extended to 31 December, if the tax returns are prepared by a tax consultant. The competent tax authorities may ask in certain cases for earlier submissions of the tax returns. Since 2011, companies have been obliged to submit their annual tax returns electronically.

Corporate tax

Corporate income tax

The corporate income tax rate (including a solidarity surcharge of 5.5%) amounts to 15.825% on taxable income. Pre-payments will be paid quarterly, beginning in March. They are generally based on the previous year's income of the company.

Trade tax

Commercial activities located in Germany are generally subject to trade tax – in addition to the corporate income tax. Pre-payments will be paid quarterly, beginning in February. They are based on the previous year's trade earnings of the company. The trade tax rate depends on the municipality in which the company is located. The trade earning is multiplied by a basic tax rate of 3.5% and an individual multiplier of the relevant municipality, which ranges in the most cases between 350% and 500% (examples: Berlin 410%, Frankfurt 460%, Munich 490%). This causes an effective trade tax rate of between 7% and 17.5%.

Types of investment in Germany

For launching business investments in Germany, foreign investors have the following opportunities:

Permanent establishment

A permanent establishment is defined as a fixed place of business that serves the business of an enterprise and over which the foreign investor exercises control. This does not require human intervention. The presence of an internet server is sufficient. If such an establishment is used for investments by a foreign investor, the profit derived is deemed to be trade earnings and is thus subject to non-resident tax liability and is taxed only on its sourced income.

If the permanent establishment derives dividends from shares in corporations, the tax treatment will depend on the legal form of the foreign company. If the foreign company is a corporation, the dividend income is 100% tax free. Only a lump sum of 5% of the gross income, representing non-deductible business expenses, is added back to the taxable income.

Direct investments

Income derived from direct investments by foreign investors is only subject to non-resident tax in Germany. Where direct transactions take place between foreign investors and domestic customers, a permanent basis in Germany is not required.

German partnership

A German partnership itself is not a taxable entity for income tax purposes. Its income is determined at the level of the partnership, but allocated to the partners in proportion to their respective ownership and subject to tax on the level of the partners. The German partnership itself is liable to trade tax, if its business activity is qualified as a trading activity.

Partnerships are available as general partnerships or limited partnerships. The difference between both is the liability of the partners. Where business is carried through a German partnership, the foreign investor is subject to income tax on the German-sourced income. The determined profits are taxed at the personal German tax rate of each partner. If the foreign investor is a corporation, it is subject to German corporate income tax of 15.825%.

German corporation

A German corporation is an independent taxable entity and subject to corporate income tax on its entire worldwide income.

Distribution of profits from a German corporation to its shareholders triggers withholding tax (capital gains tax) in an amount of 26.375% (including a solidarity surcharge of 5.5%) of the gross dividend. The corporation is required to remit these taxes to the tax authorities and the net dividends to the shareholders. If the non-resident recipient of the dividends is a corporation, the withholding tax rate is often reduced by a Double Taxation Avoidance Agreement between Germany and the corresponding country. The withholding tax liability on the gross amount of the dividends is discharged by the amount withheld.

Exit taxation: The gain on the sale of shares in a German corporation is 100% tax free besides a lump sum of 5% of capital gains, which is qualified as non-deductible expenses. Where the foreign seller is an individual or a partnership with individual partners, 60% of the gain on the sale is subject to income tax and 40% is tax free. Germany's tax treaties typically allocate the right to tax capital gains on the sale of shares to the seller's country of residence.

Losses

Losses incurred in a fiscal year are deductible in the same year without any restrictions. Remaining losses can be carried back to the preceding accounting period up to an amount of €1 million. If there are losses remaining after a carry-back, they may be carried forward for an unlimited time. The offset of losses carried forward is limited to €1 million plus 60% of the remaining profit ('minimum taxation rule').

Capital gains tax

The tax rate for capital gains amounts to 26.375% (including a solidarity surcharge of 5.5%) of the gross dividends. The capital gains tax must be withheld before disbursement of the net dividend.

Double Taxation Avoidance Agreement (DTAA)

In some cases, a company is classified as tax resident both in Germany and in a foreign country. If both countries claim the right to tax the income, it is necessary to refer to the DTAA, if applicable. The DTAA provides for which country will be allowed to levy taxes with regard to the taxable income. Germany currently has DTAA's on income and capital with 96 countries (status as 1 January 2014).

Tax audits

The performance of tax audits will depend on the size and type of the taxable company. Large-scale companies are audited almost regularly at 3-year intervals. Tax audits are field reviews of the books, records and other tax-relevant documents of the past years.

Acquisition (asset deal, share deal)

As commonly practised at an international level, German law distinguishes between the acquisition of shares (share deal) and the acquisition of significant parts of a company (asset deal) with respect to company acquisitions. If an individual company is sold, only the assets are transferred; in sales of companies, the company shares are generally transferred. As an exception, company assets but not shares are transferred if:

- A company is insolvent and business operations are to be continued by the way of a 'reorganisation' with a new company under a new framework
- Only parts of a company are to be transferred, e.g. a production line is to be spun off
- The transfer of assets offers fiscal advantages.

It should be noted that the employees of a company or division must be taken over by the buyer in an asset deal ('transfer of undertakings'). This also applies for the acquisition of an insolvent company. Staff cutbacks in connection with the purchase of a company must be prepared carefully due to the regulations of German labour law.

In Germany, the performance of a due diligence process and business valuation prior to the

acquisition of a company is also a common practice. In business valuations, the capitalised value is generally determined and used as a basis for negotiating the purchase price.

The acquisition of a company often requires notarisation, e.g. the transfer of shares in a GmbH. Errors in form may render the acquisition invalid. Further notarisation entails additional costs.

As soon as the target firm is listed at a German stock exchange, the provisions of the securities law (e.g. regarding insider trading, reporting duties upon reaching thresholds or a squeeze-out) must be observed.

The acquisition of a company by foreign investors generally does not require government approval. One exception is when the acquisition poses a threat to public order or security in Germany, such as in the event of acquisitions involving arms manufacturers.

Transfer pricing

Business relations between affiliated companies must be assessed for tax purposes using the arm's length principle. The companies concerned are required to fully document their transfer prices. The transfer pricing documentation is usually divided into a factual documentation and an arm's length documentation. The factual documentation must contain records of type, contents and scope of the business relations to the affiliated companies as well as on the economic and legal framework. The arm's length documentation must describe the transfer price method and the reasons for the suitability of the method applied.

Taxation of Individuals

Basic principles

All natural persons with either a residence or a habitual abode in Germany are subject to income tax on their worldwide income with unlimited liability. Citizenship is not a relevant factor. The status of unlimited liability is also important for tax allowances and filing options.

In addition to the income tax, a solidarity surcharge of 5.5% and church tax of 8% or 9% (if the resident is member of a recognised church) is levied on the assessed amount of income tax. Non-residents face a limited tax liability, since they are only subject to tax concerning their income from certain German sources.

Determination of taxable income

Residents are subject to tax with their worldwide income only if it falls under one of the seven categories itemised in the German Income Tax Act (GITA).

In the first step, each source of income has to be calculated separately. There are basically two methods for the first three categories, which are income from agriculture and forestry, income from trade or business, and income from self-employment. For further information, see 'Business Taxation'.

The remaining four non-business categories are income from employment, income from capital gains, rental income from real estate, and income from other sources as defined by the Act. The 'net income method' has to be applied for these types of income. Using this method, the taxable income is computed by deducting the income-related expenses from the gross income in accordance with the cash method.

For employees, a lump sum allowance for income-related expenses of €1,000 is automatically deducted per calendar year, unless higher costs are claimed.

The final income is derived by deducting special as well as extraordinary expenses from the total net income.

Special expenses are mainly social security expenses and premiums for other insurances (e.g. health and/or nursing, unemployment), donations or membership dues for non-profit organisations and church tax paid.

Extraordinary expenses are unavoidable expenses due to unusual circumstances or hardship (e.g. costs of medical treatment not reimbursed by the health insurance). Only the amount that exceeds a certain 'reasonable burden' can be deducted.

Finally, an amount of €3,504 per parent and child is deducted to obtain the taxable income. If, however, the child benefit of €1,104 per parent and child is more favourable than the tax benefit of the deduction, the allowance is not granted. If the taxable income is €8,354 (€16,708 for married couples or registered partners) or lower, no tax will be levied. Individual income tax is imposed at progressive tax rates from 14% up to 42%. The tax rate to be levied depends upon the amount of the income itself. Where the income exceeds €250,731

(€501,462 for married couples or registered partners), the tax rate is 45%. For married couples filing jointly, the tax rate is determined by the splitting system.

Double tax avoidance

To avoid double taxation, Germany has signed double tax treaties with a number of states. There are generally two methods to achieve this goal. Either the tax paid in the foreign state will be credited to a certain amount by the German tax office (credit system), or the German tax office will not levy taxes on income from a source in the foreign country (exemption system). The latter method is used in most treaties. Nevertheless, Germany reserves the right to take account of this income for purposes of determining the applicable average tax rate on the income taxable in Germany.

According to the German Regulation of Taxation Art (2 par. 1 Abgabenordnung, AO) the double tax treaties shall take precedence over provisions of the German Income Tax Act (EStG). Nevertheless German legislation has added paragraphs to this Act which claim priority over certain rules of double tax treaties (e.g. art. 50d par. 8, par. 9, par. 10 EStG). Therefore the German Federal Court of Finance (Bundesfinanzhof, BFH) asked the Federal Constitution Court (Bundesverfassungsgericht, BVerfG) whether these provisions are to be held constitutional or not.

Capital gains tax

Since 2009, investment income has been taxable at a flat rate of 25% (26.375% including solidarity surcharge). This includes dividends, interest and capital gains on the sale of securities purchased on or after 1 January 2009. From that date on only this category of income is generally exempt from the individual taxation. Instead a flat rate withholding tax will be levied by the bank or company which pays the interest. A lump sum of €801 (€1,602 for married couples or registered partners) is deducted as income-related expenses. This will only be recognised by the bank if an exemption order for capital gains is filed with the bank in advance. The amount can be split if a person has several bank accounts held in different banks.

Although the flat rate withholding tax has been implemented, the Act gives the tax payer several options to have their capital gains income taxed differently, if it is more favourable for them. One reason for this can be that they missed the deadline to file the exemption order with the bank or it can be that even when the capital gains income is added to their income, the personal tax rate would still remain lower than 25%. Besides that there are other options if the capital gains are related to business assets which have to be filed with their yearly tax return. Withholding tax will be credited in these cases.

In contrast to the former legislation, higher costs relating to investment income exceeding the lump sum are no longer deductible. According to the Court of Finance of Düsseldorf, costs related to capital gains income, that the tax payer received from 2008 and onwards are still deductible even if they are higher than the lump sum.

Filing requirements and payment of tax

The tax year is the calendar year. Domestic taxpayers are required to file a yearly income tax return by 31 May of the following year, unless the return is prepared by a professional tax consultant. The tax consultant can apply for an extension to 31 December. The tax indicated on the final assessment notice of the tax office has to be paid within 1 month after the date of issue. Every tax year married couples or registered partners have the option to decide whether they want to file their tax return jointly or separately. This will of course depend on the total amount of tax levied.



Indirect Taxes

Value added tax

The German value added tax (*Umsatzsteuer* or *Mehrwertsteuer*) system is fundamentally based on European directives. Most of the regulations in all EU member states regarding VAT are identical, as EU law generally ranks higher than national law. Liability for Germany VAT is not linked to citizenship or nationality; the main criteria are sustained conduct of business activities and taxability within Germany. The latter is usually the case if the place of supply is Germany.

VAT applies for virtually all transactions of goods and/or services. Subjects liable for VAT are all individuals and entities that sell any kind of good or offer any kind of service. Exemptions are made if the business is very small and does not break a certain threshold of turnovers. Normally, the provider owes VAT; in some cases, a 'reverse charge' mechanism applies and the recipient owes VAT.

In general, VAT paid during a business transaction is neutral to the business, as it can be deducted by the receiving company. Special regulations apply if output transactions are not subject to VAT; input VAT deduction is limited to certain cases (e.g. intra-community supplies).

Businesses in Germany normally receive a tax reference number (provided by the local tax office) for all taxes. The same goes for foreign entities that engage in conducting business in Germany. On top of that, a VAT identification number is needed to conduct intra-community supplies, which is supplied by the German Federal Central Tax Office (*Bundeszentralamt für Steuern*).

In general, goods and services are subject to a tax rate of 19% at this point. Certain turnovers get a reduced rate of 7%; examples are the supply of books, food items and flowers. Special goods and services are not subject to tax all (as they are deemed to be not taxable or tax free in Germany); examples are intra-community supplies of goods and services, and exports of such items. It is important to note, however, the above-mentioned problem with deducting input VAT in cases of non-taxable output transactions.

Normally, companies have to file monthly (in some cases quarterly) VAT returns to the tax office, stating their output VAT (payable) and their input VAT (deductible) for the respective time frame. Please note: VAT is payable at the moment a turnover is conducted, not when the invoice is sent out. Moreover, it generally does not matter whether a customer has paid yet. Input VAT is only deductible if the company is in possession on an invoice complying with the requirements of German VAT law. Depending on the respective VAT return, an amount due has to be paid to the fiscal tax until the 10th day of the month following the time frame the return was filed for. Upon request, the deadline can be extended by 1 month.

In addition to filing VAT returns to the tax office during a year, businesses must also file an EC sales list every month with all intra-community sales of goods and services. In this list, the

turnovers have to be assigned to the VAT ID numbers of the customers.

If a foreign business has German input VAT but no business activity in the country, then this business can only claim a refund of such VAT using the VAT refund procedure offered by the German Federal Central Tax Office. In this procedure, invoices must be submitted electronically; in case of serious doubt, the Central Tax Office might request original documents.

Real estate transfer tax

Real estate transfer tax (*Grunderwerbsteuer*) is imposed on any kind of real estate transfer, whether or not the seller and/or the buyer are German citizens or reside in the country. In other words, if a British company sells German real estate to a Dutch person, this is still subject to German real estate transfer tax. Normally, both transferor and transferee are liable, but if the contract stipulates the party supposed to pay the tax, the tax office is required to adhere to this stipulation before going after the other party.

More importantly, real estate transfer tax is also triggered by the transfer of at least 95% of the shares of a partnership that owns real estate. The same applies for the transfer or combination of at least 95% of the shares in a corporation. The respective indirect transfer is also included.

Tax exemptions are specified for various transfers such as inheritance, donation, and acquisition by spouses. If real estate is transferred between a partnership and a person involved in that partnership, partial tax exemptions also apply. Moreover, a specific regulation applies to reorganisations within a group of business corporations, where tax exemptions can be achieved under certain conditions.

The amount of tax is normally calculated on the basis of the purchase price. Where there is no purchase price (e.g. in case of business exchanges or business combinations), the value is calculated using the German Valuation Law. Federal real estate transfer tax law provides for the tax rate to be 3.5%; however, each of the 16 German states has the power to determine their own tax rate, since the real estate transfer tax revenue belongs to them and not to the federal government. (See Table 1).

Table 1. Overview of the tax rates in different states

Baden-Württemberg	5.0%
Bavaria (Bayern)	3.5%
Berlin	6.0%
Brandenburg	5.0%
Bremen	5.0%
Hamburg	4.5%
Hesse (Hessen)	5.0%
Lower Saxony (Niedersachsen)	5.0%
Mecklenburg-Vorpommern	5.0%
North Rhine-Westphalia (Nordrhein-Westfalen)	5.0%
Rhineland-Palatinate (Rheinland-Pfalz)	5.0%
Saarland	5.5%
Saxony (Sachsen)	3.5%
Saxony-Anhalt (Sachsen-Anhalt)	5.0%
Schleswig-Holstein	6.5%
Thuringia (Thüringen)	5.0%

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The Next Step

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