Rödl & Partner

Second Edition

Fostering understanding

Martin Wambach (Editor)

How to reconcile entrepreneurial expectations with reality abroad –

financial reviews, experience and recommendations to control companies abroad

Fostering understanding

"Our clients are just like us unremittingly active around the world. We cross linguistic and cultural boundaries for mutual success. The credo is always: understand and be understood. Our colleagues will give everything for this."

Rödl & Partner

"The more people from different countries and cultures meet, the greater our group grows and the more important mutual communication becomes. We must interact with one another to create new Castells. In dialogue we develop great things and grow beyond ourselves."

Castellers de Barcelona

Rödl & Partner

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Editorial

Dear Entrepreneur,

At our forum Going Global in June 2013 we presented the first edition of our book 'How to reconcile entrepreneurial expectations with reality abroad – financial reviews, experience and recommendations to control companies abroad'. This publication attracted so much interest that within a short period of time we received enquiries for more than 1000 printed copies and several hundred digital versions. In addition, we received numerous positive responses and reports for which we would like to thank you. Much of your feedback expressed the wish to receive even more practical reports from more countries. Now with the second edition we would like to fulfil this wish by expanding the section with practical experience reports to include more than 30 countries.

The basic structure of the book remains unchanged. We will begin with a short story from everyday business. Mr. Albert Mayer, regional manager for Central and Eastern Europe for a German Mittelstand company has some doubt as to whether everything is running smoothly in country X. Later on, in the chapter 'How the Mittelstand ticks' we will examine the typical managerial characteristics for the Mittelstand and develop an understanding of their approach towards internationalisation. We will look at the special role of management staff outside Germany. The phenomenon of the estrangement of the subsidiary abroad from the parent company in Germany is the focus of the next section. The course of the estrangement is usually the result of a complex process and sometimes also conscientiously a controlled development. Using the fictional 10 point plan we introduce you to typical facts and give you some recommendations about how you can protect yourself against this phenomenon. The largest part of the material is dedicated to practice reports from over 30 countries. We have put together exemplary facts from the areas of business, tax, law and administration which could present typical barriers on the way to a successful founding and control of subsidiary companies and give you specific recommendations for preventive action and how to handle such situations. Our aim is not to admonish, but rather to show you how you can use existing instruments and structures in your company with appropriate adjustments for the foreign location to minimise risk. In the chapters 'Financial accounting – more than bookkeeping' and 'How to remain in the driving seat' we give you further specific recommendations on how to control your commitment abroad. We pay special attention here to two apparently nondescript areas: financial accounting and the audit of the annual financial statement. However, both provide effective potential for improvement which frequently as yet has not been exploited.

The special quality of this publication (as with the first edition) is achieved through direct reference to our expertise and the experience we were able to collect in over 30 years of our own international business operations. Therefore I am happy that in this second edition my international colleagues have purposefully made their contributions in a qualified manner. This form of co-operation between partners in different office locations and over international borders highlights the special spirit which makes us at Rödl & Partner so efficient and gives us our distinct identity. Dear colleagues, many thanks that despite your demanding daily work you are also able to find time for such projects.

A special thanks goes to Dirk Adams, RA, Cologne, Germany as the responsible project manager who also in the preparation of the second edition ensured the necessary discipline with all participants and with a high level of commitment pressed ahead with the project which in the meantime has taken on a considerable dimension.

A thank-you also goes to Thorsten Widow, our manager for global corporate communications. Together with his team around Beate Heß he ensured the use of clear language, a corresponding layout and the publishing in digital form.

As a well-known saying goes: 'One learns by experience'. But this does not exclude learning from the experiences of others. Let us together exploit your and our wealth of experience and exchange our experiences gained from the international operations of subsidiary companies for our mutual benefit. I would be very pleased if this second edition also attracts your esteemed interest and that you will communicate to us numerous suggestions and ideas as to how we can further improve our international business operations.

I wish you lots of reading fun – and trust that you keep in mind the need for action!

Nuremberg, Cologne in May 2014

Your

Martin Wambach

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Internationalisation

Internationalisation –
A small story

Mr. Albert Mayer, regional manager for Central and Eastern Europe for the company HX Frost GmbH, was very impressed: the new managing director in country X finally appears to be the hoped for right appointment. The personal connections described by him up to the highest level are impressive. He can and wants to really make something happen. And turnover is actually on the way up. Naturally, the new success wants to be shown off, i.e. a new company car to impress customers, better office rooms, more personnel, numerous business trips, etc.

On the other hand the managing director is actively reducing costs. The auditor is exchanged for a local auditor at lower cost and the external accounting service provider is replaced by internal financial accounting personnel personally known to the managing director to be extremely competent. Therefore the expensive accounting program is no longer required. Apart from that the managing director knows one or two good tricks to save on tax and contributions. However, it is annoying that since then it is always very tedious to receive the reporting in an understandable form and language. There are also repeated requests for loans or postponement of payments. During visits to the office which always take place in a friendly atmosphere the managing director has, however, explained that in country X a number of things are different, and, in particular, much more complicated. But no problem – the managing director will take personal care of everything.

Yet Albert Mayer is undecided: perhaps it will simply take a little longer until everything runs smoothly, and surely another reason is the different business cultures…

It is no surprise that German companies are strongly attracted by new and fast-growing markets abroad. The business opportunities, entrepreneurial freedom and impressive success often go hand in hand with a pleasant business climate. Traditional values such as hospitality, the upkeep of personal relationships and the feeling of 'capturing' new countries represent an additional incentive. The other side of the story is that true to the motto ‘other countries, other traditions’ one might be unsure of the extent to which established standards of business conduct in Germany can be practiced or demanded at faraway locations. Before we answer this question, it's worthwhile having a closer look to understand the special characteristics of German Mittelstand companies to see how the Mittelstand ticks.

Time to make an assessment.

Rödl & Partner

This is how the Mittelstand ticks

This is how the Mittelstand ticks

The success story of the German Mittelstand has all to do with the dominant success of niche products in global markets. Technical innovation, excellent flexibility and exceptional commitment are the essential reasons for this success. But we sometimes ask ourselves how Mittelstand companies with their limited resources can found and manage subsidiary companies in faraway continents.

In public one seldom hears of problems with the foreign companies of the Mittelstand. This is because in comparison to large groups Mittelstand companies generally tend to have a lower profile in the media and if there is a report on them this is approved by the company management in advance. But a glimpse behind the scenes reveals a different story. Mittelstand companies may well have difficulties with their companies abroad – and once these difficulties are known they are usually serious.

Major mistakes and misconduct in small foreign companies can quickly jeopardise their continuation. But after the name of the foreign unit bears the name of the Mittelstand global market leader, everything is done to avoid the threatened loss of image. It is not uncommon for the means used to absorb the investment budget of a complete year.

It is quite apparent that many of the successful German Mittelstand companies run risks with the management of their foreign companies which are not be underestimated. One can only understand the essential nature of these risks and therefore also only create realistic countermeasures through an understanding of the entrepreneurial commitment with which the German Mittelstand company runs its business.

The owners of Mittelstand companies are entrepreneurs and they attach importance to the fact that they run their business differently to the managers of large international groups. Mittelstand owners are also not investors which follow a rational shareholder value policy. They work for the well-being of the company, their employees and the local community. While company groups focus on the public representation of their success, the Mittelstand managers are more concerned that the company is considered to be a well-managed company in the region.

A well-managed company in the eyes of the Mittelstand especially includes an atmosphere of mutual trust. In this respect the Mittelstand are well aware of their role model. In contrast to managers controlling company groups, the behaviour of the boss of the Mittelstand company is also actually noticed. This is because many of the employees have many years of company service, one has daily contact, and the work is carried out intensively together.

Mittelstand managers are well paid, but they are not primarily motivated by money. An interesting scope of duties, a high level of responsibility and should it be necessary a direct path to the boss all contribute to their long-term service in the company. As everyone does what is required by the task and situation, the Mittelstand does not require guidelines. Guidelines are something for large company groups where staff departments have to be occupied and administrators tend to hide away behind the requirements of the group.

In addition to the fact that Mittelstand understanding of management is characterised by trust, a further significant difference to large group company groups is the clear focus on technical/commercial function. This is because in their capacity as managers the Mittelstand do not maintain a financial portfolio but rather run an actual business. And in their daily business the important priorities are the customer and the product. Sales and engineering work together to repeatedly win customers and provide them with first-class service. Customers and therefore the typical Mittelstand company have no need for an inflated finance department or other staff departments.

The commercial department manages the necessary financial accounting including the annual financial statement and supplies the company manager with the figures he feels are important. The Mittelstand is not generally concerned with 'economic value added' or 'return on investment'. Key performance indicators are rather turnover and natural the profit. Each product must make its contribution to the success of the company. For this purpose there are turnover lists, pre-calculations and post-calculations. A small commercial department can manage this using practical company software. In this process the IT resources in the Mittelstand tend to be lean. Money is only spent on expensive systems if they promise a clear advantage for sales, logistics or production. Even when the importance of business ethics in the company is clearly understood and the head of the department is at least vested with power of attorney or he even has the level of a managing director, the department is consciously kept small. This is because “administration” does not create business.

The dispensation of bureaucratic structures and a highly motivated trust-based organisation are key tools where the Mittelstand companies are more effective in the market than large groups. And why shouldn't one use this recipe for success with a venture abroad? Mittelstand companies are aware that the founding (or also acquisition) and development of a company abroad require a considerable effort. The significant bottleneck here is the personnel resources as in contrast to large companies the Mittelstand companies can only in exceptional cases recruit technical specialists from among existing employees for a longer stay in faraway countries. One consoles oneself with the thought especially in the difficult set-up phase that the lack of local knowledge of such personnel means they would only be able to make a limited contribution anyway. This is particularly true for junior staff more likely

to be open for a stay abroad than their older colleagues and managers. At best there is the willingness to send technical specialists abroad in their technical function for a limited period of time. As a matter of principle, however, it is not en vogue for the Mittelstand to send employees abroad for a long-term stay. The widely held view is that in the long term the business is better managed by local managers, people who know the country. The fact that these people are also considerably less expensive than employees sent abroad is a pleasant side effect.

Consequently the requirements placed on local managers are very high. The general manager required for a subsidiary company should have the respectively defined technical or commercial qualifications and have the qualities of an independent entrepreneur. This corresponds to the entrepreneurial commitment of the Mittelstand and is a sheer necessity, i.e. the right candidate must independently develop and manage the business far away from the parent company without the benefit of integration in a large support structure. The recruitment process of the general manager generally takes this profile into account. Whereas his salary may be generous if one makes a comparison in local terms, it is taken for granted that the personnel costs for commercial administration will have to cost less. Therefore the office will make do with one qualified business person and a single person to do the financial accounting, naturally paid at the local salary rates.

If possible – and especially in the set-up phase – the financial accounting and the IT can be outsourced to an external service provider to keep the burden of fixed costs as low as possible. A further potential for saving is the selection of a local auditor who provides his service for a fraction of the fee demanded by an international organisation. But if, however, an international auditing firm is chosen, then a lean auditing format is preferred because at the end of the day the company is not part of large company group. And with regard to the selection of tax and banking services, the local employee at the company will know best what is required in the country and what it should cost.

The personnel resources outlined for the subsidiary company abroad follows the same entrepreneurial principles for the management and organisation which are pursued in the parent company, i.e. a technical and commercial focus concerning entrepreneurial decisions and limitation of the commercial department to the absolute minimum. In comparison to the company headquarters, the foreign subsidiary is much smaller and its structures have to be correspondingly leaner.

Partly due to the lean structure, the Mittelstand entrepreneur prefers not to burden employees in the subsidiary with bureaucracy, but to allow them more freedom. In this process he trusts that the management personnel in place know exactly what they have to

do and act accordingly. In other words, the location may be small and a long way away, but in principle it will function as the same way as the parent company does back home. What can one realistically expect from the employees located far away? For the foreign subsidiary to actually function in the same way as practiced by the entrepreneur in the parent company, the local management personnel must correspond to the standards which the employees at headquarters have to abide by at the parent company. Yet while the employees in the parent company are characterised by a training and socialisation process spanning a number of years, experienced management personnel for the foreign subsidiary have to be acquired on the market. On closer inspection it becomes apparent that the required independence abroad even results in higher requirements placed on professional competence, diligence and personal integrity.

In the last decades many countries outside the old industrial regions have made good progress regarding the qualification of their management personnel. However, in the fast growing emerging economies, the Mittelstand entrepreneur has to ask himself what kind of arguments he can offer to acquire the best people. Here it would seem to go against his natural principles to win the competition with international groups by offering a higher salary. The meeting of the existing list of requirements often seems like trying to do the impossible. For example, if the general manager has to be a well-qualified specialist and at the same time have independent entrepreneurial spirit, this will exclude younger motivated candidates who at least in the early years will require a certain level of support from the company organisation. This essentially leaves experienced candidates with professional entrepreneurial skills. But why should such a person wish to continue his career in a small company with just a few employees? In fact there are many indications that important points for this person may be the salary, company car and the title of managing director.

The situation will be similar regarding the selection of the business assistant. If, for example, the foreign subsidiary is a production facility, the business assistant will basically have to cover the full range of responsibility at the subsidiary similar to that required of the head of the commercial department at the parent company. Taking the lean personnel resources into account, the person at the subsidiary will have to manage the accounting, act as controller and treasurer, and also have to be able to competently handle the tax consultant, external IT service providers, and other experts. The Mittelstand company often underestimates this wide range of requirements. And if the parent company is aware of it, the question remains to be answered as to which well qualified person can take up the position. Who will cover this demanding range of duties and given the lean personnel structure of the department is also prepared to take over a multitude of simple office tasks himself?

In general there is evidence to suggest that starting with the choice of personnel in their foreign subsidiaries, Mittelstand companies often do not have the experience and competence required for the subsidiary in combination with the necessary management organisation characterised by personal responsibility and trust.

It makes no difference whether this concerns the commercial or technical department: a lack of competence combined with a "relaxed" management organisation harbours considerable risks. Past experience shows that as well as risks occurring through carelessness, dangers can also remain unrecognised due to a lack of competence and experience. For example, the daily business of the technical department neglects the subjects of occupational safety or safeguards against hazards. In the commercial department, for example, data protection, tax transfer pricing documentation or special customs regulations are not sufficiently observed. If insufficient knowledge of the prevailing regulations leads to these duties not being dealt with, this can lead to a considerable amount of damage. If we take all these conditions into account, it becomes clear that one cannot leave a relatively small company far away from the parent company to its own devices.

Diligence and reliability are virtues which the employees at headquarters have acquired in the course of a training and socialisation process. Someone who turns out to be unreliable will not reach or stay in a management position. It is an open secret that in this respect in some regions of the world other standards are applied. On our holidays we may well appreciate the easy-going attitude of the locals in the foreign country, but in our own organisation this behaviour would be seen as carelessness which could have serious consequences. An example of this could be the conclusion of business transactions which are not fully understood. While this would be a capital sin for a German business person, a number of colleagues abroad like to rely on external advice.

In general the Mittelstand entrepreneur quickly realises that sometimes in a foreign subsidiary there is a different understanding of diligence and reliability. Instead of reacting with corresponding control mechanisms, this knowledge is usually accepted in a broad minded manner as being typical for the country and the management at the subsidiary is allowed to control itself. A common proven tool for self-regulation is the implementation of dual control. Given the low staffing level the effectiveness of this control mechanism is, however, limited by the actual situation. Firstly, the initial supervisory step is missing: whatever the manager, for example the commercial manager, has to sign will due to his high level of operative duties frequently have been prepared by himself so that the item can only be checked by the general manager or production manager. But which of these two is in a position to be really able to evaluate and check the financial transactions of the business operative? Furthermore, if the management style of the general manager is

based on hierarchy, there remains the risk that he will not scrutinise further because he may wish to save himself the embarrassment of not being in the know. In fact in many countries the principle of dual control does not usually apply to the boss: the CEO at the top of the company signs by himself. According to the understanding of the country a second signature would put into question the sole management position of the general manager. Experience has shown that the implementation of the corresponding signature regulation at this level is extremely difficult. In addition, one cannot necessarily assume that management personnel you only see a few times a year have the same level of integrity you know from long-serving employees in the parent company. This is because without prejudice to the foreign management personnel one has to accept that one does not know them as well as the employees at home. Apart from that there is the fact that in a number of countries a low level of corruption is common. Usually this so-called petty crime may not be known in detail to the Mittelstand entrepreneur, but in principle will be known for the country in question. In the hope that certain limits will not be exceeded, this is accepted as typical for the country provided the team at the subsidiary otherwise do a good job. This is at least implicitly also a component of the Mittelstand trust-based organisation.

It should now have become clear how crucially important it is for the trust-based organisation to function for the management of the Mittelstand subsidiary abroad. In this process, however, the trust is often questioned from one side, although trust can only function if it is mutual. In fact each manager in the parent company has to ask himself to what extent does he himself enjoy the full confidence and appreciation of the team at the subsidiary. But in this context it should also be considered that in contrast to the day-to-day business at the parent company one doesn't see each other every day. The colleagues in the company abroad do not experience the Mittelstand boss every day and therefore it is much more difficult for them to form an opinion about his integrity and reliability. Instead, the managers from the parent company fly to the subsidiary several times per year for a few days and in this short time try to completely work through their agenda. It is obvious that at the subsidiary one gets to know colleagues differently compared to the daily business of the parent company.

In countries with a bigger prosperity gap than Germany another factor is that the visit from Germany is made using 4 to 5 star hotels and therefore leaves a noticeable impression on the monthly result of the subsidiary. This may well not yet lead to distrust, yet it documents a certain distance between the parent company and subsidiary which is not easy to overcome. Then, when a certain level of petty crime is presumed the question arises whether the own behaviour in the eyes of the employees abroad may subjectively move the boundaries of the tolerated corruption. The trust-based organisation usually provides the necessary freedom for this.

From a rational point of view, one has to admit that many mechanisms of the Mittelstand trust-based organisation do not work with the management of faraway foreign companies or at least take a lot longer until they take effect. To the extent, however, that the function of the trust-based organisation cannot be fully assumed, risks will arise and the controls deemed to be unpleasant will become a reality. In this situation the focus will not be on a systematic risk management. The main control instrument in the Mittelstand is the financial reporting system. As the reporting system orients very strongly to the control philosophy (turnover and profit) of the parent company, a lean income statement is the main component of the at best monthly financial reporting measure. Furthermore, a balance sheet is usually also sent and much more seldom a liquidity report. Regular cash-flow statements are rather the exception with the Mittelstand.

Under consideration of the lean IT infrastructure, the regular reports do not come from a global ERP system, but from a manual or semi-automated written Excel file. The line structure of these reports is highly aggregated or at least analysed in a much aggregated summary. Anyway, normally only limited capacity is available in the parent company for the analysis of the monthly reports. Investment controlling is carried out in parallel and is not at the top of the list of priorities. This is another reason why the contents are usually not questioned. It is also indirectly assumed that the preparation of figures is made according to the same rules as in Germany. Local accounting plans, other booking habits and deviating valuations remain undetected.

If need be they are adjusted in the course of the annual consolidated financial statement. And whether the auditor of the foreign company really sees the necessity for this depends partly on the scope of his audit assignment and also on his knowledge of the German accounting standards. One striking example of the pitfalls of the reporting process is the transition from the income statement of the Anglo-Saxon cost of sales method over to the total cost method used in German financial reporting. In the Anglo Saxon single circuit systems the input materials are usually directly booked from the material store to the order (work in progress). This concerns a booking between inventory accounts so that a material cost is not reflected. Consequently, in the transition to the total cost method the cost of materials has to be retrospectively determined as a residual value from performance, results and the other expenses.

If one considers that the cost of materials in production companies represents the largest cost item, it becomes clear that in the manual determination of such a supposed residual amount for the financial reporting process errors in other expense items will be forgotten. Anyway the line structure of the financial reporting is oriented to the reporting of the control practices of the parent company. But items deemed to be important and necessary in the

parent company need not be the same as the facts which have to be observed on a practical basis in the subsidiary. For example, currency hedges relating to orders in Germany are typically made in a single valuation unit. The intermediate resulting book gains and losses are not subject to special monitoring because they neutralise as the order is executed. In countries where the currency is not freely convertible, currency hedging is frequently made on the basis of the flat rate foreign currency requirement as a balance of the planned foreign currency transactions in sales and purchasing. This form of protection clearly represents a much higher form of risk but is often hidden in a collective item included in the reporting.

Also, when the turnover and result are correct in the financial reporting, each Mittelstand entrepreneur should ask himself how meaningful his lean reporting really is and what risks are associated with the manual preparation of Excel files.

The answer to these questions decisively depends on the extent to which the commercial department really understands the working methods of the colleagues in the company abroad. How much does the parent company understand of the processes in the subsidiary company? The commercial support the subsidiary receives from the parent company is mainly concentrated in the founding phase of the company when the legal questions are clarified, the auditor is selected and the lean reporting system is introduced. In contrast, the setting up of commercial systems and procedures is usually the responsibility of the commercial manager as ultimately only he and the auditor are familiar with and can implement the local requirements. In other words: the parent company generally does not set up the greater part of the commercial organisation at the subsidiary.

In later years the business operative from the parent company mostly only visits the subsidiary once per year (or less). He cannot spare any more time and the Mittelstand entrepreneur also has no understanding of the necessity. Along with a courtesy call at the local bank, during these visits the local auditor is primarily consulted in order to discuss the annual financial statement and the management letter. Furthermore, together with the commercial manager from the subsidiary, the planning, sales projections and possibly also individual order results and financial questions are discussed. Any subjects not coming to light in these meetings will continue to remain hidden. The meticulous search for possible deviations and inconsistencies would not be in keeping with the principles of the trust-based organisation.

Basically the parent company is aware that a number of processes in the subsidiary are being handled a bit differently to how they should be handled. But detailed knowledge of these processes is usually not available. In fact, also here one trusts that matters are proceeding in the proper manner. However, the definition of the proper manner can vary greatly between different countries.

And a number of other differences can be identified in the commercial organisation. With the total cost method and currency hedging two remarkable differences between the commercial systems of the parent and subsidiary companies have already been mentioned. Without attempting to list all of the differences, further points are listed in the following which are typically organised differently in small subsidiaries abroad.

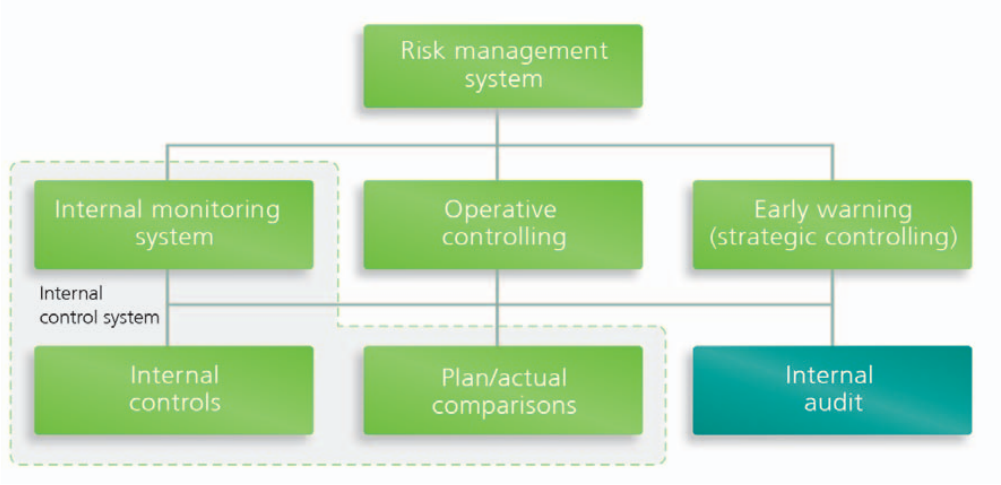
In the process of cost accounting, the components of the manufacturing costs are often deferred very differently. If a regulation does not exist which is valid for the whole group, it will not be possible to seriously compare cost rates or product costs. If changes in inventory also have an impact, the effects on the income statement and balance sheet vary greatly. While nowadays in most German companies in principle a planned, standard or normal cost accounting prevails, in some countries – mostly tax-based – an actual cost accounting is still used. In the case of underemployment this causes the manufacturing costs to rise. In the case of inventory stockpiling, however, the negative effect is only later visible with the revenue recognition.

In various companies non-recurring payments are usually deferred very differently. While, for example, one company discloses a high loss during the holiday period, a different company has distributed the corresponding idle costs to the productive periods. This effect is difficult to overlook and is therefore known in the parent company. It is clear that with these fluctuating results a number of effects can easily be booked which one is reticent to discuss.

While in the parent company there are usually very strict regulations regarding the formation, utilisation and release of provisions, the provisions account in smaller subsidiaries abroad is frequently the place where all deferred items end up. Although the figures are adjusted for the audit at the end of the year, the bookings made in the course of the year are not always transparent regarding an appropriate utilisation or release according to expenses. To the innocent, everything would seem to be in order.

In respect of the handling of payments, in most German companies it is in the meantime usual to make payment transactions once or twice per month. Payment orders are then usually imported via the financial accounting system into an electronic banking system and the payments made are reported back in the same way and booked. In the best case this procedure is concluded and fully documented in the system. In contrast, in many countries payments are still made manually based on forms, printed payment orders, presented checks and even with bills of exchange. Quite apart from the associated disadvantages with regard to productivity these procedures do not reliably provide complete documentation and traceability in the IT system. In reality it requires a thorough paper filing system, which can only be checked through personal inspection. As personal inspection is rather untypical for a

trust-based organisation, this opens up undreamed of possibilities for fraudulent acts. These circumstances are promoted by systematic weaknesses in risk management. Company-wide ERP systems tend to be rare. In fact the situation is usually that the internal accounting has grown organically over the years consisting of numerous local financial accounting programs. The operative controlling of the parent company is much more concerned with the company planning, ad-hoc troubleshooting of crisis situations or financial accounting questions with subsidiaries. There is often insufficient time for a planned and systematic discussion about deviations. Strategic controlling in the sense of monitoring appropriate early warning indicators in the different markets and areas with the aid of suitable instruments such as competitor evaluation, trend assessment, etc. seldom takes place systematically.



The same is true for the internal audit. In practice an aversion to internal audits can be identified in Mittelstand companies. The inspection or monitoring of the correctness of business processes is seen as counterproductive to the trust-based culture. The setting up of staff departments and management of internal audits is considered to be an excessive amount of red tape or an investment which is not productive. In this way the company structure of Mittelstand companies differs greatly from that of large groups which have their own staff departments for legal, compliance, company development, risk management and internal audit matters. In the Mittelstand these duties are regularly taken over by the managing directors or other management personnel in addition to their existing duties.

The risk here is not so much the non-existence of the staff departments but rather the gradual lack over time of information and expertise. As well as with the set-up and operation, the difference in procedures between the Mittelstand and listed or group

companies, however, is also evident in the founding process. Mittelstand companies regularly reduce the utilisation of external consultants in the areas of law, tax and commerce to the absolute minimum. Managers trust in their own research. Drafts for articles of association are frequently made without external assistance, whereby the task of the consultant is restricted to having a "quick look".

If an acquisition is made of a foreign company or part of a company, the execution of due diligence using qualified advisors is still not yet usual practice. Inspections and reviews of the financial, commercial, legal and tax situation of the target are made using own personnel. As a result it is possible that specialities of the respective country are overlooked. This can lead to serious consequences such as questionable ownership of real estate or machines, costly procedures regarding the termination of employment or a lack of a basis for claims relating to contract defects.

As already indicated, the Mittelstand would be able with just a few specific measures such as the complete use of existing structures or the involvement of external consultants to compensate for its lack of expertise or information, but very often there is – especially in the Mittelstand – a fear of consultants, or, shall we say, scepticism regarding consultants. This admittedly often results from the conduct of the consultant himself with pre prepared "standard solutions" for problem scenarios, the use of incomprehensible jargon and the failure to ask about the exact circumstances from those who best know the details, namely the company management. When high fees are then charged for "standard solutions", the Mittelstand entrepreneur being usually very cost conscious politely rejects the proposals and addresses the problem himself – or in fact fails to address the problem correctly. Apart from the unfortunately frequent consequences for the company, this behaviour from the company management is fully understandable. A rethink to remove the scepticism regarding consultants is also advisable for some consultants. What is required is a sense of proportion, attentive listening, individual solution approaches and understanding for the business and the language of the client. This is the only way to talk on equal terms which can lead to measures which are co-ordinated together and implemented.

Our overview illustrates how the Mittelstand sees itself and the approach it takes regarding the subject of internationalisation and subsidiaries abroad. Numerous differences to listed companies can be identified, whereby at this point it should be emphasised that listed companies are not necessarily more successful. The current example of ThyssenKrupp in Brazil and many others show that there is no one-size-fits-all solution for permanent economic success in foreign markets or that despite an apparent professional approach even listed companies have to fight risks which are similar to those the Mittelstand are faced with. It is not our intention to make any judgement as to which way is ultimately more successful.

Our aim is to highlight important aspects and provide information to help companies prepare for the task of controlling subsidiaries abroad. The next chapter will raise awareness of these issues where we will address the phenomenon of the estrangement of the subsidiary abroad from the parent company. Estrangement is usually the result of a complex process where the previously mentioned aspects regarding the control of subsidiaries abroad come into play.

More form than substance

More form than substance –
A different perspective sharpens the focus of the big picture

With the support we provide for German companies abroad we are happy to report that together with our clients we have been engaged in many successful stories where the trust in the local partner turned out to be completely and fully justifiable. Unfortunately there are also a not inconsiderable amount of cases where due to an unreliable employee or partner the business has suffered substantially. The appointment of management positions – as already indicated – is never really easy. In foreign countries this subject takes on special significance. The entrepreneur is faced with the following important question: should I send a manager who is familiar with our company culture or should I opt for a local manager who may know the country but is not familiar with the German corporate culture?

Occasionally at the beginning of their venture in a foreign country German Mittelstand companies send one of their proven experienced managers or at least an employee from the middle management. The advantage is that these persons know the company and therefore also the company philosophy and are able to represent the products or services. But they do not know the market or the competitive environment and are not familiar with the respective local business customs. This can considerably hinder such an important start at the new location.

If, in contrast, highly qualified foreign management personnel are acquired to take over the position of the manager abroad, this step is also associated with risks. Foreign management personnel often have a relatively low emotional connection to the company which can lead to undesired departures which are difficult to plan because the company across the road is willing to pay a much higher salary. In addition, in some cases the management structure which is typical for German Mittelstand companies – characterised by trust and the granting of entrepreneurial freedom – can lead to a change of the self-perception of the local management as these – as is customary in that country – expect hierarchical structures.

In the worst case such a self-perception can lead to the fact that the position as a local managing director is conscientiously being used to his own advantage.

At the start	**"Without management or control":**
My employer →	My own company
My targets →	The success of my company
My salary →	My fair share of this success

From our activities in connection with such cases it is possible to identify some reoccurring and typical patterns of behaviour.

We therefore see it as our responsibility to raise your awareness as our client by sharing our knowledge with you so that you can take the appropriate measures in good time.

Now how can one recognise whether there is a possibility of undesirable developments? In such cases it is helpful to change the viewpoint and put yourself in the position of the other party, i.e. in the position of the local managing director who is acting for his own advantage and not in the interests of the company. As you are not familiar with these kind of manipulative actions we would like to introduce you to the following 10 point plan where we will take on the role of your mentor who will show you the tricks which would be helpful if you were to take on the role of the local manager who is primarily concerned with furthering his own interests as managing director of the subsidiary in the foreign country.

We have decided on this unusual means in order to bring you closer to a different way of thinking and acting.

You will see it's easier than you think!

The 10-point plan

Point 1

Win the trust of the German company management

In foreign countries it is much easier to build up personal relationships with Germans and gain their trust than it is in Germany itself. A lack of knowledge of the language and culture and the associated insecurity deceive some German entrepreneurs into being less choosy in the selection of the person they will have to trust.

These points can be selectively used in combination with the following measures to build up trust:

- Good knowledge of the German language
- Development of personal relationships for example through use of first names (in Germany this is usually a special demonstration of trust), invitations to restaurants, visiting the family home, invitations to join a hunt also in other localities and return visits to Germany, readily with the family

Notes:

- Good knowledge of the German language is no replacement for professional knowledge and in particular does not guarantee an honourable character.
- Non-locals will find it almost impossible to differentiate between traditional hospitality and its misuse. Nobody need fear that the rejection of an invitation will be assessed as an insult. Business partners will accept this because you come from a different cultural background.

Recommendations:

- The introduction of compliance regulations which if necessary can be referred to.
- Check the acceptance of personal invitations and if necessary consult knowledgeable people.
- Before hiring management personnel or entering into a business relationship always carry out an integrity check (naturally while observing privacy rights).

Point 2

Impress the German company management

In Germany a culture of modesty prevails. Personal relationships also do not play a role to the extent that they still play in former socialist states and as a result are maintained with less energy. However, the unusual showing off attributes of (apparent) success are very effective and can mislead the German who may conclude that the person opposite him is successful and a powerful personality.

This opens up possibilities for:

- Mentioning of acquaintances with and relations to prominent public personalities, judges, police, etc.
- Arrangement of appointments with prominent public personalities, politicians, celebrities, etc.
- Membership of associations
- Awards/certificates
- Luxury goods (cars, watches, clothes, houses, hotels/holidays)
- Insider information/good relationship to employees in public authorities

Notes:

- The knowledge of the role of status symbols in transition countries with extreme social change enables the correct classification thereof.
- The high financial burden associated with the acquisition (often financed by credit) and maintenance of status symbols can lead to financial difficulties which can threaten the company. This in turn lowers the threshold for irregular action, e.g. embezzlement and the employee/partner is a potential target for blackmail (e.g. with industrial espionage).
- Good relationships are naturally decisive for the development of the corporate network and the success. However, they represent a higher potential risk for example for the granting of impermissible advantages or corruption.

Recommendations:

- There should be regular inspections as to whether the living conditions of partners/employees correspond to their income and living situation.
- Reports of emergency financial situations (e.g. requests for loans and advances, loss of a car, moving, and salary garnishments) should be followed up and if necessary discussed with the employee/partner.
- The achieving of success not measurable through the balance sheet result should be agreed upon.

Point 3

Win control of the legal position of the subsidiary in the foreign country

One objective is the ability to control the legal position of the subsidiary for one's own advantage and to avoid too much influence from the German side on legal structures.

The following measures can lead to success, supported with appropriate arguments:

- We'll take care of it ourselves ("Founding a company is very easy in our country – we always do it ourselves and we've never had problems up to now.")
- A contract which is unfavourable for the German side ("We'll take care of that – we have a very good lawyer/notary who will draw up the contract.")
- The lawyer is a friend/acquaintance ("He will do the job for a lower price.")
- Contract concluded with a notary ("We will have the contract certified by the notary, then everything is sure to be correct and secure.")
- Arbitration court (national) ("For the arbitration of disputes we will agree on the local arbitration court for commercial matters – the national courts are all no good.")
- Contractual penalties ("Such contractual penalties are normal in this country.")
- 50/50 shareholding ("That is fair".)
- Minority shareholdings ("It will be very motivating for me if I have an interest in the company.")

Notes:

- Certification from a notary in principle means more security, but this is no replacement for the qualified drawing up of the contract. Furthermore, care should be taken to observe that in a number of countries the duties of the notary with regard to neutrality and clarification are considerably less strict than in Germany, whereby the inspection of the contents of the documents partly does not place or is subject to unclear or at least to differing standards.
- Local arbitration courts are (in contrast to internationally recognised arbitration courts) usually controlled by certain persons or local interest groups and therefore not recommended. A decision to go through the appeal stages is usually not made. National courts usually (provided international arbitration courts have not been agreed upon) represent the "lesser evil" of the two.

Recommendations:

- No 50/50 shareholdings without regulations to deal with possible deadlock. Otherwise the company may be unable to take any action, e.g. not be able to dismiss a managing director who is no longer required or not be able to appoint a new one. In such cases the last resort is liquidation and in order to avoid possible loss of the investment there is the considerable risk of blackmail.
- The concession of participation rights (e.g. for employees) should be carefully weighed up because also minority interests (for example in case the shares are sold) can lead to considerable problems.
- A competent consultant who is free of local conflicts of interest will create the right legal conditions for your commitment which will enable you to have the necessary security and control.

Point 4

Act as if you are conscious of costs

Mittelstand companies are especially conscious of costs. Using the cost argument one can usually avoid the inclusion of consultants and other service providers who will enforce the interests of the German side.

›
› No contract "No one will benefit from a contract here – it will only cost money and if there is a dispute the courts will not work anyway, the right contacts are much more important." /"Why do you want a contract? I thought we trusted each other, my good friend!").
› Show moderation with the fixed salary – high profit sharing ("I would like to be judged by my success and have the necessary self-confidence.").

Notes:

› High profit sharing with a low fixed salary can lead to a temptation to embellish results.

Recommendations:

› A healthy relationship between the fixed salary, profit sharing and incentive payments for achieving success not measurable through the balance sheet result.

Point 5

Ensure control over the figures of the subsidiary in the foreign country

Care should be taken that the control possibilities from the German side through an auditor or external person are restricted as much as possible.

The following measures can be used to achieve this:

- No external financial accounting ("That is not usually done here/that will create problems/that is too expensive and will achieve nothing.").
- No execution of the annual financial statement or management reviews.
- If there is a statutory audit requirement, take a local auditor ("The auditing is only a requirement which is a nuisance and the information is of no value anyway which is why one can safely take the cheapest supplier." / "We know an auditor who will give us an unqualified audit opinion without any problem.").
- Tendering of the auditor with subsequent control of the tendering procedure so that the desired auditor gets the job for an excessive price with a kick-back payment to the organiser of the tendering.
- Hiring of friends/relations/dependent persons for the financial accounting/CFO.
- Regular information about obscure financial accounting regulations, numerous outstanding issues.
- Regular presentation of German/English reports not possible (e.g. for technical reasons or due to lack of enough staff or translation capacity).

Notes:

- The view that the outsourcing of financial accounting is only practical at the beginning of the activity is incorrect. This takes away the possibility of an important and unbiased control instrument. If all the costs of doing own financial accounting are taken into account (IT, personnel recruitment, illness, etc.), outsourced financial accounting is often only insignificantly more expensive.
- An independent and qualified audit of the annual financial statement provides (for example via the management letter) important information on the commercial situation of the company and the condition of the financial accounting.

Recommendations:

- Commissioning of an international auditing firm by the parent company for the audit of the annual financial statement or voluntary annual financial statement or review when there is no statutory obligation.
- Outsourcing of the financial and payroll accounting and reporting to an international financial accounting firm which can provide the necessary answers to any questions at short notice and can also handle the transition for the local GAAP to HGB or IFRS in order to ensure understanding and comparability.

Point 6

Show success

Experience shows that if success is shown the requirements with regard to transparency and control can be reduced to minimum.

For this purpose it is relatively easy to bring about some success at least in the short term and sometimes in the medium term, for example, as follows:

- Disclose a high level of receivables – without a legal or commercial requirement to do this.
- Value adjustments of receivables are only made on a small scale (“in country X this is not possible or very difficult to do”)
- Have an “independent” valuation report made (e.g. for current/fixed assets).
- Push turnover and growth at any price, which is why security is neglected.
- Regularly report about own merits and regularly report on alleged errors and failures of external consultants (“They can't and don't do anything and cost a heap of money.").

Recommendations:

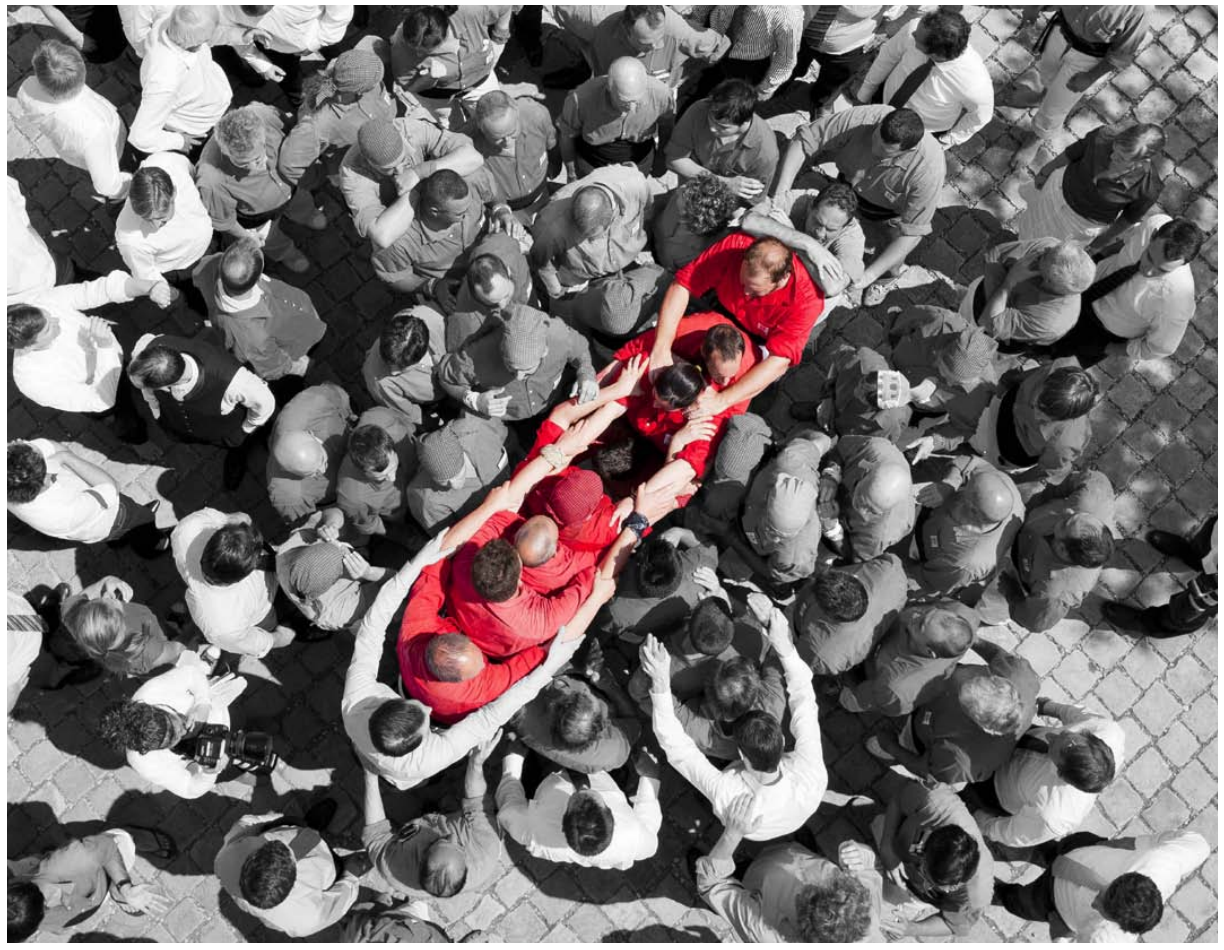
- Even when a positive commercial development is reported, compliance and control measures should not be neglected.
- See recommendations to point 5.

Point 7

Build up safety net for one's own cause

Sooner or later it's likely that fraudulent actions will be discovered. In order to avoid negative consequences, one should take measures in time to be prepared for such a situation:

- Make your contact in the parent company susceptible to blackmail by proposing tricks in order to "save" tax or social contributions.
- Propose to utilise the subsidiary in the home country for the purpose of saving tax.
- Set up illegal cash box (e.g. using allowances for employees on supposed business trips).
- Complicity in granting an advantage/bribery.
- Double-employment in the company and the subsidiary/ensuring power of representation after dismissal as managing director.



Recommendations:

- Zero-tolerance policy for illegal cash box and bribery.
- Clear guidelines and transparency at all levels and the corresponding documentary requirements.
- Changes to improve tax situation only on the basis of the corresponding independent clearance certificates.

Point 8

Exploit own position

Starting from a stronger position after the above points, these should be used for one's own interest.

The following is possible:

- Use of company assets for own purposes (machines, fuel, offices)
- Founding of companies through front men who have a commercial relationship with the company
- Settling of salaries and services via companies abroad
- Off-the-record sales
- Employment of family members/circle of friends
- Creation of "ghosts"
- Holiday as training/education
- Demands for kick-backs in the contract award process, etc.
- Impermissible granting of financial benefits
- Involvement of "agents" (especially for the export business)
- "Charity" to obtain public contracts
- Purchase of company assets (e.g. land) at excessive prices
- Setting up of own customer database (see golden exit)
- Demand more financial support from business partner
- Demand financing

Note:

- It is not only about direct gain, but also about compliance infringements which at first glance are of use to the company (setting up of an illegal cash box whose contents can be used for bribery payments to win orders) but which can damage the company considerably (e.g. exclusion from participation in public tenders).

Recommendations:

- The statement of the responsible person that he only acted in the interest of the company must be addressed in a preventive way through corresponding training and compliance regulations in writing.

Point 9

Continual defence

In the case of queries (“The earnings situation according to the books is excellent – but why is there a lack of liquidity and why do you continually need shareholder loans?”) or the case that there is mention of a clear suspicion of compliance infringements, one can argue as follows:

- “This is the only way to do business in country X.”
- “In country X everything is more complicated than in Germany.”
- “If you want success, then you'll have to let me do it my way.”
- “You don't understand it and you don't want to understand it.”
- “In country X you have to do it that way.” (should always be checked)

Point 10

The golden exit

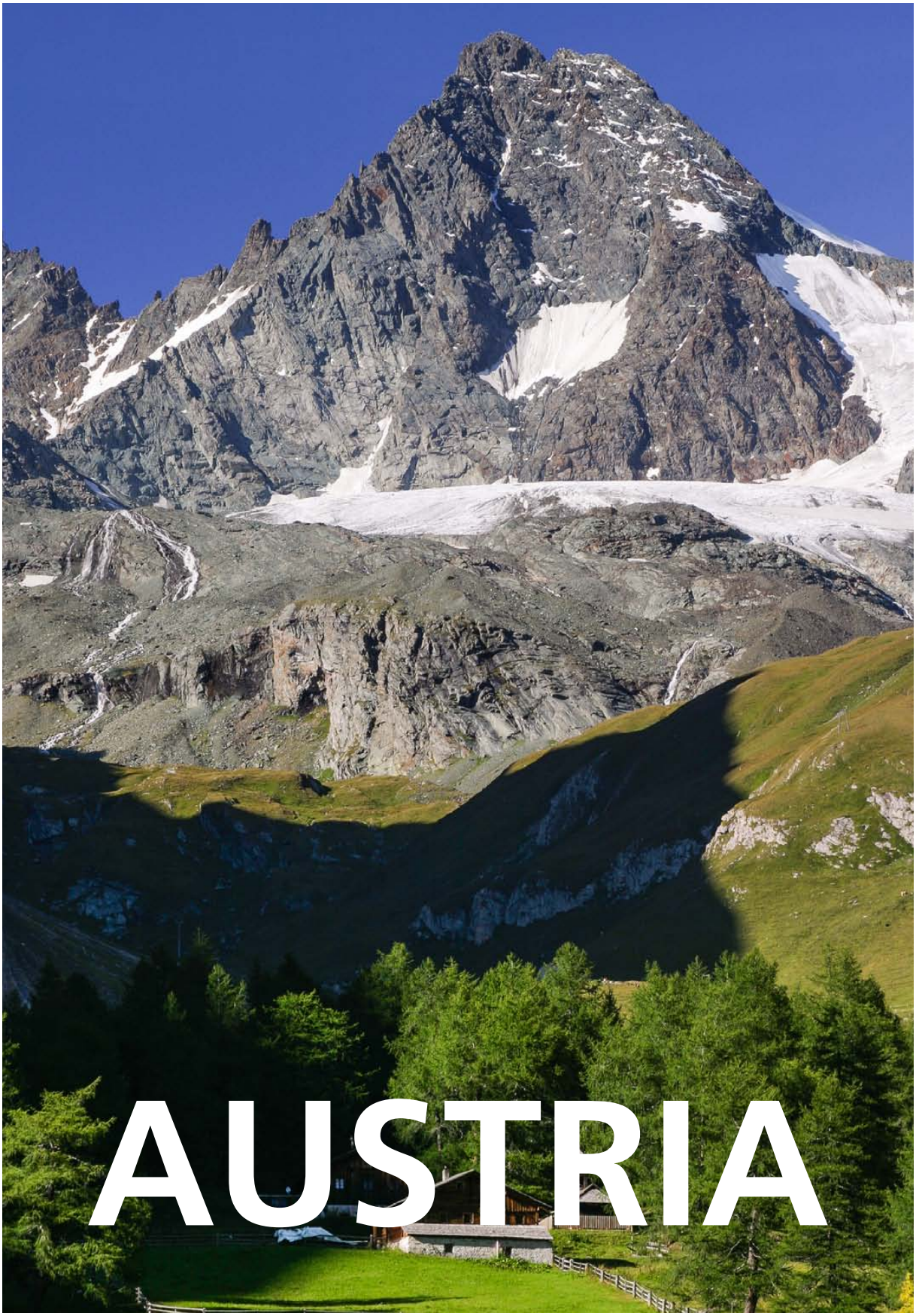
If discovery is imminent, one should prepare to leave the company and in financial terms use this opportunity to once again get the most out of the company:

- Build up threatening posture, see blackmail in point 7
- Threaten bankruptcy; scandal; personal consequences for the responsible employee on the German side, if necessary threaten suicide
- Assert claims for holidays allegedly not taken
- Threaten regulatory investigations (occupational safety, etc.)
- Demand high settlement
- Exploit employment conditions (in a number of countries in the case that entitlements are not completely settled it is foreseen that payment of the salary is to be continued until all entitlements have been settled/set-offs with counterclaims of the company are not allowed).
- Taking of personnel/knowledge/customers
- Plundering of the illegal cash box
- Block decisions if shareholder
- Dispose of shareholding

In the hope that you have not yet contacted your corporate counsel or even the public prosecutor we would like to close this chapter. It was important for us to give you a different insight into business activity abroad – away from the point of view of the company management mostly in faraway Germany, and into the wide world of opportunities but also high-risk growth markets in foreign growth markets.

We would once again like to emphasise that the described courses of action and procedure and the inherent malicious intent of these actions at the cost of the German business partner – or while still maintaining the other point of view, i.e. the foreign operators furthering their own interests – do not at all represent the usual case. Individual incorrect behaviour can never be a benchmark for the assessment of the individual region or countries. There are black sheep everywhere and it is only important to be able to recognise the way they act, whereby in business life this is considerably more difficult than in a flock of sheep. This is because along with black and white there is a wide range of colours. In the next section we would like to be more precise and using real cases from the ASEAN countries, Baltic states, China, India, Russia, Czech Republic, Turkey and the Ukraine to show examples of problems in the management of subsidiary companies abroad. We will always begin with an oversimplified short overview of the relevant fiscal themes for the relevant country. Then we will continue with examples from the areas of auditing, tax, law, administration and then over to fraud and white-collar crime.

After the examples from the countries we have prepared examples from our international auditing practice.


AUSTRIA

AUSTRIA

German holidaymakers are not the only parties who maintain intensive relations to the neighbouring country of Austria. In economic terms Germany is also by far Austria's most important trading partner. Both exports and imports exceed the trade conducted by Germany with other countries such as Italy, France or Switzerland.

The economic structure is increasingly dominated by the growing trade and services sector while in comparison the areas for production, construction and forestry are steadily losing their significance.

A healthy economy is obviously not harmed by this development because according to official statistics for 2011 Austria can describe itself as the EU country with the lowest unemployment rate.

Generally speaking German entrepreneurs must surely not fear as many big surprises in Austria as perhaps in Asian countries. For example, in the area of financial accounting and balance sheet preparation there are hardly any differences. Most entrepreneurs will also not experience any big surprises with regard to tax.

However, the fee laws in Austria are not commonly known. Basically speaking, fees may be charged for a number of written documents, administrative acts and legal transactions, e.g. with rental contracts which in some cases can even amount to several thousand euros. If the fees are not correctly assessed, a fee increase of between 50 and 100 % can result. However, here the principle of acting quickly in good time is valid as often it may be difficult to correct errors.

Austria corporation tax is also a mystery to many. This could be in connection with, for example, a capital increase for a domestic joint stock company or a capital injection from a shareholder into a domestic joint stock company (waiver of claims, etc.). The corporation tax amounts to 1 % of the respective value of the performance and in some circumstances can be painfully high.

The use of company vehicles also involves one or two stumbling blocks. For many, the Austrian car registration tax regulation (abbreviated to NOVA) is indeed a novelty. The tax is a one-off levy calculated from the consumption or engine capacity as a percentage of the vehicle value. The tax is due when a new vehicle is delivered to the buyer or if a vehicle is registered for the first time in Austria. It should be observed that the vehicle is subject to an appropriateness check with regard to the tax (based on the level of luxury). If the acquisition costs of a car or estate car exceed a certain value (40,000 euros), depreciation on the amount above this value is not possible.

An element known to bind Germany and Austria together is the common language. Naturally in the area of auditing there are one or two differences worth mentioning which is why the auditor of the annual financial statement in particular with companies with international operations has to point out these finer points to the company group management with regard to German differences and therefore the auditor must have knowledge of national as well as international financial accounting and auditing standards. The required independence (also in Austria) of the auditor means that a long-term connection to a client is not possible. Every year the company to be audited has to choose and commission the auditor of the annual financial statement. The condition for the execution of a binding audit of the financial statement for joint stock companies is that on two consecutive closing dates at least two of the following criteria must be fulfilled: a 4.84 million euros balance sheet total, 9.68 million euros sales revenue or an annual average of 50 employees.

Furthermore, regardless of the size of the company there are business sector specific requirements for the execution of statutory audits for banks, insurance companies, and, for example, pension funds. Private trusts are addiitonally subject to a statutory audit of the annual financial statement. Due to the ISA 600 auditing standard, companies integrated in national and international company groups which under local law are not subject to a statutory audit increasingly decide to carry out a voluntary audit whereby the scope or extent of the audit (full audit, review, agreed upon procedures) for such companies is laid down by the auditor of the company group and this is generally co-ordinated in advance with the company group management.

Practical examples

Auditing

Background facts:

A third generation German family-owned company developed a sales network in a number of European countries. Since the eighties the family group had founded subsidiaries abroad or concluded contracts with commercial agents. The sales market in Austria was processed by an (independent) commercial agent whereby rumours began to circulate concerning the worsening creditworthiness of the commercial agent and then there was some apprehension that the market in Austria may collapse in the short or medium term due to the bankruptcy of the commercial agent. Furthermore, reports became more frequent from the financial accounting department of the company group regarding accounting irregularities with the commercial agent and the logistics department also sent reports more frequently to the company group management which was concerned with the subject of sales and warehousing in Austria. In the last three years larger stocks were taken by the Austrian commercial agent who then at irregular intervals made return shipments to Germany due to alleged defects and the issue of credit notes was requested. In short, co-operation with the Austrian commercial agent led to an inherent risk potential and to higher administrative expenses which had a negative effect on profitability.

What can be done now?

Due to the contract conditions in the specific case there is in principle the possibility of execution of "agreed upon (audit) procedures" which could be carried out by internal group employees or by an auditing firm to be commissioned which can make use of the appropriate expertise and legal know-how. As an alternative there is also the possibility of founding a subsidiary in Austria. In recent years and decades Austria has often especially been called a "bridgehead" by German companies and in particular selected for the eastern European area to enable processing of the Austrian market and also to enable expansion in the bordering countries. Naturally this strategy is associated with further (long-term) investments. Among other things the consolidated group accounts are enlarged by a further unit. However, in addition to the evaluation of reports during the year this also offers the possibility of the local annual financial statement or the resulting HB-II reporting (prepared acc. to German commercial law or international balance sheet regulations) by an external trustee firm. Above all, family-owned companies which have grown organically and are expanding in Europe which do not have an international internal auditing system increasingly use the possibility of the audit of the financial statement of their foreign subsidiary companies to carry out specific additional audits or also commission specific investigation activities in the case of firm evidence. The auditing activities required here often bridge the gap of routine inspection of the internal (local) control system up to the execution of embezzlement audits.

What should one have done differently from the beginning?

In company groups and sales structures which have grown historically, the taking of decisions regarding the maintenance of the status quo or the execution of changes to the legal and commercial fabric is not easy. It is hereby certainly beneficial to know you have a strong partner at your side which already has its own international network and can point out other decision alternatives. Rödl & Partner offers a large range of (cross-border) services ranging from the identification of alternative actions to the execution of legal, tax and commercial due diligence and on-going tax representation and the provision of auditing services. Companies can, for example, co-ordinate with the company group auditor and the locally commissioned auditor of the annual financial statements to set investigation activities and special audit tasks which in the area of "fraud" can have a preventive effect and contribute towards increasing the degree of control. Finally, mention should be made of the excellent punctuality which Rödl & Partner comprehends to be normal and due to the "one firm" concept of Rödl & Partner makes a contribution to a result which is satisfactory for all involved parties.

Taxes

Background facts:

A German company operating in the area of IT consulting and distribution of IT products would like to get a foothold in in Austria. As the company assesses the Austrian market to be extremely positive a local office was immediately founded in the form of a GmbH (from now on: subsidiary) in order to process the Austrian market. For this purpose three sales representatives were employed. One is assigned to the western part, one to the middle part and one to the eastern part of Austria.

Naturally and without delay in order to take the extensive travel program of the sales representatives into account a mid-range car equipped with comfortable options was procured and made available to each sales representative. The respective purchase price of each car was approximately 55,000 euros including Austrian sales tax.

In order to save these costs at a different place, the setting up of a separate financial accounting department at the local subsidiary was dispensed with. The financial accounting and the monthly sales tax return was carried out by the German parent company. Without questioning the case the bookkeeper deducted the input tax from the purchase of the car and all other costs in connection with the car in the sales tax return. Unfortunately the bookkeeper was not informed that a deduction of input tax in connection with a car in Austria is not permissible. This is also valid for all other costs such as fuel and repairs.

After business developed as well as expected, the financial accounting for the subsidiary was placed in local professional hands. As “non-deductible input tax” suddenly appeared in the financial accounting, the first questions were asked by the parent company and as a result the hitherto incorrect handling of the input tax came to light.

What can be done now?

First of all the completely frustrated bookkeeper had to be calmed down. At the same time, however, there was no way to avoid the correction of the previous years which were partly already considered as final in order to avoid further damage. The biggest impact was in the year of the acquisition because the highest input tax amounts were booked in this year and for these input taxes the interest on arrears was the highest.

If the financial accounting had continued to be managed by the parent company, one would have had to discuss this with the personnel of the financial accounting department and provide

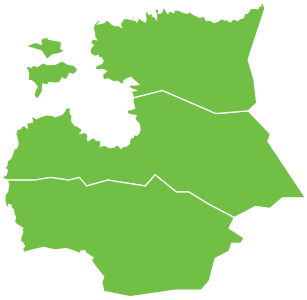
appropriate training. As in this case the financial accounting was passed on, the problem is unlikely to repeat in the future.

What should one have done differently from the beginning?

There is surely nothing against the parent company managing the administration (for example financial accounting) of a foreign subsidiary. However, there would have been inexpensive methods to learn about the possibilities in advance. The safest way would naturally have been to consult a professional local tax consultant. Even if it is "only" the neighbouring country – one should act according to the old proverb of "When in Rome, do as the Romans do!"

BALTIC STATES

BALTIC STATES



In 2004, Estonia, Latvia and Lithuania became part of the European Union. Since then these countries have already largely aligned their legal systems through implementation of the European directives and the application of European regulations concerning the legal relationships in "old" Europe. As a result, German companies in these countries will find similar legal conditions in many areas as in Germany. The recovery of cross-border debts and the enforcement of court rulings are also greatly simplified through the corresponding EU regulations. Moreover, in relation to Germany there are no restrictions regarding currencies or customs barriers.

Furthermore, English and often also German is generally spoken in all three countries and parts of the population have a historical closeness and affinity to the German language and culture. Its geographical position and eventful history has made the Baltic area the hub for trade between Central and Western Europe, Russia and Scandinavia. Given the qualifications of the people who live there in terms of language and culture, the Baltic states are also particularly suitable as a starting point for the development of the Eastern European markets.

However, due to the relatively young age of the legal and economic regulations and the resulting lack of legal practice, there remain some deficits in the area of legal certainty and the judiciary which must be managed through suitable preventive measures. There are also differences in the form of contracts and some shortcomings of the authorities occasionally lead to misunderstandings and problems. Furthermore, German companies should consider the following special points:

- Due to the manageable size of the national markets the Baltic states should be considered as a single economic zone. However, the zone includes three different legal systems with their individual characteristics. The effect of this is that the use of contracts in several Baltic states always requires an inspection with regard to compatibility with national law to see if adjustment to national characteristics is required.

- In particular in Latvia, due to misleading legal regulations and questionable court rulings, insolvency law is occasionally misused as a measure for debt enforcement and as a means to squeeze unwelcome competitors from the market. Here we recommend following up all claims made on the company, if necessary to object to the claims in time in a qualified manner and in the case of doubt to have these checked by specialised lawyers regarding the initiation of facts leading to insolvency.

- In comparison to Germany, labour law in the Baltic states is more bureaucratic and due to its application in the light of its socialist traditions very friendly to employees. In the

formulation of employment contracts these facts should be considered and the less flexible approach concerning the application of labour legislation should also be taken into account.

› It should be observed that although also in the Baltic states certification by a notary basically represents more security, but that this, however, is no replacement for a qualified formulation of the contract. The reason for this is that the duties of the notary with regard to neutrality and clarification are considerably less stricter than in Germany and the inspection of the contents of the documents is only made with regard to formal requirements or is subject to unclear or at least to varying standards.

› Local arbitration courts are (in contrast to internationally recognised arbitration courts) almost always controlled by certain persons or local interest groups and therefore not recommended. A decision to go through the appeal stages is usually not made. National courts usually (provided international arbitration courts have not been agreed upon) represent the better alternative.

› The acquisition of land or land used for forestry is partly subject to temporary restrictions for foreigners. An acquisition, however, can usually easily be realised through basic organisational measures.

› Under no circumstances comply with (supposedly national or industry typical) claims from unclear and sometimes extreme regulations with regard to securities, contractual liability law and contractual penalties – here there is a risk of malpractice! In such cases the support of qualified experts should be made use of from an early stage.

Rödl & Partner has been represented in the Baltic states since 1993. In their function as experienced lawyers, auditors and tax consultants more than 100 employees at the locations of Vilnius, Riga and Tallinn support and advise clients mainly from the German Mittelstand, but also companies with international operations from other countries – ranging from owner managed family businesses to listed companies.

ESTONIA

ESTONIA

Founding of a company

According to the legal regulations the founding of a company is possible by one or more persons. The founding requires a founding decision or memorandum of association and the articles of association of the company in notarial form. For the founding the shareholders must make a contribution to the company's capital in cash or in specie. For this purpose a bank account must be set up for the company. The share capital of a company with limited liability must amount to 2,500 euros and the share capital of a joint stock company to 25,000 euros.

The managing director (GmbH) and the executive board members (AG) must also be appointed (for this a declaration of consent of these persons is required in writing), whereby the company and headquarters of the company and contact data of the company must be supplied and certain other legal requirements met including payment in cash of the prescribed stamp duty. The documents presented to the commercial register including the memorandum of association must be in the Estonian language. For registration in the commercial register an application must also be submitted by a notary or through a special internet portal with digital signature.

Takeover of a company / joint venture

The sale of company shares or shares of listed companies is allowed with restriction unless the law (e.g. competition law) or the articles of association define a restrictive or special regulation.

Legal forms of business

In Estonia it is also possible to act as a sole trader and also to found a general partnership or limited partnership. The sole trader and the shareholders of the general partnership are personally liable for the obligations of the company, whereby for a limited partnership at least one shareholder (general partner) assumes unlimited liability for the obligations of the company and a further shareholder (limited partner) assumes limited liability to the amount of his contribution to the capital.

Company management

A company is represented and managed by the company management or the executive board. The managing director/executive board members are appointed by the shareholders or if a supervisory board exists (compulsory for AG) from the supervisory board. The company management or the executive board may consist of one or more members. All managing

directors or executive board members can represent the company on their own account unless a special regulation is defined in the articles of association. A managing director of the GmbH is appointed for an unlimited or limited period (if the articles of association require this). An executive board member of the AG is appointed for the limited time period of 5 years. A company can also have a supervisory board and an authorised officer. With an AG the supervisory board is compulsory.

Foreign exchange law (foreign exchange restrictions)

There are no restrictions with regard to the movement of capital, execution of payments and transfers. Commercial transactions and other transactions with a value exceeding 15,000 euros must be included in the financial accounting. Suspicions of money laundering must be reported if the value of cash transaction exceeds 32,000 euros. All banks, notaries, law firms and auditors including companies are obliged to notify the authorities of violations of the law against money laundering and financing of terrorism.

Financing possibilities (required track-record)

The Estonian commercial banking market is shared by 4 Scandinavian banks which almost control the complete banking sector. Apart from that there are also small banks. There are no special regulations for the financing of loan projects. The financing depends on the project in question. It is possible to find co-financing such as through domestic or EU funds or through private investors. As Estonia is a member of the euro zone, EURIBOR is valid as the base interest rate. The interest on a drawn credit is based on the EURIBOR rate plus margin. It is possible to replace the variable interest rate with a fixed interest rate.

Real estate and acquisition of land

There are no restrictions for the acquisition of real estate for the citizens of Estonia, the European economic area and OECD member states. Legal acquisition restrictions are especially valid for legal entities of third countries and for all other legal entities which wish to acquire more than ten hectares of land or forestry area.

Labour law

In Estonia an employment contract must be concluded in writing. If the formal requirement is not complied with, the employment contract is also deemed to be concluded if the employee performs his duties properly and the worker is paid with wages. It is assumed that an employment contract is concluded to be unlimited in time. A time-limited employment contract

can be for a period up to 5 years if it is well-founded and especially, for example, where the labour supply needs are temporary such as with seasonal work. The employment contract regulation is not applicable to managing directors and executive board members.

The usual working time is 40 hours per week and 8 hours per day (full-time work). The employer must pay social taxes to the amount of 33 % for the employee and an employer contribution for unemployment insurance benefit of 1 % of the gross wage. The employer also has to withhold 21 % income tax, a 2 % employee contribution to unemployment insurance benefits and possibly a 2 % contribution to the collective insurance for the pension from the pay.

Dismissal protection

Withdrawal from an employment contract is not possible. The employer can terminate the employment contract extraordinarily if there is good cause and in particular due to culpability of the employee or the financial position the company. Dismissal protection is accorded to pregnant women, persons bringing up small children, and also workers' representatives.

Trademark law / industrial property rights

The personal creations of people in Estonia are protected. Protected objects of intellectual property include works of art, trademarks, technical inventions and similar works of personal creation which are not industrially produced. These are protected by copyright law (see Estonian authors' society). Industrial property rights (trademarks, patents und utility models, product design, geographical indications of source, topographies of semiconductor products) differ from copyright law and the associated rights such that these rights do not automatically exist with the creation of the product, but are subject to a patent application process. Each area is regulated by law taking EU law into consideration.

Financial accounting obligations

All trading companies in Estonia are required to maintain financial accounting. The trading companies must also at the latest 6 months after the end of the financial year draw up an annual report (annual financial statement and management report) and present this to the commercial register (for publication). The annual financial statement must be according to the Estonian principles of orderly financial accounting which are based on IFRS SME or IFRS. The company management or executive board are liable for compliance of this obligation. The company's financial accounting department can write the financial reports and declarations or this work can be outsourced.

Tax returns / tax consulting

Companies which pay tax must submit tax returns on a monthly basis. The wage and social tax return must be presented by day 10 and the sales tax return by day 20 of the following month. In practice around 99 % of all tax returns are submitted electronically. A change to a tax return is possible and in justified cases will be authorised.

Special points regarding the company tax audit

The tax office does not carry out comprehensive tax controls. The inspection is made using risk analysis in which the commercial area and also the tax behaviour of the company and the other companies in the industrial field are taken into consideration.

Audit of the annual financial statement and appointment of the auditor of the annual financial statement

The annual report (annual financial statement and management report) of an AG must be audited by an auditor. The audit of the annual report of a GmbH is obligatory if the threshold variables laid down in the legal regulations are exceeded. The current threshold variables are listed at the internet site www.roedl.ee. The auditor can be selected for one or a number of years. The audit fees depend on the respective agreement. The audit fee must not be linked to the company result.

Liquidation / ending of the company

The ending of a company is made through a liquidation procedure unless otherwise specified in law (e.g. with insolvency). The liquidators of a trading company are the managing director or executive board members to the extent that the articles of association, shareholders' meeting or a court ruling stipulate otherwise. The implementation of the liquidation process may not be carried out by natural persons who according to the law or a court ruling have the right to be appointed a managing director or executive board member. Apart from that, at least one liquidator must have his domicile in Estonia. The duties of the liquidators are to end the running operations of the company, to list all the liabilities, to dispose of the remaining assets and satisfy creditors.

Other administrative or special bureaucratic points

In respect of other administrative or special bureaucratic points mention should be made that the official process in Estonia is largely carried out in electronic form. Persons with an Estonian

ID number (permanent residents of Estonia) can apply for the Estonian ID card and using this card are able to electronically sign documents. This possibility accelerates the official process and enables the easy managing of most formalities without having to leave the house or office. Commercial register registrations and real estate transactions, however, require a notarial form.


LATVIA

LATVIA

Founding of a company

The following elements are required for the founding of a company:

- founding decision (single shareholder) or a memorandum of association (several shareholders)
- Articles of association
- Share capital for a company with limited liability (SIA) to the amount of 2,800 euros or less when the company to be founded corresponds to the criteria defined in the commercial code, whereby the share capital for a joint stock company (AG) is 35,000 euros
- Business address and approval of the owner of the real estate
- Declaration of consent of executive board members to join the executive board
- Application to the commercial register
- The fee paid to the state and fee for the public notification of the registration

Signatures from executive board members and founders on the application to the commercial register must be authenticated by a notary.

Takeover of a company / joint venture

A sale of company shares is allowed. Restrictions can only be laid down in the articles of association or prescribed by the competition act. The other shareholders have the right of first refusal on the acquisition of company shares sold by a shareholder. Two or more persons or companies can found a company which does not have the status of a legal entity. Such companies include, for example, business partnerships and legal firms.

Legal forms of business

In addition to joint stock companies and companies with limited liability, the commercial code also regulates the activity of individual entrepreneurs (registered business persons) where the person is liable for the company's obligation with all of his assets, regulates limited partnerships which are separate companies with own legal entity where at least one shareholder assumes liability for the company to a limited extent and the liability of the other shareholders, however, is not limited, and also regulates general partnerships which are an association of several persons without the status of a legal entity, whose liability with respect to creditors is unlimited.

Company management

The executive board can consist of one or more executive board members who are appointed by the shareholders' meeting for an unlimited period unless otherwise defined in the articles of association. Executive board members assume liability for the company's obligations. Shareholders can file suit against the executive board. An executive board member can represent the company on his own account or together with a second executive board member or an authorised officer. The executive board member may resign his office at any time by informing the company about this. The executive board member can be dismissed by a shareholders' meeting. In addition there is the possibility of appointing one or more authorised officers who can act together or on their own. One can grant the authorised officers the right to purchase and sell real estate owned by the company.

Foreign exchange law (foreign exchange restrictions)

In Latvia there are no restrictions defined with regard to transfers of foreign exchange. It should be noted, however, that certain entities such as banks, notaries, lawyers and auditors are obliged by legal regulations to notify the competent authority of transactions which are considered to be a risk business such as large cash transactions, substantial money transfers, etc.

Financing possibilities (required track-record)

In Latvia financial means can be acquired from banks, state financing, financing from EU funds and private capital. In order to receive financing, at least a business plan and cash flow statement must be presented. This can be for small projects or for projects whose financing does not require an evaluation of the financial risks. The acquisition of private capital in Latvia is not usual or only practiced to a small extent.

Real estate und acquisition of land

After joining the European Union a transition period was defined in Latvia of ten years in which the right of foreigners and foreign legal entities to acquire agricultural areas and forestry was restricted. These restrictions will most likely not be extended after June 1, 2014. There are no other restrictions for the acquisition of assets, but there are diverse restrictions in connection with construction in special areas such as dunes or nature reserves. For the purpose of the acquisition of agricultural areas and forestry the foreigners often found legal entities in Latvia. It should furthermore be observed that with the sale of real estate in a municipality the respective administration authority has the right of first refusal.

Labour law

Employment contracts in Latvia are written in the Latvian language, whereby a translation in different languages can be attached. Fixed-term employment contracts may only be concluded for a maximum of three years. In 2014 the maximum period will most probably be adjusted to 5 years. The income tax on the income achieved with a dependent employment relationship amounted to 24 % in the tax year of 2013. In 2014 the tax rate will most likely remain at 24 % and then decrease in 2015 to 23 %.

In 2013 compulsory deductions for social security contributions amounted to 35.09 % of which 24.09 % were paid by the employer and 11 % paid by the employee. The changed law "Insured through the state insurance fund" foresees a tax rate of 34.09 % for 2014 of which the employee will pay 23.59 % and the employee will pay 10.50 %.

The normal working time amounts to 8 hours per day and 40 hours per week. In 2013 the monthly minimum wage with normal working time amounted to 285 euros and from 2014 will be increased to 320 euros. Every employee has a right to an annual paid holiday. This holiday must last for at least 4 calendar weeks, excluding public holidays.

Dismissal protection

Special dismissal protection exists for pregnant women, women who have recently given birth and nursing mothers. The disabled and temporarily disabled are also protected. Union members may only be given their notice after approval in advance from the union. When staff is reduced, the following groups of people are subject to special dismissal protection: long standing employees, socially disadvantaged, workers taking early retirement, those persecuted for political reasons and employees with dependent children.

Trademark law / industrial property rights

Trademarks, patents and industrial designs are registered with the patent office. The patent office also negotiates disputes between applicants or petitioners and other persons. The assessments of the patent office can be contested in court.

Domain names are registered with the agency of the university of Latvia "Latvijas Universitātes Matemātikas un informātikas institūts" Tīkla risinājumu daļa (NIC).

It is not necessary to register author rights, subsidiary rights, expertise or trade secrets. These are protected by legal regulations.

Financial accounting obligations

Registration in the commercial register makes the company subject to tax. Companies have an obligation to maintain financial accounting, whereby the company management is responsible for this.

The financial accounts are managed by a person qualified in accounting methods such as a bookkeeper or outsourced bookkeeper. A contract is concluded with this person in writing which defines the duties, rights and liability in connection with the financial accounting. A company manager may only maintain the financial accounting of the company if he is the sole owner of the company, executive board member or individual entrepreneur (registered business person). The accounts must be maintained in the Latvian language and all the supporting documents retained in Latvia. If the financial accounting is carried out by an externally outsourced bookkeeper, the executive board bears the administrative and criminal liability for the financial accounting, whereby disputes with external service providers must be resolved under civil law.

Documents, accounting registers, inventory lists, annual financial statements and documentation of the accounting firm have to be systematically retained by companies for the time period defined in the law on financial accounting. The companies are obliged to correctly submit tax returns and notifications within the respectively valid time period.

Tax returns / tax consulting

The corporation tax return for the tax period must be submitted at the same time as the annual financial statement of the company (see chapter on audit of the annual financial statement).

The tax is to be paid within 15 days after the submission of the tax return and the annual financial statement.

The sales tax return must be submitted after the end of the tax period in paper format within 15 days, but in the electronic reporting system within 20 days, whereby the tax must be paid within 20 days after the end of the tax period. The sales tax return for the taxable year must be submitted by May 1 of the following year. The tax is also payable by May 1 of the following year.

Reports on compulsory contributions for social security must be submitted by the date defined in the assessment of the tax office in the month following the reference month. The social contributions must also be paid within this time limit.

Taxpayers can submit corrections or supplements to the tax returns in the course of three years after expiry of the payment deadline defined in the respective tax laws for the respective tax unless within this time limit a company tax audit for the respective taxes and tax periods is introduced or carried out.

Special points regarding the company tax audit

The analysis of the data contained in the tax return submitted by taxpayers is carried out using the information available from the information systems of the tax office. If risk factors are determined, a decision to carry out control measures such as a company tax audit is made. Internal tax audits are included in the inspection plan. Since October 2013 the tax office informs companies to be audited about the planned company tax audit prior to the start of the inspection to enable the companies to remove inconsistencies. As a result there is a possibility that the companies included in the inspection plan are removed from the plan.

The tax office can carry out a company tax audit for the previous 3 years, whereby for transfer prices up to the previous 5 years can be inspected.

Audit of the annual financial statement and appointment of the auditor of the annual financial statement

An annual financial statement consists of a financial report and the management report about the development of the company in the financial year which has ended. The financial report consists of the balance sheet, income statement, cash flow statement, listing of the changes in equity and the notes. Companies which do not exceed two of the variables listed below are not required to write the management report, cash flow statement and list the changes in equity:

- Net turnover: 500,000 Lats
- Balance sheet total: 250,000 Lats
- Average annual number of employees: 25

Annual financial statements must be submitted by companies not later than 1 month after the annual financial statement is determined and not later than 4 months after the end of the financial year. Companies which exceed 2 of the above-listed variables and companies which are parent companies of a group and which write consolidated annual financial statements, must submit their annual financial statements not later than 7 months after the end of the financial year. The legal regulations prescribe an audit of the financial statement if at least 2 of the above-listed variables are exceeded.

The fee for the auditor of the financial statement is set by mutual agreement. The amount of the fee for the auditor of the financial statement depends on the key financial figures of the respective company and can range from 700 euros to 60,000 euros.

According to a shareholders' resolution, dividends can be calculated and distributed a number of times per year. After the adoption of amendments to the commercial code in 2014 it will also be possible to distribute profit in the current year with a maximum frequency of every 3 months provided the defined conditions are met. This possibility, however, is not applicable to companies whose share capital is below 2,800 euros.

Liquidation / ending of the company

The activity of a company can be ended due to a shareholders' resolution, a court ruling, a decision of the commercial registry office or an assessment of the tax office. A liquidator is appointed for the purpose of liquidation who informs creditors of the respective company, draws up a closing balance sheet, distributes the remaining assets and makes an application to remove the entry from the commercial register.

If the assets of the company are not sufficient to satisfy creditors, insolvency proceedings for the company are initiated. The liquidation of the company lasts at least 3 months.

Other administrative or special bureaucratic points

Declarations and notifications are submitted to the tax office via the electronic reporting system.

A basic or limited power of attorney is sufficient to represent the company, whereby a power of attorney authenticated by a notary is required in certain cases and power of attorney must be given for the signing of the application to the commercial register and documents which accompany the application, for the registration of real estate in the land register, etc.

In Latvia electronic signatures are valid and are accepted by all the state administration authorities, bodies of self-government and increasingly by companies. Thanks to the electronic signature fewer documents have to be authenticated by a notary.

Since November 24, 2010 Latvia has removed the requirement to legalise documents drawn up by the states of the European Union, European economic area and Swiss confederation. This means that documents created in these countries do not require further confirmation (legalisation or apostille).

LITHUANIA

LITHUANIA

Founding a company

A company can be founded in a short time (usually within two or three weeks) and is generally not a problem. The required share capital is comparatively small to realise the advantage of limited liability.

The founding of a **joint stock company (UAB in Lithuania)** requires presentation of the following documents to the company registry office:

- if the founder of the company is a company: an original certificate with apostille authentication of registration for the founding company;
- articles of association of the founder; notarial certification/authentication and with apostille if the articles of association were drawn up and signed in Germany.
- resolution of the managing body of the founding company regarding the founding of the company;
- deed of incorporation of the company;
- statutes of the company (in triplicate);
- minutes of the founding meeting of the UAB;
- certification by a bank registered in the Republic of Lithuania that the share capital or at least an amount corresponding to the minimum capital was transferred to the account of the company to be founded;
- certification by the owner of the premises regarding the availability of the premises for the headquarters and operations of the company, confirmed (when a legal entity) through signature and stamp of the managing director or a different person authorised for representation; alternatively: copy of the ownership title of the premises;
- application to register the company with reference to defined registration details legally required by company registration law and disclosure of the list with the submitted documents;
- proof of payment of the stamp duty for the registration;
- sample signature of the managing director (signed either in the presence of a notary from Lithuania or notarial authentication through a notary from abroad with apostille);

The founding of company in Lithuania in the legal form of a closed joint stock company (UAB) is subject to the following fees:

- registration fee 198 LTL (approx. 57 euros);
- reservation of the company name 56 LTL (approx. 16 euros);
- notary fees approx. 800 LTL (approx. 232 euros);
- bank certification of deposited share capital between zero and 100 LTL (approx. zero to 30 euros), depending on the respective bank.

Takeover of a company / joint venture

A takeover of a company is made through the sales of company shares or the acquisition of companies as a property complex. The procedure to acquire companies as a property complex is more complicated and therefore in practice not common. The contract of the company acquisition as a property complex has to be authenticated by a notary.

The sale of company shares is made through a simple contract in writing, whereby a notarial form is not required. With the selling of company shares it is not possible or only with restrictions possible to negotiate rights of pre-emption. In Lithuania joint ventures can be founded on the basis of a consortium agreement. Through the conclusion of the consortium agreement the parties (two or more persons) combine their property, their work and their knowledge in order to achieve a certain objective or carry out a certain activity. The consortium agreement has to be made in writing unless the law foresees a notarial form. If a condition regarding the written form is not fulfilled, the agreement is deemed to be void.

The profit resulting from the combined activities is distributed to the parties in proportion to their contributions. The parties are naturally entitled to make agreements regarding the other profit shares.

Legal forms of business

The greater part of the legal entities in Lithuania consists of joint stock companies.

There are the following types of corporations:

UAB (in Lithuanian: uždaroji akcinė bendrovė)
Share capital: at least LTL 10,000 (approx. 2,899 euros);
Number of shareholders: not more than 250.

AB (in Lithuanian: akcinė bendrovė)
Share capital: at least LTL 150,000 (approx. 43,478 euros); shares can be traded publicly.

MB (in Lithuanian: mažoji bendrija)
Shareholders must be natural persons. Limited liability. Maximum ten shareholders. No share capital, otherwise the share capital comprises shares. The shares of the shareholders correspond to their deposits in the MB.

Business partnerships:

TŪB (in Lithuanian: tikroji ūkinė bendrija)
Shareholders of the TŪB assume unlimited liability. Two to 20 company founders are required.

KŪB (in Lithuanian: komanditinė ūkinė bendrija)
Three to 20 company founders are required, of which at least two have to have unlimited liability. The other shareholders assume limited liability. Lithuania has nothing comparable to the German legal form of GbR. A company with at least a partial legal capacity which without registration only exists through conclusion (with an assumed implied consent) of articles of association does not exist in Lithuania. Along with joint stock companies the law in Lithuania also recognises the sole proprietor/sole trader.

IĮ (in Lithuanian: individuali įmonė)
Unlimited liability for the shareholder. Sole trader. IĮ can be converted into a UAB or AB.

Company management

Managing director

With a closed joint stock company only a single person is appointed managing director. The employment contract must be concluded with the managing director and accordingly it should be formulated to comply with Lithuanian labour law and corporate law. The managing director organises the daily operations of the company, hires employees and concludes legal transactions, etc.

Executive board

The executive board is a collegial administrative body of the company. It must consist of at least three members. The executive board is appointed by the supervisory board for a period of office with a maximum of four years. If the supervisory board is not formed, the executive board is appointed by a general meeting.

The executive board checks and authorises the strategy of the company, the annual report of the company, the administration structure, the proper organisation of branch offices and representations of the company, and gives approval for the conclusion of important legal transactions of the company etc.

Foreign exchange law (foreign exchange restrictions)

In Lithuania there are no special restrictions regarding the transfer of foreign exchange. However, foreign exchange may only be used through agreement of the parties for cashless payments. In Lithuania euros can also be used for cash payments.
All companies, institutions, organisations and banks are obliged to keep to the rate of the official rate of exchange of the Bank of Lithuania for foreign exchange.

Financing possibilities (required track-record)

Companies in Lithuania can be financed by borrowing funds from banks, through state financing, financing from EU funds or through private capital. The source of the financing may be chosen voluntarily.

There are no special track-record conditions to obtain the financing. Financing institutions, however, are obliged to lend responsibly and accordingly the financing institutions require a business plan which lists details of the revenues and payments of the company, the cash flow statement, etc.

Real estate and the acquisition of land

Real estate acquisition contracts require a notarial form. Due to the limited clarification duties of the notary it is necessary to have real estate acquisition contracts drawn up by qualified lawyers. Provisional agreements are also recommended. The claim of ownership of real estate can only be asserted against a third party after entry in the property registry (similar to the German land register). Until May 1, 2014 foreign natural or legal entities were not allowed to purchase agricultural land and forest areas. However, acquisition is also possible by a subsidiary founded in Lithuania or special purpose entity without any problem. The acquisition of property in the form of buildings and other real estate is possible without restrictions.

Labour law

The employment contract must be concluded in writing and is deemed to be concluded as soon as the parties have agreed on the conditions of the employment contracts. The content of the employment contract is formed by the contractual conditions agreed by the contract partners which serve to define the rights and obligations of the parties.

The hourly pay or the monthly salary of an employee must not be below fixed minimum rates. From January 1, 2013 employees working in companies, facilities and organisations have a

right to a monthly minimum wage of LTL 1,000 (289.62 euros) and a minimum hourly rate of LTL 6.06 (1.76 euros). The working time must not exceed 40 hours in the week. The maximum daily working time must not exceed 8 working hours. The weekly working time is limited to 48 hours, including overtime.

Dismissal protection

Workers cannot be dismissed:

- during a temporary period of incapacity to work or while on holiday,
- during a period of military service or during fulfilment of other civic duties of the Republic of Lithuania, and
- in other cases defined by law.

If the employee, after the period of time with special dismissal protection has ended, does not appear at the workplace, the employment contract with him can be cancelled according to other reasons provided in the employment contract.

Lithuanian labour law defines the principles of dismissal protection for pregnant women and employees bringing up children, and for the sick and injured at the workplace. It is not allowed to cancel the employment contract of pregnant women from the day they present a valid doctor's certificate of the pregnancy to their employer and a further month after the maternal leave has ended.

The employment contract of employees bringing up a child or children younger than three years old may only be terminated if the employee is at fault. In the event of an incapacity for work due to injury at the workplace or an occupational disease the claim of the employee to special dismissal protection is limited until the time he is available for work again or the type of disability has been determined. After the disability of the employee has been determined, the employment contract may be cancelled under observation of the special conditions of the labour code.

Trademark law / industrial property rights

Industrial property rights are protected in Lithuania in the same way as in Germany. In Lithuania industrial property rights correspond to European and international standards. Legal areas such as trademark law, patent law and domain law are strongly influenced by EU guidelines and regulations and provide investors with legal certainty with regard to the protection of intellectual property. Industrial property rights such as trademarks, patents und utility models, product design, geographical indications of source and topographies of semiconductor

products differ from copyright law and the associated rights such that these rights do not come into being with the creation of the product, but after a corresponding patent application is filed according to patent law. The main office for the registration of brands, patents und utility models is the state patent office in Vilnius. The trademark protection is granted for ten years after registration, whereby the time period can be lengthened without restriction. Copyright is collectively managed in Lithuania by the associations LATGA and AGATA.

Financial accounting requirements

The annual financial statement is confirmed by the general meeting. It must be disclosed to the commercial register within 4 months and 30 days after the end of the respective financial year. A shortened annual financial statement can be drawn up if 2 of the following 3 variables are not exceeded on the balance sheet date:

- Sales revenue for the financial year: 3,478,000 million euros,
- Balance sheet total: 1,739,000 million euros,
- Average number of employees: 15.

Companies with limited liability can use either the national business accounting standards of the Lithuanian institute for accountancy or the international accounting standards (IAS). Listed companies must only use the international accounting standards (IAS).

Tax returns / tax consulting

Corporate tax returns must be submitted by the first day of the 6th month of the next tax period. This means if the tax period is identical to the calendar year, the corporation tax return for the calendar year must be submitted by June 1 of the next calendar year. The period for the payment of income tax is identical to the time limit for submission of the income tax return.

Sales tax returns for a tax period (usually a calendar month) must be submitted by day 25 of the following month. The annual sales tax return must be submitted by October 1 of the next calendar year. The period for payment of the sales tax is identical with the time limit for submission of the sales tax return.

A monthly declaration of the income tax withheld by the employer must be made by day 15 of the following month. The withheld income tax must be paid by day 15 of the current month (if taxes for the time period from day 1 to day 15 of the corresponding month were withheld) or by the last day of the current month (if taxes for the period day 16 to the last day of the corresponding month were withheld).

The monthly declaration of the compulsory social security contributions must be submitted by the 15th workday of the calendar month. The period for the payment of the social security contributions is identical to the time limit for submission of the corresponding declaration.

The annual real estate tax return must be submitted by February 1 of the next calendar year and the calculated real estate tax must also be paid within this time limit.

The property tax return is filled out by the Lithuanian tax office. The tax return is submitted to the taxpayer by November 1 of the current calendar year. The calculated property tax must be paid by November 15 of the calendar year.

Tax payers can submit changed tax returns with new calculations for taxes already declared for the current calendar year and for the last five calendar years. There are no restrictions regarding the submission of corrected tax returns and there are no additional fees for this. However, if due to the corrections the amount of tax to be paid increases, the corresponding interest on arrears is calculated.

Special points regarding the company tax audit

The company tax audit is carried out by the tax authorities to inspect a certain tax or to inspect the complete company. Usually company tax audits are carried out unrelated to events according to a plan confirmed in advance. In special cases the tax authorities can carry out a company tax audit if there are reasons to believe that the taxes were not correctly calculated. The tax authorities do not have the right to carry out a repeat tax audit if certain taxes have already been audited.

Exception: the tax authorities receive knowledge of new circumstances.

The other form of inspection of taxpayers is the tax investigation. This can be launched at any time to inspect all taxes and can also be repeated. The result of the tax investigation is a written request by the tax authorities to remove any errors or discrepancies determined during the investigation. If the taxpayer is not able to remove the errors or discrepancies, a complete company tax audit can be carried out.

The tax authorities can launch a company tax audit or investigation for the current calendar year and for the previous five calendar years.

Audit of the annual financial statement and appointment of the auditor of the annual financial statement

The annual financial statement confirmed by the shareholders' meeting must be submitted within 30 days after the confirmation together with the report of an independent auditor (if an audit is a statutory obligation) to the commercial register. Here the documents are available to the public.

If the company distributes interim dividends, the interim statement for the corresponding time period must be prepared.

An audit of annual financial statements is required for:

- all public institutions;
- companies with limited liability (UAB) which fulfil at least 2 of the following 3 criteria:
  - turnover exceeds LTL 12 million (approx. 3.5 million euros) in the financial year;
  - the value of the assets listed in the balance sheet exceeds LTL 6 million (approx. 1.7 million euros);
  - the average number of the employees is more than 50 in the financial year.

The audit can only be carried out by a certified accountant. The auditor is not allowed to audit the same company for more than 7 consecutive years. In the case of companies in the public interest this is reduced to 5 consecutive years. After the maximum number of consecutive years a break of 2 years must be made before the company can again be audited by the respective auditor.

There are no restrictions for the remuneration of the auditor, which is subject to the agreement of both parties. Auditors inspect the annual financial statement of the company according to the international standards on auditing (ISA).

Liquidation / winding up the company

The life cycle of a legal entity ends either through liquidation or conversion. Conversion or liquidation is decided by a shareholders' resolution. The conversion must be made known to all the creditors, whereby the special rights for creditors apply. The liquidation is administered by a liquidator confirmed by a shareholders' resolution. In the liquidation the business operations of the company are ended, notice given to employees and documents are placed in storage which are to be retained. The greater majority of the companies, in particular with a foreign connection and high turnovers are audited by the tax office before the end of the liquidation and if necessary required to pay extra taxes before deregistration from the commercial register can take place.

Other special administrative or bureaucratic points

The founding of a Lithuanian UAB (similar to a GmbH) usually lasts up to two weeks. Before the company is founded, we recommend reserving the name of the future company in the commercial register in order to avoid misuse of the name. Due to the bureaucratic procedure of the public authorities in the planning phase, companies should expect possible delays which cannot always be avoided. In particular construction companies should observe that the execution of construction activities in Lithuania requires the so-called recognition of the construction law which is an administration process which can last for several months.

Practical examples

Auditing

Background facts:

The German Hastig AG acquires a Lithuanian holding company with three subsidiaries in Estonia, Latvia and Lithuania. In the preparation phase before the transaction, due to "time and cost reasons" a financial due diligence was dispensed with, i.e. there was no inspection of the financial circumstances of the holding company and its subsidiaries and the business relations within the group.

After the transaction is concluded with the agreement of a part purchase price retention and after the company shares have been transferred and the first inspection is made by the owner there are doubts about the reliability of the figures which were used to calculate the purchase price.

What can be done now?

Rödl & Partner is commissioned to carry out a post-closing due diligence, an examination of the financial circumstances after conclusion of the contract. It turns out that the capitalisation of various expenses does not comply with applicable financial accounting standards. Corresponding corrections to the balance sheet for the current and previous financial year lead to a reduction of the purchase price still to be paid by a six figure amount.

Contrary to the assurance included in the contract of sale, documentation with regard to transfer pricing is not available. The transactions between the group companies were obviously not conducted at market prices which foreseeably will lead to considerable fiscal claims. Therefore Rödl & Partner draws up a transfer pricing documentation for the previous years and corrects the affected tax returns.

The costs for the writing of the transfer pricing documentation and the payment of the tax arrears are asserted against the seller and this is set off to the extent that the purchase price retention covers this amount. Further claims to reduce the purchase price, however, cannot be enforced due to the subsequent insolvency of the seller.

What should one have done differently from the beginning?

A financial due diligence would have revealed the incorrect capitalisation, the inadequate transfer prices and the lack of an existing transfer pricing documentation prior to conclusion of the transaction and this would have saved time and cost-intensive measures in the follow up as well as the damage which could not be compensated for.

In particular, the areas shown by experience to be "classic" weak areas or pitfalls with transactions in the Baltic states should be inspected at an early stage of the transaction process.

Law

Background facts:

The German company Hotte KG designs, builds and installs heating systems for industrial users. A corresponding standard contract regularly finds use in all countries outside Germany and is negotiated and signed without the inclusion of a local legal advisor.

The contract includes only very inadequate arrangements regarding the applicable law and the competent court for hearing disputes. In addition, the duty of the ordering party to co operate in the manufacturing process is only inadequately recorded in the contract.

When the system is delivered to the installation site, an adequate power supply for the commissioning process is not available. The result is the mutual assignment of blame about the cause of the inadequate power supply followed by withdrawal of the German manufacturer from the contract.

What can be done now?

Rödl & Partner is commissioned to enforce the claim for compensation regarding repayment of the labour costs in the plant. At the same time negotiations are conducted with the ordering party regarding the disassembly of the system and his duty to co-operate.

The German court invoked by Rödl & Partner claims jurisdiction and decides that German law applies to the contract. In the proceedings Rödl & Partner successfully claims that the ordering party neglected his duty to co-operate and must therefore compensate the German manufacturing company for the damages arising from the recession of the contract.

Provisional measures applied for by Rödl & Partner at the Lithuanian court before the start of legal proceedings served to ensure that the judgement was successfully enforced.

What should one have done differently from the beginning?

The consultation of a local legal advisor for the formulation and negotiation of the contract would have avoided the greater part of the costs incurred for the proceedings and could have considerably shortened the length of the proceedings. Each cross-border contract should include the competent court and applicable law, whereby here it is important to ensure consistency, e.g. for medium and large sums in dispute renowned international arbitration courts may represent an alternative to the competence of national courts.

In the course of the support for contract management provided by Rödl & Partner it is often possible to avoid language and cultural misunderstandings regarding the duty to co-operate and execution of the contract.

Tax

Background facts:

The German Retrobis GmbH wins a tender to renovate numerous public buildings over a time period of 8 months with an order volume in the upper six figure region.

A number of employees are required on the building site for the execution of the construction work without the opening of a fixed place of business in the form of an office or branch office in the country where the construction work is executed. The project originally planned for 8 months is delayed, whereby the project length finally lasts 2 years.

Immediately after conclusion of the construction work the local tax authorities carry out a tax audit and inform Retrobis GmbH that through the execution of the construction work a tax presence in the country of the construction work was established. They therefore require the German company to submit translations in the language of the country of all existing contracts and documents related to the project and to pay arrears of corporation tax and sales tax for the previous years plus penalties and interest.

What can be done now?

Rödl & Partner entered negotiations with the competent tax authorities. This allowed a positive influence on the course of the tax audit to the extent that the local tax authorities dispensed with a full translation and documents only had to be translated on a sample basis.
Our detailed explanations of the allocation of earnings and attribution of costs between the headquarters and the business establishment were accepted as plausible and as a result the requirement for further verification in this respect was dispensed with. This considerably reduced the costs and time required to deal with the situation.

On the basis of the result of our co-ordination with the German tax office it was possible to achieve a final settlement with the Lithuanian tax authorities in the form of a mutual agreement regarding the total amount of outstanding taxes and default fines. This considerably reduced the originally required amount of tax to be paid and a double taxation was largely avoided.

What should one have done differently from the beginning?

Even a cost-conscious Mittelstand company should examine the possibility of setting up a place of business abroad before the start of business operations and to check the consequences for the company and employees. This is particularly valid for construction and assembly activities which according to the applicable double taxation treaties are often subject to temporary privileged treatment. However, often the first proposed project duration is exceeded which means it is important to continually check whether the deadline has been exceeded. Under some circumstances short activities which are repeated can also lead to the deadline being exceeded and thereby lead to a tax presence (place of business).

The timely registration of a tax presence with prior consultation regarding the profit distribution strategy between the headquarters in Germany and the tax presence and the meticulous collection of documents can avoid problems with the local tax office abroad.

Financial Accounting

Background facts:

The local management of a 50/50 joint venture company has requested substantial loans from the German shareholder, KleinWerk GmbH, in order to compensate for a "short-term liquidity shortage" as otherwise wages would not be able to be paid and therefore notice would have to be given to some workers. At KleinWerk GmbH the situation takes the management completely by surprise. As one is dependent on the services of the company and its highly qualified employees to fulfil existing customer orders on time, a granting of such a loan is taken into consideration.

The figures requested and presented to KleinWerk GmbH differ significantly from the data recorded in the financial accounting of KleinWerk GmbH, whereby it is not possible to clarify the reasons for the differences.

As the confidence in the local company management or partner is severely shaken, Rödl & Partner was commissioned to audit the financial accounting to determine the financial situation.

It was determined that the financial accounting carried out by the local accounting firm owned by the wife of the CFO of the joint venture company did not meet the legal requirements and financial accounting standards and had serious shortcomings in all areas.

There was a serious requirement for corrections, in particular with regard to the writing off of uncollectible bad debts, which partly resulted from unauthorised transactions with state institutions in CIS states. The necessary depreciation of inventory was also omitted together with the required revaluation of the real estate portfolio. This considerably changed the balance sheet presentation.

What can be done now?

The serious financial difficulties of the joint venture company revealed after the corrections had been executed and the determination of considerable liability risks made extensive restructuring a must. Corresponding to our recommendations measures were introduced including the dissolution of the joint venture and the separation of divisions with a high risk level.

Extensive control and compliance measures were introduced (dual control through introduction of additional control bodies and qualified general representative body, a step-by-step approval process for transactions with a risk classification, contract management / customer contracts etc.). The complete financial accounting of the company was outsourced to Rödl & Partner.

What should one have done differently from the beginning?

Binding financial accounting standards should be agreed with subsidiary companies and compliance with these standards should be regularly checked. Alternatively, the financial accounting should be outsourced to a professional financial accounting firm, whereby the local supplier with the lowest price is not always the best choice.

Furthermore, compliance regulations adapted to the local circumstances should be agreed whose observance from all employees is secured by contract and is continually monitored.

White-collar crime

Background facts:

Due to repeated violations of instructions issued by the group management, Mr. Kubilawitsch, regional manager of the German company Larbsky GmbH & Co. KG, is dismissed. Discussions with his successor in this position, the former assistant of Mr. Kubilawitsch, result in the suspicion of criminal offences in connection with the acquisition of orders in a non-EU country.

It was necessary to inspect contracts, legal relationships and the corresponding cash flows in connection with the existing suspicious circumstances.

What can be done now?

One of the things the investigation revealed was considerable payments made for non existing "market studies" via a company in an offshore country to a "consultant" as well as typical contractual arrangements for the purpose of bypassing the existing profit and foreign exchange restrictions in the destination country.

Based on our recommendations a complete restructuring of the sales activities was undertaken in the destination country. An extensive contract management and compliance program was introduced and a tax correction was undertaken.

What should one have done differently from the beginning?

In addition to regular reports on the business activities a general representative body should be agreed upon for selected, especially high-risk transactions with certain non-EU countries, to ensure that the managing director can only act together with a second person along the lines of dual control. Such restrictions of the managing director for internal relationships and where appropriate in the external representation of the company can, for example, be implemented in Lithuania through the appointment of a general representative body with an additionally established board.

Further misunderstandings can be avoided regarding which behaviour is actually "in the interest of the company" through clear compliance regulations, training and continual monitoring.

Summary

The accession of the Baltic states to the European Union with the implementation of the European directives and the application of European regulations have adjusted the local legal systems to the Western European standard. In spite of slightly different operating conditions and the cultural and language differences in the three countries, investors can find a stable and secure platform for market entry or expansion of market share in each of the three countries in the Baltic and Eastern European area.

The co-ordination of a secure market entry and long-term market success in each of the three Baltic countries in combination with required consulting services for all legal, tax, auditing and financial accounting matters can be managed by our experts at Rödl & Partner offices in Lithuania, Latvia and Estonia.

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BRAZIL

BRAZIL

In the meantime, German industry can look back on a considerable tradition in Brazil which has developed organically. In Latin America, German companies and their products have an exceptionally good reputation. The first large companies arrived from Germany at the end of the 19th century and beginning of the 20th century, first of all with trading offices and later with production facilities. Many companies – especially Mittelstand companies – followed and today all industrial sectors are represented.

When Brazil in 2010 reported a GDP of USD 2,143 billion, the country – at least in terms of figures – had become an economic power. Despite considerably corrected estimations and forecasts for growth in the following years, Brazil has in total performed well. Recently, however, the country has been characterised by a rather weak economy and is also undergoing political upheaval. In particular, in 2013 the currently growing middle class for the first time expressed clearly their deep-rooted anger and disappointment in public regarding the political reality. These strong feelings seemed to be directed at almost everything including extensive corruption which at least in relation to the authorities and large companies influenced by the state continues to be a daily experience, a complex tax system with a high burden and not much service in return from the state which primarily but not only affects the health system, education (schools and universities) and public transport which continues to be a challenge for employees on a daily basis in combination with a patronising and patriarchal leadership style of the currently dominant PT worker's political party which obviously does not recognise that Brazilians are politically mature citizens.

Notwithstanding this, Brazil remains a stable investment location with positive prospects. Just the expected investments in connection with the soccer world cup in 2014 and the Olympic Games in 2016 are estimated to be three figure billion amounts. But the most important driver of growth by far in Brazil continues to be domestic consumption which is growing steadily. Economists forecast average annual GDP growth of 3.6 % over the next 50 years.

Entrepreneurial success here depends on many different factors. The Brazilian market is complicated, demanding and in many ways is very different to Germany. Adjustments are necessary and investors partly have to dismiss cherished expectations. Yet with all the differences, quality and reliability also pays for itself in Brazil.

Cultural differences

One of the most significant challenges for a German entrepreneur in Brazil is the Brazilian mentality which is even more different to the German mentality than expected. In addition, the reality of life in Brazil is totally different to the stereotypes which "we" usually have in our heads when we think of Brazil. São Paulo is the economic heart of the country. No beach in sight. No samba in the air.

Language

Without Portuguese it is even difficult in São Paulo. English (not to mention German) is usually not enough. Claimed knowledge and actual knowledge of language in fact partly diverges to a great extent. In the southern part of the country there are a number of German "enclaves". But the greater majority of German companies are based around São Paulo.

Management and relationship of the boss to employees

The hierarchical element is very marked. Brazilian employees expect comprehensive and detailed guidelines. Independent original thinking is not really encouraged. The "ideal" boss is a kind, wise patriarch who never loses his cool.

Financial accounting

Taxes must in principle be declared every month. The means in practice a closing date for the financial accounting on the day 25 of each month (for example, to enable "dynamic" reporting deadlines) is not possible. In addition to standard tax returns which must all be submitted by the internet, the financial authorities receive a comprehensive monthly overview of all bookings included in the general ledger. In addition, numerous auxiliary calculations and explanations must be submitted with the aim of enabling an automated plausibility inspection.

Personnel expenses are often booked locally as a distribution or appropriation of net income as the local law basically allows this. This practice must be taken into consideration when assessing the economic situation.

The annual financial statement must be prepared by April 30 of the following year.

Tax law

Brazilian tax law is surprisingly complex and has more than 80 different taxes and contributions which are the responsibility of different tax authorities. In total in relation to the gross domestic product the tax and contribution ratio are roughly comparable to that of Germany.

Remarkable special points in particular exist in the area of commercial taxes. A seemingly simple question such as "How high is the sales tax rate in Brazil?" with regard to an import of goods into Brazil requires the answers to at least the following information:

- Customs tariff number for the imported goods
- Value of the goods (CIF)
- Import port
- Headquarters of the importing company
- Headquarters of the end customer
- Use of the goods at the end customer

Then it is possible to calculate the commercial taxes incurred by the import. These are in total six taxes on transactions each with a different basis for assessment and parties entitled to collect the respective tax: II (customs), IPI (industrial product tax), PIS and COFINS (social contributions), ICMS (sales tax) and IOF (financial transaction tax). II and IOF are always costs. With PIS and COFINS it depends on among other things according to which method the importing companies determine their corporation tax.

ICMS is a state tax with the result that there are 27 turnover tax laws each with a number of rates and different exemptions.

Transfer of foreign exchange

This is fully transparent. All movements of foreign exchange between Brazil and abroad are subject to control through the Brazilian central bank. If the money is correctly declared in the import process, an export at a later point in time is not a problem.

Financing

The current interest rates for company financing are between 3 % to 5 % per month if they are at all available for companies. The bureaucratic hurdles are partly considerable.

As a result the German companies finance themselves here either through equity or via shareholder loans. Concerning the tax deductibility of the interest on the shareholder loans the following limits must be complied with:

- The relationship between equity and the shareholder loan must not exceed 1:2.
- The maximum permissible interest rate is currently 3.5 % plus LIBOR (here: six month LIBOR in USD – independent of the life of the loan and the currency of the loan)
- If the limits are exceeded, the interest rates can only be deducted within the described limits.

Labour law

Due to its extremely one-sided orientation on the employee side the Brazilian labour law constitutes an enormous burden for companies. Originally conceived to protect illiterate farmhands from their brutal masters, it is today with a shocking matter of course attitude even directed at managing directors and therefore naturally leads to results which are difficult to comprehend.

This is all not made easier by the fact that the jurisdiction is not willing to adequately take into account the current legislative difficulties. In fact the reverse is true.

Although this investment obstacle is today the subject of political discussion, it is nevertheless not foreseeable that this will result in corresponding measures.

Founding a company / principles of company law

The forms of company which exist here are basically comparable with the forms of company known in Germany. However, as the taxation is based on the legal form, more complex structures are not required. In entrepreneurial practice the company with limited liability (Sociedade Limitada, abbreviated to Limitada) is almost exclusively used. This form is relatively easy to manage.

Foreign nationals can found a company in Brazil without restrictions or hold an interest in Brazilian companies provided their activity is not involved in an area which the state protects against foreigners such as the press, broadcasting, television and air traffic.

Share capital

In contrast to the German GmbH with the founding of a Brazilian Limitada there is no obligation to bring in a minimum share capital. The only exception to this is for companies who have import or export as their company purpose. In this case "sufficient" capital must be available. A fixed rule as what this might mean has not existed up to now. Foreign capital must be registered as an investment at the Brazilian central bank. This ensures that imported capital can later be re-exported.

Shareholders

A Limitada must be founded by at least two shareholders who can be domestic or foreign legal entities or natural persons. A foreign shareholder, however, has to have a legal representative (Procurador) who must be resident in Brazil and must represent the foreign shareholder with regard to the Brazilian tax authorities and assumes corresponding liability.

Company purpose

Difficulties with the founding of the company are frequently concerned with the definition of the company purpose in the contract. The company must be able to prove it has business premises where the company can pursue and actually realise exactly this company purpose (e.g. also storage capacity). This is inspected in practice.

Formalities

As Brazil has not yet ratified the corresponding international agreements, legal transactions – for example the submission of important documents necessary for founding a company (power of representation, commercial register extracts, company contracts, etc.) to the authorities – still require a supplementary attestation for notarial authentication and legalisation through Brazilian representation in Germany (embassy, consulate). Before submission in Brazil the documents must first of all be translated into Portuguese by a certified translator.

Managing director

The company can have one or more managing directors, whereby their appointment is made in the articles of association or by resolutions. If the managing director is not a shareholder, his appointment requires the approval of two thirds of the shareholders and if not all of the share capital is paid in then even unanimous approval is required. Managing directors can only be appointed if they are Brazilian or have an unlimited residence permit and have a Brazilian tax

number for natural persons (CPF). If a foreigner is appointed, a minimum investment of BRL 600,000 has to be proven to the Brazilian central bank. The managing director can also then receive a permanent visa which is coupled to a period of office for the managing director of five years.

Amendments to the articles of association

Amendments to the articles of association require a qualified majority of 75 % of the share capital. Companies with more than ten shareholders are subject to stricter requirements for the formalities for calling a shareholders' meeting, whereby this requires timely publication in an official communication organ and three formal announcements in a daily paper with a good circulation.

Liability of shareholders and the managing directors for certain liabilities

Each foreign shareholder of a Brazilian company requires a legal representative (Procurador) who is resident in the Brazil. The Brazilian financial authorities regularly apply pressure through access to this person's private and business assets if tax, labour law or social security related obligations of the company are not settled. Similar rules apply to managing directors.

Practical examples

Auditing

Background facts:

A German company from the premium consumer sector wanted to acquire a Brazilian family owned company to simplify and accelerate entry to the domestic market. The target company had been active on the market for many decades, had a strong brand and approx. 120 employees in one plant. In commercial terms, this seemed plausible.

In the course of a tax due diligence it was established that on the liabilities side the formally overindebted target company consisted more or less completely of liabilities relating to the areas of tax, social security and labour law. The possibility made available at regular intervals by the Brazilian tax authorities through the Federal Tax Amnesty Program (REFIS) to provide non-declared and/or previously unpaid tax liabilities with a generous discount provided the black sheep would turn into a white sheep had already been exploited on the balance sheet without the existence of the required formal conditions.

In a clarifying, personal meeting with the owner of the target company we were informed that for decades the target company had either not paid taxes and social contributions or paid these after they were due for payment and that this was justified to counteract government corruption.

What can be done now?

We examined whether it makes sense within the framework of the acquisition to separate the target company from the questionable liabilities in order to even enable the acquisition to take place.

This was unfortunately not possible in Brazil as according to the instrument of the Trespasse (similar to the transfer of an undertaking), the acquiring party assumes liability with an asset deal for liabilities in the areas of tax, social security and labour law, backdated by five years plus interest plus penalties.

In such a case a contract designed to reimburse expenses will have practically no effect. The usual procedure to retain part of the purchase price in an escrow account was not possible here as the liabilities and the risks not yet registered from the underlying facts constituted a multiple of the discussed purchase price.

What should one have done differently from the beginning?

Trust. Observe. Who?

This example brings starkly into contrast the subjects of corruption and tax evasion in the environment of Brazilian family-owned companies. We know from other projects that historically and culturally speaking there is often a different understanding to that pursued by the current compliance standard. This risk can be addressed and qualified through execution of a tax due diligence. Usually – but not always – a practical solution can be found which both sides can agree to.

Taxes

Background facts:

An internationally successful company in the field of medical engineering at the premium end of the market has been working for many years together with a distributor in the Brazilian state of São Paulo. In order to further push sales in Brazil, an own subsidiary was founded and the co-operation with the previous sales partner maintained.

With the primary objective of achieving the hoped for growth as quickly as possible without excessive costs, the previous sales partner was formally appointed as managing director of the own subsidiary and the imports were processed through his company. In practice that means his import permit (RADAR) and his approval for the products were used with the health authority ANVISA.

Subsequently the sales targets were mainly met, but with a margin which was considerably below expectations.

What can be done now?

We examined the previous arrangements and established that the linking of the two companies for the import led to an unnecessary accumulation of trading tax which in turn reduced the margin. Contrary to what one might expect, the accumulation of commercial taxes in Brazil is by no means merely a cash flow theme.

The question of whether for example PIS and COFINS are costs or transitory items depends on the method of the determination of taxable income of the purchasing company. Under some circumstances companies here can choose between Lucro Real and Lucro Presumido, whereby Lucro Real mainly corresponds to a balance sheet determination of income. With Lucro Presumido the basis for the assessment is determined simply on the sum of the outgoing invoices and a defined percentage applied to calculate the presumed profit.

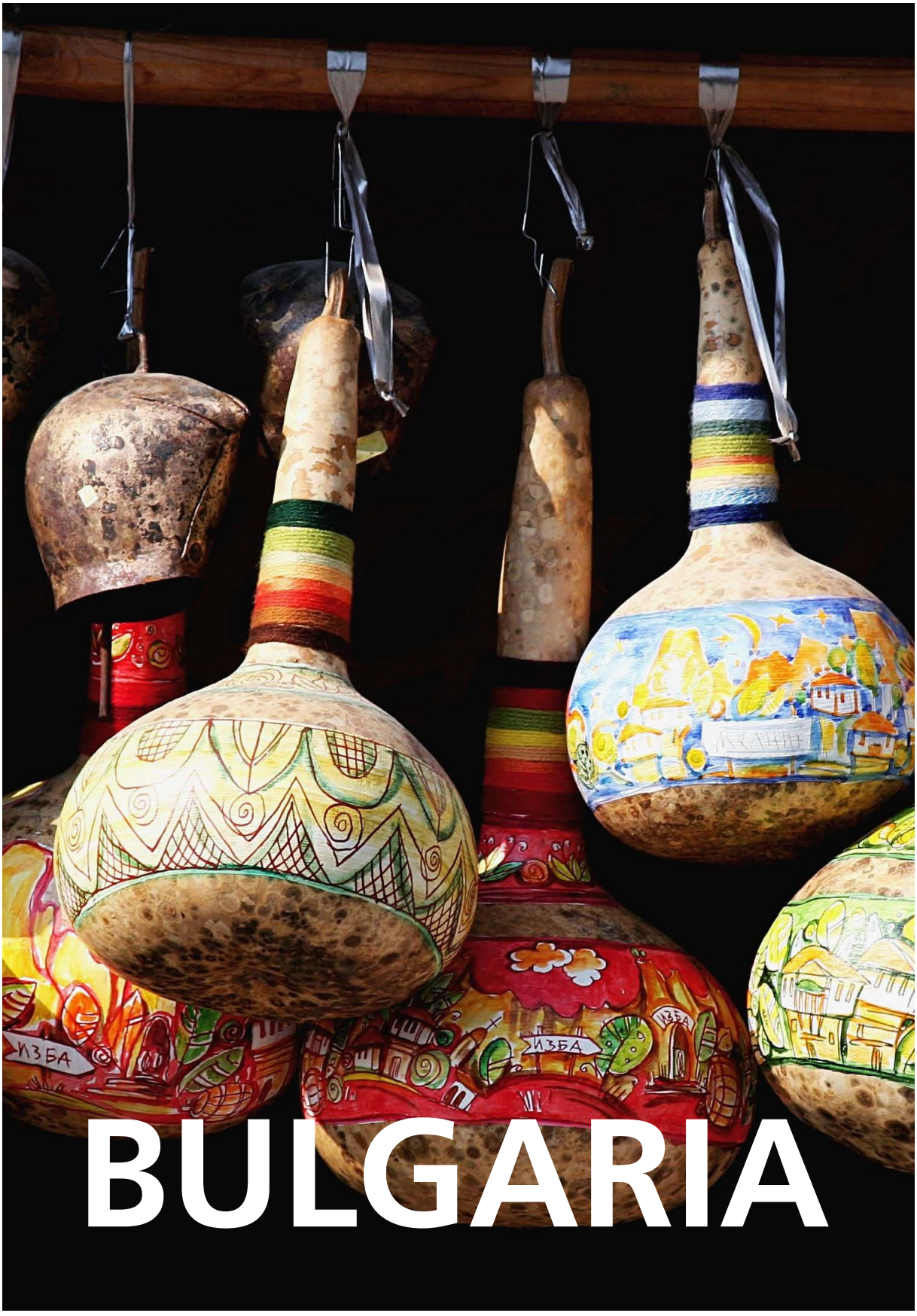
This method naturally makes sense when the actual profit is higher than the presumed profit. The more so as loss carried forward can then not be used. Companies in the start-up phase seldom meet these business requirements.

Nevertheless the Lucro Presumido is relatively popular with Brazilian family-owned companies as the financial accounting obligations are then markedly lower.

What should one have done differently from the beginning?

A market entry will often not be successful without checking the business model in advance from a tax point of view. In Brazil even the simplest entrepreneurial practices should be examined to establish whether they make sense.

The reason for these unexpected barriers is mainly the complex Brazilian commercial tax law with a host of taxes (and more than one sales tax) which despite a certain similarity on a meta level in fact when it comes to the details often functions in a way which is different to the way one might expect. European sales tax law does not serve as a blueprint for the Brazilian tax system.



BULGARIA

BULGARIA

In Bulgaria, prior to joining the European Union, all of the main EU directives were implemented in national law. At the beginning of 2007, Bulgaria joined the European Union and since then has offered a reliable legal framework for the business operations of foreign companies.

The Bulgarian tax law system is largely adjusted to the European framework so that an investor from the European zone can easily find his way around and is not confronted with serious "cultural" differences in this respect.

The Bulgarian civil and commercial law is very similar to German civil and commercial law. This can be explained by the fact that at the beginning of the nineties the German commercial code was used as a basis for the new creation of the Bulgarian commercial law. A number of differences nevertheless remain which should be mentioned such as use of the non-possessory pledge as a means of providing security. In contrast to the German right of lien, in Bulgaria a right of lien can be transferred without transfer of the possession. This legal practice is widely used in Bulgaria to provide security covering claims. In this process the security of the company as a whole is pledged.

Despite modernisation and adjustment, Bulgarian labour law is still very conservative and bureaucratic. The general unfriendliness of the legal regulations to employers has its roots in the socialist years.

Bulgarian real estate law is not characterised by serious differences to German law. However, criticism has to be made of the functionality of the Bulgarian land register. The information supplied by the electronic land register is not very reliable as registrations are partly missing or incorrect. When checking real estate we therefore always recommend a visit to the local land register office.

Although since joining the EU the function of the Bulgarian court system can be described as reliable, a number of weaknesses nevertheless exist. In particular the Bulgarian judges are often inexperienced with the interpretation and application of European legislation which as a result can often lead to the wrong interpretation or application of European regulations. In order to take preventive action lawyers are especially called upon in the application initiating the proceedings to include a "textbook" representation of the application area of the regulation and to list conditions necessary for the application of the said provision and interpretations of the said provision.

The Bulgarian financial accounting requirements can be described as bureaucratic, and in particular bureaucratic regulations govern the presentation and retention of documents.

Practical examples

Auditing

Background facts:

The subsidiary of a large German company has been successfully doing business in Bulgaria for many years in the field of food production. The non-compulsory auditing was initially carried out by Rödl & Partner. As the subsidiary continued to grow, the company management in Germany decided to appoint a new local managing director who was primarily responsible for the purchase of raw materials and finances of the company. The new managing director immediately begins to "optimise" the processes of the company. This includes changing of the auditor with the reasoning that a non-compulsory audit can be carried out by a local company at lower cost. In the next three years the profit of the company shrinks by almost 30 %. The headquarters in Germany is perplexed by this development. The auditing department of Rödl & Partner in Bulgaria is commissioned to carry out an internal audit of the financial accounting of the subsidiary. The results of the internal audit are generally positive, the financial accounting is maintained correctly. Just a single fact stood out negatively for the auditor. In the last three years the company had procured certain raw materials at a purchase price which was far above the usual procurement price in the market. The auditor carries out a short market analysis and establishes that there are no explicable reasons which would justify such a purchasing strategy. There were sufficient grounds for suspicion that the managing director procured raw materials from certain suppliers at excessive prices and simultaneously received a "bonus" from the supplier for the conclusion of the business. After a number of telephone calls with the supplier it was established that the managing director had actually received "kick-back" payments.

What can be done now?

The lawyers of Rödl & Partner dismiss the managing director with immediate effect and file a claim for compensation with the civil court. In addition, a referral is made to the public prosecutor.

What should one have done differently from the beginning?

An experienced and independent auditor would already have discovered change to the purchasing policy of the company in the first year and informed the parent company in Germany in the management letter.

Taxes

Background facts:

The Franz & Sepp Bulgaria EOOD company, a subsidiary of Franz & Sepp AG is enjoying substantial growth. The German managing director who is also responsible for the company management of the Bulgarian subsidiary is delighted with the new construction order – the Bulgarian company has signed a contract to manage the execution of a construction order in the role of a general contractor. The total order is worth 20 million euros. The managing director dispenses with local legal and tax consulting as he has already managed similar projects in other Eastern European countries and therefore feels he has the necessary experience. In addition, the ordering party is a company with which there is a good business relationship so that he has full confidence in his business partner. The order is carried out according to the terms of the contract – the part acceptance is made according to the progress of the construction work and accordingly progress payments (after invoicing) are made.

With the final acceptance the parties agree that the final invoice to the amount of 1 million euros will not be written as the ordering party has complained about construction defects and warranty claims against the general contractor which amount to 1 million euros. Thereby the claims are to be set off against each other. In the acceptance report all the construction defects are bindingly listed. After conclusion of the project the tax office carries out a tax audit at Franz & Sepp Bulgaria EOOD. In the course of this audit the construction contract is checked extensively and it is determined that the agreed final invoice has not been written. In the tax assessment it is determined that the sales tax to the amount of 20 % of the invoice which was not written must be deemed as existent and is therefore due for payment.

What can be done now?

Rödl & Partner is commissioned to contest the tax assessment. In the preparation of the appeal the tax consultant establishes that the set-off made with the claim of the ordering party from the warranty was not documented and therefore cannot be presented as proof of the set-off. In the argumentation in support of the appeal one was only able to point out indications of the set-off, whereby such indications were in particular included in the acceptance report and in the correspondence between the parties.

What should one have done differently from the beginning?

The involvement of a local tax consultant in such large projects is inherently important. He is familiar with the practices of the tax office and right from the start would have worked

towards an exact documentation of all transactions relevant for the tax situation. The result of the tax audit would have been without problems from the point of view of the company if the parties had had documented the development of the project and the setting off process in writing.

Law

Background facts:

In 2008, the German Mittelstand company Fuchs AG wanted to outsource its production to Bulgaria. After a long search a small Bulgarian company was found which was ideally suited to handle the contract plating. The opinion of the company management in Germany was that a due diligence of the Bulgarian target was not necessary as the company was small and easy to understand. The low purchase price of 100,000 euros did not justify a costly due diligence process. In addition, the assistant to the company management was a native Bulgarian and could translate the important documents of the target company such as balance sheets, commercial register and land register extracts. In 2013 the locally competent judicial enforcement officer contacted the company and announced that the enforcement of mortgage on the company property had to be endured. The company management in Germany is outraged at the news: "What mortgage can that be! The property had no financial burden! According to the land register extract, the seller was the owner and no mortgage was registered!"

What can be done now?

Rödl & Partner was commissioned to investigate the matter. The investigation established that in 2004 a certain Mr. Ivanov, at that time owner of said property took out a consumer loan to the amount of 10,000 euros secured by a mortgage on the property. As the mortgage was made in a legally effective way and also applies to the current owner, the enforcement proceedings could only be avoided by the payment of 10,000 euros by Fuchs AG. The recourse claim has to be asserted against Mr. Ivanov.

What should one have done differently from the beginning?

When a company is acquired in a foreign country the execution of a due diligence by local professionals is always to be recommended. In the circumstances of the case just the inspection of the current land register extract was not sufficient. In Bulgaria the land register is not based on properties, but is based on the owners, i.e. the land register extract only provides

information on the current owner and his obligation. The current land register extract provides no information regarding the legal predecessors and their obligations. For this reason in Bulgaria it is usual that with the acquisition of land the complete ownership chain (with all obligations) for the last ten years are legally examined.

White-collar crime, Financial Accounting

Background facts:

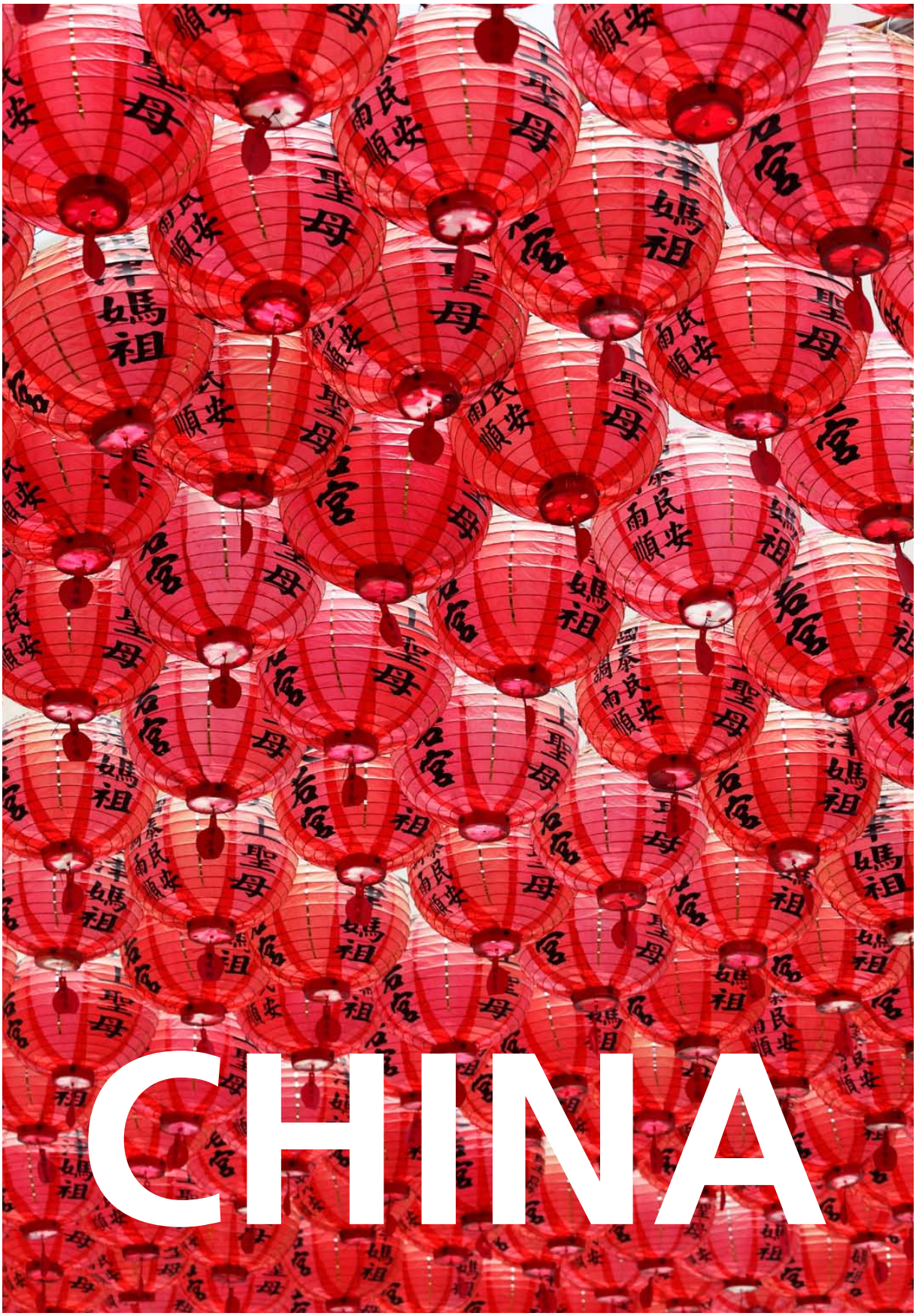
During an event a tax consultant from Rödl & Partner reports on the taxation of companies in Bulgaria. In the presentation he especially highlights the corporation tax rate of 10 %. After the event a guest asks him: "Are you sure that tax rate is 10 %? I have been active in Bulgaria with my own subsidiary for 3 years now and according to the corporation tax return we pay a tax rate of 15 %." After a consultation Rödl & Partner was commissioned to carry out an internal tax audit of the Bulgarian company. This revealed that since the founding of the company the financial accounting had been made by the wife of one of the Bulgarian managing directors. As the main person managing the accounting she was also responsible for the preparation of the corporation tax return. It turned out that the tax return of the company had incorrectly shown a tax rate of 15 %. Shortly after submitting the tax return and payment of the tax the Bulgarian managing director made an application for repayment of the overpaid tax of 5 % at the tax office. For the repayment process, he gave details of a newly opened company account which was not known to anybody.

What can be done now?

The first measure should be the immediate dismissal of the managing director and the withdrawal of all bank authorisations followed by legal action against the managing director to claim reimbursement of the corresponding amounts and the simultaneous blocking of his bank accounts as a temporary protective measure.

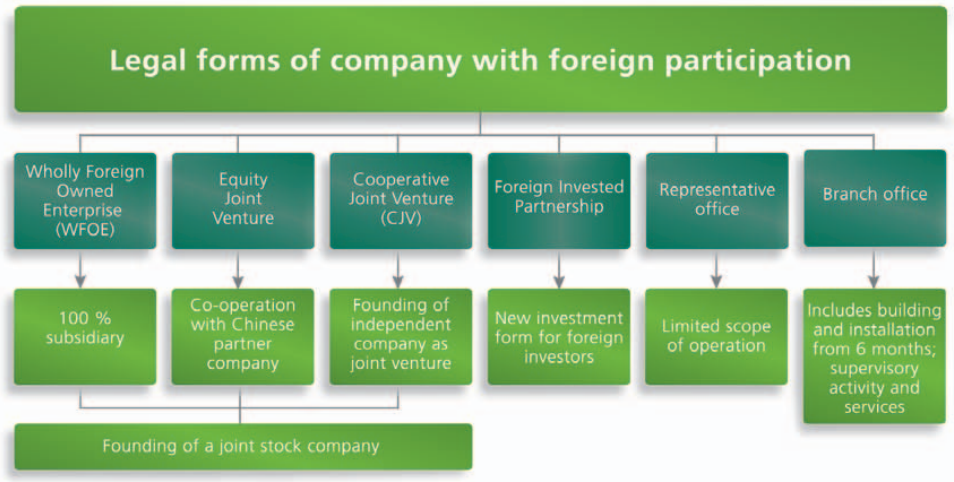
What should one have done differently from the beginning?

Commission an independent and reputable consulting firm to do the financial accounting, the preparation of the annual financial statement and the corporation tax return. The outsourcing of the financial accounting is a method which allows the parent company to exercise regular control.


CHINA

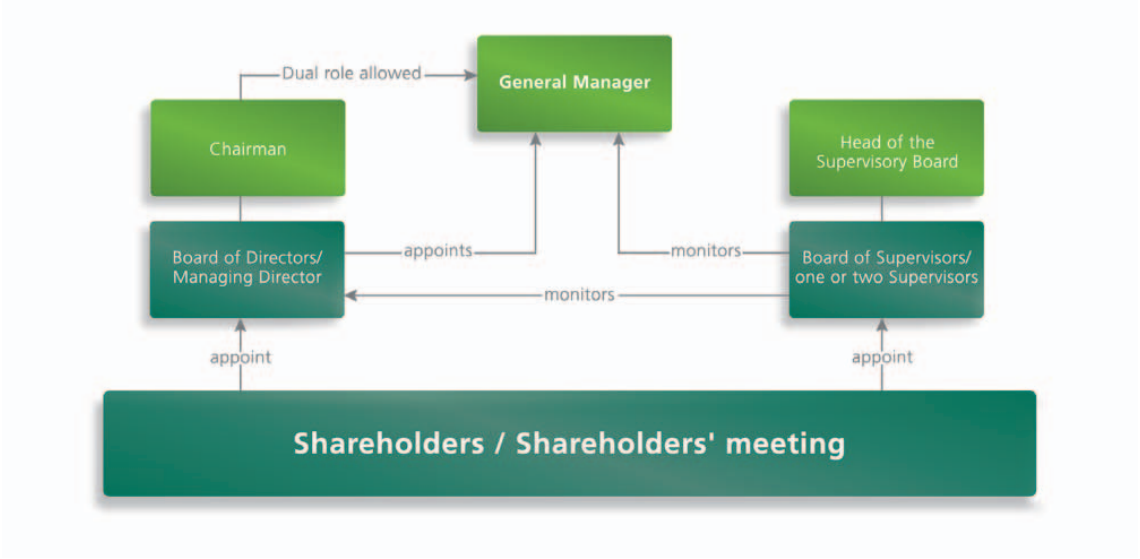
CHINA

The legal conditions in China are partly fundamentally different to those of Germany. The most frequent company form for foreign investors is the 100 % subsidiary. In addition, joint ventures, partner companies or representative offices can be founded as shown in the graphic:



When founding a company it is essential to observe the guideline catalogue for foreign investment which lists the promoted, restricted, allowed and prohibited foreign investments in China. For the founding of a company a person must be named as legal representative and the purpose of the business must also be given. This is noted on the business licence. The company may not exceed the specified business activity. The operative company management of the company is undertaken by the general manager. In addition, depending on the articles of association there is a board of directors or a managing director.

The following figure provides an overview:



In contrast to the euro, the Chinese currency RMB is not freely convertible. Cross-border payments in foreign currencies and in RMB are subject to foreign exchange restrictions. Financing possibilities in China are considerably more restricted than in Germany. For example, factoring is not practiced in China. Foreign currency loans, including shareholder loans from the German parent company, may only be taken up in a certain relationship to the registered share capital. There is a maximum investment sum.

Furthermore, in the legal system one can observe the labour law is partly stricter and more employee-friendly which can lead to problems when cancelling an employment contract. The appendix to the employment contracts of general managers or CFOs should also include a stamp policy because in China a stamp can be used to completely replace a signature. The stamp should therefore be stored separately and in a safe place where third parties have no access.

China is well-known for violations of intellectual property rights and copyright. However, now that China has joined the World Trade Organisation, the situation has improved. In order to legally safeguard against the theft of intellectual property, invention patents, design patterns and industrial designs and brands should be immediately registered in China.

A double taxation agreement exists between Germany and China. However, in practice processing by the Chinese tax authorities can vary so that as well as studying the agreement it is also necessary to draw on the practical experience of professional advisors. A branch office is more quickly founded than expected in China and with individual projects the employees sent out could possibly be subject to personal income tax from the first day they arrive. When sending out employees the existing social security agreement between Germany and China should also be checked.

In Germany invoices are only printed on company paper. In China this is not sufficient for invoices in the domestic Chinese market. So-called "Fapiaos" must be issued. They are invoices containing sales tax. Corresponding blanks are available from the tax authorities. Fapiaos are required to carry out input tax deduction.

The audit of the annual financial statements for FIEs (foreign invested enterprises) is generally obligatory. The Chinese reporting standards are becoming ever closer to the IFRS. However, Chinese accounting practices cannot yet be compared with Germany and creative financial accounting is frequently seen in China. This is exactly why it is worthwhile having a highly qualified auditor who delivers more than just a 3 page report with the address of the company and the words "Everything's okay".

If you already have a representation located in China and your commitment is developing favourably enough that you are now planning to found a subsidiary, then please plan in good time. The founding of a new company usually takes two to three months (depending on the industrial sector) and with the liquidation of a company or representative office a longer period of time should be taken into account.

We at Rödl & Partner will advise you on your special situation. We will help you to recognise risks early and to establish efficient structures. We offer Mittelstand companies with international operations customised solutions for the Chinese market with four offices in Beijing, Guangzhou, Hong Kong and Shanghai.

Practical examples

Auditing

Background facts:

A number of years ago a German company started a joint venture with a Chinese partner to be able to distribute technical equipment to the Chinese market. From the start a local auditor was commissioned to prepare the audit of the annual financial statement. Every year this auditor delivered an unqualified audit opinion without any reservations. Naturally for an unbeatably low-priced fee. In addition, the 3 page report was quick to read which especially pleased the Chinese partner as then he could attend to more important matters.

However, as time passed the German company became more sceptical because the communicated figures could not be reconciled to the business operations. Reluctantly, this year the Chinese partner agreed to engage Rödl & Partner to prepare the audit of the annual financial statement.

Suddenly the qualified auditor's report included wrongly declared customs duties going back more than three years, social security contributions which were not completely paid, bookings without documents and bank accounts which had not been adjusted for years. This does not correspond to proper financial accounting as we know it in Germany.

What can be done now?

The execution of an internal audit is advisable. Errors made over a number of years have to be examined in detail. In addition, employees should be trained or retrained to avoid such mistakes

in future. Rödl & Partner offers services for auditing including internal audits and training and provides clients with tax and legal support in order to best avoid possible tax or legal risks.

What should one have done differently from the beginning?

Even cost-conscious Mittelstand companies cannot afford to dispense with high quality financial accounting. The training of the Chinese employees or the sending of German financial accounting personnel from the start will ensure that the financial accounting is properly managed. Clients should receive advice beforehand on complex issues such as the payment of social security contributions to avoid later surprises. Regular monitoring of and support for the Chinese company is necessary together with critical analysis of the facts of the situation. In addition, an auditor such as Rödl & Partner which is also able to carry out HGB audits is an important control institution, especially as you yourself are a long way away. The higher fee also has a high value because legal or tax risks can have serious consequences and even lead to loss of the business licence.

Taxes

Background facts:

"Great!", thinks Mr. Nürnberg, shareholder of Fürth GmbH, "this year we have sent out a German employee to China and our Chinese subsidiary is already making a profit. Now we can increase the wage burden in China. And how practical it is that invoices abroad are even tax free!" Mr. Nürnberg shortly writes an invoice for "Wage expenses: 50,000 euros" to the Chinese subsidiary. In the evening he meets a good friend who also does business in China. His friend talks about the tax authorities in China and slowly Mr. Nürnberg starts to have doubts about his invoice. The next morning he calls Rödl & Partner and asks for advice.

What can be done now?

The subsequent on-billing of costs for wages presents several risks. A simple charging-on of the costs would only be possible if China was the business employer and this is clearly defined by a contract. To make matters worse, the employee sent out usually continues to be insured for social security in Germany. The condition for this, however, is that no costs are recharged. In the present case the costs should be covered in the form of a service fee. For this purpose a service agreement must be concluded. In addition, there is the risk that the German parent company will be forced to establish a branch office in China. The consequence of this would be that Fürth GmbH would have to pay business tax and corporate income tax in China.

What should one have done differently from the beginning?

Before the employee is sent out there should be clarity about whether the wage costs will be passed on or not. The International Expatriate Team department at the Rödl & Partner headquarters is available to answer special questions on the sending out of employees. Our four offices in China are your partners in the country. Tax matters and legal steps regarding social security should be clarified before the employee is sent out. This allows clarification of whether the charging on of the costs will be tax-free by means of a so-called cost and reimbursement agreement or not. And it's always true to say that employment contracts and other legal arrangements should be fixed at an early stage and be "water-tight", i.e. without loopholes. Our Chinese legal advisors will help you to achieve this – naturally in German.

Law

Background facts:

In the past the German Hangover GmbH took out protection worldwide for the brand name "Schwips". In their venture in China the brand name was then, due to legal regulations and for better recognition, translated into Chinese characters by the local business partner without the permission of the Hangover GmbH company and then also put on the products. After some time the Hangover GmbH decided to separate from its Chinese partner and to found an own subsidiary. Suddenly, however, this subsidiary was confronted with a restrictive injunction and claim for damages from the former Chinese partner who alleged that the trademark of the German company violated trademark law. To the surprise of Hangover GmbH, the business partner had registered the Chinese translation of the brand name "Schwips" in China as his own brand and now demanded impoundment of the products and compensation in China.

What can be done now?

Now quick action was called for to prevent the impoundment of the products and to contest the claim of a trademark violation. The experts from Rödl & Partner called into action prepared a nullity suit against the Chinese business partner. The enforcement of such an action in China depends on many factors and is only achievable with difficulty. Rödl & Partner was, however, successful in proving the malice of the business partner as the partner had exploited his position of commercial agent to damage Hangover GmbH. As a result the Chinese subsidiary was able to register the brand name in Chinese characters in the usual way and continue to concentrate on its successful business operations in China.

What should one have done differently from the beginning?

A distribution partner contract should have been concluded before the start of the venture in China which in particular also protects the intellectual property. Furthermore, the brand name in Chinese characters should be registered by Hangover GmbH at the trademark office in Beijing to protect the intellectual property and comply with the legal regulations. Rödl & Partner as your Chinese legal experts in the country support you with a comprehensive, high quality legal advice in the German language with the preparation of contracts, registration and enforcement of your intellectual property rights and copyrights in order to avoid similar unpleasant surprises in the best way possible. In this way we help protect you against additional obligations so that you can completely concentrate on your business operations.

Law / Administration

Background facts:

Mr. Yen has organised his collection of stamps neatly and tidily in the drawer of his desk, including the stamp for the legal representative, the contract stamp, the invoice stamp, the finance stamp, the customs stamp and naturally, not least, the company stamp.

Mr. Yen works as supervisor of the financial accounting in the Chinese subsidiary of the German Haushaltswaren GmbH. As he also wishes to share his good position with his friends and relations, he hires his brother as a warehouse worker, concludes a catering contract with the wife and finalises a consulting contract with his brother-in-law. The best thing for the family here is that apart from Mr. Yen no one really has to work. The wife cooks every day for her husband, the brother provides her with the newest household articles he has taken from the warehouse, and the uncle passes on the news from the local community in the course of the occasional enjoyable "business meal" so surely no-one will have anything to say about such contracts. When the auditor informs the managing director in Germany about these points he asks himself how this was possible without his signature.

What can be done now?

It might seem strange for a German entrepreneur, but in China the mark of a stamp is usually sufficient to conclude a contract. A signature as is required in Germany is not necessary. The most important stamps are the company stamp and the stamp of the legal representative. Using these two stamps one can conclude almost any type of contract and the contract is legally effective. In order to maintain control in the company, these stamps should therefore

not be in the possession of a single person. In the present case Mr. Yen has abused his position. In cases with such a breach of trust the only course of action is the instant dismissal and enforcement of claims for damages.

What should one have done differently from the beginning?

Rules governing the use of stamps should already be laid down when the branch office is founded. These rules define who uses and stores which stamp. The rules governing the use of stamps can then be included in the appendix of the employment contract of the respective employee. In the case of a violation there is at least internally a legal basis to make the corresponding employee accountable in a civil or criminal court. The liability regarding external parties remains unaffected by this. Many contracts and daily transactions only require the company and finance stamp. Important contracts, e.g. bank registrations or purchase of company shares, also require the stamp of the legal representative. If it is the case that the legal representative is located in Germany, it may be practical to store his stamp externally. Rödl & Partner also offers clients a service to store stamps. Stamps can be stored at our premises and are only released with the approval of the responsible person.

Fraud

Background facts:

Mr. Windig is owner of Sturm GmbH, manufacturer of storage battery systems for the field of wind energy. Five years ago Mr. Windig heard about enormous wind farms in North China and saw an opportunity to expand and opened a representative office in the country. He hired the trustworthy chief representative Mr. Chen who made a business-like impression and also spoke good German. Mr. Chen received a low wage of 10,000 RMB (approx. 1,300 euros) and a commission on each sale. Business really boomed and Mr. Chen was happy to receive monthly provisions of 80,000 RMB (approx. 10,100 euros). As business was so good, after three years a decision was taken to close the representative office and the trading company Sturm-China was founded. Mr. Chen had proven himself and Mr. Windig trusted him to handle the founding of the company in a professional manner. After all Mr. Chen is Chinese and knows the conditions and authorities in the country. Why involve an expensive consultant? At the same time Mr. Chen was appointed general manager.

Shortly afterwards the boom in China ended. Wind farms were no longer popular and the energy sector which is very much controlled by the state now promoted nuclear power stations to supply the conurbations on the east coast with electricity. "Luckily things are continuing to

run well in Germany. And Mr. Chen only receives a salary of 10,000 RMB so that our personnel costs are low", thought Mr. Windig. A short time later Sturm-China needs more money. Due to foreign exchange controls, this is not possible through formal channels, but a transfer of 50,000 euros would not be noticeable on the private account of Mr. Chen. When last month Mr. Chen once again requested money Mr. Windig asked himself where the first 50.000 euros could be. "Which 50,000 euros? This much money has never arrived on our business account", answered Mr. Chen.

What can be done now?

Mr. Windig outlined the case to Rödl & Partner and a fraud audit was immediately carried out. After the removal of the commissions Mr. Chen could not maintain his standard of living. Using cash advances he had purchased expensive jewellery and paid for private trips. Expense claims of 15,000 euros pro month were usual. Mr. Chen's oldest friend and also in charge of the financial accounting at Sturm-China had always nodded these measures through. In return for his co-operation Mr. Chen had then made him a gift of a new Mercedes – naturally paid for by the company. Rödl & Partner immediately prepared the instant dismissal of Mr. Chen. The fraud audit was able to establish the extent of the financial loss and accordingly charges were made.

What should one have done differently from the beginning?

Trust is good – control is better. Every German entrepreneur should keep an eye on the market and the employees. Commission a consultant to support you with the founding of a company. Critically question the demands of your Chinese subsidiary. They may be a sign of bad management. Check the business in the country and have a professional audit of the financial statement made and also internal audits in the course of the year might be an option. Rödl & Partner is familiar with all the relevant themes through the multidisciplinary co operation of legal advisors, tax consultants and auditors.

White-collar crime

Background facts:

After a number of years of business operations Mr. Wang takes over as new managing director of the management of the Chinese "Starlight Ltd.", a 100 % subsidiary of the German "Sonnenschein KG". Mr. Wang notices irregularities with transfers, expense claims and similar points and he also has a suspicion who may have been responsible – the long serving manager of the financial accounting department, Mrs. Diabolo.

He advises the parent company in Germany which immediately contacts Rödl & Partner. As a result the experts at Rödl & Partner carry out a fraud audit in order to establish the extent of the breach of trust. Accordingly, the suspicions of Mr. Wang are confirmed and Mrs. Diabolo is accused of extreme breach of trust. Mr. Wang immediately acts on the findings and authorises the instant dismissal of Mrs. Diabolo. However, a few weeks later the company is taken to court for unfair dismissal. Mrs. Diabolo, who has stolen from the company over many years, now demands an enormous settlement due to her dismissal. Mr. Wang again asks Rödl & Partner for legal advice.

What can be done now?

At Rödl & Partner the team for corporate crime, the so-called white-collar crime team, is put on the case. The experts advise Starlight Ltd. to first of all stop the proceedings at the employment tribunal, where only one word against another would stand, by bringing criminal charges against Mrs. Diabolo. In order to bring criminal charges in China, however, the civil servants must first be convinced that indeed a serious case of corporate crime is present.

This is where the client benefited from the experience Rödl & Partner has in dealing with the authorities. After this persuasion process is completed, Rödl & Partner supports the police to collect evidence in order to meet the high standards for evidence of corporate crime and to prepare the court proceedings. Mrs. Diabolo, who in the meantime has been taken into custody, is sentenced by the court to six years of imprisonment. In the same proceedings a large amount of the losses can be reclaimed.

What should one have done differently from the beginning?

The introduction of an appropriate internal control system would have made it much more difficult for the employee to inflict damage on the company. Rödl & Partner is happy to support you in the preparation, implementation and on-going adjustment of an internal control system.

Many small and medium-sized companies fear the costly and resource intensive internal control system. But good results can also already be achieved with a relatively low level of resources which better protect your company against misappropriation. In order to prevent employees from inflicting damage on the company, moral values, for example, must be lived and dual control or triple control introduced.


CZECH
REPUBLIC

CZECH REPUBLIC

Although the Czech legal system in terms of continental law overlaps with the German regulations, in connection with the assessment of company forms under corporate law basic problems frequently occur as described in the following.

German clients are used to the fact that representation of the company in addition to representation by the managing director can also take place jointly with a managing director and an authorised representative with power of attorney. At the present time, this type of representation regulation is not possible in the Czech Republic due to the fact that according to Czech law this power to act under company law is based on differing legal grounds (action due to original duty is with the managing director – power of attorney for the authorised representative).

In connection with a Czech GmbH this can lead to problems if for the existing dual control principle a second managing director is not to be appointed, whereby on the other hand this is a problem for GmbH & Co. KG solutions if the German Komplementär-GmbH has this representation regulation due to the fact that in this case the German authorised representative also has to be registered in the Czech commercial register.

In the course of examining existing company law structures, time and time again we see cases where either a German GmbH with only one shareholder holds or wants to acquire 100 % of the company shares of a Czech GmbH (společnost s ručením omezeným) or this construction already exists in the Czech Republic (the German company holds 100 % of the Czech GmbH which in turn should take over a further Czech GmbH). In spite of a violation of the prohibition of a two-layer structure for a sole trader GmbH, these cases are often registered in the commercial register, whereby the contracts to transfer the company shares, however, are essentially invalid. The company has been illegally founded and can be declared invalid by a court order. It is difficult to retrospectively find a solution to such a problem.

In addition, German clients assume that the parties retain the right to choose the legal form at will. According to Czech law, however, foreign law can only be chosen if there is a foreign element (e.g. a foreign partner, service performed abroad). The Czech subsidiary of a German company is a subject of Czech law and does not constitute a foreign element. Apart from that, the Czech company is obliged to maintain its financial accounting according to the law no. 563/19 and the 23 Czech financial accounting standards. In this respect, the legal form of an annual financial statement according to Czech law has a different form and structure compared to the form as known in Germany. For this reason, in addition to the local financial accounting, regular "adjustments" between the local financial accounting and the German or international regulations are often required. In addition to the foreign structure of the annual

financial statement there are also differences with regard to the content of the individual financial accounting ledgers and the currency (euros/Czech crowns).

In contrast to German tax law, according to the Czech legal regulations there is an obligation to prepare documentation of the transfer prices used. There is, however, a document from the finance ministry which recommends the documentation of transfer prices. If a company audit is undertaken by the tax authorities, the tax office will require the documentation of the transfer prices in the form which is recommended in the document from the ministry.

In 2012, in order to avoid sales tax evasion, liability for tax was introduced. In individual cases, the customer is now liable for sales tax if he pays the supplier the remuneration for performed deliveries or services into a foreign bank account or a bank account which is not made known to the Czech tax office or which was not published on the website of the Czech tax office. In order to avoid sales tax evasion, the financial authorities have drawn up a blacklist of unreliable entrepreneurs. In fact customers are also liable for sales tax from companies which are not included on the blacklist. These legal requirements seriously increase administrative costs for the entrepreneur.

According to the Czech tax code, the tax office can invoke different penalties. These penalties include penalties for late submission which are charged it the submission of the tax return is late or is not made, or penalties for delay which are charged if the payment of tax is delayed. The tax offices are obliged to determine incidental tax expenses. They are, however, not entitled even partly to dispense with these. Furthermore, the statutory disclosure requirement must be observed. If the annual financial statement is not disclosed, there is the threat of penalties from the registry court and from the tax office. The penalty payments for delay are determined according to the tax liability. The administrative fines for non-disclosure of the annual financial statement are determined according to the balance sheet total and for medium-sized companies may amount to several thousand euros.

Practical examples

Business Process Outsourcing

Background facts:

A German parent company founds a subsidiary in the Czech Republic. As the German parent company, however, has already a number of terrible stories about Czech managing directors, under no circumstances does it wish to appoint such a managing director. The company prefers to take two of its own people from Germany and Austria in order to jointly take over the company management of the Czech subsidiary. Both managing directors are only authorised to manage the company together, but continue to reside in their own countries and in fact are never present in the Czech Republic. In addition to the tedious act of obtaining two signatures for important business decisions there are also communication problems and this results in lengthy negotiations, incorrect decisions and costs for courier services, etc.

What can be done now?

In this case Rödl & Partner can only recommend a change to the situation as soon as possible and to only appoint a single managing director who is authorised to sign by himself and at the same time has his permanent residence in Czech Republic. This will simplify and accelerate decisions, lessen communication problems and therefore remove unnecessary costs.

What should one have done differently from the beginning?

The German parent company should have recognised from the beginning that it is necessary to have a local managing director who is responsible for the operative business and will manage daily problems.

Business Process Outsourcing

Background facts:

In the Czech Republic electronic mail boxes are a popular method to transfer documents. These mail boxes are quick, secure and also easy to use because they are maintained in the Czech language. Yet it is precisely this which often represents an insurmountable problem for the German managing director of a Czech subsidiary because he just as many of his other German managing director friends speaks almost no Czech. As such an electronic mail box cannot really be so important, the German managing director simply neglects to observe the mail box until one day the company receives an official demand for payment in connection with the electronic mail box.

What can be done now?

The legal department of Rödl & Partner quickly finds the reason for the official demand for payments. It concerns the non-compliance of a deadline for statutory obligation which was communicated to the company via the electronic mail box. In order to ensure that this situation does not repeat, Rödl & Partner now regularly checks the electronic mail box for the company. This ensures that in future a statutory deadline is not missed which could lead to a fine.

What should one have done differently from the beginning?

Already with the legal founding of the company it should be clarified who is assigned to regularly check the electronic mail box.

Taxes

Background facts:

Mr. Michel, German joint owner of Kunst GmbH is happy about the quantity of works of art which one can purchase in the Czech Republic. "Great", he says and as a result follows his business instinct and decides to found a company in the Czech Republic which will take care of the purchasing of works of art from Czech artists. He therefore founds the company Umění s.r.o. The works of art purchased in the Czech Republic are then resold to German Kunst GmbH. Mr. Michel registers the Kunst GmbH in the Czech Republic as a taxpayer subject to sales tax. The business runs well and Mr. Michel is very satisfied that the Kunst GmbH can offer its German customers such a wide range of works.

After some time, however, he learns from a customer that his competitors offer works of art at lower prices. "How can that be possible?", he asks himself. In fact he starts to consider that the problem could have something to do with the sales tax and accordingly contacts the tax experts of Rödl & Partner.

What can be done now?

The tax consultants of Rödl & Partner examine the transactions together with Mr. Michel and after a detailed analysis an important fact is determined, namely that in the Czech Republic the company Umění s.r.o. purchases exclusively from private persons who are not an entrepreneur in the sense of sales tax and therefore need not pay sales tax. The sale of works of art by the Kunst GmbH is also made exclusively to such private persons. Due to these conditions, the tax consultants of Rödl & Partner conclude that it would clearly be more favourable for Mr. Michel to use an existing sales tax special regulation.

What should one have done differently from the beginning?

With the benefit of hindsight, Mr. Michel understands that the conventional sales tax regulation which he knew formerly is disadvantageous. The use of the special regulation allows him the possibility of not having to burden the total price for the works of art to be sold with German sales tax. Instead, only the price mark-up is subject to sales tax. This knowledge enabled Mr. Michel to lower prices to the satisfaction of his customers and thereby to become competitive again.

Law

Background facts:

Not a rare occurrence. The client X GmbH decides to reduce costs. For this purpose, the company would like to transfer a production line to one of its subsidiary companies, the Y s.r.o.. According to extensive pre-planning, on the advice of the legal department the shareholders now want to conclude a purchase contract. The legal department then makes this contract available to Rödl & Partner for a final check one week before the transfer of the production line. Here, however, a problem is encountered. Rödl & Partner determines that the share capital of Y s.r.o. only corresponds to the legal minimum of 200,000 CZK (approx. 7,700 euros). After it turns out that the purchase price of the production line amounts to 2,000,000 euros, Rödl & Partner points out that according to compelling regulations of Czech law the acquisition of assets to the value of more than 10 % of the registered capital requires the preparation of an evaluation report through a judicially appointed expert and the purchase price must correspond to the value in the expert evaluation.

What can be done now?

On the basis of power of attorney, Rödl & Partner immediately appoints an expert assessor. The expert discusses the planned purchase price and further factors with the client and carries out a tour of the production line. Within a few days a value evaluation can be prepared which confirms the purchase price.

What should one have done differently from the beginning?

The transfer of assets between associated companies represents circumstances with regard to normal trading relationships and also with regard to a one-off transfer which are subject to the special attention of the Czech authorities. Therefore clients should engage Rödl & Partner at an early stage as their competent advisor for the arrangements of the respective transfer in order to avoid tax problems in connection with transfer prices and competently and efficiently solve questions with regard to the legally secure implementation of the transfer.

Law

Background facts:

The ABC company has no operations in the Czech Republic either with an independent company or through a so-called organisational unit. It only delivers goods from Germany to a single customer in the Czech Republic, whereby in addition this is often made without a proper purchase contract, but just on the basis of an order. Sometimes it occurs that the Czech customer does not settle his invoice. Then Rödl & Partner comes into play to advise the German ABC company as the creditor.

Sometimes a reminder from a lawyer helps, but not always. Now the client wishes to take legal action to assert a larger claim. And this is usually the beginning of a long and frustrating process which is described in the following.

Everything has to be translated by a state-certified translator and some documents even have to be confirmed by an apostille under the Hague convention. There are no delivery notes which confirm acceptance of the goods. Legal proceedings are initiated before court. The court fee (4 % of the value in dispute) must be immediately paid by the client. The proceedings have only just started and already so many costs have been incurred. This is justifiably disappointing.

And nothing happens for quite a long time – the Czech courts in fact work very slowly. If mention is made of this before court, the answer is: "There are still 300 cases in front of you." This represents a further disappointment.

After two years the day finally arrives. There is actually going to be an oral hearing. The defendant excuses himself due to illness which leads to a further adjournment. For the new court hearing the judge requires further documentation (translated into Czech naturally) and in addition the named German witnesses should be present. But unfortunately these persons no longer work for the ABC company. That results in further costs, the passing of more time and a further disappointment.

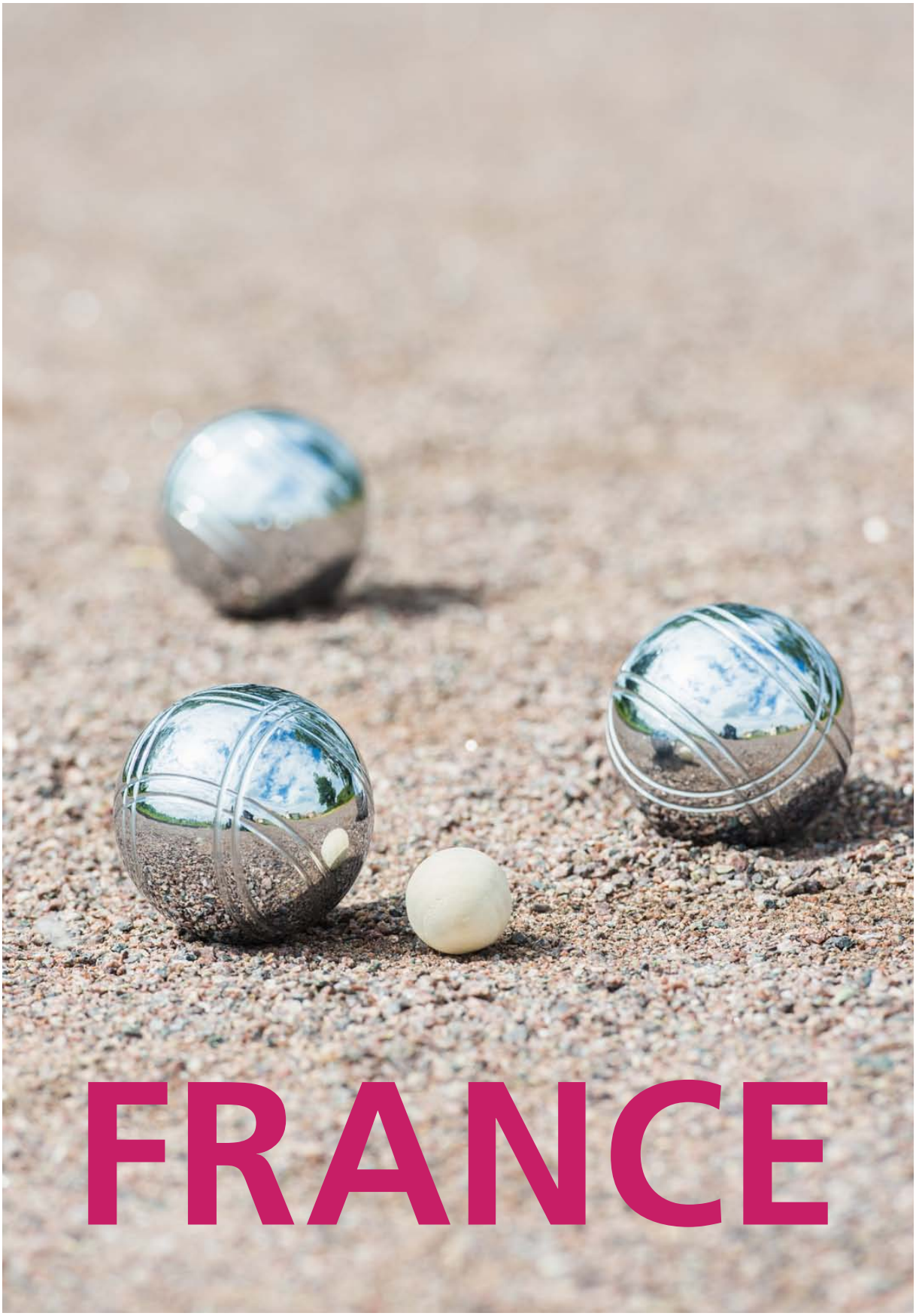
The next surprise comes without delay. The contract is determined by German law, whereby the judge discovers this after two years. As a result an opinion on German law is required and specifically from the ministry of justice which also leads to months of delays and so the frustrating situation grinds on.

What can be done now?

Due to the fact that in this case all available financial means have been used up, it is no longer possible to do something about the situation. It is therefore even more important to allow for suitable regulations before the business transaction is concluded and to obtain expert advice.

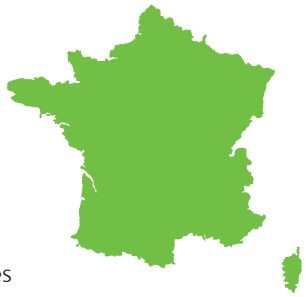
What should one have done differently from the beginning?

Prior to concluding the respective business, German companies should take legal advice. This allows changes to be made to the contract with the addition of arbitration clauses, applicable law and clarification of responsibilities which is important because after the delivery is made it is often too late. If something does go wrong, legal proceedings should be seen as the last resort and are to be considered together with the client taking into account the costs and benefits of such a time and cost-intensive procedure.



FRANCE

FRANCE



At the present time there is a certain reluctance to invest in France, whereby in particular investors are frightened off by the lack of predictability with taxes and labour law in combination with the traditional willingness of workers to protest in France. But companies from Germany remain the most important investors in France. Germany and France continue to work closely together and still represent the largest and most closely connected economic partnership in Europe. In figures, more than 3,100 offices of German companies employ approx. 300,000 people in France.

Beyond the cultural affinity these two countries share, the "Grande Nation" offers definite advantages for the German entrepreneur in the areas of technology, innovation and creativity.

Different types of investment incentives encourage foreign companies to make investments and create jobs, such as interest-free loans, subsidies for investments, in research and development and tax exemptions or tax credits for research expenses. These will shortly be expanded to the innovations of small and Mittelstand companies.

In geographical terms France lies at the centre of Europe and offers first class infrastructures for freight and public transport and advantageous energy price regulations. This central position attracts numerous German companies which plan to distribute their products in France, Southern Europe and the countries of Northern Africa.

Under certain conditions which are checked in advance by a tax specialist, foreign companies with reduced activity in France can be declared eligible to use a liaison office with the result that in France the company is not bound to financial accounting and tax obligations.

The founding of a new business in France increasingly leads to choosing between the branch office which has no legal personality (and from this clearly indicates its German origin) and the joint stock company which enables operation as an entity under French law. On the financial accounting and tax level the two choices are the same, i.e. the company is subject to tax in France and must maintain its own financial accounting. It is a particular feature of the country that the French legal system requires a uniform and obligatory chart of accounts. If a tax audit is carried out, each violation of this regulation can lead to the risk of non recognition of the financial accounting and taxation by the authorities, whereby it should be noted that these audits are made at random (without a comprehensive inspection). Our German clients strongly tend to centralise their financial accounting and financial transactions at the headquarters in Germany which enables direct integration of the turnover of the foreign branch offices and better control over reporting and consolidation. Using this

arrangement we recommend the keeping of parallel independent financial accounting in order to avoid any significant tax risk. This is despite the additional work which this means for the companies.

The most used legal form for the subsidiary of a group is the SARL (GmbH), which offers the advantage of simplicity in its organisation with one or two managing directors who may have German nationality. The SAS (joint stock company in simplified form) is the more recent legal form which we cannot necessarily recommend to our clients due to the fact that an auditor for the annual financial statement is stipulated even if there are no activities as soon as the controlling interest is held by a legal entity (applicable to groups which own a subsidiary in France).

Concerning the audit of the annual financial statement, France is considerably different to the other European states with regard to the legal duration of an auditor's mission which is six financial years and the applicable statutory fees which are determined according to the normal number of working hours dependent on turnover, financial income and the balance sheet total. It should be noted that the majority of German groups are not familiar with this regulation and only first learn about it when a decision is made at an international level to change the auditor. The statutory audit of the annual financial statement usual in France which is required for companies with consolidated group accounts enables the entry of a new auditor without, however, being able to force the official auditor to withdraw. When appointing a uniform auditor worldwide care should be taken to ensure that the French auditor of the annual financial statement must be appointed by a shareholders' meeting within six months after the end of the financial year, i.e. much earlier than in Germany.

In the area of the accounting standards there are no substantial differences between the French and German annual financial statement. There are only significant adjustments of the result to be made with companies which operate with long-term contract agreements to take into account the differences between the French accounts system (percentage of completion method) and the German HGB (completed contract method).

In spite of the apparent uniformity, care should be taken that the structure of the income statement shows different allocation differences, in particular because the French legal system lists all taxes, with the exception of corporation tax as operating expenses. This distortion can lead to serious disputes between purchasers and sellers in connection with cross-border acquisitions with a price determined by an EBIT multiplicator. Bearing this in mind, we therefore recommend beforehand the commissioning of an expert who is familiar with these differences to confirm the financial conditions in letter of intent or if applicable the sales contract (SPA).

The standard corporation tax rate in France is currently 33.33 %, payable in four quarterly advance payments on the basis of the taxable income of the previous year and a final payment (in April of the year following the reporting date of the annual financial statement, December 31). Companies with a turnover lower than 7.63 million euros and whose capital is held at least 75 % by natural persons or by companies which correspond to the same conditions, are taxed at the reduced rate of 15 % limited to 38,120 euros. This is a tax advantage which German family-owned companies benefit from as they run their operations in France with small company structures.

If the situation indicates a loss, the subsidiary (or the branch office) generates tax losses which are not limited in time and which can be offset against future taxable profits. Recently, the French system has allowed itself to be inspired by the German method to the extent that a limit for offsetting losses per year of 1 million euros + 50 % of the taxable income of the financial year was introduced. Here it is made clear that the principle of carrying forward losses not yet offset is maintained without a time limitation. According to the French accounting standards, the future tax advantage formed by the existing tax losses is not recorded in the local annual financial statement, but it can possibly be taken into account with the HB2 adjustment.

The French social law is perceived by other countries as being the social system in Europe with the most obligations and each potential investor considers these specialities of the system before he makes his investment decision. The specialities of the French system are numerous, whereby a special mention can be made of the systematic binding to tariffs for each activity to secure a minimum income, the regulation of the 35-hour week, the obligation to have a works council, the statutory profit-sharing mechanism for employees where there are more than 50 employees in the company, and an extremely strict employment termination procedure which is designed to offer legal protection for employees and penalise companies which do not comply with the formal requirements.

The social security structure is very advantageous for those insured and the associated costs for the employer are correspondingly high as the burden of social contributions on average is 50 % of gross pay. The recently introduced social law highlights the competitiveness of the companies, whereby in January 2013 a tax credit was introduced for competitiveness and employment (CICE) which for a gross monthly pay below 3,600 euros corresponds to a reduction in social contributions of 4 % in 2013 and 6 % in 2014.

The provision of a company car in France is not advantageous, whereby although it represents a benefit for the employee, in return on the entrepreneur side is subject to extraordinary taxation. This is particularly valid for the sales tax in the purchase price and the operating costs/maintenance, depreciation of the purchased vehicle or leasing rate, which are non-

deductible with a vehicle value above 18,000 euros. The French car tax is paid by the companies for each vehicle used in French national territory, including for vehicles acquired or rented abroad.

It should also be noted that in connection with the payment of salaries French companies do not hold back any tax for wages as is the case in Germany. The submission of the income tax return and the payment of this tax is purely a private matter.

Practical examples

M&A

Background facts:

The Stressteam company has decided to acquire a competitor in France. Negotiations have been in progress for months with the management of the target company and finally late in the night on account of a closing organised by a Paris law firm a sales contract (SPA) is signed. The price noted in the protocol to the contract consists of a fixed price and an additional price payable within the next two years. During this time period the seller will continue to manage the purchased company. He receives an earn-out to the amount of 50 % of the annual EBITDA which is corrected by a certain number of expenses and earnings listed in the SPA, and here in particular the services of the seller which will be invoiced by his private company.

When the first annual financial statement is due the contract parties prepare the calculation of the earn-out and discover that the results determined from both sides are not in line with each other. The seller especially questions the application of the method by presenting a drafting error and he is of the opinion that the formulation of this paragraph is not true to the spirit of the contract.

What can be done now?

Pursuant to the SPA it is expressly stated that the audit firm Schlauberger will be engaged in the case of a dispute between the contract parties regarding the fixing of the additional

price. Therefore this firm is contacted and the firm carries out a corresponding audit and presents its conclusions which draw attention to a certain number of deviations in the handling of the so-called current expenditures which are or are not used to calculate the EBITDA. Incidentally, the term of operating expenses is defined by the French conditions differently to the conditions of the German commercial code (HGB). Worthy of special note here are the taxes which with the exception of corporation tax in France are recorded in the operating results and discounted costs which are shown as a financial loss while in Germany these are treated as a reduction in margin. Finally the auditor concludes that in financial accounting terms the calculation formula agreed by Stressteam and the seller represents an irregularity. The contract parties, however, have signed the contract and therefore they are obliged to fulfil the agreement.

On the basis of this expert opinion the contract parties cannot come to an agreement and feel compelled to re-negotiate the additional price which leads to extreme tension and a loss of confidence between the investor and the seller who continues to manage the acquired company.

What should one have done differently from the beginning?

For cross-border investments we urgently recommend to investors that before a closing they should engage an expert consultant who has good knowledge about the financial accounting regulations which apply in the respective countries of the purchaser and seller and in particular to pass on the paragraphs of the SPA concerning price determination. This will enable the expert to recognise any lack of clarity in the definition of the financial references chosen by the contract parties (e.g. EBITDA/EBIT, net financial debt) and possibly to highlight the distortion resulting from the application of the local financial accounting regulations.

The handling of off-balance-sheet obligations (traditionally provisions for retirement as a potential liability) is also a complicated issue which is often only later on identified in the course of due diligence and afterwards causes disputes if this is not clarified prior to the signing of the SPA.

Taxes

Background facts:

The Spardose company has been distributing its products on the French market for a number of years with the aid of a small team covering the commercial and marketing aspects of the operation. After an enquiry from the German administrative authority which intends to check whether the results are not burdened by losses abroad, the company asks a French tax consultant to check the situation. After a corresponding investigation of the organisation and the area of responsibility of the team on French national territory, the tax consultant declares that the activity carried out essentially represents a dependent branch office which is liable to pay tax in France. The German company was previously of the opinion that the operation was a liaison office and not an entity with regard to the legal or tax systems in France. The results achieved through these activities were entered into the financial accounts in Germany and taxed accordingly there. The input tax on the acquisitions and services in France were retrieved via the portal set up for this purpose for foreign companies.

What can be done now?

Every branch office in connection with corporation tax and other taxes is subject to the same tax obligations as a company, including sales tax. As a result, the Spardose company should have been registered in France and should have maintained financial accounting according to the system of accounts prescribed by French law. The non-observance of these regulations can lead the administrative authority to initiate a taxation of income due to the rejection or absence of the financial accounting, i.e. it can apply flat-rate taxation based on the turnover.

As soon as a foreign company identifies the existence of a branch office in France, a voluntary declaration is a possibility, whereby it must be clear that the correction regarding the last six financial years is costly because these costs result from the work involved in reconstructing the annual financial accounting according to the French regulations. This work must be entrusted to a local tax consultant who will formalise the information he receives from the German company concerning the French activity. However, we recommend that our clients should first of all make an estimation of the results achieved in the past in order to estimate the deferred tax expenses and the risks associated with previous financial years which were not properly recorded.

In respect of the future (and possibly previous) operating activities, the principle of the remuneration of the branch office must be defined and if possible using a transfer price policy which is documented according to the regulations. The invoices issued by the branch

office must include all the obligatory notes according to French law. In addition, the opening of a local bank account is recommended.

What should one have done differently from the beginning?

The above story clearly indicates that before the start of any activity in France, there should be a cautious and organised procedure with an analysis made by a tax specialist in order to determine whether the foreign company is acting in the context of a liaison office without being a legal or tax entity or in the form of a branch office. This examination enables – along with your safety aspects regarding the German and local administrative authorities – the anticipation of obligations and regulations which will have to be observed after the activity commences. If the hypothesis of a liaison office is rejected, then indeed the tax system and the maintenance of financial accounting according to the French system of accounts will become obligatory for the foreign company.

Even when more and more companies opt to carry out the financial accounting in their offices in Germany, it is quite common for our clients to entrust us with the execution of parallel financial accounting to enable complete compliance with the local regulations. In January 2014, new regulations came into force defining the content and format of computer files used in electronically generated financial accounting required for audits. This represents a sound argument for the parallel option.

Law

Background facts:

For a number of years now the Mannschaftsgeist company has had to deal with repeated, serious economic difficulties which have forced it for operational reasons to consider the cancellation of an employment contract of an employee. In order to prevent such a measure French labour law obliges the employer to offer the employee a different job if possible in one of the companies of the group before the decision to cancel the employment contract is made (in France or outside France).

In practice the employer has to offer the respective employee a free position in the same category in his position or possibly a position from a lower category provided that such positions which exist in the company group are available. To the extent that this is not the case with the Mannschaftsgeist company and the impossibility of offering a different position can be justified, the company decides to lay off the employee and to invite him to the preliminary meeting prescribed by law to announce the decision. According to the regulations, in the course of the meeting the employee is handed documents about the possibility of concluding a so-called "contrat de sécurisation professionnelle" contract for unemployment insurance benefits (see "CSP" below). The employee is entitled to accept the CSP within a period of 21 days.

After observance of the statutory period of notice of 15 days, the company sends the notice of termination of the employment contract by registered letter with acknowledgement of receipt and advises the employee of the commercial grounds for the dismissal. Too late! In the meantime the employee had accepted the CSP. In this respect the notice of termination is deemed to be illegal because the notification of the grounds was not made in time.

What can be done now?

If notice of termination is deemed to be illegal because it was made due to a late statement of grounds and ultimately without an "effective and serious reason", the employee is entitled to compensation which he can claim before court. French labour law proceedings are made in two steps. The first step consists of arbitration. In order to reach agreement outside court, the parties have the possibility of concluding a so-called "transaction" (settlement contract). This avoids legal proceedings and saves time.

What should one have done differently from the beginning?

Even when the employee accepts the CSP and as a result notice of termination is not given, the employer is not released from his obligation to communicate the grounds for the dismissal in writing. The notification must be delivered before the CSP is accepted. But in practice it is impossible for the employer to foresee the point in time when the employee will give his opinion on the subject of the CSP. As he can declare his acceptance before the employer sends the notice of termination, the employer must communicate the grounds for the dismissal as soon as possible. The presentation of the commercial reasons in a written document to be given to the employee during the course of the preliminary meeting regarding termination of the employment at the same time as the documents regarding the CSP option appears to be the most secure method to pass on the grounds for dismissal.


GEORGIA

GEORGIA

Georgia is a democratic republic in Eastern Europe located between the Caspian Sea and the Black Sea. There are borders in the north to Russia, in the south to Turkey and Armenia and to Azerbaijan in the east. The capital city is Tiflis and other large cities are Batumi, Suchumi, Kutaissi, Rustawi and Sugdidi. The area of the country is 69,700 square kilometres, the size of the population is approximately 4.5 million.

The official language is Georgian (as well as Abkhazian in the territory of the autonomous area of Abkhaz). Common foreign languages are German, English and Russian. The official national currency is the Lari (GEL) which consists of 100 Tetri. This currency has been in circulation since 1995.

Its attractive geostrategic position as a transit country for oil and natural gas into the EU, the existing high level of education and the political plans to further promote education as well as the countryside and history are positive aspects for potential investors. The developing tourism and banking sectors makes the country even more attractive for foreigners.

Legal forms of business

According to Georgian law, business partnerships and joint stock companies are conceivable as possible legal forms.

Business partnerships:

Open trading company (general partnership)

In the open trading company the shareholders carry unlimited personal liability for the liabilities of the company. An open trading company is founded by the union of two or three natural persons. The partners are jointly and severally liable. There are no regulations which regulate the minimum amount of capital for an open trading company. The company has its own legal personality.

Limited partnership

The Georgian limited partnership is comparable to the German model. It consists of at least two or three natural persons or legal entities. It is a company in which the general partners are liable for the obligations of the company with all of their assets and the limited partners are only liable to the extent of the capital they have paid in and as a result they do not participate in the company management. The Georgian legal system does not define a minimum amount of capital for a limited partnership.

In Georgia the form of the business partnership is not often used. It hardly offers shareholders any tax advantages and due to the personal liability is associated with a high level of risk. Due to this the joint stock company is the most common legal form of company in Georgia.

Joint stock companies

Company with limited liability

This company is comparable to the German GmbH. The liability risk is limited to the assets of the company and the shareholders are only liable to the extent of their investment in the company. The company can be founded by a natural person or legal entity. The company with limited liability can be founded by a single person.

The enterprise act in Georgia defines a share capital for a GmbH which can be set to be any amount in the articles of association (in certain cases, e.g. for insurance companies, a minimum share capital is required in order to receive a licence). This must be paid in when the company is founded.

The shareholders' meeting is the highest administrative body of the GmbH and as a result decides the strategic direction of the company. The daily business and the representation are made by the company management (director(s)). The company is liable for all business related actions of the director, but not for any dishonest conduct for which the director is responsible.

Joint stock company

The founding of a joint stock company also only requires a single shareholder. Just as with a GmbH, the liability here is also limited to the company assets and for the shareholder to the extent of his investment contribution. The founding of a joint stock company also requires share capital, whereby the upper or lower limit of the capital is not defined by law but is contractually fixed by the shareholders. In order to acquire the shares of the company, a contribution must be made to the share capital.

The issue of shares can be made in the form of preference shares or ordinary shares, whereby the holders of preference shares do not have a right to vote but do have a right to a fixed dividend. Ordinary shares on the other hand guarantee the shareholder voting rights at the general meeting to the extent of the shares held.

The most important body of the joint stock company is the general meeting which decides the strategic direction and the election of the supervisory board of the company. A supervisory

board is obligatory with open companies or companies registered with the Georgian national bank and with closed companies only from 100 shareholders. The supervisory board defines and monitors the company management of the joint stock company.

Cooperative

The cooperative (Co) is an organisation where the members can be natural persons or a legal entity. The cooperative is founded through the payment of a minimum membership amount defined by the members. The organisation serves to promote common economic benefits and increase the profits for members. In this process, the cooperative should primarily act in the interests of members and only secondarily promote their financial interests. The liability for the obligations of the organisation is limited to the assets of the cooperative.

Forms of activity for foreign investors

In Georgia, foreign legal entities and natural persons can engage in economic activity without restrictions. Foreign investors can found a new company according to Georgian law or acquire an interest in an existing Georgian company. Apart from that, in Georgia it is also possible to open up a representation or branch office of a foreign company.

The principle of freedom for economic activity is valid in Georgia for domestic and foreign investors. Some types of economic activity which for example are classed as particularly dangerous require a licence which is issued by a ministry or other administrative organ. The types of activity which require a licence are defined by the Georgian legal regulations.

Branch offices (representation)

Under the Georgian enterprise act a branch office is not a legal entity. The opening of an office does not require registration for the company. The opening of a branch office by a foreign legal entity, however, is subject to compulsory registration in the public register of Georgia (enterprise department). In spite of the missing legal personality, the office can undertake all actions which are required for the purpose of doing business in Georgia. The taxation of the office is the same as it would be for a legal entity, but the withholding tax on dividends is not applicable. The liability for the obligations of the offices is carried by the parent company.

Other forms of activity for foreign investors

In Georgia the representation of a foreign enterprise is not limited to branch offices because Georgian law prescribes special forms for the legal authority of commercial enterprises.

Especially important are the regulations regarding a commercial agent, power of attorney and legal commercial power of attorney.

According to article 11 of the Georgian law relating to commercial enterprises, the business transactions of the enterprise and the commercial agent are regulated through a contract concluded with the commercial agent. The commercial agent is not defined in the Georgian legislation, but in general a commercial agent is a self-employed business person who is commissioned to enter into commercial transactions for one or more other enterprises (suppliers) or to conclude transactions in his or their name (agent for a single company or for a number of companies). He works in a third party's name and for the account of others. The labour law is not applicable for the regulation of the legal situation.

As already mentioned, the commercial agent is seen as a self-employed person. He makes transactions on behalf of third parties and on the account of others. According to article 709 of the Georgian civil code acceptance of the order obliges the person commissioned to supply one or more business transactions in the name and at the cost of the ordering party. The relationship between a foreign legal entity and a commercial agent can be regulated by a service contract. In 1986 the council of the European Union issued a directive for the regulation of the legal relationship between the commercial agent and company. This directive can also serve as a basis for a contract.

General power of attorney

According to article 10 par. 3 of the Georgian civil code, a person accorded general power of attorney must be registered in the commercial register. The power of attorney entitles the holder to represent the company in all types of judicial and extra-judicial business and legal acts which are associated with the operation of a trading business. The person with power of attorney is only permitted to dispose of and burden real estate to the extent that he has been explicitly given the authority to do so.

A limitation of the scope of the power of attorney is invalid with respect to third parties. This is in particular true for the restriction that the power of attorney shall only be exercised for certain transactions, certain types of business, under certain circumstances, for a certain period of time, or at individual locations. A restriction of the power of attorney on the operation of one or more branch offices of the company owner is only valid in respect to third parties when the offices are operated under different companies. Companies are considered to be different in the sense of this regulation if the branch office has an affix added on, which is then considered to be the company name of the branch office.

Mobility of the enterprise

Thanks to the open economic policy, in Georgia enterprises enjoy extensive mobility. Accordingly, the founding of a company and procedures for foreign investors can be completed in Georgia or by Georgian enterprises abroad and the respective location of the enterprise can be moved across the border. A foreign company which is founded and registered in Georgia can therefore move its headquarters from Georgia to outside the country without having to give up business operations or commercial activity.

The relocation of the company's domicile is possible when at the time of the relocation

- an appropriate international agreement allows this,
- the company is not involved in insolvency, criminal or civil proceedings, and
- there are no outstanding tax liabilities of the company in Georgia.

Conversion of a company

Georgian law allows the conversion of a company in three ways: change of the legal form, a merger or a split. All conversions are subject to compulsory registration. They must therefore be registered at the commercial register of the national registry office, whereby all creditors of the enterprise must be listed. These must also be informed when the conversion is to take effect in order to ensure a settlement is made.

A change of legal form can be made from each legal form to another legal form. The basis of the conversion is the decision of the shareholders, whereby the possibility of a conversion should already be part of the articles of association. Depending on the existing legal form the procedure to change the legal form is made differently. In order to convert a company with limited liability into a joint stock company and vice versa, the approval of at least 75 % of the shareholders is required.

All other form changes have to be unanimously agreed. This regulation does not apply when the shareholders have included a deviating regulation in the articles of association. Mergers can be divided into two categories: the merging of two companies and a takeover. The merging of at least two companies results in a new company. In this case the new company takes over the rights and the obligations of the earlier companies.
In the case of a takeover at least one company is taken over a by a second company. In this case a new company is not formed. The company doing the takeover integrates the company taken over into its own structure and from that moment on also takes over the rights and obligations of the company taken over.

The merger of a company with a GmbH, a joint stock company or cooperative requires the approval of 75 % of the shareholders present at the general meeting. All other forms of merger require unanimous agreement. It is possible to dispense with this procedural regulation, however, when an appropriate condition is included in the articles of association.

The splitting of a company is the third form of conversion. In this case a company is split into two or more companies. The companies created in this way exist independently of each other. However, they are severally liable for the obligations of the split company. The legal succession must be regulated in the resolution to split the company.

Liquidation of a company

The first step towards liquidation of a company is a corresponding shareholders' resolution. After that the shareholders, or if authorised accordingly the supervisory board or company management, appoints an insolvency administrator.

In order to start the liquidation process a corresponding entry is required in the public register. The national registry then informs the Georgian tax authorities which determines the tax liabilities of the enterprise. This should take up to 90 days after the registration has been made. In addition, the creditors of the enterprise are informed about the liquidation.

The insolvency administrator disposes of the assets of the company and passes on the generated revenues to a court or a notary. The received funds are used to pay creditors. When all the demands of creditors have been satisfied, the remaining amount is distributed to the shareholders after three months. After that the company is removed from the public register and is thereby liquidated.

Labour law

One of the advantages of Georgia is certainly the structure of the population. Around 65 % of the population is between 15 and 59 years of age and the education standard is generally quite high. Furthermore, it is particularly attractive for foreign investors that Georgian labour law is one of the most liberal in the world. The labour law is standardised in the Georgian labour code. It regulates the relationships, rights and obligations of the parties, working conditions and termination of the employment contract, etc.

Pre-contractual relationships

Georgian labour law grants employers the right to obtain all information about applicants. At the same time it obliges employees to communicate to their employers all information about circumstances which might represent a danger for third parties or which could cause problems during the execution of the employment activity. An applicant is entitled to receive comprehensive information about the workplace in question, the work time, conditions, etc. There is no right, however, which requires an explanation of why an applicant is or is not selected.

Trial period

In order to determine the ability of a person in relation to the required activity, a contract can be concluded with the candidate for a trial period of a maximum of six months. The employment contract for a trial period may only be concluded once. The contract must be concluded in writing as otherwise it is valid as a normal employment contract. A person who has concluded a contract for a trial period has a right to remuneration for his work. If the trail period or employment contract ends, the activity of the employee must be remunerated according to the work hours performed.

Labour protection

The working age begins at the age of 16. The employment of a younger person requires the permission of the parents or its legal representative. Apart from that, the planned employment must not have a negative influence on the physical or mental development of the respective person or restrict his possibilities to receive education.

Persons under 14 years of age may only be engaged in the areas of sport, culture, art and advertising. Furthermore, the law prohibits night work (from 10 pm until 6 am) for pregnant women, women who have recently given birth, breastfeeding mothers or minors without their express agreement. It is prohibited to employ persons under the age of 18 years in casinos, night clubs and pornographic activities or in the distribution or transport of toxic pharmaceutical substances. Persons under 18 years of age and pregnant women may also not be engaged in dangerous or heavy work.

Georgian labour law prohibits the direct or indirect discrimination of employees. Discrimination is defined as the treatment of certain persons with the aim of creating a hostile, humiliating, degrading or offensive environment or to worsen the conditions in comparison to other employees. The differentiation between certain persons due to the importance or special points of their work is not considered to be discrimination.

Working conditions

Georgian labour law does not require a minimum wage and therefore the parties can agree to any wage or salary. The usual working time is 40 hours per week. Extra-contractual overtime must be remunerated. The breaks between the individual work days must be at least 12 hours, whereby a deviation here is not allowed. In addition, the employer is obliged to provide safe working conditions and provide employees with all necessary information. In the case of an occupational injury the employer shall indemnify the employee for all damages.

Overtime

The employee must agree to work overtime hours in the following cases: a) in order to remove a natural catastrophe and/or its consequences without remuneration; b) in order to remove an industrial accident and/or its consequences – against reasonable remuneration, whereby it is prohibited to employ a pregnant woman, or a women who has recently given birth or a handicapped person for overtime hours without their approval. Overtime hours mean the provision of work by the employee when the time period exceeds the 40 hours per week for adults, 36 hours per week for young people between 16 and 18 years of age and 24 hours per week for young people between 14 and 16 years of age.

Holidays

The labour law grants employees paid holidays of at least 24 work days per year. In addition, employees have a right to unpaid holiday of 15 work days. An employee only has a right to holidays after eleven months of employment. Pregnant women and mothers of small children have a right to maternity leave for the birth and afterwards up to 730 days of which 183 days are paid (200 days in the case of complications during birth or multiple births). An employee who adopts a newly born child has the right to 550 days of holiday (of which, however, only 90 days are paid holidays). Maternal leave and holidays due to an adoption are financially supported by the state. The parties of an employment contract can agree to additional remuneration arrangements.

Paid public holidays:

- **January 1 / 2** – New Year's day holidays
- **January 7** – Christmas day
- **January 19** – Epiphany – the baptism of Christ
- **March 3** – Mother's day
- **March 8** – International women's day

- **April 9** – the day when the law to re-establish the independence of Georgia was passed; day of national unity, civil accordance and the common remembrance of all those who died for the national integrity of Georgia
- **Easter days** – Good Friday, Easter Saturday, Easter, the day after Easter – the day of praying for the dead on Monday (dates are variable)
- **May 9** – the day of victory against fascism
- **May 12** – Remembrance day for the holy apostle Andreas, founder of the Georgian Apostolic church
- **May 26** – Independence day in Georgia
- **August 28** – Day for Maria
- **October 14** – Mtskhetoba
- **November 23** – Giorgoba

Termination of the employment relationship

The ending of the employment relationship can be made mutually or from one side. Mutual grounds to end the contract may be the end of a time-limited contract, the death of one of the contract parties or a cancellation contract.

In addition, the contract relationship can be cancelled from one side. If the employee wishes to cancel the contract, he must notify the employer about this one month in advance. If the employer declares the termination, he must pay the employee a settlement amounting to one month's salary.

The termination must also be based on a ground as defined by the labour law, for example:

- economic reasons, technological or organisational changes which lead to a reduction in the number of employees in the production or services area;
- dismissal on the request of the employee;
- dismissal through agreement between employer and employee;
- insufficient professional suitability of the employee for the position occupied due to a lack of qualifications, professional knowledge or experience;
- gross violation of obligations which the employee according to the employment contract has agreed to or which are foreseen by the internal regulations of the employer or works agreement;
- infringement of the employee of the work discipline or negligent acts with non compliance of the conditions of the employment contract, the internal regulations of the employer or the works agreement within one year after the previous warning or application of disciplinary measures;

- unless otherwise specified by the employment contract, a long incapacity for work of over 40 successive calendar days or of over 60 calendar days within six months. In that case according to the civil code the employee has a right to paid and unpaid holidays;
- other objective circumstances which justify dismissal.

Real estate and acquisition of land

The Georgian civil code specifies that articles are either movable or immovable. In the Georgian civil code there is only one definition of immovable articles and this includes land and its raw materials, plants growing on the land and buildings and other structures connected to the land so that they cannot be removed without destruction of their purpose.

An item of real estate can belong to a natural person or legal entity or the state. A right of ownership to real estate is recognised and guaranteed within the scope of Georgian law. In order to prove ownership of real estate, the owner requires an extract from the national agency for registration of real estate.

Third parties can assume that the entries are correct and complete in the national registration agency of Georgia. Some time ago the land was mainly owned by the state. Today most of the country has already passed into private ownership. Due to its main function, immovable assets are strongly connected to where the property is situated. The regulations with regard to real estate are frequently decided by the states themselves. The same idea is explained in the national law of Georgia. Article 10 of these regulations postulates the exclusive jurisdiction of the courts of Georgia for disputes concerning land in Georgia.

Georgian law distinguishes between pieces of real estate according to their purpose. Real estate is divided into agricultural and non-agricultural areas. For a piece of real estate to be valid as agricultural it must be registered as such in the national registration agency. In addition, it must be used for growing crops or livestock breeding. Since June 2013 the ownership of agricultural areas has been restricted. Only Georgian natural persons or legal entities may purchase or inherit agricultural areas in Georgia.

The constitution of Georgia stipulates that the general law regarding ownership, the acquisition or disposal of property and the right to inherit property are recognised and cannot be removed. This means that there are a number of possibilities to become the owner of real estate of which one can be privatisation and the purchase of the real estate.

Procedures and regulations are specified in the law pertaining to property owned by the state which foresees three forms of the privatisation of real estate:

- auction
- direct sale
- direct sale on the basis of preliminary selection procedures

Law concerning foreigners

In 2011 the requirement for a visa to enter Georgia for a stay up to 360 days was removed. This relaxation of the residence regulations is valid for the EU states and also for Albania, Andorra, Antigua-Barbuda, Argentina, Australia, Bahrain, Barbados, Belize, Bolivia, Bosnia and Herzegovina, Botswana, Brunei, Canada, Chile, Columbia, Costa Rica, Cuba, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Iraq, Iceland, Israel, Japan, Korea, Kuwait, Lebanon, Liechtenstein, Malaysia, Mauritius, Mexico, Monaco, Montenegro, New Zealand, Norway, Oman, Panama, Paraguay, Peru, Qatar, Russia, San Marino, Saudi Arabia, Switzerland, Serbia, Seychelles, Singapore, South Africa, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Surinam, Thailand, Trinidad and Tobago, Turkmenistan, Uruguay, the US and Vatican. For persons from most of these countries, an ID card will suffice as a travel document.

Otherwise, according to Georgian law there are three possibilities to enter Georgia and stay there. These are: with a visa, a residence permit or a special permit (for citizens of certain countries).

Visa

A visa is issued by the Georgian consulate in the respective home country (or by civil registration if the foreigner is already resident in Georgia). It entitles a person to enter Georgia and to reside for a certain time period.

There are four types of visa: an ordinary visa, a business visa, a diplomatic visa and the student visa. Diplomatic visas are issued for government members, members of diplomatic service (and their families), etc. Business visas are issued to persons who represent international organisations in Georgia or who are making an official visit to Georgia. An ordinary visa is issued to persons visiting Georgia for business, entrepreneurial, tourist or work related purposes. A student visa is issued to persons who possess an invitation to an accredited educational institution.

Visas can be issued for time periods of 90 days (for single or multiple visits) or up to 360 days (only for multiple visits). In accordance with international agreements, diplomatic visas, work visas and ordinary visas can be issued for up to 15 years. Student visas are only issued for 360 days. If a student wishes to remain in Georgia, an application for a residence permit must be made.

Residence permit

A residence permit can be issued to be temporary or permanent.

A temporary residence permit can be issued for up to six years to persons who:

- work in Georgia;
- study in Georgia or are undergoing medical treatment in the country;
- are invited by the government in the national interest as a highly qualified professional or expert;
- are a guardian of a person with Georgian citizenship;
- have a Georgian citizen as their guardian;
- have a Georgian parent, spouse, brother or sister or grandparents;
- are a victim of human smuggling.

A permanent residence permit can be issued to an applicant who:

- has lived for the last six years in Georgia (with the exception of time periods for studies and medical treatment);
- is a grandchild, child, parent, brother or sister or spouse of a Georgian citizen;
- is a scientist, artist, sportsperson and its residence in Georgia is in the national interest;
- who has lost his Georgian citizenship.

Tax law

Protection of taxpayer rights

One of the most important elements of the tax law is the protection of taxpayer rights. Georgian tax law includes corresponding regulations. The new civil code added a number of new regulations.

Furthermore, in a similar way to the legal systems of western states, Georgian tax law recognises the elementary principles of access to information, the confidential treatment

of data and the restitution of overpaid tax. All natural persons and legal entities subject to payment of tax are entitled to view data recorded about them and to obtain fiscal information. In addition, they can rest assured that all data – excluding data included in the public registry (legal form, identification number, address, etc.) – is treated as confidential. Overpaid taxes or fines are also refunded or offset against future taxes. The taxpayer is also granted the opportunity to safeguard his interests directly or via a representative (tax agent).

A special feature introduced with the revision of the Georgian tax law is the tax ombudsman who in co-ordination with the parliamentary chairperson is appointed by the Georgian Prime Minister to monitor the protection of taxpayer rights. The ombudsman examines the objections submitted by taxpayers and writes an annual report and passes on recommendations to the tax authorities as to how the respective offence can be compensated.

Furthermore, taxpayers have the right to contest the decisions of the tax authorities, to receive decisions concerning tax investigations, to apply for exemption from tax fines and not to comply with instructions from the tax authorities which are unlawful.

An appeal against a decision of the tax authorities at the finance ministry or in court is permissible within 30 days after receipt of the tax assessment. After the appeal is received at the finance ministry, the examination of the alleged infringement is made either by the tax authorities or by the arbitration council. If the decision is not rectified, further legal action remains an option.

In order to promote economic co-operation and investment measures, Georgia has concluded a double taxation agreement with Germany, Austria, Switzerland and also Armenia, Azerbaijan, Belgium, Bulgaria, China, Czech Republic, Denmark, Estonia, Finland, France, Greece, India, Iran, Ireland, Israel, Italy, Kazakhstan, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Qatar, Romania, Singapore, Spain, Turkey, Turkmenistan, UK, Ukraine, Uzbekistan and the United Arab Emirates. In addition, in 2011 preparations were set in motion to conclude a double taxation agreement with Albania, Argentina, Belarus, Brazil, Iceland, Iraq, Jordan, Liechtenstein, Marshall Islands, Mexico, Montenegro, Oman, Panama, San Marino, South Korea, Syria and Vietnam.

Taxes

Georgian tax law specifies only six types of taxes. There are five national taxes (income tax, corporation tax, sales tax, consumer tax, import tax) and only the wealth tax is a local tax in the sense of a municipal tax.

Income tax

All natural persons have to pay income tax. A person who has a residence in Georgia is subject to tax without restrictions which therefore includes his income worldwide. The obligation to pay this tax is also valid for non-resident persons subject to limited income tax liability. Thanks to the double taxation agreement, however, tax is only paid on income generated in Georgia. Income in the sense of Georgian tax law is income generated from an employment relationship (salary/wage and cash-value benefits), economic activity (especially dividends) and other income which can include, for example, the beneficial acquisition of goods or also income from private sale transactions. Tax loss carried back is excluded while tax loss carried forward to future years is possible depending on the engagement of the taxpayer as a company. The taxation is made for the calendar year and currently amounts to 20 %. Interest and dividends are subject to a tax rate of 5 %.

Corporate tax (tax on profits)

Just as with income tax, corporation tax is also based on the calendar year. The tax rate amounts to 15 %. In view of the double taxation agreement, foreign companies are subject to corporation tax if they have a branch office in Georgia or generate other forms of income. Companies and sole traders are obliged to pay corporation tax on a quarterly basis and to the amount of respectively 25 % of the total corporation tax amount based on the income from the last tax year. Payments must be made at the latest by the May 15, July 15, September 15 and December 15. Companies which have not made a taxable profit are not subject to this advance. The corporation tax is based on the IFRS and a number of fiscal modifications. Companies are treated as corporation tax subjects unless they are classified as a micro business or a small business. Micro-businesses or small businesses may be subject to simplified financial accounting rules and tax advantages (taxation only according to the tax law). The classification of these orients to criteria such as the employment of workers and annual income.

Furthermore, certain incomes may be exempt from corporation tax, e.g.:

- income from international organisations, legal entities and non-profitmaking organisations financed by the state which are not derived from commercial activity;
- membership fees, donations and scholarships received from non-profitmaking organisations;
- income from the disposal of bonds of the Georgian state or the Georgian national bank and also interest from deposits at the national bank;
- income realised and reinvested before 2014 derived from agricultural activity;
- income from the liability of a Georgian insurance;
- certain income from the field of IT;

- various income arising from the promotion of medical supply and modernisation or the promotion of tourism;
- various income from international financial companies, special trading companies and companies in free industrial zone companies.

Tax loss carried forward is also possible for corporation tax, but not tax loss carried back. In addition, Georgian tax law recognises numerous tax deductions. In principle, items are tax deductible which are consumed in order to generate the taxable income such as the manufacturing costs of goods for sale, working materials or salaries and wages. Expenses of a company which are not tax deductible are in general those which do not promote the own company and do not serve to promote the purpose of the company such as, for example, corporation tax itself, fines and penalties, but also expenses which are incurred when utilising a micro-business.

Furthermore, depending on the object or group subject, the instrument of depreciation is applicable using different methods. Dividends are subject to a withholding tax to the amount of 5 % but only to the extent they are distributed to private persons, non-profit organisations or foreign companies. Otherwise they are not subject to tax. The tax rate on interest income is 5 %. Under certain conditions, however, the adding of interest to taxable income is not made.

Sales tax

The Georgian sales tax rate is 18 % and must be paid on a monthly basis. Sales tax is due with the performance of any service or delivery of goods in Georgia including the import or export of goods in and out of Georgia. Imported goods temporarily in transit are subject to a tax rate of 0.54 % per started month, but in total not higher than 18 %.

Only registered taxpayers or those who would be subject to registration are entitled to deduct sales tax. The obligation to register exists for business operators who within a time period of 12 successive months record business transactions amounting to a total of 100,000 GEL unless their activity is restricted solely to a free trade zone. Registration is also, for example, obligatory within two days for persons who export one or more goods with a total value of over 100,000 GEL. Furthermore, a voluntary registration can be made by any taxpayer. Registration is uncomplicated and is usually made in one day. Deregistration is possible in the case of liquidation or on request.

According to Georgian tax law, there are two types of tax exemption, one with the right to deduct input tax and one without the right to deduct input tax.

The following business transactions do not result in a right to deduct input tax:

- export of operable and strategic financial services;
- import of goods and services governed by Georgian law relating oil and gas;
- (temporary) import of goods for the personal use of foreigners working in the oil industry;
- delivery of agricultural original products (e.g. grains and seeds) by agricultural workers;
- delivery of services related to education or medicine;
- deliveries to real estate;
- certain imports with a limited quantity of tobacco products and alcohol by private persons (except import from a free trade zone);
- certain imports with a limited quantity and value of goods depending on the period of absence from Georgia (except the import from free trade zone);
- transfer of shareholdings in a partnership, except when in return for the shareholding individual assets are acquired;
- transfer of assets of the partnership to their exclusively natural owner to the extent that since the founding no conversion took place;
- delivery/import of certain medicines, vehicles, publications and mass media including baby products;
- lottery and gambling services;
- temporary import of goods which are completely exempt from sales tax, etc.

Input tax can be deducted for the following examples of business transactions:

- export of goods;
- delivery of goods to foreign diplomatic representatives;
- services in the area of export/re-export of goods and goods in transit;
- delivery of gas to thermal power plants;
- cross-border transport of goods and passengers;
- transfer of assets in the course of conversions;
- asset contributions to share capital;
- delivery of gold to the Georgian national bank;
- tourism services;
- services for ships which import goods into Georgia.

Consumer taxes

In Georgia, consumer taxes are levied on drinks containing alcohol, tobacco goods, vehicles and minerals resources such as oil and gas. The fixing of the amount is determined by the volume of amount generated whereby the tax rate is different depending on the type of

consumer good. In addition, alcohol products (from 1.15 ‰) and tobacco must have a corresponding tax seal. While the consumer tax for imported goods is paid directly in the import process, there is currently an additional requirement for information on a monthly basis.

Consumer taxes must be paid in cases with:

- the manufacture of goods subject to tax in Georgia;
- imports or exports of goods subject to tax into or out of Georgia;
- manufacture of goods not subject to tax from goods which are subject to tax;
- the supply of liquid gas and/or natural gas for vehicles;
- the providing of a mobile telephone service.

Exemption from consumer taxes with a right to deduct input tax exists with the export of goods subject to tax (except scrap metal) and the delivery of Georgian goods for sale in duty free zones.

For the following business transactions, however, there is a tax exemption without the right to deduct input tax:

- alcoholic beverages manufactured by natural persons for own consumption;
- import of 400 cigarettes, 50 cigars, 50 cigarillos, 250 grams of other tobacco goods or a combination of all the mentioned products up to a total quantity of 250 grams by natural persons within a calendar day by an aircraft or within 30 days by other means of transport including import of four litres of alcoholic beverages;
- fuel in the fuel tank of the vehicle with which a person enters Georgia;
- import and/or delivery of aviation fuel, lubricants or other auxiliary products for international flights or international sea voyages;
- import of goods for private consumption of diplomatic representatives and their relatives in a broad sense;
- vehicles with the number 8703 according to the classification of goods according to the nomenclature for export products;
- consumer goods which within three years after their export return to Georgia unchanged and are re-imported.

Import tax

Import tax must be paid by persons who import goods into the economic area of Georgia. The tax is calculated either on the value or volume of the goods. The tax rate of the import tax is according to the type of the goods to be imported.

Differentiation is made between three main groups:

- 1. Group: food, mineral water, juices, wood, concrete, stone, clothes and jewellery goods taxed at 12 %,
- 2. Group: private property, cables, pork meat, cheese and further certain types of foods at 5 %,
- 3. Group: including alcoholic beverages and vehicles are taxed with a variable tax rate.

Numerous goods are exempt from tax. These in particular include humanitarian goods and goods which assist in the removal of natural catastrophes. Goods are also exempt which serve international passenger traffic, baby foods, diabetic foods and goods from a special economic zone.

Wealth tax

This tax is also based on the calendar. The local wealth tax may not exceed a highest rate of 1 %. The charging of the tax is different for private persons and companies.

For private persons within Georgia the reference point for the taxation is the legal position of the property. Taxable objects are all forms of real estate and land inclusive their buildings (regardless of how advanced), yachts and motor boots, aircraft and helicopters and objects leased by foreigners/foreign companies. Foreigners with business activities in Georgia on the other hand have to pay wealth tax on all tangible and intangible assets. Domestic and foreign private persons, however, can benefit from tax exemptions.

The taxation of the domestic and foreign companies is made according to the tangible assets recorded on the balance sheet, machines not installed, plant under construction, fixed assets and rented items of property.


HONGKONG

HONGKONG

Hong Kong as a so-called special administrative region is part of the People's Republic of China. It is, however, in certain areas due to the handover contract between the UK and People's Republic of China legally independent. According to the contract, the colonial common law will continue to be valid until 2047. Hong Kong is a free port with low tax rates and is one of the most liberal economies in the world.

For investment activities usually a so-called private company limited by shares is used which in the main is similar to the German GmbH apart from the fact that the influence of the shareholders against the power of authority of the board of directors is less. The board of directors is the real centre of power in the company. A company founding lasts approx. two weeks, whereby a notarial certification is not required. Other legal forms are usually not practical.

Joint ventures are often formed with local partners, whereby here it should be observed that the proportion of the shareholdings is correspondingly reflected on the board of directors and care taken that the (foreign) partner has sufficient possibilities to control and influence the company. The joint venture agreement then takes priority over the articles of association.

The capitalisation of a Hong Kong company is low. There is not a requirement for a minimum amount of share capital, but usually it amounts to HKD 10,000 (approx. 1,000 euros). Financing is usually made via shareholder loans as capital increases and decreases are disproportionately time-consuming. An annual financial statement must be prepared and attested before it is submitted to the Inland Revenue Department to determine the corporation tax (16.5 %), whereby it is not published.

The labour law in HK is essentially liberal. It was only recently that a statutory minimum wage of HKD 30 per hour was introduced. Employee protection and in particular dismissal protection as known in Germany does not exist in Hong Kong. The employee on-costs for the employer are low (max. HKD 1,000 social insurance contributions per month) and tax must be paid by the employee himself (15 % income tax).

In addition to corporation and income tax there are only a few other types of tax such as stamp duty for the transfer of shares and acquisition of property. There is no sales tax (VAT).

Practical examples

Taxes

Background facts:

The German company U would like to hire Mr. X, resident in Hong Kong, to penetrate the Chinese market for U. Mr. X shall mainly operate in China, but proposes that he should receive his full salary in Hong Kong because there is a lower tax rate there. This is "the usual thing to do".

What can be done now?

There is now the risk that the elements of the offence of tax evasion are satisfied in the People's Republic of China because Mr. X must pay tax on his salary in China for services he has provided in China.

What should one have done differently from the beginning?

In such constellations it is recommendable to conclude two employment contracts with Mr. X. One employment contract according to the law of the People's Republic of China and the second employment contract according to the law of Hong Kong. The tax approval must then be separately obtained from each of the authorities.

Law

Background facts:

The German company X has concluded a contract with the limited company C registered in Hong Kong for the delivery of goods. X pays the agreed purchase price, but C does not deliver.

What can be done now?

Even when the prospects for success in legal proceedings are good, it should first of all be examined whether C at all has sufficient physical substance and assets to make economic sense of enforcement. Trading companies in Hong Kong are often just letter box companies without appreciable assets which means enforcement is essentially ineffective.

What should one have done differently from the beginning?

Prior to the conclusion of the contract a check should be made of the creditworthiness of the contract partner and if necessary a safeguard demanded in the form of guarantees or personal guarantees from the shareholders, etc.

Law / Administration

Background facts:

The German company X would like to contest a decision of the immigration department in the case where a work permit was refused.

What can be done now?

In Hong Kong there is no independent administrative law as known in Germany. Decisions from the authorities are only justiciable to a limited extent and then only within the context of civil proceedings.

What should one have done differently from the beginning?

In such cases it is recommendable at an early stage to include a law firm in the negotiations and the application process. The process of changing a decision already made by the authorities is considerably more time consuming and complicated than obtaining legal advice from the beginning and having a legal representative.

Fraud

Background facts:

The German taxpayer S purchases shares from the Hong Kong company G to the value of 100,000 euros and these are allocated accordingly to his portfolio of securities which he can view on the home page of company G. After the share price has risen he would like to sell the shares for a profit. But now he finds out that at company G nobody reacts to his calls or emails any more. A short time later the home page of the company G goes offline.

What can be done now?

S can check whether legal proceedings in Hong Kong are worthwhile. In most cases, however, company G will be just a letter box company which means enforcement is essentially ineffective.

What should one have done differently from the beginning?

Avoid involvement in these kind of transactions which are generally only made to evade paying taxes in Germany.

Corporate (white-collar) crime

Background facts:

The German company X learns that in the Hong Kong subsidiary bribes have been paid for many years to a business partner and authorities in the People's Republic of China in order to obtain certain orders.

What can be done now?

The subject must be immediately examined and fully sorted out. The so-called organised and serious crimes ordinance in Hong Kong means that actions in Hong Kong which aid and abet an action which is a criminal offence abroad are also punishable by the law of Hong Kong. Due to this extension of punishability, the mere tolerating of a criminal act in China by the company directors of the Hong Kong company is relevant in relation to criminal law.

What should one have done differently from the beginning?

We recommend the implementation of an internal control system right from the beginning which will prevent such types of behaviour. In addition, it is advisable to outsource the financial accounting.


HUNGARY

HUNGARY

Founding of a company (registration obligations, special bureaucracy)

In Hungary, investors can choose between nearly all of the legal forms already known from Germany. The most popular company form in Hungary is the company with limited liability, the so-called "Kft." In Hungary there is a well-functioning commercial register which can be completely accessed electronically. The application to found a company is transmitted by the representing lawyer electronically to the respective register court. The company only becomes legally effective with the registration in the commercial register. The signing of the foundation documents by a Hungarian lawyer removes the need for a notary as the signing by a lawyer fulfils the formal requirements. If the foundation documents are signed abroad, the signatures must be certified by a notary. Apart from that, in Germany a supplementary attestation in the form of an apostille is required.

Takeover of a company

The takeover of a previously founded company in Hungary is easy to accomplish by means of a share deal. However, in the case of the acquisition of a share in a company with multiple shareholders the legal right of first refusal of the remaining shareholders has to be taken into account which can be expanded in the articles of association. In addition, the acquisition of the individual assets/facilities of the company is also possible by means of an asset deal and is also practiced. It is, however, important to point out that with an asset deal according to the current Hungarian property law it is not possible to acquire the facilities of a company in the course of a single transfer of going concern, but instead all of the individual assets have to be separately named and transferred (Hungarian sales tax law, however, does have a legal institution similar to an operational handover). Finally, it should be observed that also in Hungary there are regulations concerning the transfer according to employment law. Particular attention must be paid to the respective regulations if in connection with an asset deal not all of the workforce is to be taken over.

Company management

Hungarian law also differentiates between the internal company management authority (limitable through the articles of association or company management regulations) and the external right of representation (which basically cannot be limited). The representation rules (single or joint representation) have to be listed in the commercial register. As far as authorised representatives are to be appointed, it should be taken into consideration that an authorised representative can only be a person who has an employment relationship with the respective company. A full power of attorney or general power to negotiate assigned to individual persons

or employees in Hungary is not permitted by law. It is only possible to work with specific special power of attorney for a certain, clearly defined task (or scope of functions).

Foreign exchange restrictions

The previous foreign exchange restrictions were abolished in Hungary in 2002 as part of a harmonisation measure prior to full EU membership in 2004.

Real estate and acquisition of land

Due to the fact that in Hungary agriculture is an important factor in the total economic performance of the country, the regulations with regard to the acquisition of farmland are particularly important for possible foreign investors. In general, according to the current prevailing Hungarian legal regulations only Hungarian private persons can acquire farmland to a restricted extent in terms of area. The new law governing farmland which came into effect on May 1, 2014 foresees in accordance with EU regulations that in general also natural persons from EU member states can acquire property in the form of farmland under the same conditions as Hungarian natural persons.

Natural persons according to the law are not to be seen as farmers, but from May 2014 they can acquire a maximum of one hectare of farmland. At the present time (and also after the changes in May 2014) stricter regulations apply regarding the right of first refusal, whereby a number of certain persons (among others also the Hungarian state) are granted a legal right of first refusal. From the spring of 2014 the acquisition of property and also the use of farmland is subject to authorisation from the respective authorities. There is only the possibility in very limited cases that a Hungarian company (with or without a legal personality) can acquire property in the form of farmland.

It is also important that in Hungary the purchase contract regarding the acquisition of a property has to be countersigned by a lawyer. A sales contract and the registration of the change in the land register are required for the transfer of ownership (constitutive effect). Reservations are usual in form of marginal notes and are an important instrument to secure the entitlement to register in the land register.

Labour law

In 2012, a new labour code came into effect in Hungary. As before, the new labour code regulates the individual and collective labour law as well as other non-standard forms of employments. The new labour code generally offers more flexible possibilities for the

employment of workers. A tendency is noticeable that the freedom of disposal of the employment contract parties was strengthened and that the law only contains compelling regulations with regard to a number of fundamental guarantees concerning the employment relationship.

Taking into account that many regulations of the previous labour code are no longer included in the new labour code or have been rephrased, in all cases a thorough examination should be made of the extent to which the existing interpretations of the Hungarian courts can be applied in the light of the range of regulations or how they are now to be interpreted.

Dismissal protection

The maximum duration of the trial period in Hungary is only 3 months. During the trial period there is no protection against dismissal. There are certain (i) prohibitions of termination (for example notice of termination of an employment relationship during pregnancy and during maternal leave) to be taken into account and also certain (ii) termination restrictions for employees who are due to retire or (iii) special dismissal protection regulations in collective labour law regarding an employee who is active in a union.

Liquidation of the company

As far as a Hungarian company is solvent the shareholders are at any time entitled to liquidate the company without a legal successor. For this purpose a corresponding shareholders' resolution must be made and this, together with other, specific company-law documents, must be submitted to the registration office. It is important to point out that by law the registration office procedure must be carried out by a lawyer and that the corresponding shareholders' resolution also requires the countersignature of a lawyer. The liquidation of a Hungarian company is a complex process which as experience shows can last up to three years, whereby before submission of the application to deregister the company at the registration office among other things balance sheets must be prepared and a number of authorities have to be informed.

Other administrative or special bureaucratic points

In Hungary, when providing personal data, e.g. in contracts, it is always important to also give the complete (first name and surname) maiden name of the mother. This serves to identify the respective person more exactly.

Tax law

The Hungarian taxation procedure is mainly characterised by the principle that self assessment is valid. Accordingly, a company liable to pay tax must calculate, register and pay its tax liability by itself without a provisional assessment having to be made by the tax office.

Taxpayers may carry out an internal audit at any time until the time when an audit is carried out by the tax authorities in order to correct its tax return and tax payment without the imposition of a fine. However, a self-revision surcharge must be taken into account for a correction made starting from the day after the stipulated deadline to hand in the tax return has expired until the day when the self revision form is submitted.

The audits carried out by the financial authorities can be divided into two categories. The first category consists of a retrospective, detailed tax audit which is made according to the audit guidelines and the second type consists of regular audits in Hungary for the 3,000 most important taxpayers determined by the highest tax liability.

The tax audit is conducted with the aid of the official audit guideline. This guideline defines all the relevant audit objectives in the current tax year and the main activity areas to be audited, i.e. a group of taxpayers (e.g. car rental companies) or taxpayers in an area of the country (e.g. taxpayers in the Pest region) are audited. The tax audit has to be carried out within the limitation period and also within the defined review period. If the audit reveals a tax deficiency, the deficiency is punished by financial authorities in the form of a financial penalty and legal proceedings are possible and not unusual.

Auditing

All companies in Hungary with a double-entry system are subject to mandatory statutory auditing. Companies are exempt from this, however, which have an average sales revenue below a certain value (in 2013 sales revenue value was < 200 million forints (HUF), and from 2014 < 300 million forints (approx. 1 million euros). The last two previous reporting years are used to calculate the amount of the sales revenue. Furthermore, a further condition for the actual audit obligation is that the average number of employees in the company in the last two years was at least 50.

The company cannot claim exemption from the audit obligation in relation to the non realisation of the limit value if the company is included in a consolidation. Newly founded companies have to determine the value limit due to the information contained in their business plan.

Auditing activities in Hungary must be carried out in compliance with the national auditing guidelines which in principle conform to the international standards on auditing (ISA).

Financial accounting

According to Hungarian financial accounting law no. C/ 2000; RLG, all companies are obliged to maintain a double-entry system for financial accounting. Branch offices of companies with a foreign domicile in Hungary are also considered to be companies in the sense of the Hungarian RLG financial accounting law. In addition, the financial accounting may only be conducted in the Hungarian language (§§ 3 and 12 RLG).

The accounts must be maintained according to the regulations of the Hungarian RLG and where the law allows the possibility of choice (e.g. valuation of inventory by the first-in first out method or average prices), according to the regulations which are listed in writing in the financial accounting policy of the company. In the case of a company audit the financial authorities can check whether the financial accounting system corresponds to said conditions.

The company must report all business transactions in the annual financial statement which can have an impact on assets and liabilities or on the result of the reporting year (§ 15 par. 2 RLG).

The Hungarian RLG financial accounting law prescribes uniform account categories. The account categories one to four include the balance sheet accounts, whereby the account categories one to three are the accounts for assets and the account category four the accounts of the liabilities. The figures required for the preparation of the income statement and to determine the balance sheet result are included in the account categories five, eight and nine. The account categories five and eight include the costs and expenses. The account category nine records the proceeds and income.

Practical examples

Auditing

Background facts:

A subsidiary of a German company in Hungary working to commission was billed for service fees and price corrections from other group companies under different legal titles.

In 2011, costs passed on from the group amounted to approx. 1,050,000 euros and in 2012 approx. 1,350,000 euros.

In the course of the audit of the annual financial statement at the company we determined that the written contracts for the transactions concluded with the affiliated companies were not all available in writing. We pointed out to the company that according to the Hungarian civil code the contract parties can conclude a contract verbally, but that an independent third party must conclude a written contract for business transactions of such volumes.

The Hungarian corporation tax law includes further specific country regulations for the purpose of calculating expenses with regard to tax. According to Hungarian corporation tax law, expenses incurred which are not in the interest of the entrepreneurial activity cannot be recognised under law. Services provided whose value exceeds 200,000 forints and where due to the circumstances it is possible to determine that services were provided contrary to sensible entrepreneurial thinking can also not be taken into account. The regulation relates to services between affiliated companies and also to transactions with third parties.

For this reason, at an early stage in 2012 we proposed that verbal contracts should be put into writing and verified by further detailed information and documents that the services were actually provided and that the incurring of the costs was actually in the interest of the company. We frequently referred to the potential difficulties and associated tax risks, but the company management of the group was only prepared to focus on possible solutions at the beginning of 2013. In the meantime the group finds itself in a difficult financial situation. A new crisis manager was appointed who quickly recognised that measures should be immediately introduced to stabilise the group once more.

What can be done now?

The crisis manager has made use of Rödl & Partner and together with our colleagues from the tax consulting division we examined the tax risks and the accounting for the individual transactions according to corporation tax law and the OECD transfer price guidelines. Our legal department has drawn up contracts in writing for the contracts which were concluded verbally under consideration of the special points with respect to the legal requirements and form.

The Hungarian company prepared the proof of performance for the services it provided and respective documents and timesheets indicating the hours worked.

At the right time because just as the contracts and documents were ready for signing, the Hungarian tax office made contact and carried out a company audit regarding the repayment of sales tax. In the course of the company audit the tax office had access to the complete documentation with regard to the accounting and accepted these with the statement that the formal regulations had been complied with. The audit of the amounts in the contracts will be the object of a later comprehensive company audit.

What should one have done differently from the beginning?

In the course of our audit we become familiar with the activities and processes of the Hungarian subsidiary. Our task is to assess the risks present in the company and to advise the company management and the shareholders about such risks. The above example demonstrates that once a risk has been identified the required measures should be introduced without delay. Witten documentation to verify the legality of the intra-group expenses in accordance with the Hungarian regulations should have been made at the very beginning.

Taxes

Background facts:

A German company (plant contractor) and a Hungarian company (ordering party) have concluded a series of contracts to build up a number of (technically complex) conveyor lines in Hungary. The installation was planned in a number of stages and lasted a couple of years. In the process the German company used Hungarian subcontractors.

The German company started the installation process and wrote its invoices without Hungarian sales tax as an intra community delivery. The German company received invoices listing Hungarian sales tax from the Hungarian subcontractors. Due to the lack of a Hungarian tax number, the German company was not able to reclaim the input tax from the subcontractor invoices in Hungary in the usual way, whereby in an input tax refund procedure, however, its application was rejected on the grounds that the German company has a branch office in Hungary and therefore has to register itself in Hungary for sales tax. One year after the start of the installation process the German company decides to retroactively apply for registration for sales tax in Hungary, cancelled all invoices issued up to that point without sales tax and issued new invoices which included Hungarian sales tax.

Due to the corrected invoices, the German company has carried out the corresponding correction to the tax returns and paid the tax arrears. The financial authorities, however, due to late payment charged the company with the payment of default interest on arrears to the amount of several million forints (HUF).

What can be done now?

The above described situation left the German company with no choice other than to pay the interest on the arrears.

What should one have done differently from the beginning?

In principle, the problem came down to the fact that the concluded contracts did not clearly define whether the delivery was an intra-community delivery with the associated installation or the activity was a construction and installation activity.

The German company initially assessed the delivery from a sales tax point of view to be an intra-community delivery with the associated installation. However, in the meantime the company management has changed its opinion and wanted the object of the contract to be

understood as a construction and installation activity. In the first contract the German company should have clearly defined the character of the contract. According to the EU sales tax directive and Hungarian sales tax law both options are possible.

As far as an intra-community delivery with the associated installation was actually the case, the German company was not allowed to register for tax in Hungary and the invoicing should have been maintained up to the end of the execution of the contract without the inclusion of sales tax. The German company could have contested the rejected application to deduct input tax in court. But if from the beginning the case concerned a construction and installation activity, then before the beginning of the activity the German company should have registered itself for sales tax in Hungary, its invoices should have listed Hungarian sales tax, the tax could have been declared and the input tax from the subcontractor invoices could have been deducted from the tax to be paid.

Law

Background facts:

The German XY-GmbH decides to expand its sales structure worldwide and would also like to start business operations in Hungary. Accordingly, XY-GmbH founds a (sales) company with limited liability according to Hungarian law, a so-called "Kft." company, with the German parent company as sole shareholder.

The German company management has appointed a Hungarian managing director to manage the Kft. who reputedly as an experienced businessman maintains good contacts to potential customers. In the contract of employment it is agreed that the managing director will be given the title of commercial manager. After a short time, however, it turns out that the managing director does not possess the qualities required to successfully manage a company and has entered into disadvantageous business relations which can only be ended with a considerable loss to the company. Furthermore, due to a coincidence the German company management has also learned that the Hungarian managing director has also apparently misappropriated company funds through fictitious invoices to companies of closely linked acquaintances and friends.

After the German company management learns about the above-mentioned irregularities, a resolution is carried out to immediately dismiss the Hungarian managing director from his office of managing director, but without a notice of termination in writing of the underlying employment relationship. A new managing director is appointed in his place.

The former managing director now takes legal action against the company through the respective industrial tribunal and claims compensation due to the unlawful ending of his employment relationship.

What can be done now?

In this situation it is important to send the former managing director a corresponding notice of termination at the earliest opportunity in order to limit his possible claim to a loss of income due to the unlawful notice of termination. Furthermore, the initiation of criminal proceedings can be considered.

What should one have done differently from the beginning?

Due to the fact that with the commissioning of a managing director the factors of company law and also employment law have a role to play, these factors must be appropriately taken into account in the design of the employment contract of the managing director. In this respect when the Hungarian subsidiary was founded, the employment contract of the managing directors should have already included a "uniform legal relationship for the managing director" because the task of a managing director also includes the operative management of the company and the management of company affairs.

In these cases the employment contract in parallel to appointment under company law in connection with the regulations to end the employment relationship should expressly refer to the fact that a dismissal under company law is also to be viewed as notice of termination of the employment relationship. Therefore, apart from the corresponding resolution from the shareholders' meeting to dismiss the managing director, the notice of termination of the employment relationship of the managing director does not require any further legal declaration from the side of the employer. The action against unfair dismissal of the former managing director and the considerable associated costs and time involved could easily have been avoided.

Financial Accounting

Background facts:

A German company has founded a branch office in Hungary. Rödl & Partner has informed the German company that the financial accounting of the branch office will have to be carried out to comply with the regulations of Hungarian financial accounting law. The company decided, however, to maintain the financial accounting of the branch office according to Hungarian law in Germany and Rödl & Partner in Hungary should only prepare the tax returns of the branch office according to the documentation and figures made available by the company and also to prepare the annual financial statement of the branch office according to the account balances and documentation provided by the company.

Rödl & Partner prepared the sales tax returns based on the figures provided, but it was frequently the case that despite an urgent request the data was not made available before the deadline to submit the tax return. Rödl & Partner also did not receive account balances required for the preparation of the annual financial statement and therefore it was not possible to prepare the financial statement.

A number of years after the founding, the competent tax office carries out a company audit in relation to sales tax. In the course of the audit, on the basis of the documentation provided by the client the financial authorities determine that for a number of tax assessment periods a zero report was submitted, although on the basis of the actual figures there was an obligation to pay sales tax. For this purpose, the financial authorities used the figures (which did not include a zero report) for the sales tax. In addition to the payment of the sales tax a significant fine was imposed on the company.

In the meantime the shareholders and der company management in Germany understood that the financial accounting for the branch office had not been managed separately, although this was required.

As the company was not in a position to transfer such a high fine in one amount, an application was made to the financial authorities for payment facilities. A requirement for the submission of the application for payment facilities was the sending of the last two annual financial statements and an interim financial statement. Due to the tight deadline to submit the application for payment facilities the annual financial statements had to be prepared at short notice. It was therefore agreed that Rödl & Partner based on the account balances made available would prepare the annual financial statements since the founding without conducting a check of the correctness of the figures. During the preparation of the annual financial

statements Rödl & Partner found errors in the account balances and the company requested these to be corrected.

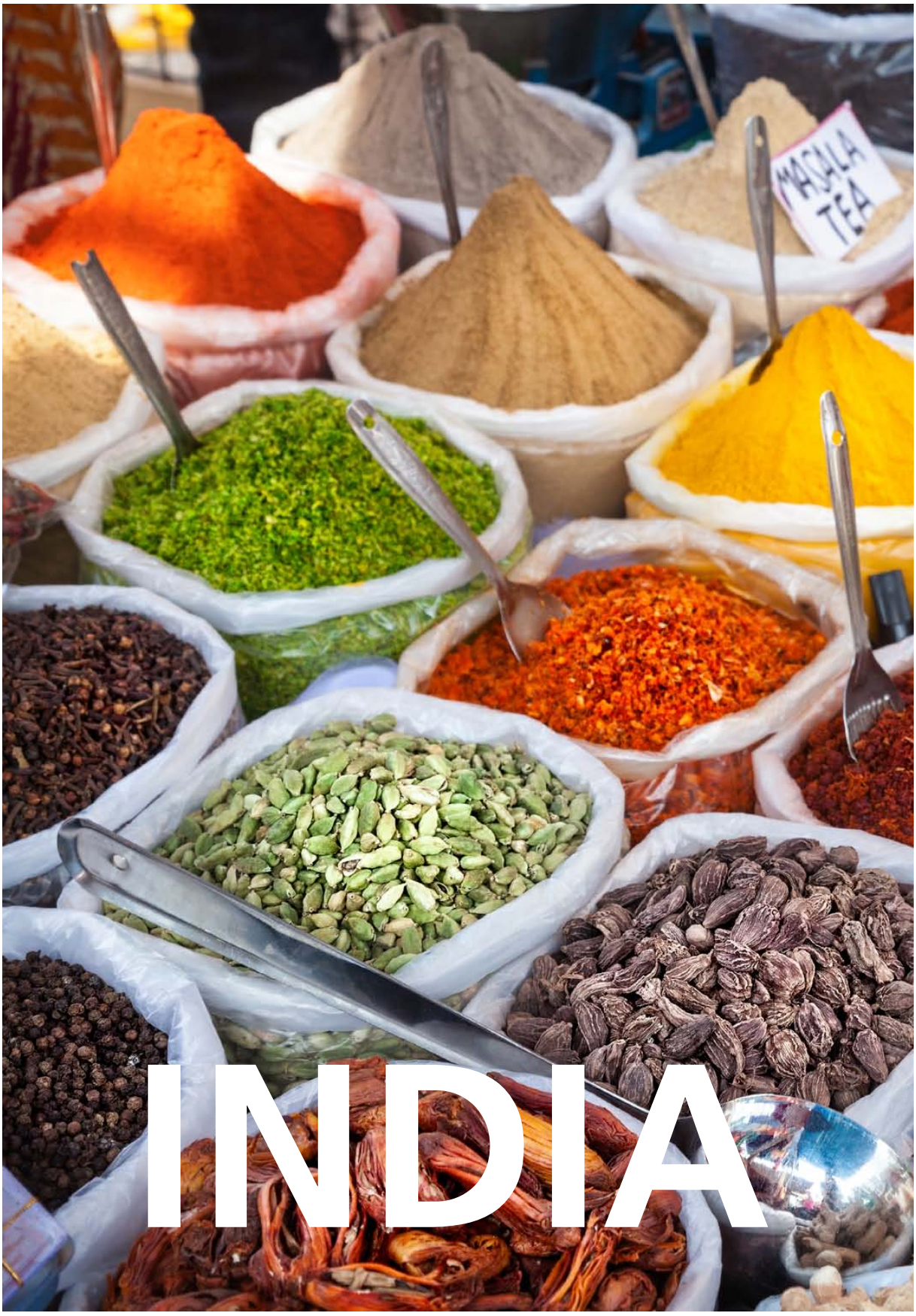
Finally, the client was granted payment facilities, but there is a risk that in future a company audit will be carried out. In the event of a company audit all the account balances, entries and financial accounting documents will be checked and it is very probable that further errors will be found in the financial accounting.

What can be done now?

The financial accounting for all the years since founding the branch office should be examined and checked. If the number of errors found leads to more time being required to correct the errors than the new booking of the documentation, then a new booking would be the best solution. After the correct preparation of the financial accounting, the tax returns und the annual financial statements can be prepared again.

What should one have done differently from the beginning?

The Hungarian legal regulations should have been considered from the very beginning and the financial accounting should have been carried out separately according to Hungarian law.



INDIA

INDIA

At first glance, in contrast to other Asian countries India appears to be remarkably "easy to access". Many Indian business people have many years of experience of western countries. English is the generally recognised and used language in business life. The surprise is even greater when it becomes clear that apparently "clear" details and statements in reality have no meaning or a completely different meaning. After some time it is evident that the completely different cultural background of the Indian contact person poses a great obstacle and a risk for western companies.

Indian negotiating partners are extraordinarily experienced in representing and asserting their positions. From a western point of view the negotiating culture is often perceived to be demoralising and frequently a western contact person interested in a "constructive" and "quick result" will make wide-ranging concessions which later are very difficult to correct.

In Indian law, a "common law" system, fundamentally different principles are valid in many areas such as in contract law or in corporate law. The most important decision-making body of an Indian GmbH, the board of directors, works strictly according to majority rule. Only the majority on the board will also secure control of the own subsidiary. The structure of the court system is also significantly different to that prevailing in continental Europe. The Indian judiciary is also incredibly overloaded. The duration of legal proceedings in the first instance in India is commonly ten years.

The structure of Indian tax law is very complex and the execution by the financial authorities can result in a high burden for the taxpayer. For example, there are four different types of sales taxes. An extensive system of withholding tax requirements on a national level and often also with cross-border payments also extends tax liability to the contract partner.
The financial authorities are focused on tax transfer prices. Starting with the first rupee, there are extensive obligations to disclose and justify pricing.

Due to the various types of tax and notification requirements, the obligations relating to financial accounting for Indian companies require highly qualified support which is usually not given by "all-round" employees.

Rödl & Partner is active throughout India and has own offices with German and Indian advisors in Delhi, Mumbai and Pune. On the same premises, Indian auditors and lawyers for legal proceedings provide comprehensive support for strategy planning, daily operations and crisis situations.

Practical examples

Auditing

Background facts:

When an Indian subsidiary was established the German parent company relied completely on the Indian managing director who had already proven himself in the area of sales. An auditor was proposed to audit the annual financial statement for an "amazingly" low fee. In a local meeting, the representatives of the parent company were very impressed with the personal presentation of the performance profile and personal experience of the proposed auditor. The financial accounting was also managed for a low cost through an "all-round" employee selected by the managing director. In the following years an unqualified audit opinion was always given.

When the local company repeatedly reported losses and there was a recurrent need for fresh capital, the German parent company decided to commission the Rödl & Partner audit team to carry out the audit of the financial statement. Already when the first draft of the annual financial statement was received it was apparent that in the local company the basic principles of balance sheet management and valuation were not known. The audit of the annual financial statements turned out to be a formality which was simply rubber stamped. Inventories had not been properly recorded. There were numerous errors in the area of withholding tax and in the area of inventory discrepancies amounting to a seven-digit euro amount.

What can be done now?

Rödl & Partner was commissioned to reconstruct the processes of the last years and also to clear up inventory discrepancies. A control system in the area of incoming and outgoing goods was defined and checked during the year. The employee in the area of finance was replaced by an employee with considerably higher qualifications, whereby Rödl & Partner assisted with the selection of the successful candidate.

Rödl & Partner also took on the processing and correction of incorrect notifications in the area of withholding tax and various other areas.

What should one have done differently from the beginning?

Highly qualified employees in the area of finance are usually incorrectly labelled as being an unnecessary cost factor and high quality auditors are seen as a burden because they ask questions about structures and procedures and do not accept the "final word" of the "managing director".

Due to the remote premises it is particularly important and also supportive for the local managing director when an auditor with structured working principles is selected as a sparring partner to audit the annual financial statement who will name critical areas right from the beginning. These can then be systematically checked and secured.

An internal or external financial accounting department with well qualified personnel initially leads to higher costs, but will also maintain order in complex circumstances and allow the management to concentrate on developing the business.

Taxes

Background facts:

The German company "Anlagen-AG" is negotiating an extensive contract (for an eight-digit euro amount) with an Indian customer for the supply and commissioning of a production line. There is a global business relationship between the two companies. Therefore the contractual documentation is incomplete and has not been audited from a tax point of view either by the ordering party or by Anlagen-AG. After two years of activity the project is nearly finished. When the final payment is due the Indian customer declares that his own tax consultants had interpreted the contract such that Anlagen-AG had established a tax presence in India. Therefore 43 % of the total remuneration had to be retained for the withholding tax. Instead of the final payment, a claim would now be made for a repayment. The tax liability for the project for Anlagen-AG and its Indian subsidiary including penalties for delay and fines amounts to 100 % of the order volume.

What can be done now?

Clarification has to be made as to whether a branch office has actually been established or whether a different argumentation can be pursued with a chance of success. The facts of the present case clearly indicated that only certain services can be assigned to a branch office subject to the payment of tax to considerably reduce the financial risk. As there was a risk of expiry by limitation, the required tax returns had to be prepared and submitted at short notice. The personal tax liability of the engaged employees also had to be checked and explanations had to be submitted. Legal appeals were made against the tax assessments and these were ultimately successful. The Indian ordering customer then had legal certainty and was able to pay the outstanding amount.

What should one have done differently from the beginning?

Due to the Indian system with its withholding taxes, the question of the tax classification of a process is already relevant before the tax office is involved at all. The Indian payee has to check whether and to which extent withholding tax must be retained. In the early stages of a cross-border project it is therefore necessary to consider the possible tax consequences and how the development of a branch office subject to the payment of tax van be avoided. In the case in question, had an Indian subsidiary been available, given clear contractual arrangements, it would have been able to process important parts of the projects. A transparent structure would have drastically reduced the tax risk for all involved parties.

Law

Background facts:

The German "Maschinen GmbH" has had an authorised dealer in India since 1990 with an exclusive contract. The contract is subject to German law. For a long time the Indian market was just a "minor area" of operations for Maschinen GmbH. The long-serving Indian partner is clearly unable to keep up with the requirements of the now thankfully expanding Indian market. Two meetings in India take place without a result. In order not to damage its brand, Maschinen GmbH decides to cancel the contract with an extraordinary notice of termination. At the same time Maschinen GmbH appoints a new distributor in India. Maschinen GmbH then receives a letter by DHL courier in which the lawyer of the Indian dealer advises that the dealer has filed suit against the dismissal in Mumbai and that a hearing on interim protective measures will take place two days later. The Maschinen GmbH company does not view the court in Mumbai as competent and is of the opinion that the summons has not been correctly or formally handed over. Some days later Maschinen GmbH receives, also via DHL, notice of the court ruling which provisionally bans Maschinen GmbH from commissioning a different authorised dealer or to be itself active in India. The new distribution partner of Maschinen GmbH is also sued in the same action.

What can be done now?

A defence in court has to be organised. An attempt has to be made to remove the provisional court order. In addition, own legal proceedings against the authorised dealer have to be prepared. In parallel, an attempt has to be made through negotiation to achieve a withdrawal of the legal action. This will require numerous personal meetings with the advisors and the parties. As a result, the authorised dealer seeks a face-saving solution and accepts payment of compensation.

What should one have done differently from the beginning?

In particular, when dealing with long-serving Indian contract partners it is urgently necessary to have a conflict strategy. Before notice of termination is given the risk of litigation should be exactly assessed. Temporary legal protection in India also threatens contracts which foresee a different legal venue. An intensively negotiated end of the contract with payment of a settlement and a loose further co-operation is frequently more economic than a confrontational approach. If a confrontation is unavoidable, the lodging of a pre-emptive brief and close monitoring of the court calendar will at least minimise surprises. A well prepared legal team can often effectively block attacks and strengthen the negotiating position.

Company Administration

Background facts:

The financial accounting processes in the Indian subsidiary were left over a number of years in the hands of the manager of financial accounting and his employee. Both had a good relationship to the auditor of the annual financial statement of the company. The audit of the financial statements always lasted a very long time, but ended with a successful result. From one week to the next the manager of the financial accounting now announces that he will leave the company because he has received a "better offer". Immediately afterwards the second employee in the financial accounting department also hands in his notice and so a transfer does not take place.

It turns out that the documents of the financial accounting department are in an awful state. Representatives from the authorities appear, in particular from the tax authorities and trade control department, and announce demands based on formal obligations which due to insufficient data and a lack of understanding of the background are hard to comprehend or fulfil. There is a danger that a large supplementary payment must be made together with fines and even the closing of the business.

What can be done now?

The status of compliance of the tax and other obligations must be clarified as quickly as possible from the available data and as far as necessary from the inspection of records at the authorities. An analysis must be made of how the threats of the representatives of the authorities to close the business can be objectively countered. In practice the authorities accept the removal of shortcomings if the processes are professionally managed by a consultant to the company. Periods of notice can be extended through discussion with the authorities provided qualified consultants are at hand.

What should one have done differently from the beginning?

In India personal relationships quickly lead to a change of loyalty and therefore from a western point of view lead to "irresponsible" behaviour (change of job, the taking of data). The introduction of a transparent system and a regular critical assessment in the area of the audit of the annual financial statement are necessary in order to secure business processes.

Rödl & Partner manages the financial accounting for many companies as an external service provider. This establishes a defined system of processing and the company is not affected by the change or incapacity of an individual employee.


ITALY

ITALY

Germany and Italy can look back on a history of strong cultural, political and military links and lively economic relations. This closeness which has grown over time has been further consolidated on all levels since the formation of the European Union. For example, in 2012 Germany was the most important trading partner for Italy in terms of exports and imports. Germany is also one of the countries with the most direct investments in the country with the greater part being made in northern Italy.

In Italy foreign entrepreneurs find legal conditions for the founding of a company or branch office, formation of contracts and judicial enforcement of claims which are basically comparable to the German legal system. However, when dealing with the Italian authorities the entrepreneur has to come to terms with a considerable amount of bureaucracy which can frustrate a schedule and also require a lot of patience as in addition to the high number of forms the implementation and interpretation of the laws may be handled differently with the various authorities in the different regions. In addition, there are peculiarities which should be taken into account by German companies who wish to get involved in Italy. In the following we would like to give you some illustrative examples:

In the judicial enforcement of claims, civil procedures provide comparable processes such as the court order, court injunction, appeal and revision. In practice, despite many reforms to accelerate proceedings, the Italian legal procedures are still characterised by their lengthiness. For example, even with simple legal disputes a civil court ruling in the first instance on average takes three to five years. Therefore, depending on the constellation of the case, contractual arrangements for arbitration are recommended. The time advantage gained by arbitration, however, has to be set against the usual high costs. The drafting of the contract should also take into account measures to secure claims and continuous monitoring of outstanding claims must be undertaken.

Labour law is historically characterised by strong union representation and a worker-friendly legislation and case law. Article 1 of the Italian constitution 1 January 1948 already declares in the first paragraph that Italy is a “democratic republic based on work”. As a result, numerous collective wage agreements are also used in questions of interpretation even if the parties had explicitly excluded their application. In addition, there are numerous conditions designed to protect workers which impede a notice of termination or which have a negative financial result for the employer. Furthermore, the fragmentation of the labour law into numerous separate laws and sub-provisions leads to interpretations in favour of the employee in case of doubt.

In addition to this aspect of the legal situation, in Italy there are high employee on-costs to be taken into account which for normal employees usually amount to 27 to 29 % for the employer.

As previously was the case in the United States regarding the social security number, in Italy it is the personal tax number with which the identity of a natural person can be established or noted. The "codice fiscale" is often required in connection with nearly all contracts or for matters concerning daily life even without any relevance for tax. Therefore, one of the first actions undertaken by a German citizen who wishes to become active as an entrepreneur in Italy is to apply for such a tax number via the Italian diplomatic representation in Germany or directly in Italy at the appropriate office. The allocation of the tax number which is valid for life does not itself, however, lead to tax duties requiring action.

The payment of taxes in Italy is made with many deviations to the German practice. Instead of the sequence of "tax return – tax assessment – payment of tax", in Italy the tax payment must first be made (to deadlines which cannot be extended) according to own calculations which is followed by the submission (to deadlines which cannot be extended) of the tax return after which there may be a tax audit. If this process establishes that tax payments have been omitted, are too low or are late (also even by a single day), the result is penalty payments with significant amounts. The tax payment itself can also not be made simply by bank transfer, but as is the case with most public taxes it has to be made via an electronic form (F24) at the account-holding Italian bank which requires the input of the respective code number for the tax type, the beneficiary public authority and the respective tax period.

In addition, at the beginning of the activity a tax analysis should be undertaken of possible consumer taxes. For example, in Italy there is a tax on lubrication oil which is due on imported products containing lubrication oil (e.g. engines) and which leads to compulsory membership of a consortium for the disposal of waste oil. Although these taxes generally do not have a great economic impact, their non-observance can lead to a criminal liability.

When calculating the tax liability, the relationship of turnover to fixed assets should be examined. If this has a negative deviation, a minimum amount has to be taxed under application of an increased corporation tax rate which already has to be taken into account with the payment of the tax (balances and advance payments) which in particular has consequences for inactive companies. The tax authorities also check the amount of the declared assessment basis for the paid taxes using statistical comparable values for the reference field in order to determine possible deviations and in such cases are likely to carry out a tax audit.

It is not only the payment of taxes which is complicated. The recovery of overpaid tax is also difficult, whereby requests for refunds of sales tax balances which cannot be set off must include a bank guarantee and a number of years has to be allowed for the process.
For proper financial accounting, certain registers have to be set up and maintained such as a

journal and the sales tax register in which all the respective invoices and movements have to be entered. These and further special points regularly lead to practical difficulties when the German financial accounting software should also find application in the Italian subsidiary.

The points presented here only represent a small part of the special legal and tax points to be found in Italy.

Personal consultation and the elaboration of individual concepts for all questions relating to an entrepreneurial commitment in Italy is possible with 150 German and Italian employees available at our offices in Milan, Rome, Padua and Bozen who have many years of experience and technical expertise in the areas of legal consulting, tax consulting and auditing.

Practical examples

Taxes

Background facts:

The D GmbH company founds a subsidiary in Italy and the company is equipped with substantial fixed assets in order for it to pursue its operations. In the first years, however, due to start-up difficulties it only achieves a low turnover and a corresponding loss according to civil law.

While preparing the tax return for the second year the company determines that the regulations regarding fictitious companies applies. If, with the existence of a certain level of fixed assets, a certain minimum turnover is not realised, the company is deemed to be fictitious ("Società di comodo") and is subject to higher taxation. The higher taxation is achieved by raising the tax base and application of a higher tax rate. For the tax base a profit is assumed which is oriented to the amount of the fixed assets (and is usually substantially higher than the effective tax base). Corporation tax, on the other hand, amounts to 38 % instead of the normal tax rate of 27.5 %. Resulting from the application of the regulation for fictitious companies it is not allowed for the company to offset existing sales tax balances.

What can be done now?

As the deadlines for the application for suspension of the regulation for fictitious companies have already expired, Rödl & Partner Italy assists the subsidiary with the preparation of the tax return, whereby the correct application of the regulation for fictitious companies is observed.

What should one have done differently from the beginning?

The client should have contacted Rödl & Partner Italy in order to learn about the country specific regulations in Italy. The comprehensive support for clients includes the continual monitoring of whether the regulation for fictitious companies is potentially applicable to clients. If there is a corresponding risk, Rödl & Partner makes a preventive application to the local tax office in order to suspend the regulation in the actual case of the company. In this respect, objective reasons for the specific case are presented to the tax office to justify suspension of the regulation.

If the application is well prepared, the request to suspend the regulation for fictitious companies is usually granted and the client can make the tax calculation according to the usual regulations and is not subject to restrictions in the handling of tax assets.

Law

Background facts:

The Italian subsidiary of a German industrial group receives a statement of claim from a former managing director who was dismissed from his position after disagreements on business policy. The former managing director who also worked for the parent company in Germany was also appointed as a managing director at a number of subsidiaries in Italy and one of these – not the one which received the claim – had paid the complainant an impressive remuneration which in line with the common understanding at that time was meant to cover all the offices.

The managing director now claims from the defending company (i) additional payment of a managing director's remuneration and (ii) the subsequent payment of his salary as in his opinion he worked as a company executive, plus compensation for damages and settlements associated with unfair dismissal from his employment contract and the alleged unpaid social contributions. Due to the activity of the complainant for many years at the Italian subsidiaries and the worker-friendly regulations in particular for company executives, the claims – without the social contributions should the company lose the case – amount to several million euros.

What can be done now?

The appointment of a managing director to an Italian company and the definition of his powers should always take into account aspects of company and labour law. Usually the Italian managing director is only awarded remuneration on which due to a special classification

between dependent employees and free employees social contributions are only due to a low extent. As soon as a managing director, however, is subordinate to the instructions of a shareholder or a different managing director such that he is no longer free to manage the operative business, then he is considered to be a subordinate employee to be remunerated accordingly and his salary is subject to full payment of social contributions. Due to the special qualification which is assumed to exist for such a position, the classification of this employee is regularly that of an executive manager (dirigente).

In order to avoid the claims from the alleged employment relationship it is therefore necessary to provide evidence that the managing director in the performance of his duties was not subject to instructions about the manner in which he should perform his duties.

However, regarding the remuneration for performance of his duties it was necessary to provide evidence that it was the common understanding of the parties that the remuneration paid by the affiliated company was also meant to cover the performance of duties in the defending company which implies that the complainant had renounced a separate remuneration.

What should one have done differently from the beginning?

Already with the appointment of a managing director the company law and labour law specialists at Rödl & Partner work closely together to carefully co-ordinate the position with regard to labour law, the classification according to company law and limits of power of the managing director regardless of whether the new managing director previously had the status of an employee in the company or not.

If the managing director should also not be an employee of the company, it must be ensured that he can autonomously carry out the operative business on the basis of comprehensive powers and also that in the performance of his work he is not otherwise subject to the instructions of others, e.g. through the specification of holiday days or working times. If the performance of his duties is furthermore not remunerated, for example, because as in the case described, the managing director is already comprehensively remunerated in a different group company, an express waiver of the remuneration should be added to the documentation.

But if the transfer of such comprehensive powers and freedom is not desired, then a contract of employment should be concluded from the start with obligations in particular with regard to compulsory contributions. The same is reversely true. If an employee is also to be appointed a managing director without losing his legal position with regard to social contributions, his powers have to be limited.

The exact arrangement respectively depends on the individual position of the managing director, the corporate governance rules of the company group and the actual operative situation at the local level in order to elaborate the most appropriate solution for a problem free co-operation between managing director and shareholders and consensual separation at a later date.

Law

Background facts:

The Italian subsidiary of a client located in Milan would like to initiate legal proceedings to recover a receivable which in the meantime has risen to a high amount from a customer located in southern Italy and gives a corresponding mandate.

The contracts made by the client for delivery of goods are subject to the client's general terms and conditions for goods which are formulated according to Italian law which foresees Milan as the court of jurisdiction. The general terms and conditions are printed on the written offers of the client and the customer has countersigned the letter of offer as a sign of acceptance.

What can be done now?

According to the Italian code of civil procedure, in the absence of a deviating agreement the court of jurisdiction is the location of the defendant. Such a deviating agreement can also be concluded between business persons in the general terms and conditions. Sections 1341 and 1342 of the Italian civil code, however, foresee that certain provisions which deviate from the law to the disadvantage of the contract partner must be separately listed and also countersigned to indicate acceptance.

If such a separate acceptance has not taken place, the agreement for the court of jurisdiction is not a legally effective part of the contract. The legal action must be brought via a communicating lawyer before the court at the location of the customer.

What should one have done differently from the beginning?

In addition to the correct preparation of the content, the numerous formalities of the Italian law must be observed. The separate listing which was not made and signing of the conditions of the general terms and conditions such as for example concerning the deviating court of jurisdiction, liability restrictions, tacit contract renewal clauses or reasons for termination is an error which frequently occurs which can lead to the invalidity of these provisions. The inclusion

of these provisions in the contract to be legally effective must therefore be observed in the preparation of the general terms and conditions and the design of the contract documents and with the conclusion of the contract itself by making sure that the separate signature is appropriately made.

Law

Background facts:

The German majority shareholder of an Italian S.r.l. (GmbH) receives a copy of a court application filed by the managing director of the company to liquidate the company due to inactivity of the shareholders' meeting according to section 2484 no. 3 of the Italian civil code "codice civile". In the application the managing director claims that despite repeated formal summons to shareholder meetings to discuss the financial crisis of the company, the majority shareholder has not reacted to the summons and therefore the shareholders' meeting could not take place due to the absence of quorum.

The client, on the other hand, claims that he did not receive the summons in question, but that in the case of important questions the shareholders' meeting had previously met according to the rules, for example, to authorise the last annual financial statement. He now asks for advice on the best possible course of further action.

What can be done now?

In order to object to the court application, the client must intervene in the action brought before the court with a plea in writing. This plea in writing must already include the reasons why the application should be rejected, i.e. the mentioned summons which was not received and the approval of the annual financial statement which took place.

The settled case law defines the approval of the annual financial statement as a typical case for an important decision which is the responsibility of the shareholders' meeting. As far as over a time period of at least three financial years no approval is given for the annual financial statement, this is regarded as a clear sign of the inactivity of the shareholders' meeting. In this respect the actual approval of the last annual financial statement is a substantial piece of evidence for the functionality and activity of the shareholders' meeting.

The court accepted the argumentation of the majority shareholder and has rejected the application to liquidate the company.

What should one have done differently from the beginning?

The dispute with co-partners and in this case the attempt of a shareholder to use all legal means to realise the result he seeks is unfortunately impossible to prevent. With a majority of shareholders – and particularly with shareholdings of respectively 50 % which in our experience are not advisable – there should therefore always be clear rules concerning the majority required in the articles of association and if applicable also in collateral agreements which on the one hand should protect minority shareholders but should also not lead to a deadlock. The same should be made on the level of the company management so that the interests of the shareholders in proportion to their entrepreneurial commitment are also protected with regard to operative questions. Finally, such deadlock situations should be regulated by a corresponding process which can be legally mutually agreed before the situation arises. The corporate law specialists of Rödl & Partner are able to comprehensively advise the client with the contract design due to their experience with the courts in order to prevent such disputes.

Transfer Prices

Background facts:

In addition to other subsidiaries, D GmbH also has a subsidiary in Italy with which it maintains different business relations. In order to minimise possible risk associated with transfer pricing adjustments and the resulting increase in taxes, D GmbH has drawn up a master transfer price documentation file in the English language which corresponds to the EU master file method. Partly due to resource reasons, however, the transfer price documentation was not checked for compliance with local transfer price regulations.

In its tax return the Italian company stated that it maintains a transfer price documentation file. Shortly afterwards a company tax audit was carried out and the transfer price documentation was required for inspection.

What can be done now?

The taxpayer only had ten days of notice to submit the transfer price documentation and as the transfer price documentation in Italy must correspond to strict formal requirements (including a special breakdown) and be available in the Italian language, the existing documentation could not be adjusted to comply with the Italian regulations within the given time period. According to a provisional audit finding the adjustment of the transfer prices resulted in an increase in taxes and a penalty payment amounting to 200 %. In an extrajudicial arbitration proceeding, Rödl & Partner was able to reduce the increase in taxes and reduce the penalty payment to 100 %.

What should one have done differently from the beginning?

In principle, the taxpayer did not make a significant mistake because he attempted to minimise the transfer pricing risk through preparation of a master transfer pricing file on the basis of a method which is generally also accepted in Italy ("EU master file method"). But it would have been urgently advisable to at least have the master file reviewed locally in advance as this would have enabled the identification of special local peculiarities and a quicker reaction as required. This is especially true in Italy where due to the current financial crisis the tax authorities have intensified audits to check the appropriateness of the transfer prices. This has been made primarily with the objective of generating more tax through transfer pricing adjustments and in addition in the case of formal deficiencies of the transfer pricing documentation to demand penalty payments.


KAZAKHSTAN

KAZAKHSTAN

The legal framework and legal certainty are relatively well developed in Kazakhstan, whereby there are also considerable weak points. Despite the existing legal hurdles, in 2013 an increase in the growth of German direct investments was evident. According to information from the Delegation of German Economy in Central Asia this amounted to 750 million US dollars. German companies maintain trade relations with Kazakh partners through approx. 200 representative offices and branch offices and 400 subsidiaries located in Kazakhstan. A further 1500 companies operate on the market in Kazakhstan from Germany and/or from Russia.

Similarly as in Russia the first contact with a Kazakh business partner can be difficult in terms of communication, whereby cultural differences are apparent. Close contact to the Kazakh business partner is essential for the establishment of a successful commercial relationship.

Thorough preparation and knowledge of Kazakh business operations is decisive for a successful start-up on the Kazakh market. Instead of managing a very promising business with standard contracts and then only involving a professional consultant after the situation has resulted in a legal dispute, we highly recommend that you first of all clearly establish the creditworthiness and reliability of the Kazakh contract partner and in particular with new business relations. Already this measure may help to avoid the greater part of the difficulties which in practice are frequently experienced in cross-border delivery relationships with Kazakh partners. If you close both your eyes here, this amounts to gross negligence. Remarkably, the principle from Lenin continues to apply: "Trust is good, control is better".

In particular, there are considerable risks associated with contract design. There are reasons why there is a lack of trust in the judicial system and its independence. The reason for this distrust of the system is the high degree of corruption, inadequate qualification of judges and the inefficient enforcement of court rulings. A well-advised German company should take preventive measures to protect itself against default of payment through use of the principle of payment in advance.

When founding a company in Kazakhstan, the right form of company is important together with careful selection of the local managing director. Given that the restrictions of the representative powers of the managing director only apply to the internal relationship and the company has the burden of proof to establish that its contract partner at the time the business was concluded was aware of the restrictions in the external relationship, it is necessary to include an appropriate control mechanism in the articles of association. When concluding contracts, current proof of the right of representation or respectively the resolution concerning the appointment of the managing director should always be presented from which further information can be taken.

Rödl & Partner is represented in Kazakhstan at the locations of Almaty and Astana. Our team of Kazakh and German lawyers, tax consultants and auditors has been supporting clients since 2009 with regard to all questions about investments in one of the most important future markets between Europe and Asia – in the German language with a comprehensive service.

Practical examples

Taxes

Background facts:

A company based in Germany delivered a machine to Kazakhstan. A contract was concluded to split the price between the supplier component and the local service components (supervision, consultation and service). In connection with the performance of services in Kazakhstan a tax presence was registered in accordance with Kazakh tax law.

The invoicing for the local services was only to be made after the end of the project. The company was of the opinion that submission of a tax return was not necessary as anyway a "zero rate tax return" would be submitted. All claims for costs in connection with the whole project for the performance of the local services were only to be asserted after the conclusion of the work consequently reducing profits for the group through submission of the complete tax return in Kazakhstan. As a result, over a time period of more than two years neither quarterly nor annual tax returns were submitted for the branch office. The submission deadlines for these time periods had expired some time ago when the company contacted Rödl & Partner.

What can be done now?

After a tax audit to examine the facts, the company was informed that the deduction of company management expenses and general administrative expenses is also possible for the branch office of a legal entity which is non-resident in order to minimise the profit realised in

Kazakhstan. The company was also advised that also those costs incurred in the last two years of the branch office could be claimed as operating expenses in the tax return submitted for corporation tax and therefore were not lost. In spite of the existing basic possibility of reducing the tax base the situation arose that due to the non-submission of the zero rate tax return penalties for delay and administrative fines had to be paid.

What should one have done differently from the beginning?

The question of the deduction of the company management expenses and general administrative expenses should have been urgently discussed with expert advisors immediately after the registration of the branch office of the company as a non-resident legal entity. In such a case the company would have been advised that according to Kazakh law the recognition of expenses can be determined by two methods, namely the proportional division of expenses and the direct allocation of expenses for the purpose of deduction. The company would have had the possibility from the start of adjusting the financial accounting documents to the requirements of the commercial accounting standards in Kazakhstan and would also have been able to avoid the payment of penalties for delays and administrative fines.

Law

Background facts:

A legal firm advised an oil company which delivers lubricant oil to a Kazakh company. The oil company had a commercial contract in which the legal firm in the case of a legal dispute defined Cologne, Germany as the court of jurisdiction. After lengthy negotiations with the Kazakh contract partner the legal firm approached the Rödl & Partner team in Almaty. The team established that in the meantime the Kazakh GmbH had made an application to open insolvency proceedings.

What can be done now?

There is a no treaty between Kazakhstan and Germany regarding the mutual recognition and enforcement of court judgements. The consequences of such a choice of court agreement are that a German court ruling cannot be enforced in Kazakhstan and that the debtor in the case of the legal assertion of claims in Kazakhstan would almost certainly have raised a plea for lack of competence. The choice of a Kazakh court of jurisdiction would have been a better option.

What should one have done differently from the beginning?

It is always recommendable to explore the possibility of including an arbitration clause in the contract. In 1996 Kazakhstan adopted the New York Arbitration Convention of 1958 concerning the recognition and enforcement of foreign arbitration awards. Kazakhstan and also the Federal Republic of Germany have ratified this convention. In the present case, for example, it would have been possible to name the Kazakh international court of arbitration located in Almaty as the court of jurisdiction. This would have enabled the possibility of controlling the procedure and organisation of the court proceedings. In addition, it would have been possible to make enquiries about the solvency of the Kazakh company as debtor. As a result, it is possible to examine whether a Kazakh company is subject to legal proceedings and whether this company in the last quarters in comparison to the previous years has even paid tax. Both are important indicators of impending insolvency.

Law / Administration

Background facts:

A successful German company agrees to a Kazakh GmbH as intermediary to the ministry for the supply of equipment to print passports. The delivery of the equipment via the Kazakh GmbH to the authorities made economic sense to the German company because according to the Kazakh legal system a Kazakh company is given preferential treatment with public tenders compared to a foreign company.

At the time when the contract was signed with the Kazakh GmbH, the possibility of a guarantee agreement with the authorities was not considered. After a six-figure receivable has been outstanding for a period of more than one year, the managing director of the Kazakh GmbH gave the assurance that he would sign a payment undertaking agreement within one month and pay the liabilities of the GmbH. After the period of one month it was established that there was a change of the managing director and shareholder at the Kazakh partner and that the Kazakh GmbH was now in liquidation.

What can be done now?

The absence of a guarantee agreement and the delayed approach to the (former) managing director means that the fulfilment of the liability by the Kazakh GmbH as sole debtor has no chance of success. Due to the good co-operation between the German company and the Kazakh authorities the hope now remains that the receivable will be covered by the authorities.

What should one have done differently from the beginning?

At the contractual level there was a possibility according to Kazakh law to provide a guarantee for the intermediary company. The design of the contract of guarantee between the German company and the Kazakh authorities as end buyer should have been made to protect the interests of all those involved. The experts at Rödl & Partner therefore advise either the implementation of the payment in advance in principle or to obtain professional advice regarding international transactions.


MEXICO

MEXICO

Due to its geographical position, Mexico with its high population of more than 112 million inhabitants and liberal economic policies has developed to become an attractive commercial location for companies. The connection to the Atlantic and Pacific oceans and a growing number of harbours offer excellent conditions for international maritime trade and also the land borders of Mexico provide important access to the markets of northern and central America. Mexico has signed the North American Free Trade Agreement (NAFTA) and is one of the countries with the most free trade agreements in the world. This number of free trade agreements directly influences the continuous intensification of the international interlinking of Mexico and simultaneously improves the conditions for foreign investments in the country. The lively economic exchange between Germany and Mexico can look back on a tradition of almost two hundred years. In 2012 German companies invested more than 580 million euros in a market which opens up regional and international business areas across borders around the world.

Legal forms of business and founding a company

The most common legal forms chosen in Mexico are the Sociedad Anónima (S.A.) and the Sociedad de Responsabilidad Limitada (S. de R.L.). Both legal forms have the structure of a joint stock company. In addition, it is possible to found a partnership. In Mexico companies are almost always founded as joint stock companies because the liability of the shareholder is limited to their contribution and there are no significant tax or legal disclosure differences between incorporated companies und business partnerships.

Common legal forms

Sociedad Anónima (S.A.)

The S.A. is the most common company form. The S.A. is a joint stock company. In order to found the company there must be at least two shareholders, whereby one of the shareholders can hold a symbolic stake with a single Mexican peso. The shareholders can belong to the same company group. There is no legally stipulated minimum share capital. The share capital is defined by the articles of association and confirmed by shares.

The shareholders' meeting (Asamblea de Accionistas) is the highest authority of the S.A. The shareholders' meeting authorises and confirms all the actions of the company. The decisions are binding for the company management. The shareholders' meeting must take place at least once per year at the location of the company within four months after the closing of the financial year. The shareholders can be represented by means of a simple letter

of authorisation. Furthermore, the shareholders can take unanimous decisions outside the company location, but these must be confirmed in writing.

The company management and the representative of the S.A. are responsible to the board of directors (Consejo de Administración) or the single administrator (Administrador Único). There is no restriction with regard to the citizenship or domicile of members of the board of directors or the single administrator. Furthermore, third parties who may also be shareholders can be entrusted to represent the company. The representatives can be equipped with general power of attorney whereby the power of representation is regulated by law or equipped with special powers of attorney which authorise certain actions. The powers of attorney are revocable at any time. In addition, the delegation of authority to other persons is possible.

A special point of Mexican corporate law is the office of the Comisario. As an independent authority the Comisario performs an information and supervisory function. Those not eligible for this office are members of the board of directors, the single administrator or employees of the company and subsidiaries where the company has a business interest of more than 25 %. The Comisario has in particular responsibility for the preparation of the annual financial statement report and the obligation to call the shareholders' meeting and to inform the shareholders. Due to this area of responsibility, in Mexico it is usual that the position of the Comisario is held by a tax consultant or auditor.

The shares of the S.A. are usually transferred by a simple endorsement. However, the articles of association can include provisions to the contrary. All the shares have an equal value and transfer the same rights unless otherwise stipulated in the articles of association of the company. The shares are recorded in a share register giving details of the shareholder and the number of the shares with confirmation of the successful share transfer. In the case that shares are issued in order to increase capital, the shareholders have a priority right to purchase the shares in proportion to the amount of capital they have contributed.

Sociedad de Responsabilidad Limitada (S. de R.L.)

The S. de R.L. is comparable to a German company with limited liability. The founding of the company requires at least two shareholders, whereby the company share of the second shareholder can be limited to a single Mexican peso. In contrast to the S.A., the number of shareholders with the S. de R.L. is limited to 50. The minimum share capital is not stipulated by law. At the time of the founding at least 50 % of the share capital has to be fully paid in und registered.

The shareholders' meeting (Asamblea de los Socios) is the highest authority of the S. de R.L.. The same rules are valid as for the S.A. in respect of the representation of shareholders at the shareholders' meeting and the possibility of holding a meeting outside the company domicile. The company management and the representation of the company is made by a managing director (Gerente Único) or a company management committee (Consejo de Gerentes). The company management can be dismissed at any time. The appointment of a Comisario is not obligatory for the S. de R.L..

Unless otherwise defined in the articles of association, the transfer of company shares and the acceptance of new shareholders require the approval of the shareholder which holds the majority of the share capital. With a legal transfer the co-shareholders can assert a preferential right within 15 days from the time the approval is given.

Founding a company

Prior to the founding of a company the Mexican ministry of economic affairs (Secretaría de Economía, SE) must be notified of the required company name. The founding of a company must be certified by a Mexican notary. The founding certificate consists of the articles of association and the first shareholders' meeting where the founding capital is paid in, the company purpose is defined, the company authorities are named and if applicable a power of attorney is issued. The shareholders do not have to be personally present for the company founding. A power of attorney to found the company must be attested by a notary and legalised with apostille in the country of origin of the shareholder. The founding of a company in Mexico takes approximately six weeks.

Joint ventures

In addition to the founding of a subsidiary, it is also possible together with other investors to found a joint venture company or to enter into a joint venture agreement (Asociación en Participación) which represents a type of silent partnership. Such a silent partnership has no legal personality and no share capital. It consists of at least two members of which one as a silent partner does not act externally and therefore is not liable. If a profit share of more than 49 % is agreed, foreign investors must register at the national commission for foreign investments (Comisión Nacional de Inversiones Extranjeras, CNIE). The agreement is only subject to the written form. An entry in the commercial register is not required. The company is treated as a company enterprise in terms of tax.

Foreign exchange law

The Mexican banking system is characterised by the Mexican central bank (Banco de México), the full service banks (Instituciones de Banca Múltiple), the development banks and the trustee banks. The Mexican peso is freely convertible to all other currencies and there are no exchange restrictions with regard to the repatriation of capital and repayment of an intra-group loan in a foreign currency and the transfer of dividends, intra-group interest and profit. Mexican companies are obliged, however, to form a statutory reserve to the amount of 5 % of the annual turnover until this has reached 20 % of the share capital. Foreign currencies for the transfer of fees and remuneration payments and the payment of imported goods are freely available on the foreign exchange market. There is no obligation to register for direct foreign investments to the extent that they are made in a foreign currency.

Liquidation of the company

A Mexican trading company is ended according to the reasons listed in the general law on trading companies (Ley General de Sociedades Mercantiles) which are as follows:

- overrunning of the company period
- achieving or impossibility of achieving the company purpose as listed in the articles of association
- shareholders' resolution to liquidate the company
- the number of shareholders is below the legal minimum or the company shares are only held by one shareholder
- losses which amount to two-thirds of the share capital

The winding up process is followed by a liquidation procedure in which one or more liquidators (Liquidador) are appointed by the shareholders and entered in the commercial register. The single administrator or members of the board of directors remain provisionally in office until the liquidator has taken up his activity. The single administrator or the members of the board of directors are obliged to disclose all documents regarding the stock of the company and to carry out a stocktake. The liquidator ends all on-going business activities, disposes of the assets, meets the claims of the creditors, prepares a liquidation balance sheet and applies for the cancellation of the company from the commercial register.

Acquisition of real estate

The law on foreign investments forbids the direct acquisition of real estate and buildings near to borders and coastal areas by foreign natural persons and legal entities. In these locally

limited areas only renting is possible using a Mexican trustee and requires authorisation by the national commission for foreign investments (CNIE). In all other areas direct acquisition by foreign investors is possible. The direct acquisition requires a declaration in writing by the investor that he submits to the Mexican legal system and also permission from the CNIE. Mexican companies with foreign shareholders, however, whose articles of association include a corresponding submission clause can make a direct acquisition also within the border and coastal regions provided that the building is not for residence. All purchase contracts for real estate with a value above 24,560.85 Mexican pesos must be attested by notary and entered in the local land register (Registro Público de la Propriedad).

All contracts for commercially used land and buildings have to be concluded in writing. Although the obligations of the landlord are regulated in the individual civil codes of procedure of the federal states in detail, it is recommendable to list these in a contract. In particular, rent contracts should include that the assured features and potential for use of the rental property for the period of renting are given and that the replacement of consequential damage is guaranteed. In the case of the non-fulfilment of repair obligations, the person renting can either cancel the contract or enforce fulfilment through a court order.

Labour law and dismissal protection

The unemployment rate in Mexico amounts to just 5 %. In comparison to the European standard, the costs of personnel are still considered to be low. Since January 1, 2014 the minimum wage by law in Mexico amounts to 67.29 Mexican pesos per day in cities such as Guadalajara, Monterrey, Mexico City and the border region to the US and is 63.77 Mexican pesos in all other regions. The average cost of a skilled worker per day is 80 to 110 Mexican pesos. The daily working time for a day's work (between 6 am and 8 pm) must not exceed eight hours and for night work (between 8 pm and 6 am) seven hours. Accordingly, the maximum weekly working time (Monday to Saturday) amounts to 48 or 42 hours.

The legal basis for labour and social law is provided by the Federal Labour Act (Ley Federal de Trabajo) which underwent major reform at the end of 2012 and the Social Act (Ley del Seguro Social). Due to the reform, in particular the legal requirements for hiring workers and the terms of employment contracts were changed and further important conditions introduced for equality and anti-discrimination at the workplace. The creation of an employment relationship does not depend on a written contract although an employment contract in writing is prescribed by the Federal Labour Act. The lack of a contract in writing is at the cost of the employer who in a legal dispute must prove the existence of all verbal agreements which deviate from the statutory protection standard.

The employment relationship can be ended by termination of the employment contract due to conduct, the person or for operational reasons. Dismissal for reasons of conduct requires that one of the statutory listed facts must be present which the employer has to prove in the event of a dispute. A warning as a necessary pre-condition for dismissal for reasons of conduct is not required by law. As soon as one of the legally required reasons for dismissal is fulfilled, the employee is informed in writing about the termination which is valid upon receipt. In the case of notice of termination which is declared to be due to a permanent unfitness for work, the employee is entitled to one month's wages or – as far as is possible – to further employment at a different workplace which is suitable. In the case of a dismissal for operating reasons, the employee is entitled to a settlement to the amount of three month's wages.

In respect of foreign employees resident in Mexico, the Mexican immigration act differentiates between persons who intend a non-permanent residence (Visitante), persons who intend a temporary residence (Residente Temporal) and those who intend to reside permanently in Mexico (Residente Permanente). As a Visitante one is basically entitled to a stay of 180 days and is allowed to engage in business operations in the country. Visitors from countries with which Mexico has signed a treaty on visa exemption or facilitated visa issue (so-called endorsement treaty) to which the member states of the European Union also belong only have to fill in an entry form when entering the country which includes personal data and details of the reason for the visit. This can be for private reasons or for the purpose of doing business. An extension of the duration of the stay or change of the resident status is not possible. A permanent stay of more than 180 days, however, allows the resident status of Residente Temporal. This first of all requires the application for a visa at the Mexican embassy or consulate post in the country of origin. After arrival in the country it is mandatory to visit the local authorities within 30 calendar days in order to receive a residence permit in the form of an identity card. A resident status as Residente Temporal allows a period of residence of up to four years. After that an application can be made for Residente Permanente. The status of Residente-Temporal and Residente Permanente allows multiple entry to the country.

Practical examples

Auditing

Background facts:

A German production company with international operations with a subsidiary also in Mexico was up to now, due to the exceeding of certain variable criteria (e.g. tax revenue more than 35 million pesos), subject to the obligation of submitting an annual tax return and an extensive tax report (dictamen fiscal) which had to be confirmed by the auditor who also prepared the annual financial statement. Now that the submission of the dictamen fiscal since 2010 also with the exceeding of the previously valid variable criteria is no longer obligatory, this year the production company decided for reasons of cost and capacity to dispense with the report and in the following year merely submitted the tax return to March 31 to the Mexican financial authorities (Servicio de Administración Tributaria, SAT).

Shortly after submission a number of necessary corrections become apparent and after a supplementary audit from SAT the company representative is faced with a number of unpleasant questions concerning alleged outstanding payments.

What can be done now?

Even when it is no longer obligatory, the voluntary preparation of a dictamen fiscal is still possible and is usually undertaken. It is still possible to submit the dictamen fiscal up to three months after the tax return. This comprehensive report enables subsequent corrections to the

original tax return, omitted payments to be made and also significantly reduces the liability risk of the legal representative of the taxpayer because in the event of an audit carried out by SAT the first references are the working documents of the auditor.

What should one have done differently from the beginning?

In principle, companies which have their company management or domicile in Mexico are subject to unlimited income tax. Tax returns for income tax, corporation tax and sales tax must be submitted to SAT annually by March 31 of the following year. Although the dictamen fiscal as an extensive tax report which complements the annual tax return is only required after certain variable criteria are exceeded, it is often voluntarily prepared and also has advantages for companies. The advantages include the already mentioned possibilities for correction, reduction of liability, in particular the accelerated repayment of tax assets (25 instead of 40 days) and the possibility of submitting data to the tax authorities on microfilm or CD.

It is therefore an advantage for companies in the following years to immediately submit a dictamen fiscal by June 30 of the following year and have this confirmed by the auditor. This makes subsequent corrections easier and also enables greater transparency for companies and the authorities and importantly also considerably reduces liability risks of the legal representative.

Taxes

Background facts:

A GmbH based in Germany is one of the leading companies in the area of induction technology. The company now plans to take on a Mexican employee who will initially conduct marketing and sales activities in Mexico and then in a second step further employees will be acquired. The employee has to report directly to the company management in Germany and not act as a self-employed employee. The GmbH currently has no plans to found an own company in Mexico. After consultation with several entrepreneurs who have been active in Mexico for a longer time, the GmbH now fears that Mexican financial authorities will view this act as the founding of a branch office subject to tax and will demand the payment of income tax.

What can be done now?

In order to avoid double taxation, it must be verifiable that the activity of the employee in Mexico is only an activity relating to preparation or an auxiliary activity. It is often very difficult to differentiate between activities relating to preparation or an auxiliary activity and other activities. It is decisive whether the activity itself represents a main or material part of the activity of the whole company. The same activity, for example, can in one company represent an auxiliary task and in a second company represent the main activity. In any case a fixed place of business whose general purpose matches the purpose of the main company does not represent an activity relating to preparation or an auxiliary activity. Each case must be separately assessed under consideration of the respective circumstances. Preparation and auxiliary activity is only that which is carried out internally for the benefit of the company, whereby it is not an entrepreneurial activity carried out in connection with third parties.

What should one have done differently from the beginning?

A tax presence is in principle a permitted form of investment in Mexico. However, it should be considered that time and administrative effort required for the registration of a branch office is not significantly less than that required for the founding of a company. Therefore, regarding the future expansion of business activities, the possibility of founding a company should be considered.

Law

Background facts:

Up to now a German company in Mexico has used temporary agency workers provided by an external service provider. After a change in the law the company management fears that due to the practice used up to now there might be a basis for an employment relationship between the hirer and temporary workers.

What can be done now?

According to recently introduced legal regulations the service to be performed by a temporary agency worker must not cover all the areas of activity of the hirer. In addition, the activity of the temporary agency worker must be different to the work performance of the employees of the hirer. There must be reasonable grounds for the special necessity of using a temporary agency worker.

What should one have done differently from the beginning?

The widespread practice in Mexico of hiring workers through own founded personnel service companies or external personnel service providers has been extensively regulated. In addition to the above-described restrictions care should be taken that the employer complies with the labour and social security regulations in connection with the hiring. The malpractice of using temporary workers to bypass the labour and security regulations now results in an offence which can lead to a fine.

Law / Administration

Background facts:

A German company would like to found a subsidiary in Mexico. During the registration of the required company name, the new name is rejected on the grounds that a Mexican company already exists and operates under the same or similar name.

What can be done now?

Using an addition or a small modification of the company name it is possible to achieve the required difference to a company name which already exists in Mexico and obtain the approval. Here it should be observed that the decision to grant or reject the registration is not always predictable and sometimes only a small common element constitutes grounds for a rejection. An alternative possibility is to have the company name authorised from the company already operating in Mexico.

What should one have done differently from the beginning?

Prior to the founding of a company the required company name should be submitted to the Mexican ministry for economic affairs (Secretaría de Economía, SE) for approval. In order to simplify this process it is a good idea at the beginning to authorise five possible company names so that the registration process initiated by the representative of the company does not fail at this point due to the rejection of the selected name by the ministry. The founding of the company must be attested by a Mexican notary. The name of the company is not automatically protected as a brand or trademark. A corresponding registration of a trademark should be made separately. In principle, with the exception of a few transactions the company can already start business operations with the notarially certified articles of association. In these cases, a notarial confirmation is necessary of the registration of the company in the commercial register.

Corruption / Compliance

Background facts:

A German company with a subsidiary in Mexico negotiates the conditions of a long-term supply contract with a Mexican company. After lengthy and costly negotiations, shortly before the contract is signed one of the negotiating leaders of the opposite party asks: "What could you do for me to help me sign the contract?"

What can be done now?

Firstly, it is essential not to take up such an offer. In order to make appropriate arrangements it is important not to handle such negotiations as a single person but always with two persons present. It is helpful to have a collection of arguments ready for such a case. Regardless of the position of the person making the offer one can refer to the legal regulations in Mexico. This is because Mexico itself has already ratified international conventions and introduced national anticorruption laws. The risk of the unconcluded transaction is subordinate to the risk of a loss of reputation and possible criminal law repercussions.

What should one have done differently from the beginning?

Even if each country has its own anticorruption laws, the above principle must be observed worldwide and is indeed regulated by law in almost all countries. This global consensus makes clear that corruption is not a minor offence and that it is not a requirement to do business. In reality corruption is just simply a form of criminality which has to be taken seriously.

In order to effectively prevent corruption it is first of all necessary for companies to identify the relevant risks. In this process it is a good idea to involve the employees from the areas of finance and controlling and also to question persons who are likely to be directly faced with the potential risk of corruption. A code of conduct represents an important measure to prevent corruption. This forms the basic framework of the internal prevention of corruption in a company. It presents a clear message from the company management in writing and reflects the company policy. In order to illustrate the formulated correct form of conduct, it is very important that this is actively communicated to managers and employees for example through regular and compulsory training sessions which are best carried out by local law firms who are familiar with the peculiarities of the country. In the course of such training sessions the subject of corruption can be illustrated by actual examples which enable and promote the exchange of personal experiences.

The ability to discover corrupt behaviour makes it important for companies to have an authority to which employees can turn to with questions or information which will be treated as confidential. From an organisational point of view the confidential contact interface can be internal or external. In practice one often sees so-called ombudsman systems consisting of trusted persons or lawyers.


ŁOTYCH
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POLAND

POLAND

Poland is one of the preferred investment locations for foreign entrepreneurs in Europe. The entry of Poland into the European Union led to a considerable improvement of the administrative and legal conditions and provided an opportunity to quickly register a commercial activity, to efficiently conduct the activity and to organise the activity according to the requirements and development possibilities of the company.

Due to the present economic situation, Poland is seen as a "green island" in the storm of the global crisis as it has maintained its financial credibility and at the same time has been able to fight the recession. The Polish economy is currently developing faster than the western European economy. The economic growth is mainly driven by private foreign investors. The key factors as to why Poland is assessed to be an economic partner with a large potential for investment in Europe include its economic stability, the intensive development of its infrastructure and a level of debt which is acceptable.

The economic success and attractiveness of Poland has contributed towards many foreign companies opting to engage in economic activity in Poland. The largest share of new investments in Poland is connected with companies funded by German capital. If German investors can benefit from Polish profitability this is especially due to the fact that the legal conditions are similar to those found in Germany and that the collection of receivables and the enforcement of court rulings is made possible on a cross-border level through EU directives. Furthermore, in relation to Germany there are no foreign exchange restrictions or customs barriers.

The general principles for a commercial activity carried out by natural persons or legal entities from the EU/EFTA region are subject to the same conditions and rules which are valid for Polish persons and are free of restrictions. Due to the particularities of the Polish legal and tax system foreign entrepreneurs wishing to expand their investment in Poland, however, have to be aware of how to use and exploit the legal and tax opportunities in due time and also how to recognise and limit potential risks – especially when preventive measures are necessary. The foreign entrepreneur can freely choose the legal form with which he wishes to carry out his activity. Concerning trading companies, the Polish civil code foresees six forms of commercial activity:

- general partnership;
- partner company;
- limited partnership;
- limited partnership with shares;
- company with limited liability;
- joint stock company.

The most popular form of the legal forms for the execution of commercial activity in Poland by foreigners is primarily the joint stock company with limited liability. The concept of founding a Polish GmbH was inspired by German law and therefore the legal rules on how to manage the company should be absolutely transparent for German investors. The most important advantages of a GmbH include the relatively low amount of required share capital of the company (5,000 PLN), the possibility of commencing the commercial activity immediately after the coming into effect of the articles of association (i.e. before registration in the commercial register) and the fact that the shareholders of a Polish GmbH are not personally liable for the debts of the company. A Polish GmbH may not be set up just by a domestic or foreign one-person company. Apart from that, the articles of association have to be certified by a notary.

The Polish civil code defines the minimum content of the articles of association for trading companies. However, depending on the requirements of the investor we recommend the inclusion of many additional and flexible regulations. The management of the company is granted to the personally liable company management which may also include foreign citizens. For contacts between the company and the company management – including employment contracts or management contracts – and in the case of disputes with the management the company is in principle represented by an authorised representative who is appointed by a shareholders' resolution. There are, however, possible cases where a managing director can, according to the so-called organ theory, sign a contract in the name of both parties. Such a case exists when a managing director carries out duties in two separate companies and concludes the contract in the name of these companies.

However, if the entrepreneur decides for a partnership, the limited partnership is the recommendable option. The most important legal aspects of a limited partnership are that at least one shareholder (general partner) is liable without limitation to creditors for the liabilities of the company and at least one shareholder (limited partner) is liable only for an amount which is regulated in the articles of association. The articles of association of a Polish KG require notarial certification but they are only effective after registration in the national court register. Foreign entrepreneurs usually opt for a mixed arrangement of a limited partnership whose general partner is a company with limited liability. This serves to limit liability and to fine-tune the tax costs of the commercial activity.

Furthermore, foreign investors can found branch offices in Poland. From a legal point of view the branch offices do not have their own legal personality and their activity is limited to the commercial activity of the foreign company.

Poland offers foreign entrepreneurs excellent access to a well educated population with competitive labour costs. In comparison to Germany, however, the rights of Polish workers are

particularly protected and are restrictively interpreted by the Polish courts. This role is fulfilled by the Polish labour code which represents the most important source of the rights of the Polish employee. Each employment contract has to comply with the conditions of the labour law. If a condition is agreed in the employment contract which is less favourable than the regulations of Polish labour law, this condition is automatically replaced by the corresponding conditions of the labour law. However, if the entrepreneur concludes an employment contract with employment conditions which are more favourable than the conditions of Polish law, then these conditions are binding. Such a situation especially occurs with the definition of the holiday entitlement of an employee which in Poland is lower than in Germany. Furthermore, the content of the employment contract must at least correspond to the prevailing conditions of the labour code.

Foreign investors may be confronted by special barriers with the acquisition of land and forestry real estate. In respect of this, until May 1, 2016 German entrepreneurs have to obtain a special authorisation from the Polish ministry of the interior. The authorisation is issued by the minister for internal affairs through an administrative decision provided the defence minister and the minister for land development have no objection. Besides this, it should be emphasised that a German entrepreneur is defined as a company funded by German capital, whereby this also includes a company not directly controlled by a foreign person (i.e. also a company where a German citizen can influence the selection of company management). Furthermore, the acquisition of agricultural real estate with an area of more than five hectares is in principle restricted by the right of first refusal for contracts of sale and the right to purchase in favour of the agency for agricultural real estate in the case of other types of contract. The realisation of these rights is such that in certain legal situations and with the occurrence of certain conditions contained in the contract the agency is authorised to take over the position of the purchaser. The right of first refusal of the agency is excluded when the sale is made to near relatives or due to expansion of agriculture. If the agency is unable to exercise its rights, it is nevertheless possible that a possible tenant of the agricultural property has right of first refusal.

German investors can benefit from different various grants provided they register a commercial activity in Poland. In order to develop the business activity, investors have access to a substantial amount of EU funds. This support is particularly high in the area of agriculture. However, the process to obtain agricultural subsidies is extremely formalised. The subsidies are granted after an application has been made by the farmer and after many conditions have been fulfilled – including the land area as defined by law for the agricultural property. Such an application must include information about the agricultural conditions of the grounds and drawings of the agricultural land or breeding farms must be included. The principles for the granting of funds are primarily regulated in EU directives.

The Polish special economic zones represent an effective incentive for foreign entrepreneurs. Special economic zones are designated areas in Poland where investors can engage in commercial activity at more favourable conditions. At the current time there are 14 special economic zones in Poland. The preferential conditions enable the possibility of obtaining regional aid and exemption from corporation tax. In order to take advantage of these benefits, the investment must satisfy certain conditions, whereby in particular the value of the investment must be at least 100,000 euros and it must always be for a duration of five years. The commercial activity in the area of a special economic zone requires authorisation.

Rödl & Partner has been represented in Poland since 1992. As we have now been providing consulting services to companies for more than 20 years we are familiar with the special requirements and opportunities of the local market. In this time period our lawyers, auditors and tax consultants have amassed extensive experience and built up a reputation as a leading consulting firm for foreign investments.

Practical examples

Taxes

Background facts:

In Poland the German company Oderwart acquired agricultural products from 2007 to 2010 from Polish flat-rate farmers. After acquisition the goods were resold to Germany and transported. In addition, in 2007 the company sold goods to a Polish company. The company was not registered in Poland from 2007 to 2011 as being subject to sales tax.

The company applied for the repayment of the sales tax according to the process valid for foreigners. However, the applications were rejected for the reason that in this matter the invoices were proof of expenses of the applicant and at the same time represent sales tax flat rate invoices (VAT RR invoices). These represent a special form of sales documentation and can be issued by persons who acquire agricultural products or services from flat-rate farmers. Here it should be observed that only active sales tax registered companies which deduct sales tax are entitled to issue such invoices and the applicant must not be an active sales tax registered company in the Republic of Poland.

What can be done now?

Rödl & Partner was commissioned to effect the retroactive registration of the company as a sales tax registered company. A sales tax register was generated for the years 2007 to 2011. Corrections were made to the invoices which were previously incorrectly issued because the invoice must include certain VAT RR flat-rate elements. Contact was taken up with the Polish

flat-rate farmers because the corrections of the invoices had to be signed by the flat-rate farmers.

As in the case in question the amount of sales tax to be repaid amounted to a figure in the millions, the execution of a company tax audit by the Polish tax office was unavoidable. Rödl & Partner represented the company in the course of the company audit.

In the end, the sales tax which had been applied for was transferred in its entirety to the bank account of the company.

What should one have done differently from the beginning?

A consultation with a local tax consultant right at the start would have avoided a large part of the consulting costs which were incurred later and would have considerably shortened the time required for the repayment of the sales tax. The company could have received this sales tax already in the years of 2007, 2008, 2010 and 2011– and not as late as 2012.

However, the company was lucky as it contacted and commissioned Rödl & Partner at the right moment. If Rödl & Partner had been commissioned at a later date, the right to repayment of the sales tax may have become time-barred.

Law

Background facts:

The Polish company (company with limited liability) whose company management consists of three managing directors with German and one managing director with Polish citizenship included the following general rule of representation in the articles of association: "Authorised to submit a declaration of intent in the name of the company is the chairman on his own account, the ordinary managing director – together with the chairman or a different managing director and in the case of issuing power of attorney – together with the person holding power of attorney".

There are many situations where the Polish ordinary managing director of the above-named company have to make decisions very quickly and must also conclude many contracts because the activity of the company requires this (e.g. conclusion of delivery contracts which are necessary for the on-going business activities of the company).

In these situations obtaining the signature of the second managing director from Germany was not possible and the Polish managing director signed for contracts by himself. This situation came to light when Rödl & Partner in 2013 carried out a due diligence covering the years from 2010 to 2013.

What can be done now?

Due to the fact that contracts only signed by the ordinary managing director are void, Rödl & Partner was commissioned to find a solution. Firstly, the company was informed that the change of the general rule of representation through a change to the articles of association is possible and recommendable if the representative rule of the company has not worked up to now. In addition, the company was informed that due to the judgement of the supreme court of August 23, 2006 (ref.: III CZP 68/06, OSNC 2007) there is no doubt that a managing director of a company with limited liability who is only able to act together with a second managing director can be given power of attorney by the other managing director for individual activities. Regarding the contracts which contrary to the general representative rule were only signed by a single managing director making them therefore void, the company was informed that the company management and shareholders' meeting can approve all acts of a managing director which are contrary to the general presentation rule and confirm the effectiveness of these activities. Rödl & Partner prepared the corresponding resolutions which should correct the situation.

What should one have done differently from the beginning?

If the company had asked Rödl & Partner earlier about whether a managing director on his own can sign the contracts in the name of the company – i.e. contrary to the general representation rule included in the articles of association – the problem of the invalidity of the contracts could have been avoided.

Law

Background facts:

The German company Montage GmbH, which would like to perform installation services in Poland, takes on Polish employees for this purpose. These employees are Polish citizens who live in Poland and have never worked in Germany. For this purpose the Montage GmbH company concludes a standard employment contract with the employees in the German language which regularly finds application for German employees without enlistment of a Polish legal advisor. This employment contract includes provisions concerning contractual penalties and supplements for night work and overtime for the amount which is usual in Germany. The contracts do not include a choice of law clause or a jurisdiction clause.

Despite all this the payroll accounting is left in the hands of a local Polish tax consultant. After six months the company decides to transfer the payroll accounting to Rödl & Partner. When the payroll accounting documents are transferred the employment contracts are passed on to the legal department for an inspection.

What can be done now?

Rödl & Partner is commissioned to examine the employment contracts. When the facts become known it is clear that the absence of a choice of law clause means that the facts of the case will be subject to Polish law and therefore Polish labour law. Therefore the employment contracts should have been written in Polish. The breach of this requirement represents a criminal offence. The Polish labour code regulates the minimum requirements of the employment contract. Deviations to these requirements are only binding if they are more favourable for the employee than the prevailing conditions of the labour code. Therefore conditions regarding the contractual penalties and the amount of the overtime supplements are void and have to be replaced by a statutory provision. On the other hand the condition regarding the supplement for night work is more favourable.

Therefore the applicable employment contract was dissolved by mutual agreement and new contracts were concluded according to Polish labour law. In this process, however, the more favourable conditions were retained. Nevertheless the situation may still lead to a penalty due to an offence or a labour law infringement.

What should one have done differently from the beginning?

If Rödl & Partner had managed the contract management, the parties would have concluded the contracts in the Polish language and a choice of law clause would have been agreed. Labour law also requires that the cross-border contract must have a choice of law and jurisdiction clause to enable the parties to regulate their labour law rights and obligations correctly right from the start. This serves to avoid the criminal liability of non-use of the Polish language and the responsibility for labour law infringements.

Law

Background facts:

The Polish company Poland sp. z o.o. (GmbH), a subsidiary of a German company group, needed a new machine to go with its production line which was to be installed in Poland. The parent company was to choose this machine for the Poland sp. z o.o. and if necessary submit an offer. The parent company did this. The Poland sp. z o.o. received the offer from the Deutsch GmbH company addressed to the parent company for the assembly of a machine with certain characteristics. But the Poland sp. z o.o. reacted to this offer from the Deutsch GmbH company and ordered the machine according to the offer. The Deutsch GmbH company delivered the machine to Poland according to the offer and issued the invoice to the Poland sp. z o.o..

The parties have not concluded a purchase contract which is signed by both sides. The conclusion of the contract was made through submission of the offer and its acceptance. Some months after the assembly and commissioning of the machine the Poland sp. z o.o. company established that the machine does not have the assured characteristics and therefore is not compatible to the production line. Complaints concerning defects were made. The Deutsch GmbH did not acknowledge the notice of defects but attempted without success to correct the defects. However, the Deutsch GmbH was not prepared to enter into negotiations to arrive at an out of court settlement. After more than a year Poland sp. z o.o. opted to take legal action against the Deutsch GmbH.

What can be done now?

Rödl & Partner was commissioned to render an expert opinion of the claims of Poland sp. z o.o.. An investigation of the facts clearly showed that first of all the time of the conclusion of the contract, the applicable law and the court of jurisdiction would have to be established. In their expert opinion Rödl & Partner determined that the purchase contract was subject to the United Nations Convention on Contracts for the International Sale of Goods (CISG) as the parties had not expressly excluded these regulations. Alternatively, German substantive law might apply (period of limitation of claims). But in that case legal proceedings could be taken out before a Polish court. It was also clear that due to the course of time the Poland sp. z o.o. was not in a position to raise all the claims according to CISG purchase rights and legal proceedings had to be urgently started in order to prevent the possible time-barring of the claims.

Due to time and cost reasons a decision was taken to bring legal action before a Polish court. In the statement of the claim, Rödl & Partner presented the legal position in detail. After the service of the action was received the Deutsch GmbH company declared itself willing to enter into negotiations to realise an out of court settlement. Rödl & Partner managed the negotiations and the result was that the Deutsch GmbH company finally paid the complete claim lodged including legal costs and in return the Poland sp. z o.o. waived its claims and rights to compensation for damage.

What should one have done differently from the beginning?

Until legal action was taken both contract parties were convinced that the purchase contract was exclusively subject to their respective domestic legal regulations and had not considered the application of CISG law. Contract management support here provided by Rödl & Partner could have enabled the parties to negotiate and sign a written contract which would have included a choice of law clause and as a result the parties would have assessed their contractual rights and obligations correctly right from the start thereby saving high costs for legal advice and legal proceedings.

Taxes

Background facts:

A German company with limited liability took organisational measures in Poland designed to open a new branch office there. These measures mainly included actions for the organisation of facilities in which the company could carry out sales activities.

Therefore the company incurred expenses for adjustment and renting of retail space in shopping centres located in Poland. At a later date these premises were to be used by the branch office of the German GmbH in Poland for its commercial activity.

The expenses incurred by the company were supported by invoices including Polish sales tax. As the GmbH at the time the expenses were incurred was not registered as being subject to sales tax in Poland (the company was, however, subject to sales tax in Germany), the company applied for the repayment of the sales tax paid in Poland according to the procedure for foreign companies. After mediation of the German financial authorities, the company submitted a corresponding application to the Polish tax office. In the meantime the GmbH had registered its branch office in Poland and therefore became subject to sales tax.

The Polish tax office had doubts about the merits of the submitted application for the repayment of the sales tax. Therefore it made an investigation. The doubts of the tax authorities concerned a part of the invoices issued to the Deutsch GmbH company in the time period when the company registered its branch office in Poland. As a result the Polish tax authorities partly rejected the application for repayment.

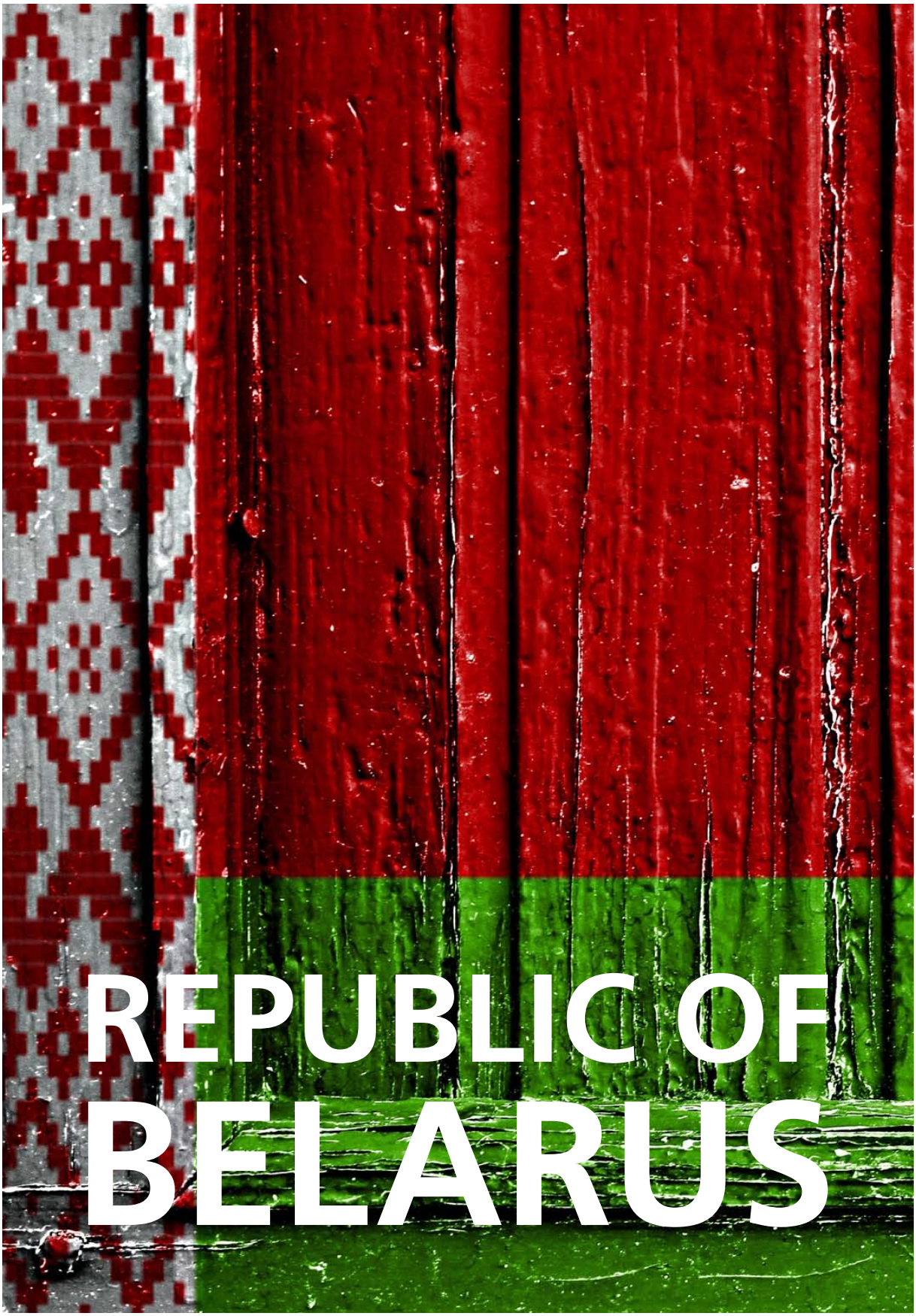
What can be done now?

As the tax authorities had opened an investigation to check the merits of the tax repayment to GmbH, Rödl & Partner acted as an authorised representative of the German company with limited liability. This considerably simplified and accelerated the proceedings because the tax authorities required that the correspondence should take place exclusively in the Polish language.

The employees of Rödl & Partner gave extensive explanations to the tax office regarding the application made by the German company with limited liability. In particular, they explained that at the time the application was made the GmbH was registered as being subject to sales tax in Germany and eligible for a tax refund. Furthermore, it was explained that the registration of the branch office of the Deutsch GmbH company for sales tax in Poland was only

undertaken after the Deutsch GmbH company had made the application for the repayment of the tax. In the time period referred to in the application the Deutsch GmbH company had not delivered goods in Poland subject to payment, had not supplied services subject to payment, had not exported goods and had not supplied goods to the European community from Poland. Therefore the authorised representatives provided arguments which confirmed the right of the Deutsch GmbH company to repayment of the paid tax.

The matter was made additionally more complicated by the fact that in Poland the tax regulations changed in the time period for which the repayment should be made. Nevertheless the proceedings ended with a positive result and the German company with limited liability received repayment of the sales tax according to its application.


REPUBLIC OF
BELARUS

REPUBLIC OF BELARUS

General overview

Due to its geographical position Belarus is a trade hub between the EU and the CIS states and is particularly suitable as a starting point to open up the markets of the customs union of the Eurasian Economic Community (EAEC) between Russia, Belarus and Kazakhstan. As a member of EAEC, Belarus offers a domestic market of 170 million consumers.

Numerous German companies have operations in Belarus, whereby in recent years in particular the focus has been on the area of plant engineering for industrial facilities. Many projects were realised with partly very good results for the involved companies. These successes have contributed significantly to the continuing high attractiveness of the market.

However, differences in the business culture and contract design and the challenges in dealing with the authorities occasionally lead to misunderstandings or problems.

As a result of the relatively recent establishment of the legal and economic systems and the ensuing lack of legal practice there are also a number of deficits in terms of legal certainty (especially also in tax law) with regard to the restrictions due to foreign exchange or customs regulations, in connection with cross-border debt enforcement and the enforcement of court rulings which have to be addressed in advance with the appropriate measures.

Furthermore, German companies should observe the following particularities:

- As far as there was no local company, up to now the registration of a representative office for the exercise of business activities in Belarus in most cases was mandatory in order to avoid the offence of an illegal activity. On February 1, 2014 numerous changes came into effect with regard to the activity of representative offices. As a result, in future representative offices are no longer allowed to exercise commercial activities. If you have a representative office in Belarus, you should immediately get in contact with us.

- Numerous activities, in particular in the construction and assembly field require corresponding certificates. An exercise of the activity without the appropriate certification can have serious consequences. An examination is recommendable at an early stage.

- Especially in the field of plant construction it is import to carefully differentiate between assembly and supervisory work. This difference has important consequences for requirements for authorisation, the legal basis for the activity and the financial accounting. These differences and the correct terminology must already be taken into account with the structure of the offer and the contract design.

- The acquisition of a Belarus company requires the observance of numerous particularities of the legal system (e.g. acquisition only via asset deal/no single shareholders) and the obligation to register as a condition for the legal effectiveness of contracts. Errors can quickly lead to the acquisition losing its validity.

- Larger projects with the involvement of the state the main legal and tax conditions are regulated in "investment contracts". These conditions take priority and can deviate considerably from the generally valid legal regulations. A careful examination is consequently essential.

- The majority of properties in the Republic of Belarus are owned by the state. It should be taken into account that each property has to be assigned an intended purpose (for example for location of industrial or retailing facilities). The violation of this obligation can result in measures such as the withdrawal of the property.

- From a historical point of view the EAEC members have numerous (and also legal) points in common. The decisive differences are, however, often hidden in the detail. This is particularly true for contracts which, for example, were designed for use in west-European legal systems. This means that when using contracts an examination is necessary to check for compliance with the national Belarus law and whether an adjustment to the national particularities is required.

- For agreements on the place of jurisdiction (e.g. in favour of EU countries), it should be observed that the corresponding rulings are usually not recognised in Belarus. The effectiveness of arbitration clauses and the recognition and enforceability of arbitration awards must be exactly analysed.

- Pricing details in Belarus contracts in principle include sales tax. The obligation to pay sales tax and withholding taxes should be checked in advance and explicitly included in the contract.

- The labour law in Belarus is excessively bureaucratic and due to its application in the light of the socialist traditions is very friendly to employees. The design of the employment contract should take this fact into consideration and in particular the less flexible application of employment law regulations.

- From a tax point of view it should be particularly observed that in the case of a representative office which fulfils the conditions of a branch office subject to tax, a tax loss carry-forward is not possible. For the allocation of the parent company expenses only the direct method is accepted.

- A refund of input tax surpluses for representative offices is in principle only possible in the course of liquidation.

- High inflation rates (annual rate currently approx. 20-25 %) lead to taxable currency profits with foreign exchange accounts. Receivables and input tax refund claims in Belarus roubles (BLR) experience massive losses in value. Free conversion is only possible to a limited extent and under certain conditions there is the obligation to convert into Belarus roubles (BLR).

- Numerous forms of documentation are subject to formal legal requirements. An invoice does not (with a few exceptions) constitute an accounting document. The decisive documents are delivery acceptance documents which must be signed by both contract parties. There are considerable accounting differences between Belarus GAP and HGB/IFRS which without a correct transition can often lead to differences which cannot be resolved in the affected financial accounting.

Rödl & Partner has had its own office in Minsk (Rödl & Partner IOOO) since 2007. The focus of our activities is in the fields of trade law, corporate law, labour law, the law governing commercial agents and distribution, support for foreign direct investments and M&A consulting, cross-border and national tax compliance and the fine-tuning for tax arrangements. In addition, we naturally also offer financial accounting and auditing services.

Our customers include a number of the largest international company groups and a series of well-known (in particular German and Austrian) Mittelstand companies.

Founding of a company

The three most common legal forms in Belarus are the company with limited liability (“OOO”), the joint stock company (“OAO” and “ZAO”) and the so-called “unitary enterprise”.

As each joint stock company according to Belarus law requires at least two shareholders and the founding of a OOO is the most common and easiest, this description relates exclusively to the founding of an OOO by two foreign companies. In total, the OOO is less regulated than the ZAO and more flexible in terms of the structure of the articles of association and the deviation to legal regulations.

The company is founded the moment when registration in the uniform, state registry takes place. The company can only start its daily operations when a company stamp has been manufactured and the bank accounts of the company have been opened and activated.

The procedure for the state registration of an OOO usually consists of the following steps:

- Preparation of the documentation for state registration (approx. 30 calendar days):
  - Obtaining of extracts from the commercial register (for legal entities as shareholders);
  - Apostille and notarial translation of the extracts from the commercial register (for legal entities as shareholders), notarial translation of passports of the shareholders (for natural persons as shareholders);
  - Co-ordination of the future company name with the registration authority;
  - Obtaining of the guarantee letter of the landlord about his willingness to make corresponding premises available to the future company.
  - Resolution concerning the founding of a subsidiary with preparation of the corresponding protocol (contract) which includes a definition of the share capital, office address of the company (for the founding decision the address of the company must be given), future types of activity of the company (at least the purpose of the activity) and the candidates for the position of the director and the financial accounting officer, whereby the documentation is subject to Belarus corporate law.
  - Opening of a provisional settlement account at a Belarus bank and the deposit of the share capital (application to open an account with the foundation document enclosed);
  - Confirmation of the articles of association by a shareholders' meeting and the signing of the articles of association by the shareholders.
- State registration at the registry (application for registration with enclosure of the postulated and notarially certified translated commercial register extracts and notarially certified translated passports of the shareholders, articles of association, certification of the payment of the registration fee, CD with articles of association in .doc or .rtf format) takes place on the day of the application and confirmations concerning registration at the tax authority, social security funds, statistical bodies and the state insurance company "Belgosstrakh" are issued within 5 working days (approx. 8 calendar days);
- The notification of information via director and financial accounting officer to the tax authority (approx. 1 calendar day);
- The manufacture of the company stamp (application with enclosure of the articles of association with registration note from the registration authority) (approx. 4 calendar days);
- The opening of a settlement account at the Belarus bank takes place on the day the application is made (application with enclosure of copy of the articles of association, shareholders' resolution concerning the appointment of the director, identification card of the director, bank card with sample signatures of the persons with power of representation which are certified by the imprint of the stamp), transfer of the share capital to the current account and closing of the provisional settlement account (approx. 1 calendar day);
- Furthermore, the book for violation and instructions and the book for audits from the tax authority are handed over as defined by law.

Therefore, realistically speaking, the founding of a joint stock company takes approximately 40 to 50 calendar days.

Takeover of a company

The takeover of a company is made by the sale of company shares or the acquisition of a company in an asset deal.

The procedure for the acquisition of the company in an asset deal is more complicated and therefore in practice not very common. The contract of the company acquisition in an asset deal does not require notarial certification. The legal transaction secured by property with the company, on the other hand, is subject to state registration including registration of the transfer of title for the corresponding real estate and is only valid from the date of the registration.

The sale of the company shares is made with a simple contract in writing, whereby a notarial form is not required. In principle, shareholders have a right of first refusal regarding the share (or its fraction) of a shareholder who is selling his share (or fraction of a share).

Legal forms of business

In Belarus, most legal entities are companies with limited liability.

Company with limited liability, OOO (Obschestvo s ogranichennoj otvetstvennostju)

- Joint stock company
- Basis is the articles of association
- No minimum share capital defined by law
- Share capital must be paid in full within 12 months of the state registration
- Min. 2 and max. 50 shareholders
- Liability of the shareholders is limited to their contribution to the share capital of the OOO

Public limited company, OAO (Otkrytoje akzionernoje obschestvo)

- Joint stock company
- Basis is the memorandum and articles of association
- Share capital: min. 400 basic units (basic unit since October 1, 2013 = BYR 130,000)
- Share capital must be paid in full within 12 months of the state registration

- Number of shareholders: unlimited
- Circulation of the shares is unrestricted
- Publicly unrestricted subscription of shares
- Closed limited additional subscription of shares

Closed joint stock company, ZAO (Zakrytoje akzionernoje obschestvo)

- Share capital: min. 100 basic units (basic unit since October 1, 2013 = BYR 130,000)
- Number of shareholders: max. 50 persons
- Sale of shares only after approval of other shareholders
- No public subscription of shares
- Closed limited additional subscription of shares

Unitary enterprise, UP (unitarnoje predprijatije)

- Basis is the articles of association
- Legal entity with no right of ownership to capital assets and whose owner is the founder
- A unitary enterprise is founded by a single person
- The company assets cannot be divided into shares (a distribution leads to conversion to a company or liquidation)
- No minimum amount of share capital
- Share capital must be paid in full within 12 months of the state registration

Company management

The shareholders' meeting and the managing director (usually called director) are obligatory management bodies of a company. The executive board and supervisory board are established as is required. On the other hand, a joint stock company with more than 50 shareholders must have a supervisory board.

The shareholders' meeting is the most important management body of a company. The managing director does not require additional power of representation to represent the company externally. He can issue the power of representation to other representatives, can conclude legal transactions and can call a shareholders' meeting.

- Managing director contract in the form of an employment contract or civil legal agreement (with a legal entity or sole trader)
- Selection of possible regulations:
  - Restriction of secondary employment of the managing director

- » Full financial liability for damage caused
- » Additional possibilities for notice of termination:
  - » With the change of a shareholder – acc. to his decision,
  - » With a process of overindebtedness (insolvency proceedings) – after decision of the asset owners,
  - » With the cancellation of the employment contract according to a resolution of the shareholder (usually with settlement to the amount of 3 salary months)
- › Notice of termination during illness or holiday not possible

Foreign exchange law

Resident persons are prohibited in principle of using foreign currency to conduct their transactions.

Currency transactions between resident persons and foreigners are carried out using foreign currency. For legal entities and sole traders, there is in principle an obligation to sell 30 % of the currency proceeds on the domestic market.

A foreign trade agreement must be made in writing and must also include the terms of payment, i.e. the payment obligation of a party before or after the performance of the other party.

Residents are in principle prohibited to make advance payments from accounts at Belarus banks to non-residents for import deliveries.

Exceptions are:

- › Advance payments made by a letter of credit;
- › Payments made from available currency proceeds from the importer (resident);
- › Advance payments in favour of residents of the customs union;
- › Corresponding authorisation from the national bank of the Republic of Belarus.

Each foreign trade transaction from residents of Belarus must be registered at the bank to the extent that the purchase price of the goods is 3,000 euros or above.

There is no obligation to register for the following foreign trade transactions:

- › Facilities for foreign trade transactions for goods
- › Transfer of business secrets, trademark protection rights, work and services.

The payment to residents of the Republic of Belarus for exports from Belarus must in principle at the latest be made within 90 calendar days after fulfilment (execution of performance of the services).

For imports the deadline for the incoming goods is 60 calendar days after the day of payment.

If the deadline for the production of imported goods (execution of work, performance of services) exceeds the legal deadline, an application for an extension of the deadline to a higher level state body or the executive committee can be made before the deadline has passed, but which cannot exceed 180 calendar days after the day of payment.

The deadlines for foreign trade transactions can on the application of a Belarus contract party be extended by the national bank of the Republic of Belarus.

Financing possibilities

In Belarus companies can be financed by banks, state capital and private capital. The taking of credit and its repayment is noted in the borrowing history of each borrower.

Banks have the right to view the borrowing history of each borrower and in order to provide capital require a business plan which details the income and payments of the company and the cash flow statement, etc.

Real estate und acquisition of land

In the Republic of Belarus a legal entity has the following possibilities with regard to land:

- Leasehold rights,
- Right to continuous or occasional use;
- Private property rights

Due to historical reasons, the majority of the real estate in the Republic of Belarus is owned by the state. It should be taken into account that each property has it assigned purpose (for example, the location distribution of industrial or retail real estate). The violation of this obligation can lead to measures such as the withdrawal of the respective property.

A foreign company may only have rights to property in the form of a leasehold right.

An investor can acquire the right of private ownership of real estate owned by the state when the local authorities carry out an auction. Prior to state registration, concerning the erection of buildings planned for the investment project and the rights to these buildings, the investor is not yet entitled to process transactions with such properties and (or) with the allocated piece of land which could transfer the rights to a third party or lead to such a possibility.

Labour law

The content of the employment contract is agreed by the contract parties under consideration of the defined obligations according to the labour code including details regarding the employer and employee, place of work and position of the employee, rights and obligations of the parties, and if applicable the duration of the employment contract, working time and holiday arrangements, remuneration conditions, etc.

The employment contract is concluded in writing and can be either for a limited or indefinite period. Employment contracts are valid as indefinite to the extent that they do not include a reference to their limitation. Instead of the employment contract a special employment contract (limited employment contract of at least one year up to a maximum of five years) can be concluded which in comparison to general labour law is characterised by certain particularities. An extension of the limited employment contract is in principle non-binding. For a limited employment contract the parties are obliged to notify the other party of the non extension of the employment relationship at the latest one month before expiry of the employment contract.

The maximum regular weekly working time amounts to 40 hours. In general it is not foreseen to offset overtime hours with free days. However, it is allowed provided the employer and employee agree to it. A max. increase of 4 overtime hours within 2 consecutive days and a max. 120 hours per year is possible with compensation in the form of additional free days or additional remuneration.

In addition to the usual documents such as an employment contract and job description, the employer is also obliged to prepare his own forms signed by the managing director which are required in the case of taking on a worker or the notice of termination of an employee. The same is true for holidays and business trips.

Each employee must have a so-called work book which lists the working time, position and reasons for the notice of termination. The employer must register all the work books. Each month a table must be prepared (checklist for the working time) with all calendar days and all employees which lists the individual days of attendance, absence and sick days, etc.

The minimum wage by law (monthly and hourly) must be upheld by employers as the legal minimum for the remuneration of work done by employees. In the course of the year the amount of the minimum wage is subject to correction under consideration of inflation.

Dismissal protection

Some groups of employees are protected against arbitrary notice of termination by the employer. This includes, for example, pregnant women, women with children up to the age of three, single mothers with children up to the age of fourteen, handicapped persons, members of commissions for industrial disputes and employees conducting public duties (members of parliament, those on military service, participants in a criminal proceedings, etc.). The notice of termination in the listed cases can only be made for an important reason (liquidation, misappropriation of employer's assets, etc.).

The employee can file suit against notice of termination within one month at the commission for industrial disputes or before court. In the other cases the employee can file suit within three months after the legal violation is known. In the case of reinstatement the employee is entitled to a settlement to the amount of the average wage for the whole time of the loss of earnings. Instead of the reinstatement the court can order a settlement to the amount of 10 times the average monthly wage. In the case of reinstatement the employee has a right to financial compensation. In this case the responsible person of the company administration bears the subsidiary financial liability.

Trademark law / Industrial property rights

If goods containing intellectual property are introduced for business purposes without the permission of the respective owner of the rights, this constitutes an infringement of trademark law. In this case the owner of the rights is entitled to make an application with the customs authorities for implementation of measures to protect the intellectual property. Such measures include in particular the stop of customs clearance and impoundment of the goods by up to 10 days. The duration of the stop can, if required, be extended by a further 10 days. Customs charges are not due for the implementation of the measures to protect the intellectual property.

The implementation of measures to protect the intellectual property includes documentation verifying the right of ownership to the object with the intellectual property (certification, licence contract, or other) and if applicable the obligation to the owner of the rights to replace his financial loss to the amount of at least 10,000 euros or to conclude an insurance contract for the same value.

If a decision to implement the protective measures is made, the protection of the respective objects is entered into the customs register for objects with intellectual property. Subsequently the protection measures are carried out automatically by the customs authorities for a maximum of two years from the day of the registration. This time period can be extended by the owner of the rights.

Within the deadline for the cessation of the customs clearance the owner of the rights has the opportunity to initiate civil proceedings to establish protective measures though filing suit to end the legal violation, collection of the losses suffered, the removal, destruction and impoundment of goods and imposition of a fine to the amount of the value of the goods.

Such legal protection is granted to trademarks and brand names which are registered at an international level (Madrid agreement for the international registration of marks worldwide, Paris convention for the protection of industrial property), or at a national level (item 12 of the law on trademarks and service marks, order concerning the registration of a mark).

In addition, violations against the laws on the use and exploitation of trademarks and marks can result in legal or criminal proceedings.

Financial accounting obligations

All companies in Belarus including branch offices and representative offices of foreign companies without business activity are obliged to maintain financial accounting.

The regulations on financial accounting in Belarus are included in the law on financial reporting and accounting and are valid for all domestic and foreign legal entities, places of business and representative offices.

The finance ministry has additional regulatory authority during the transition over to the international financial accounting standards.

Each managing director is obliged to set up an own financial accounting department with a financial accounting officer who must report directly to the managing director. Otherwise the corresponding activities must be outsourced to a certified financial accounting company whose financial accounting officer then becomes the financial accounting officer for the ordering party.

The respective financial accounting activity must be carried out to comply with the regulations of the company and are subject to the approval of the managing director.

Foreign branch offices and representative offices are entitled to take on the financial accounting regulations of the originating country to the extent that these do not contradict Belarus law. The financial accounting, however, must (also) be made according to the Belarus legal regulations.

Tax returns / Tax consulting

Income tax

The 183 day regulation is valid for the question of tax residence:

- For stays up to 183 days: only income is taxable from Belarus sources and payable to the tax authorities through the source of the income on the same day;

German citizens may present a residence certificate according to the double taxation agreement in order to be exempt from Belarus income tax.

- For stays in excess of 183 days: all income is taxable, the income tax return has to be presented annually to March 1 of the following year:
  - income tax rate with a flat rate of 12 % must be paid in full by May 15 of the following year;
  - income as payment in kind: the rental of a flat (payment of goods and services by the company in favour of the taxpayer).

Sales tax

Sales tax is levied on most sales and services, whereby an assessment in particular concerning the obligation to register for sales tax should be made beforehand.

The basic tax rate currently amounts to 20 %. The reduced rates depending on the type of activity are 10 % and 0 % (e.g. for exports etc.). For 2014 a tax increase to 22 % is expected. Tax returns must be presented on a monthly or quarterly basis on day 20 of the month following the reporting period. The sales tax must be paid by day 22 of the following month. Payment modes and deadlines for sales tax to be collected by the customs authorities are determined by the customs law of the customs union, Belarus law on customs regulations and general documentation.

Import sales tax for goods from Russia and Kazakhstan has to be paid to the tax authorities and for imports from outside the Eurasian economic union to the customs authorities.

Withholding tax

Foreign organisations who do not exercise their activity in Belarus through a branch office, but which generate income from sources in the Republic of Belarus are regarded by tax code of the Republic of Belarus as taxpayers with regard to withholding tax. The tax rates are 6 %, 10 %, 12 % and 15 % depending on the type of income. Residents in so-called high-tech parks enjoy tax concessions in the form of a 5 % tax rate. The assessment period is the calendar month in which the income is generated. Tax returns must be presented on a monthly basis by day 20 of the following month after the tax period and the tax must be paid by day 22 of the following month. Upon presentation of a residence certificate, in accordance with the double taxation agreement between Germany and Belarus an exemption from withholding tax is possible.

Corporation tax

Profit is defined as the deductible difference between income and expenses.
The basic tax rate amounts to 18 %. The accounting standards according to the tax regulations can differ from the regulations of commercial accounting. The losses incurred in the previous assessment period can be carried forward into the next year.

Profit tax returns must be presented annually to March 20 of the following year or monthly (e.g. for profits from Belarus organisations from dividends) by day 20 of the following month after the assessment period.

The annual tax must be paid by March 22 of the following year with the deduction of the paid monthly tax payments and the monthly taxes must be paid on a quarterly basis respectively April 22, June 22, September 22 and December 22.

In fact the corporation tax is therefore a cumulative advance payment and hardly depends on the monthly profit.

Special points regarding the company tax audit

The company tax audit is ordered by the tax authorities to audit a certain tax or to audit the whole company. Usually company audits are carried out without a special reason and according to a confirmed and published six month plan. In special cases, the tax authorities can carry out a company audit if there is suspicion that the tax has not been correctly calculated or paid.

Subsequent changes to the tax returns in favour of the taxpayers are possible within 3 years. Regarding disadvantages to the taxpayer, there are in principle no restrictions.

The existing (declared) compensation/offsetting claims for input tax do not become time barred (but they do, however, devaluate due to the high annual inflation rate currently at approx. 20 to 25 %).

A recalculation of the tax base by the tax authorities in favour of the state is possible for any time period.

Audit of the annual financial statement and appointment of the auditor of the annual financial statement

The annual financial statement must be presented within 90 days after the end of the financial year. Quarterly financial statements must be presented within 30 days after the end of the quarter.

The statutory audit is compulsory for:

- organisations whose financial activity is of interest to the population (open joint stock companies, banks, financing institutions, stock exchanges, insurance organisations, etc.);
- organisations where the state has an interest in their activity and which are controlled by the state (residents of the high-tech park, expert participants of the securities market);
- all organisations with foreign investments;
- organisations whose accounting has to comply with the IFRS regulations;
- organisations whose income from the sale of goods (work, services) exceeds 600,000 euros (according to 2013 law – more than 5 million euros).

The conditions concerning the statutory audit are therefore also subject to the financial accounting law of 2013. In this respect, in the event that the income reaches 5 million euros, a statutory audit has to be carried out.

If the annual accounting was audited according to IFRS rules, the new legislation exempts the organisation from the requirement of a statutory audit of the financial accounting which was prepared according to national legal regulations. Small and medium-sized organisations are exempt from the statutory audit.

Liquidation / Ending of the company

The life cycle of a legal entity ends either through dissolution, liquidation or conversion. The dissolution, conversion or liquidation is decided by a shareholders' resolution. The conversion must be announced to all creditors, whereby with a conversion special protection rights are also valid for creditors.

If, after confirmation of the provisional assessment of the liquidator, the value of the assets of the debtor or legal entity who has decided to wind up the company according to civil law is not sufficient to meet the demands of the creditors, then the application of the debtor must be submitted to the commercial court at the latest 1 month after discovery of the said facts.

Furthermore, it should be taken into account that the reasons for the submission of the application of the creditor regarding insolvency (bankruptcy) of the debtor (application of the creditor) in total are as follows:

- the creditor has reliable, documented information about the illiquidity of the debtor which is long-term;
- if the enforcement proceedings on the debtor are not executed within 3 months or in the course of the enforcement the fact is determined that the debtor assets are insufficient in order to meet the claims;

The existence of the backlog against the creditor who has made an application of a creditor to an amount above 100 basic units (1 basic unit = 130,000 BYR).

Other administrative or special bureaucratic points

Due to the bureaucratic method of the working of the public authorities, in the planning phase companies should plan for possible delays which cannot always be prevented.

In particular construction companies should take care to observe that construction activities in Belarus require an administration process which can take a number of months.

The procedure for land distribution consists, for example, of the following sections:

- Investor makes application to the local authorities at the location of the new piece of land. The application must include, among other things, details of the planned position of the building plot and its area, the purpose and planned area of the construction project, the planned scope of the investment and the sources for the financing of the construction project.
- Preliminary co-ordination of the location of the building plot for the construction project. The procedure takes approx. two months starting from the application until the allocation of the building plot. The preliminary co-ordination of the building plot location is carried out by the local authorities and made in the form of a protocol concerning the selection of the building plot position. After the confirmation of the protocol concerning the selection of the building plot position and before the taking of the decision concerning withdrawal and

allocation of the building plot, the local authorities have no right to assign this building plot to a different person or to confirm such an assignment.

› Development of the project with allocation of the building plot and taking of the decision concerning withdrawal and allocation of the building plot on the basis of the project. This stage lasts a total of 1.5 to 2 months. After completion of this stage, the local authorities make the decision concerning the allocation of the building plot to the investor.

› Natural determination of the borders of the allocated building plot on the land, state registration of the property layout and creation of the rights to the property. This stage lasts approx. 1 month. The investor acquires the right to the property after the state registration has taken place and is certified by a state registration.

The authorisation for construction and installation work must be obtained from the local authority and the Minsk Ministry of Architecture and Construction of Belarus for standardisation. After this authorisation has been obtained by the ordering party or building owner the construction and installation work can begin. The authorisation is issued within 3 working days. Its validity is limited to the deadline stated in the project documentation for the execution of the construction work.

Practical examples

Law

Background facts:

The SEP UP is a Belarus company which is 100 % owned by the Finnish company AUG OÜ. SEP is located in a special economic zone and therefore enjoys extensive tax privileges. In February 2011, the German company JUL GmbH concluded a purchase contract with AUG OÜ according to Finnish law concerning the acquisition and sale of all shares of the SEP UP and the purchase price is paid. In April 2011, insolvency proceedings are petitioned against the assets of AUG OÜ.

In May 2011, JUL GmbH as a new shareholder would like to dismiss the previous managing director of SEP UP. Here it turns out that the necessary decisions cannot be taken because in the Belarus commercial register the insolvent AUG OÜ remains listed as the owner of SEP UP.

JUL GmbH contacts Rödl & Partner in Minsk.

Our examination determined that the SEP UP is a company with the legal form of a so-called unitary enterprise. As such it does represent a legal entity, but does not, however, have shares. All the company assets are exclusively owned by the company owner and not by the company. An acquisition of the company through acquisition of shares was therefore not possible. The constitutional registration of the transfer with the registration authority was also not made. Furthermore, the contract is not available in the Russian language, a condition which is a requirement for registration. As a result, according to Belarus law, the legal acquisition of the property of the company has not taken place and on the basis of the available purchase contract due to a violation of the regulations of Belarus law also not possible.

What can be done now?

Rödl & Partner immediately contacted the insolvency administrator of AUG OÜ to ensure his co operation and to prevent conclusion of the insolvency proceedings before a recovery of the acquisition can be made. Communication was taken up with the administration of the special economic zone in order to ensure that the recovery process did not have a negative effect on the existing tax privileges due to the resident status.

For the recovery two alternative solution strategies were drawn up:

- registration of the SEP UP as a property complex and its subsequent sale to JUL GmbH (asset deal);
- conversion of SEP UP into a joint stock company with subsequent selling of shares to JUL GmbH.

For sales tax reasons the second variation was chosen. The conversion was made on the basis of the decision of AUG OÜ represented by the Finnish insolvency administrator. The corresponding contractual basis for the acquisition of the shares was drawn up in compliance with the Belarus legal regulations, was signed by the acquiring party and the seller represented by the insolvency administrator and then registered.

JUL GmbH and its affiliated company OKT GmbH & Co. KG were registered in the commercial register as the new shareholders with respectively 99 % and 1 % of the shares. The managing director was legally dismissed by a decision of the shareholders' meeting and a new managing director was appointed.

What should one have done differently from the beginning?

If Rödl & Partner had been involved earlier in the country where the target company is located and a legal examination had been made (due diligence) prior to acquisition of the company, the legal effectiveness of the acquisition and legally sound structuring of the transaction with the corresponding contractual conditions could have been possible.

This would have avoided the risk of failure of the acquisition and the total loss of the purchase price. This would also have removed the need for the involved recovery process and would have saved a considerable amount of time.

Financial Accounting / Tax Consulting

Background facts:

HGL AG is a subcontractor on a plant construction project in Belarus and manages the activity according to the legal regulations via a Belarus representative office. Due to the fact that originally the project duration was scheduled to be 9 months, registration as a taxable branch office did not take place as in DBA DE-BY an exemption for a period of 12 months is possible.

In fact, however, the project lasted approx. 23 months and therefore the conditions for a taxable branch office according to the double taxation agreement between Germany and Belarus are fulfilled. Registration of the taxable branch office, however, is not made.

The branch office determines it is subject to payment of arrears for corporation tax, sales tax, withholding tax, income tax, interest on arrears and also administrative fines totalling up to 20 % of the unpaid tax.

Due to the high amount of unpaid tax the responsible persons may also be the subject of criminal proceedings, in particular the manager of the representative office (possibly resulting in a fine or even imprisonment) and the company (corporate criminal law: confiscation of the company assets).

What can be done now?

The tax status of the representative office must be changed to that of an economically active representative office, i.e. registration of a taxable branch office has to be made. This must be made at short notice in order to pre-empt a tax audit at the representative office or the client which could lead to a considerable escalation of penalties.

The financial accounting of the representative office has to be changed to that of an economically active representative office and the corresponding entries made or corrected for the previous assessment periods.

For example, the following measures have to be taken:

- Expenses and income not yet recorded in the Belarus financial accounting must be posted locally.
- Parent company expenses must be transferred.
- Requirement for residence certificates (also of further subcontractors)

- Preparation of tax returns with the calculated sums of taxes and the respective due interest on arrears.
- Submission of tax returns and payment of taxes and imposed penalties.

Thanks to Rödl & Partner Minsk all of the measures could be realised at short notice and through timely contact with the financial authorities the amount of the fines could be reduced to a minimum, whereby criminal proceedings were therefore avoided.

However, considerable tax arrears had to be made which were only partially recognised in Germany. A particular burden is that a loss carried forward with branch offices in Belarus is not permitted.

What should one have done differently from the beginning?

The possibility of founding a branch office (and in particular the calculation of the deadlines necessary for this) should have been examined under the assumption of a realistic duration for the project.

This is valid for construction and installation work which according to the applicable double taxation agreement is often subject to a time-limited tax privilege. Often the originally planned project duration is exceeded which means constant monitoring is required to establish whether deadlines have been breached. Repeated short activities for the same customer can under some circumstances also lead to the justification of a taxable branch office.

The high time and financial cost for the post-processing, payment of tax arrears and interest on the arrears and penalties could have been avoided by:

- The timely registration of a taxable branch office.
- Early agreement of the distribution method of income and expenses between the parent company and branch office in Belarus (according to the possibility of involving the respective tax offices)
- Thorough documentation and records.
- Open communication with the responsible persons in the financial accounting of the representative office regarding questions of organisation, for example, for sending employees, use of subcontractors, deliveries of goods, etc.
- Inspection of contracts, records, files, invoices and other documents for compliance with the Belarus financial accounting regulations.
- Early contract design support for the customer (in particular regarding regulations for the mode of payment, acceptance records, sales tax) to take the Belarus particularities of the financial accounting and tax treatment into account.

Summary

Due to the high investment requirement especially in the industrial sector and high potential consumption, the Republic of Belarus is an attractive market. German products and services are favoured by decision-makers and remain the first choice for consumers.

As a result of the Republic of Belarus joining EAEC and the implementation of the EAEC requirements, the local legal systems of the EAEC states (Belarus, Russia, Kazakhstan) have been adjusted to each other. In spite of different general conditions and the cultural and language differences, in Belarus investors can find a platform for market entry or expansion of their presence in the EAEC domestic market.

In order to arrange a secure and long-lasting market entry, the experts of Rödl & Partner in Minsk are available to support you with your project business and offer continuous advice in all legal, tax, auditing and financial accounting matters.


REPUBLIC OF
MOLDOVA

REPUBLIC OF MOLDOVA

Due to its regional position between the EU and the Ukraine and its attractive investment conditions, the Republic of Moldova, also called Moldavia, is an interesting location for foreign companies. The Republic of Moldova is a parliamentary democracy. In spite of continuing internal political disputes and the unresolved situation with Transnistria, Moldovan economic policy is stable and friendly to investors. The Moldovan currency is the Leu. The country has a very small economy dependent on agriculture, whereby many Moldovans try to emigrate to the EU. After entry to the WTO and intensive negotiations with the EU, Moldova has clearly decided to follow the path to integration in the EU. As a result, Moldova benefits from the granted trading advantages of being able to unilaterally export numerous goods from Moldova to the EU without customs duties.

Moldova also offers investors excellent possibilities through the provision of numerous free trade zones and favourable tax rates such as a flat tax rate for companies of 12 %. Further on-going negotiations with the EU will cover the elimination of duties and non-tariff trade barriers for goods and other trading aspects such as services, investments, public procurement, competition and sustainable development which means that in future the business prospects for German companies should continue to improve.

Legal forms of business and founding a company

Moldovan corporate law is similar to German law. The legal forms which exist are comparable with the legal forms known in Germany. Although business partnerships also exist, joint stock companies are most common and here especially the S.R.L which is comparable to the German GmbH.

Joint stock companies

Societate cu Raspundere Limitata (S.R.L)

The form of S.R.L mostly chosen by foreign investors is a joint stock company comparable to a German GmbH. As such it is able to conclude contracts in its own name, own property, acquire rights and may be a party to legal proceedings. The personal liability of the shareholders is limited to the extent to which the shareholding owned by the shareholder is not fully paid up, whereby the liability is limited to the outstanding amount. Furthermore, the personal liability for liabilities of the company is excluded. The company acts as legal entity through its organs (managing director und shareholders' meeting). The operative business is managed by one or more managing directors who also represent the company externally. There is a difference to German law with regard to the founding phase. The S.R.L cannot be founded as a “sole trader” when the founder also only has one shareholder. In order to avoid problems

it must also subsequently be observed that the number of shareholders is sufficient for this requirement. In contrast to German law, a company with only one shareholder is not possible. The registration begins with the reservation of a company name and the submission of the foundation document with the registration authorities. In principle, the law does not define a minimum level of share capital. However, the registration process checks whether the registered capital is reasonable for the intended economic activity and can therefore be questioned.

Societate pe actiuni (S.A.)

In contrast the S.A. is based on the German AG and designed for a wide public distribution of shares. It is comparable to a German joint stock company. The transactions of the S.A. are managed by an executive board. If the number of shareholders exceeds 50, a supervisory board is obligatory. The executive board members represent the company also externally. The founding of the S.A. can be made by a natural person or a legal entity, whereby these need not be of Moldovan nationality. The company acquires its legal existence with the conclusion of the registration process. In comparison to an S.R.L there are increased obligations with regard to the balance sheet and financial accounting.

Business partnerships

Business partnerships are in principle possible, e.g. in the form of the open trading company, the trading company with limited liability (corresponds to the GmbH & Co KG) and the cooperative. Basically a number of partners bind themselves contractually to realise a certain purpose and promote this by contributions in the form of money, payment in kind or services. Unless otherwise regulated in a memorandum of association all contributions are basically valid as being equal. The shareholders must be natural persons. The company purpose is not subject to further legal requirements and the founding is also subject to limited formalities without an obligation of disclosure. However, registration with the Moldovan public registration office is required.

One difference is that in Moldova business partnerships in terms of tax are treated in the same way as joint stock companies and are subject to corporation tax.

Joint ventures

In Moldova legal entities are deemed to be foreign if at least half of the company capital is in foreign hands. However, there is a ban on discrimination for "foreign" investments which means that the question of how the joint venture is developed is of secondary importance.

Foreign exchange law

Foreign exchange trading is controlled by the national bank of Moldova. The transfer volume from and to Moldova is not restricted. Natural persons and legal entities may maintain accounts and foreign exchange accounts with registered banks.

Payments in a foreign currency between Moldovan residents in Moldova are not allowed. Legal entities resident in Moldova are only entitled to acquire foreign currencies for special legal purposes (e.g. external payments to non-residents, travel expenses, repayments on loans in a foreign currency, etc.). The acquired foreign currency must only be maintained in current accounts (not in deposit accounts) for a maximum of seven working days.
After that the foreign currency not used for payments must be converted back to MDL.

Payments and transfers between Moldovan residents and non-residents can be made in Moldovan Lei or in a foreign currency.

The following payments may only be made in Moldovan Lei:

- Payments in connection with trade in goods and/or performance of services in shops, restaurants, hotels, petrol stations or other similar businesses in Moldova but not including businesses with international traffic operations, duty-free businesses in national airports, on aeroplanes with international routes or at international points for crossing the Moldovan border;
- Payments in connection with the execution of municipal public services and other services for buildings and premises by legal entities who are resident in Moldovan;
- Payments in connection with trade and transport documents by representatives of transport companies who are not resident in Moldovan;
- Wage payments and payments of other remuneration by employers who are resident in Moldovan to employees who are not resident in Moldovan for work carried out in Moldova.

Non-residents may transfer amounts in foreign currency abroad which they have previously received from other non-residents or received in the course of their usual business operations in Moldova.

Moldovan and foreign legal entities are only entitled to receive and make payments and transfers in a foreign currency via their bank accounts. The law also foresees some situations when these legal entities can use cash to fulfil transactions in a foreign currency. In that case the law stipulates that the amount in the foreign currency which a legal entity in Moldova can receive in cash for sold goods or performed services must not exceed 2,000 euros per day.

Liquidation of the company

The S.R.L is dissolved by a time period fixed in advance, by the establishing of insolvency or by a corresponding shareholders' resolution. Furthermore, it can be ordered by a court of law if the registration authority in formal proceedings cannot determine a business activity of the company or if there is an infringement of the prohibition of a "two-layer structure".

The same is valid for the S.A. But the company remains in existence and capable of acting for the duration of the liquidation phase under the management of a liquidator, whereby it is important before liquidation takes place that an obligatory tax and social security audit is carried out. The duration of liquidation can even last longer than a year.

Real estate and acquisition of land

According to Moldovan law, it is in principle possible for foreigners – natural persons and legal entities – to acquire real estate in Moldova. There are, however, exceptions to this principle. For example, it is not possible for a foreign natural person to acquire agricultural and forestry areas. This can only be done by the state, a Moldovan citizen and Moldovan companies without foreign participation. Foreigners can, however, lease agricultural land at any time.

Licencing

In Moldova the pursuit of certain types of activity require a licence. The complete list of these activities is stipulated by law. There are currently 41 types of activity which require a licence including but not limited to auditing, construction of buildings and (or) engineering plant and networks, reconstruction, reinforcement, restoration, banking and currency exchange activity, insurance, activity of professional participants in the securities market and others.

For most of the activity types licences are issued by the state licence office (Camera Licentierii de Stat). For regulated markets such as banks, insurance, energy and communication licences are issued by the respective regulatory authorities.

Labour law and dismissal protection

Due to a strong exodus of young people to Western Europe, the Moldovan labour market unfortunately does not have a sufficient supply of human resources in all fields and lines of business especially for skilled workers and management staff. However, in comparison to the European standard labour costs can still be described as low. According to the regulations of the labour code, the regular working time must not exceed 8 hours a day and 40 hours in the

week. In addition to Moldovan public holidays, the employee must be released from work for one day in the week. The claim to holidays for recuperation amounts to at least 28 days per year. Overtime hours on normal working days are remunerated with the factor of 1.5 of the normal rate, work on public holidays with a factor of 2 and overtime on public holidays with a factor of 0.5.

The employment of workers who are not of Moldovan nationality basically depends on the issue of a work permit. Applicants must be in possession of a special visa or a residence permit. A decisive criterion for the issue of a work permit is the possibility of filling the position with a Moldovan employee. There are usually no complications regarding the filling of management posts.

An employment relationship can be ended on the initiative of one of the parties and under certain circumstances regardless of the will of the parties.

Notice of termination is only permissible under certain conditions which are strictly regulated by law, e.g. a lack of qualification for this position, non-compliance of regulations and requirements and legal restructuring of the employer. The notice of termination of an employee must be motivated and made according to legal procedures determined by law. On application of the dismissed employee, a notice of termination made without observation of the stipulated procedure could be interpreted by a court as a ground to rule that the employee be reinstated.

An employee is entitled to give notice of termination of the employment relationship with or without reasons with a period of notice of 14 calendar days.

Income tax

The income of resident and non-resident natural persons and legal entities in Moldova is subject to progressive income tax:

- 7 % of the annual income which does not exceed 25,200 MDL (approx. 1,573 euros),
- 18 % of the annual income above 25,200 MDL.

Income tax is withheld from the gross pay of an employee, whereby the gross pay includes the basic wage, remuneration for overtime hours, additional remuneration, rewards, bonuses and settlements for unused holidays and payments in the form of money or goods and other benefits received from the employer. Income tax is transferred by the employer to the tax office at the same time as the wages are paid.

Sales tax

The basic tax rate amounts to 20 %. The reduced tax rates of 8 %, 6 % and the zero tax rate are valid for delivery and import of certain categories of goods. The reduced tax rate of 8 % is mostly valid for bakery products, dairy products, medicines, sugar, plants and garden products. The reduced tax rate of 6 % is valid for imports and delivery of natural and liquid gas. The zero rate is in particular foreseen for export goods and services. Certain businesses are exempt from sales tax. An exemption means that the sales tax for such businesses is not withheld and that the input tax for such businesses cannot be deducted.

A company is obliged to register as subject to sales tax if within twelve consecutive months it has supplied goods or services to the value of MDL 600.000 (approx. 35,502 euros). A company is entitled to register itself as subject to sales tax when within twelve consecutive months it has supplied goods or services to the value of MDL 100,000 (approx. 5,917 euros).

Special economic zones

In Moldova a special economic zone is a certain part of the area of Moldova where Moldovan and foreign investors can carry out certain activities with certain tax concessions. Goods and services imported into a special economic zone from abroad or from the rest of the Republic of Moldova or exported to outside Moldova from the special economic zone or delivered within the special economic zone are taxed with the sales tax rate of 0 %.

Practical examples

Law

Background facts:

The German X GmbH operates a production facility in Moldova. The local partner would like to "modernise" the plant and requests a bank transfer of 4 million euros to be made from Germany. At the same the X GmbH in Germany carries out restructuring through mergers and consolidation in the group. The partner is not informed in writing but only informed verbally on the fringe of the annual meeting that the "old" shareholder, the X GmbH no longer exists in the same form, but that there is a legal successor. All documents were written from a German perspective without consultation with local lawyers. However, the articles of association foresee that the partner must be notified in writing. The partner who at the same time is the managing director now acts as a sole shareholder and does not approve the changes to the register. He uses the money for his own purposes. He generates fictitious claims, opens insolvency proceedings and thus attempts to take "lawful" control of the whole company.

What can be done now?

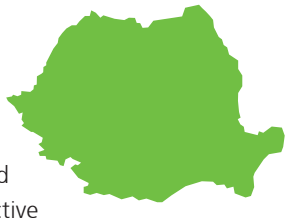
First of all the application of the insolvency proceedings has to be contested. After that an application must be made for a special audit in order to clarify the fictitious claims. In parallel, the authorities must receive notification that no shareholder change has taken place but that the legal successor has stepped in.

What should one have done differently from the beginning?

If a German investor is not sufficiently able to look after a foreign company, it is first necessary to separate the company management and the financial accounting. After that a co-ordination of company documents must take place in order to take into account changes made to the register abroad.


ROMANIA

ROMANIA



The membership of the European Union, the state development plan, the macroeconomic stabilisation, the privatisation program and accelerated economic growth make Romania one of the most attractive and competitive investment locations for all types of services and business areas.

Germany is one of Romania's most important business partners. At the end of 2012 the total level of German investment in Romania was at least 6.5 billion euros (which amounts to 11 % of the total volume of foreign investment). Foreign direct investments in Romania amounted to 2.1 billion euros in 2012. That is a considerable decrease over the last four years. Only in 2008 foreign investments amounted to 9.5 billion euros.

There are currently more than 19,000 German companies in Romania. Germany was one of the most important trading partners of Romania with an export volume of 8.8 billion euros and an import volume of 9.1 billion euros in 2012. A large part of the German investments is made by small companies.

The most important investment areas are the automotive industry, metallurgy, the wholesale trade, construction, manufacturing, plastics, textiles, the retail trade, IT and financial services.

In the first eight months of 2013 foreign direct investments went down. The investment volume decreased by around 36 % compared to the same period in 2012. The investment locations preferred by German investors in Romania are in the northern and western counties where there is easy access to German-speaking workers. Some of the most popular investment areas are manufacturing, construction, building materials and the retail trade.

According to the Romanian regulation no. 122/1990, foreign companies are allowed to found representative offices in Romania. A representative is not an independent legal entity of the parent company, but instead acts with appropriate authorisation in the name of and on behalf of the parent company. A representative office may not achieve turnover, whereby the only source of revenue is through funds transferred to Romania by the parent company in order to cover its local expenses.

A foreign company can exercise its business activities in Romania through a subsidiary or a branch office. While a subsidiary has its own legal personality and is considered to be a Romanian legal entity, the branch office is only an extension of the parent company and therefore has no own legal personality and no financial independence. The new Romanian civil code adopted by law no. 71/2011 foresees in accordance with the usual international practice that the activity of a company is regulated through the founding memorandum of association.

Exemption from double taxation for resident taxpayers is possible due to a tax co-operation agreement. Romania has double taxation agreements with over 80 countries around the world. The majority of these agreements are based on the OECD model agreement in order to avoid double taxation on income and assets.

Many foreign companies have selected Romania for their investment projects and are already benefitting from a wide range of business possibilities such as favourable production conditions, the availability of qualified personnel, the geographical closeness to central Europe and the size of the sales market as second largest country in Eastern Europe. Numerous new studies place Romania among the top 5 European locations for all types of global service activities.

According to the emergency regulation of the Government ordinance no. 34/2006 and the emergency regulation of the Government ordinance no. 54/2006, public work and goods and/or services which are owned by the state or one of its administrative units require a concession. Such concession rights can be acquired through a public tender or through direct negotiations for a time period of up to 49 years. In this time period the recipient of the concession must make investments and cultivate the real estate for which the concession was issued. A concession contract can at the most be extended by up to half of the original contract duration.

In exceptional cases under certain conditions and only for a limited time period the authorities can grant the public interest-oriented legal entity or public services the right to use public property without charges.

Since entry to the EU at the start of 2007, Romania has had access to instruments of the structural and agricultural funds. The structural and agricultural funds from the European Union pursue two linked objectives. The first is to promote the poorer regions of Europe and the second is to support the integration of the European infrastructure in particular in the area of transport.

Activities which can be promoted by EU funds include the acquisition of fixed assets (buildings, plants), the acquisition of intangible assets (patents, brands and know-how), research and development, IT development, human resources, participation at trade fairs and exhibitions and the standardisation and certification von companies.

Recent studies indicate that the outsourcing of certain activities to local business process outsourcing (BPO) companies represents a successful business strategy for investors in Romania because the local workers are well familiar with the local conditions, have the required skills

and language knowledge, and are easily accessible. Since personnel are one of the most important factors for a successful business development, the shortage of qualified skilled workers is the biggest challenge for the foreign investor. This is particularly true for German companies which build their success on highly qualified and well educated personnel.

In order to compensate for this weakness, German companies fall back on local dual systems – an efficient method to combine theory and practice. This procedure is supported from the start by Rödl & Partner Romania as we have correctly identified the trend for the coming years and given young people with theoretical education but without work experience the possibility of applying their knowledge in professional practice.

Legal forms of business and founding of a company

The regulated legal forms existing in Romania are comparable with those in Germany. The legal forms defined by law are the company with limited liability (Societate cu raspundere limitata, S.R.L.), the joint stock company (Societate pe actiuni, S.A.), the general partnership (Societate in nume colectiv, S.N.C.), the limited partnership (Societate in comandita simpla S.C.S.) and the limited partnership with shares (Societate in comandita pe actiuni, S.C.A.). The trading companies named above are legal entities and acquire their legal capacity only after they have been registered in the commercial register. In terms of tax treatment no differentiation is made for Romanian trading companies between partnerships and joint stock companies. For this reason the company with limited liability (SRL) is preferred by foreign investors in Romania.

The company with limited liability (Societatea cu răspundere limitată - SRL)

In practice, this company form is the most common legal form for smaller and medium-sized foreign investors. An SRL may acquire own rights and obligations and its own assets. Acquisition of land by the new company is only possible after the registration of the subsidiary with the appropriate commercial registry office. An SRL may have a maximum of 50 shareholders. The shareholders may be Romanian or also foreign natural persons and/or legal entities. The minimum share capital of the SRL amounts to RON 200 (approx. 45 euros). The capital must be divided into company shares with the same money value which must not be less than the amount of RON 10. The share capital of the SRL must be fully paid in for the founding of the company. The contributions of the shareholders may also be made to a limited extent through assets in kind. Services in the form of work are not permissible as a contribution. The company shares can usually be transferred to co shareholders without restriction. The transfer of shares to third parties requires a three quarters majority, whereby the right of first refusal for the co-shareholders is regulated by the memorandum of association. An SRL is founded by the memorandum and articles of association. The

liability risk of shareholders is in principle limited to the assets of the SRL. A personal liability of shareholders is excluded in principle. The shareholders are liable only for the amount of the paid-in company capital. The company acts as a legal entity through the organs of the shareholders' meeting and the managing director or managing directors. As a result of the authority granted to managing directors by the shareholders through the memorandum of association or through shareholder resolutions, the managing directors take on liability, whereby non-compliance can have a significant negative on their assets, or, in individual cases on their freedom. In principle, the managing directors are liable for the fulfilment of all obligations which are legally determined or listed in the memorandum of association. The founding of a sole trader SRL by a natural or legal entity is permissible provided the sole trader SRL is not a shareholder of a second sole trader SRL (so-called two-layer sole trader SRL). A natural or legal entity may only be a sole shareholder of a single SRL.

The joint stock company (Societatea pe acțiuni – SA)

The Romanian SA is comparable to the German joint stock company (AG). The founding of an SA must be made by at least two natural persons or legal entities. If the number of shareholders is below the minimum number over a time period of nine months, any interested party can apply to the court to dissolve the company. The minimum share capital of a Romanian joint stock company amounts to at least RON 90,000 (approx. 20,500 euros). For the founding of the company at least 30 % of the subscribed share capital must be paid in in cash or assets in kind. The remaining cash contributions must be contributed within twelve months after registration of the company in the commercial register and the remaining assets in kind within two years. Regarding the management of an SA a choice can be made between the two systems of the uniform system and the dual system. In the memorandum of association one of the two systems must be defined. The responsibility for the company management can be changed at any time by a resolution of the general meeting. The uniform system consists of a board of managing directors (Consiliul de administrație) and the dual system consists of the executive board (Directoratul) and the supervisory board (Consiliul de supraveghere). The dual system corresponds to the German legal regulations regarding the administration of a joint stock company consisting of an executive board and a supervisory board. The shareholders are only liable to half of the amount of their subscribed company capital.

The general partnership (Societatea în nume colectiv – SNC)

The founding of an SNC must be made by at least two natural persons or legal entities. It mainly corresponds to the concept of the German open trading company (OHG). The founding of an SNC does not require a minimum amount of share capital. The shareholders can be natural persons or legal entities. The shareholders assume unlimited liability with their private

assets for all obligations and company debts. The contributions of the shareholders can also be paid in to a limited extent with assets in kind. Services in the form of work may only count as a contribution under certain conditions.

The limited partnership with shares (Societate în comandită pe acțiuni – SCA)

The founding of an SCA must be made with at least five natural persons or legal entities. The minimum share capital amounts to RON 90,000 (approx. 20,500 euros) and is divided into shares.

The limited partnership (Societatea în comandită simplă – SCS)

The limited partnership corresponds to the concept of the German limited partnership (KG). In a way similar to German law, it has one or more limited partners whose personal liability is respectively limited to the amount of the contribution and who are not actively involved in the company management. A minimum amount of share capital is not required for the founding of an SCS.

Liquidation of the company

It is possible to legally dissolve a trading company when the previously defined contract duration has ended, when the agreed company purpose has been reached or is impossible to reach, or due to the nullity of the company or the opening of insolvency proceedings over the assets of the company or one of its shareholders. The liquidation of the company can also be made voluntarily through a shareholders' resolution. Furthermore, the dissolving of a company can be ordered by a court if the company has no management bodies, if no registration is determined or if the capital contributions are not paid in. A particular reason to dissolve a joint stock company is represented by non compliance with the legally required minimum number of two shareholders through notice of termination, death or incapacity of a shareholder.

Foreign exchange law

Foreign exchange transactions are regulated by the national bank of Romania (BNR). The deposits or foreign exchange revenues as a result of the proceeds of sales of goods, services and work may only be carried out in the national currency (RON), whereby as a general rule amounts in euros are contractually regulated in euros as a benchmark. Foreign natural und legal entities may maintain foreign exchanges in RON or foreign currencies and transfer dividends, revenues from the sale of company shareholding or shares abroad without restrictions.

Real estate and acquisition of land

As from January 1, 2014 the Romanian legal regulations allow foreign natural persons and legal entities to acquire agricultural areas. However, until today an indirect acquisition of any real estate property was possible by foreign legal entities through the founding of a Romanian company. This also applies when the company is exclusively in foreign hands. At the present time there is a draft legislation which is designed to limit the acquisition of agricultural land by foreign private persons.

Labour law and dismissal protection

The Romanian labour law is characterised by numerous legal regulations. The contractual freedom of the parties in the negotiation of the individual employment contracts is restricted by a series of rules providing protection for employees. The employment contract must be registered online one day before the start of the employment at the appropriate employment office. The employer is obliged to draft an employment contract in writing. The obligation of a formulation in writing is also valid for changes or additions to the employment contract. The legal working time amounts to 8 hours per day and 40 hours per week, whereby there is an upper limit of 48 hours. The minimum amount of holidays defined by law is 20 working days, whereby the usual market rate of 21 working days should be observed. The remuneration in Romania is defined by the employment contract and/or tariff agreements, whereby the agreed wages may not fall below the legally defined minimum wage.

The gross minimum wage for the year 2014 amounts to RON 850. From July 1, 2014 the amount of the gross minimum wage will be increased to RON 900. A company founded according to Romanian law is obliged to pay the wages in Romanian Leu (RON), although the wages can also be specified in a foreign currency. Furthermore, it is possible to arrange the remuneration of an employee as a salary plus performance-linked components. Special payments can also be made in the form of food vouchers by the employer. The notice of termination of an employment contract must be made in writing with a period of notice of at least 20 working days or 45 working days for management personnel. Notice of termination made by the employer is bound to strict conditions and the decision for termination must be in a special form and have certain characteristics. During the trial period the employment contract can be cancelled without notice by both parties in a written notification.

Practical examples

Auditing

Background facts:

A branch office of a company from Germany operates in Romania in the field of the retail trade. Due to the field of activity (small products with a high value), unusable products are often discovered.

From a financial accounting point of view, the company has decided to write off these products without debiting the employee for the current value as required by law.

The company separately stores a significant quantity/value of products which cannot be sold. These cannot be disposed of because the sales manager has not yet given authorisation and if a product is missed during the counting, the storekeeper is deemed guilty for the missing value.

What can be done now?

The auditing assistant from Rödl & Partner who participated in the inventory determined that according to environmental law the company must pay for the costs because the company treated the unusable products as household waste.

After an analysis of the working papers in the area of inventories, in his management letter the auditor from Rödl & Partner recommended to the company to conclude a contract with a recycling company able to legally remove the unusable products from the economy cycle.

This decision in turn resulted in a change to the tax treatment because the influence on sales tax and on the profit/loss was therefore considerable. The "household waste" goods which originally were labelled as "missing" in the inventory, were changed into a "deductible expense" and the "acquired input tax", the profit tax and the cash flow of the company were positively influenced by this change.

This also removed the risk of a penalty for non-compliance of the environmental protection regulations, which in Romania can be substantial.

What should one have done differently from the beginning?

The managing director should have informed the financial accounting department as to how to treat the unusable products and on the other hand the financial accounting department should have informed the managing director about the environmental risks (with a high risk of a penalty). In this way the administrator could have benefited from this "fine-tuning" if the corresponding measures had been implemented.

In addition to the audit report regarding the audit of the annual financial statement one should pay particular attention to the management letter.

Auditing

Background facts:

A Romanian company with foreign share capital has a natural person from Switzerland and company from Germany as shareholders. The field of activity of the company is trading with cereals and seeds. The facts shown below are the result of the audit of the annual financial statement for the current year which was carried out by the auditing department of Rödl & Partner Audit in Romania. The company was not audited by us or by a different auditor in the previous year.

The auditor from the auditing department of Rödl & Partner was presented with the annual financial statement of the previous year together with the proof of submission of the annual financial statement to the financial authorities. The annual result of 1.5 million RON corresponds to the profit/loss carried forward in the list of balances and accounts of the current year.

The draft of the annual financial statement, the basis for the annual audit, was made available to the auditors from Rödl & Partner by the company and recorded a result of the previous

year of 1.5 million RON, identical with the result from the list of balances and accounts of the previous year.

In the annual financial statement of the previous year which Rödl & Partner received from the company before its official disclosure, the result of the previous year was recorded as 950,000 RON and was therefore different to the result of the draft of the audited annual financial statement and the official data from the website of the financial authorities.

What can be done now?

An audit was made of the financial statement of the previous year with the list of balances and accounts (the original balances of the current year) and of the data from the website of the financial authorities which had received the annual financial statement of the company.

It was established that the responsible person for financial accounting of the company had intentionally provided Rödl & Partner with incorrect results and two different results of the previous years. The retained income from the list of balances and accounts of the current year of 1.5 million RON was different to the result at the financial authorities (950,000 RON). Rödl & Partner had no possibility of auditing and confirming the original balances of the current year through alternative audit actions and in this case did not issue an unqualified audit opinion.

Rödl & Partner Audit recommended that the company management should enter into a contract with a financial accounting firm.

What should one have done differently from the beginning?

The financial accounting department should have informed the company management about the disclosure of the incorrect results on the website of the financial authorities and the complete and correct representation of the financial results of the company. The company management, however, was incorrectly informed about the result of the previous year.

Even though the auditing department of Rödl & Partner as auditor was not able to issue an unqualified audit opinion, the company now has professional financial accounting services and data which completely and correctly represents the financial results of the company.

Tax Consulting

Background facts:

A Romanian company ROM operates in the area of processing metal products and acquired goods from the Swiss parent company CH. The transport was made in the name of and at the cost of CH. The release of the goods into free circulation was made either in Austria or Romania itself.

As far as the import process took place in Austria, a transportation company acted as fiscal representative for the Swiss company CH. The further transport from Austria to Romania was declared as an intra-community supply of goods from CH in Austria. As far as the import process took place in Romania, the customs declarations were made by the Romanian company.

However, ROM did not maintain proper records of which deliveries were to be assessed as an intra-community acquisition and which deliveries were to be assessed as an import. Furthermore, a number of invoices and documents were mislaid. A rough examination clearly indicated that a part of intra-community acquisitions were declared in Romania as imports in the sales tax return.

Due to the fact that the ROM company was insecure about how many of the declarations had to be corrected, the company contacted the experts of Rödl & Partner.

What can be done now?

The tax consultants of Rödl & Partner worked together with representatives of the financial accounting departments of der Romanian and Swiss company to examine the documents and the transactions and established that from the point of view of the CH company through their fiscal representative in Austria approx. 20 % of the declarations concerning the acquisitions should have been declared as intra-community acquisition of goods by CH using the intra-community tax code of Austria. As a result it is necessary to submit corrected sales tax returns and also corrected summarising information and intrastate declarations.

ROM corrected the declarations accordingly as it is not sufficient merely to take action to avoid such errors in future.

The likelihood of the Romanian financial authorities taking action in such cases is very high. According to the prevailing legal regulations in Romania, the non-submission of the corrected

declarations regarding the acquisitions or the submission of incorrect amounts leads to very high financial penalties. Such a case can also lead to proceedings for tax evasion which is not only punished by financial penalties but also punishable by imprisonment.

What should one have done differently from the beginning?

The intra-community sales tax regulations are a sensitive subject and require competent consultation. If at the start ROM had sought consultation from Rödl & Partner or had commissioned Rödl & Partner to manage the financial accounting, the effects of the post declarations could have been avoided.

Law

Background facts:

The German company X GmbH would like to found a sole trader GmbH in Romania. The sole shareholder of X GmbH is a German legal entity. The necessary constitutional documents were submitted to the responsible commercial registry office. As the parent company, the X GmbH, is a sole trader and holds 100 % of the shares to be founded, the application to register the Romanian sole trader GmbH was rejected. The parent company X GmbH was not aware that the founding of a Romanian sole trader GmbH has to be adjusted to the two-layer principle.

What can be done now?

With the founding of a Romanian sole trader SRL certain legal restrictions have to be taken into account with regard to the shareholders. It should be observed that the application documents are complete and in compliance with the Romanian legal regulations. For the founding of a Romanian sole trader special attention is given to the sole shareholder. In this context it must be taken into account that a sole trader SRL cannot be a shareholder of a second sole trader.

This general restriction is valid regardless of whether the shareholder is a Romanian or a foreign legal entity (i.e. the prohibition is valid for Romanian and also, for example, at German company level). The non-observance of the above-mentioned legal conditions regarding shareholders can lead to the penalty of having the application refused or lead to a forced dissolution of the SRL. Furthermore, a natural or legal entity can only be a sole shareholder with a single SRL.

In practice, as a possible solution to manage this legal restriction, a foreign sole trader is selected as a shareholder of a Romanian SRL who has 99 % of the share capital and in addition a foreign natural person or legal entity selected with a minimum holding of 1 % (or even 0.1 %) of the share capital. The minimum holding can, for example, be taken over by a managing director of the SRL in trust.

What should one have done differently from the beginning?

The founding of a company in Romania is governed by legal regulations which have to be discussed and taken into account beforehand with the preparation of the necessary documents. We therefore recommend that before a Romanian company is founded an exact examination is made of the local legal conditions and the shareholder structure of the foreign shareholders.


RUSSIA

RUSSIA

Russia is one of the most important trading partners of Germany. In the first eight months of 2013, the volume of trade between the two countries amounted to more than 36 billion euros. In the first half of the year, the scope of the German investment in Russia amounted to more than 15 million euros, of which more than eight million euros was for direct investments. According to figures from December 2013, the gross domestic product against expectations only grew by 1.4 %. However, due to its size and the potential for development for foreign investors the Russian market remains lucrative. The country is continually improving the investment and legal conditions for business operations.

The dismantling of bureaucracy and the fight against corruption are being pushed. As a result, in the "Doing Business Report 2014" of the World Bank, in just one year Russia climbed up 19 positions to reach position 92 from a total of 189 and therefore leads the BRIC states. In addition, the political situation in Russia is stable. In total this creates positive prospects for foreign investors. More than 6,000 German companies are already doing business in Russia via representative offices, subsidiaries or own branch offices.

Legal forms of business and founding a company

Russian corporate law is comparable to German corporate law. There is a range of legal forms which are essentially similar to the German legal forms.

Joint stock companies

Company with limited liability (OOO)

Most investors prefer a company with limited liability (OOO) which is very similar to the German GmbH. The OOO is able to acquire and transfer rights to real estate and can become a party to legal proceedings. Personal liability of the shareholders exists only in the case that the shareholding held is not fully paid up and is limited to the outstanding amount.

In order to found an OOO the decision of the shareholder to found the company and the articles of association are required. The registration of the founding is made by the tax authorities which are responsible for the maintenance of the register of the legal entities (commercial register) and for the issue of the tax number. In order to register an OOO which was founded by one or more foreign companies the presentation of the extract from the commercial register with apostille about the founders is required.

The company acts as a legal entity through its bodies of the managing director and the shareholders' meeting. The minimum share capital amounts to 10,000 roubles (approx. 230 euros). In order to benefit from the advantages of the German-Russian double taxation agreement, a share capital of 80,000 roubles is recommended.

Joint stock companies

Russian law has two forms of joint stock companies – the open joint stock company (OAO) and the closed joint stock company (ZAO). The closed joint stock company is comparable to a small German AG. The open joint stock company is conceived as a big investment project. The form is recommended when a public offering is planned. For closed joint stock companies the number of shareholders is limited to a maximum of 50. The share capital of a closed joint stock company requires the minimum amount of approx. 80,000 roubles (approx. 1,800 euros) and for an open joint stock company the minimum amount is 800,000 roubles (approx. 18,000 euros). The shareholders of a closed joint stock company have the right of first refusal to acquire the shares of the other shareholders.

Economic partnership

One year ago a new form of joint stock company was created, the economic partnership company. The legislator is of the opinion that this form is particularly suitable for joint ventures between Russian and foreign investors. The legal basis orients to the regulations of the American limited liability company or the British limited liability partnership or the German limited partnership with shares. The adoption of these regulations should enable the necessary flexibility which international investors expect. Shareholders are entitled to be actively involved in the administration of the economic partnership company. There is no legally required minimum share capital. The shareholders are free to define the time limits, the amounts and the type of the contributions to the capital.

Business partnerships

Business partnerships are defined by law, but the practical importance of this form is minimal. The business partnerships mainly correspond to the German forms of the open trading company ("partnership" in Russian) and the limited partnership.

Liquidation of a company

The company can be dissolved through the expiry of a period agreed by contract, through the establishment of insolvency or through a corresponding shareholders' resolution. Furthermore, the liquidation of a company can be ordered if no tax returns are submitted within a period of one year.

Before liquidation takes place, an obligatory tax and social security audit is carried out. Depending on the location of the company, the liquidation process can take from 10 to 16 months.

Labour law and dismissal protection

The similarity between Russian and German labour law is limited to some basic structures. Russian labour law is characterised by its bureaucratic approach. Historically, in term of the law the employee protection is very strong.

Foreigners can be employed in Russia provided they are in possession of the corresponding residence and work permits. If the foreigner is employed as a so-called highly-qualified specialist, the procedure to obtain a work permit is much simpler. The definition of a highly qualified specialist is someone with an income of over two million roubles per year.

The regular working time amounts to 40 hours per week or 8 hours per working day with a five day working week. Overtime hours are only possible with the approval in writing of the employee which cannot be given in advance, i.e. in the employment contract. The wage has to be paid twice per month in roubles. The legally required minimum holiday days amount to 28 calendar days. At least one part of the holiday must be for a continuous period of 14 calendar days.

The maximum time for the trial period is three months for management personnel and six months for the company management. In contrast to German law, the employer must present the reasons for termination of employment during the trial period. Therefore it is recommendable to carefully consider the rules governing trial periods and in particular for management personnel.

There is also dismissal protection for management personnel and the company management. The notice of termination by the employer in the form common in Germany is seldom used in Russia. From a formal point of view, Russian law poses considerable challenges for notice of termination by the employer. Even small errors in the termination process regularly lead to the ineffectiveness of the dismissal. Employers are therefore forced to strive to achieve a consensual ending of the employment relationship with the payment of a settlement.

Company management

The company management of the joint stock companies is usually carried out by the general director. The general director is a single body of the company management. He represents the company by himself without external power of attorney, manages transactions and remits instructions which are binding for all employees. The general director has to represent the company by law to the best of his knowledge and conscience. He must replace all damages to the company for which he is responsible.

The representative powers of the general director can be limited by the articles of association of the company and/or through the contract of employment. Business partners are obliged to take note of the articles of association of the company, the tax number and the registration certificate of the company with the first conclusion of transactions. In practice only a few people observe this rule.

Experience shows that many German companies neglect to effectively monitor the activity of the general director. One of the typical results of this neglect is the misappropriation of the assets of the Russian subsidiary company. This happens frequently through the assumption of fictitious liabilities owed to letter-box companies.

A number of German companies try to find a remedy for their distrust of the Russian general director by significantly limiting the authority of the general director in the articles of association and/or employment contract. These restrictions, however, can strongly compromise the ability of the company to act. For example, for tenders from companies run by the state the future business partner will not want to wait for the approval of the shareholders as stipulated in the articles of association and simply decide not to participate in the tendering process.

Russian law also has no knowledge of the dual control principle used in Germany. The appointment of several persons to be managing directors and the granting of power of attorney is not possible. For this reason a balanced system for powers of authority and control mechanisms for Russian companies is absolutely necessary.

Under Russian law the general director is accorded the status of an employee and therefore he is also covered by dismissal protection. Although notice of termination is possible at any time through a shareholders' resolution, the termination is linked to the payment of a settlement to the amount of at least three months' salary. The separation between the position of the general director in respect of corporate law and his protection as an employee in Russia has not been clearly made. The protection of the general director as an employee leads to the situation that in the case of an ineffective notice of termination he can also regain his position in respect

of corporate law. This could have fatal consequences for the company. For this reason a notice of termination of a general director should be planned in advance and implemented carefully.

Foreign exchange law

Russian foreign exchange law is very strict and formal. The control functions are taken up by the central bank of the Russian Federation and the banks where accounts are maintained. Payments between residents in Russia in foreign currencies are prohibited. However, legal entities and natural persons can acquire foreign currencies without limitation. In order to prevent own liability against the central bank, the banks often demand excessive and sometimes unjustified requirements regarding the arrangement of the legal relationship between the resident maintaining an account at the bank and his foreign business partner. The banks frequently disregard the fact that a contract is subject to a different legal jurisdiction and demand the fulfilment of the formalities which Russian contract law foresees for Russian contracts. For exchange controls one has to have some degree of patience and assume that each case is an individual case.

Professional access, permission for certain types of entrepreneurial activity

The access to a number of types of entrepreneurial activity necessitates a respective permission. This includes, for example, activities in the banking and insurance sectors and in telecommunications. The conditions to access these fields of activity are either regulated by authorisation for certain entrepreneurial activities required by law or regulated in specialist laws such as the law concerning the insurance sector. Access to a number of fields of activity is only possible with membership of a self-regulatory body (a kind of professional association). This is, for example, valid for the construction industry.

Protection of intellectual property

In Russia the protection of intellectual property is increasingly more important. The regulations governing intellectual property and its protection are codified and mainly correspond to the standards existing in Germany since Russia is a member of the international convention in the field of intellectual property and commercial legal protection.

Auditing

The conclusion of a contract with the auditor and the amount of his fee, which depends in particular on the legal form of the company to be audited, has to be approved by the founders/

shareholders. The auditor can also be appointed for a period of several years. The amount of the auditor's fee is not regulated by law. An audit of the annual financial statements is mandatory where certain criteria are satisfied and in particular it is mandatory for enterprises and bodies corporate with a turnover of over RUB 400 million for the previous financial year or with total assets of over RUB 60 million as of the previous balance sheet date. Therefore if either of the above threshold levels is exceeded in a financial year, the company becomes obliged to undergo an audit for the next year - but not for the year in which the threshold level has been exceeded. Furthermore the obligation to undergo an audit extends to all companies in certain legal forms, irrespective of whether they have or have not exceeded the above levels; this category includes in particular all open joint stock companies, banks and other lending institutions, insurance companies and stock exchanges.

Income tax

The income tax rate amounts to 13 % for residents and persons residing in Russia for longer than 183 days in the year. A tax rate of 30 % is valid for non-residents. Highly-qualified specialists are treated as residents right from the start.

Sales tax

Sales tax law in Russia is comparable to sales tax law in Germany. The sales tax rate amounts to 18 %. For some foods and children's goods a tax rate of 10 % is valid. The tax rate applicable for the export of goods is 0 %. However, for this tax rate the exporter is subject to higher documentary requirements from the tax authorities and proof must be provided. The sales tax return must be submitted on a quarterly basis by day 20 of the successive month after the end of the respective quarter.

Profit tax

The profit tax which is roughly comparable to corporation tax in Germany is calculated at a flat rate of 20 % on the profit of the company.

Wealth tax

The wealth tax is a Russian particularity. This tax has to be paid by companies which own real estate and/or movables acquired before January 1, 2013. The amount of the tax rate is defined at a regional level by the subjects of the Russian Federation (comparable to the federal states in Germany). The maximum tax rate amounts to 2.2 % of the average annual value of the available assets of the company. The tax is paid on a quarterly basis.

Practical examples

Law

Background facts:

In 2006, given the structural difficulties in Russia the German R Group decided to acquire the company of its distributor, the S-W. Bau OOO in order to secure the sales of its goods manufactured in Germany. The former general director and sole shareholder of the S-W. Bau OOO is appointed general director of the acquired company. A comprehensive due diligence was dispensed with. The head of the financial accounting department and all other management personnel (director of warehousing and logistics, sales manager, finance director) remain in their positions or are appointed by the general director.

The auditing firm was also appointed on the recommendation of the general director. Although the newly established company recorded a regular increase in turnover, the profit margin steadily decreased. The general director explained the situation with the particularities of business life in Russia, i.e. bribery payments, corruption, theft. The controlling was limited to the analysis of the information supplied by the Russian financial accounting department in the form of Excel charts.

Rödl & Partner was commissioned to investigate and determined that the general director had systematically caused a considerable financial loss to the company through fictitious contracts/invoices, through excessive prices paid to service providers and through the sale of company assets at very low prices.

What can be done now?

As far as being of economic importance, the transactions of the company can be contested. Furthermore, criminal charges should be brought against the general director. Under consideration of the new jurisdiction of the supreme economic court, compensation can be claimed from the general director.

What should one have done differently from the beginning?

A series of measures could have prevented the situation. These would have included a comprehensive due diligence carried out beforehand to reveal the conditions in the company. Furthermore, the replacement of old personnel loyal to the general director would have been advisable. In particular, the further employment of the head of the financial accounting department turned out to be an error. The parent company should be more closely involved with the selection and taking on of employees. There should also have been better integration of the company into the group structure and a continual, professional analysis of the business processes in the subsidiary. Especially at the beginning a high degree of control is recommendable. Instead of relying on the statement that in Russia nothing works without bribery, the experts at Rödl & Partner advise implementation of a specially written compliance system for the Russian company and its strict implementation.

Auditing

Background facts:

A company from Germany founded a subsidiary in the form of an OOO in Russia with the company purpose of distributing equipment to end customers in Russia. In this process the parent company in Germany defines a certain purchase price, but the subsidiary decides at its discretion about the amount of the sales price. Due to discounts or clearance sales in Germany the goods can be procured to some extent at more favourable prices. In principle, the sales price is derived from the usual price lists or due to marketing or loyalty programs reduced across the board and respectively contractually agreed.

In the course of our audits we determined a decrease in sales which deviated considerably from the normal case. The goods purchased cheaply in Germany were indeed being sold with a small mark-up, but sold much cheaper than stated in the price lists to only a single customer. The one-sided preferential treatment for this customer could not be objectively understood and was not explained in the course of our audit.

In order to avoid tax penalties the OOO made a fictitious profit and turnover taxation to the amount of the margin between the actual sales price and the sales price on the price lists. The fictitious retroactive taxation, however, led to an operating loss. In terms of the financial accounting there was at first nothing to query, but the customer nevertheless commissioned us to examine the background of this unusual business situation in greater detail.

What can be done now?

The company figures of the customer did not allow conclusions to be drawn on transactions between affiliated persons/companies. Despite this a plausible explanation had to be found for this unusual business situation. After an inspection of the shareholders, the customer, the managing director and the management personnel, the auditors from Rödl & Partner became aware of activities of the management personnel and connections in the wider social environment of the favoured customer which raised questions concerning compliance. In the circumstances of the case, the management personnel and the managing director of the company receiving one sided preferential treatment held shares in a common OOO. After questioning the parent company it was not possible to accuse the general director or the CFO of unlawful conduct as they were able to determine the sales prices by themselves, the financial accounting was made accordingly and even shareholdings in a competitor are not prohibited under employment contract law. The parent company now had to make a decision to dismiss the management personnel thereby jeopardising the existing business contacts and risk a decrease in business activity, or continue as before with an operating loss.

What should one have done differently from the beginning?

Under consideration of the legally stipulated freedom of action for the managing director, an exact definition of his authority in the employment contract is of key importance in order to prevent misuse and non-compliance. In the circumstances of the case this could be limited by an exclusion clause in the employment contract which prohibits all forms of competition or co operation with customers. As regards the infringement, binding penalties should be foreseen or such an infringement named as a reason to terminate the employment contract. It is also possible to agree a statement of commitment, whereby shareholdings in other companies of more than 5 % or other activities as an employee must be disclosed to the parent company.

Taxes

Background facts:

A company based in Austria delivered a production line to the value of 90 million euros to Siberia. In this process there was no contractual price separation between the supplier components and the local service components (supervision, consultation and service). The customs duties charged to the buyer of the production line and import sales tax also related to the full sum without differentiation being made of the individual service elements.

In addition, it was not taken into account that among other things according to the regulations of the Russian tax code the execution of certain services are subject to registration for tax and this could lead to the founding of a branch office which in the Russian Federation is subject to a limited tax on profits.

The company had not registered with the tax authorities and neither profit tax returns nor sales tax returns were submitted. Furthermore, Russian subcontractors were partly used for the local services for which Russian sales tax was paid but input tax was not deducted. The tax authorities now assessed the contract partner of the company (here due to the absence of a tax registration the reverse charge method was used) liable for sales tax for the local service components, which the contract partner planned to "transfer" to the Austrian company and as a result the tax authorities treated the Austrian company as if it had founded a branch office, whereby the profit tax for the service performed locally was re-calculated.

Due to a lack of transparent contract design, the basis for the adjusted taxation was an estimate. In addition, the tax authorities decided on penalties and interest on arrears.

What can be done now?

In the investigation, Rödl & Partner firstly carried out a tax assessment. Due to the lack of transparent contract design the tax authorities were given an especially wide range of discretion. The creation of respective documentation enabled the successful separation of the individual services and separate tax treatment which led to the lowering of the tax basis for assessment. The company nevertheless suffered a financial loss in the millions as profit tax had to be paid and in addition interest and penalties accrued due to the non declaration. The associated financial cost and loss of time could, however, have been avoided with simple measures.

What should one have done differently from the beginning?

It is particularly important with the execution of cross-border deliveries with local (Russian) service components to always take care to clearly differentiate between the individual service components in the contract design (delivery and local service). A transparent contract situation and detailed description of the individual services also enables a better estimation of the branch office risk. Furthermore, the obligation to register for tax should be observed for foreign companies operating in the territory of the Russian Federation. If the obligation to register is not observed, penalties may well be served. In addition, the scope of the used subcontractors should be estimated as the possible associated input tax deduction can in individual cases reach a substantial amount but the entitlement to deduct input tax depends, among other things, on the tax registration in the Russian Federation.

Law
Parent guarantor

Background facts:

A successful company from Germany would like to help its new subsidiary on the Russian market to win a number of contracts. In order to do this, the company declares itself willing to stand as guarantor for the subsidiary with regard to potential orders with Russian customers. The Russian subsidiary is given the job of creating the guarantee contracts. However, in order to save time the subsidiary uses standard contracts from the internet. When at some point the subsidiary company does not pay, the business partner takes up direct contact with the parent company and demands the payment of the outstanding claims. However, the parent company is of the opinion that the payment obligation of the parent company is first valid when its subsidiary has no more liquidity at its disposal.

What can be done now?

In contrast to German law, Russian law does not recognise the defence of unexhausted remedies in connection with guarantee contracts. Under Russian law the guarantor is jointly liable with the principal debtor. Accordingly, in case of default the creditors can demand the fulfilment of the obligation from the debtor and also from the guarantor itself. In order to avoid the joint liability, the parties can agree on secondary liability of the guarantor to the creditor which corresponds to the defence of unexhausted remedies. In the circumstances of the case the experts from Rödl & Partner were successfully able to contest the contract as it contained both arrangements.

What should one have done differently from the beginning?

At the contractual level there is the option to select jurisdiction which best represents the interests of the parties. Although in particular the law on guarantees is very similar in both legal systems, the emphasis is from a different point of view. Russian law sees its priority in the protection of creditors. German law on the other hand protects the guarantor. If the legal position is known it is possible regardless of the choice of law to design contracts individually such that the interests of all involved are addressed. The experts at Rödl & Partner therefore recommend that clients obtain professional advice in connection with international security arrangements.

Law
Reservation of title

Background facts:

A German company which is a manufacturer of high quality oil filters for trucks concludes a long-term delivery contract with a Russian forwarding agent with intensive operations in the Siberian city of Novosibirsk. The parties agree on the application of German law and a court of jurisdiction in Novosibirsk. In addition, the contract includes reservation of title until payment of the complete purchase price has been made to the German company. The business relationship runs for years without any problems. Due to a very severe winter a number of vehicles cannot be used because of failing oil filters. After that the forwarding agent refuses to pay. In response the German company invokes his reservation of title and now requires the handing over of its oil filters. However, the purchaser refuses this with the statement that the reservation of title according to German law does not apply under Russian law.

What can be done now?

Unfortunately, the claim of the purchaser is not entirely incorrect. Although Russian law also foresees reservation of tile, this can only seldom be enforced according to foreign law. It is therefore questionable whether a Russian court would approve the reservation of title. The experts at Rödl & Partner in this case therefore advised the direct assertion of claims from the purchase contract. Using the available documentation they were subsequently successful in determining and enforcing the claim to the purchase price at the competent court.

What should one have done differently from the beginning?

In the beginning one should have collected information concerning the effectiveness of German security interests abroad. Unfortunately, not all rights can be enforced outside Germany. However, there are always a number of possibilities to secure entitlements. In the circumstances of the case a surety from a German or Russian bank could minimise the risk. In addition, it might be possible to agree to a reservation of title according to Russian law, whereby here it is necessary to obtain expert help in order to ensure an effective formulation of the corresponding contract clause.

Law
Court of jurisdiction

Background facts:

A German entrepreneur manufactures ironmongery for the wholesale market and would now like to supply different customers on the Russian market. However, he is very sceptical about the Russian courts. Accordingly, he would like to have the contracts for his foreign activities subject to the jurisdiction of the German courts. He therefore changes his general terms of business slightly and declares that the court of jurisdiction is in Germany.

What can be done now?

In particular with cross-border relationships there are formal and procedural pitfalls which should be avoided. A corresponding agreement has not been concluded between Germany and Russia for the recognition and enforcement of court rulings. The result is that in principle German court rulings cannot be enforced in Russia. In the circumstances of the case the German court of jurisdiction would even have been a hindrance for the German entrepreneur because on the one hand court rulings could be enforced against him but he on the other hand could not have enforced rulings from Germany in Russia. He could only take hold of the German assets of the company, although this seldom exists. In this case the better choice for the German entrepreneur would have been a court of jurisdiction in Russia.

What should one have done differently from the beginning?

In general there is the option of integrating an arbitration clause in the contract. The advantage of such a clause is that the rulings of the arbitration court can be enforced at an international level when these are recognised by countries which have signed the New York convention. Germany and Russia are both members of the convention. However, for the effectiveness of the arbitration clause, the court should be clearly named. This type of court also offers the possibility of determining the process and arrangement of such proceedings oneself. This corresponds to common practice and serves the interests of both parties.

Administration

Background facts:

A Russian subsidiary is financed by the German parent company for more than two and a half years. In this time period more than 500,000 euros were made available for this purpose. In the process the general director was not carefully selected and at the same time given a 3 % shareholding in the subsidiary which later turned out to be a serious error. The question of the internal and external financial accounting of the Russian subsidiary was also left completely in the hands of the general director without the inclusion of any special control mechanisms. The managing director employed an external employee known to him to handle the financial accounting who was only allowed to act on the personal instructions of the managing director. For two and half years the German parent company waited in vain for traceable reporting from its Russian subsidiary. Requests to present the current reporting were ignored by the Russian general director and his trusted financial accounting employee. The parent company therefore had no overview of the entrepreneurial activities of its subsidiary. Instead, after a period of time had elapsed, the Russian general director demanded even more money to finance the company.

However, as the activity of the general director no longer inspired confidence, a decision was taken to liquidate the subsidiary.

What can be done now?

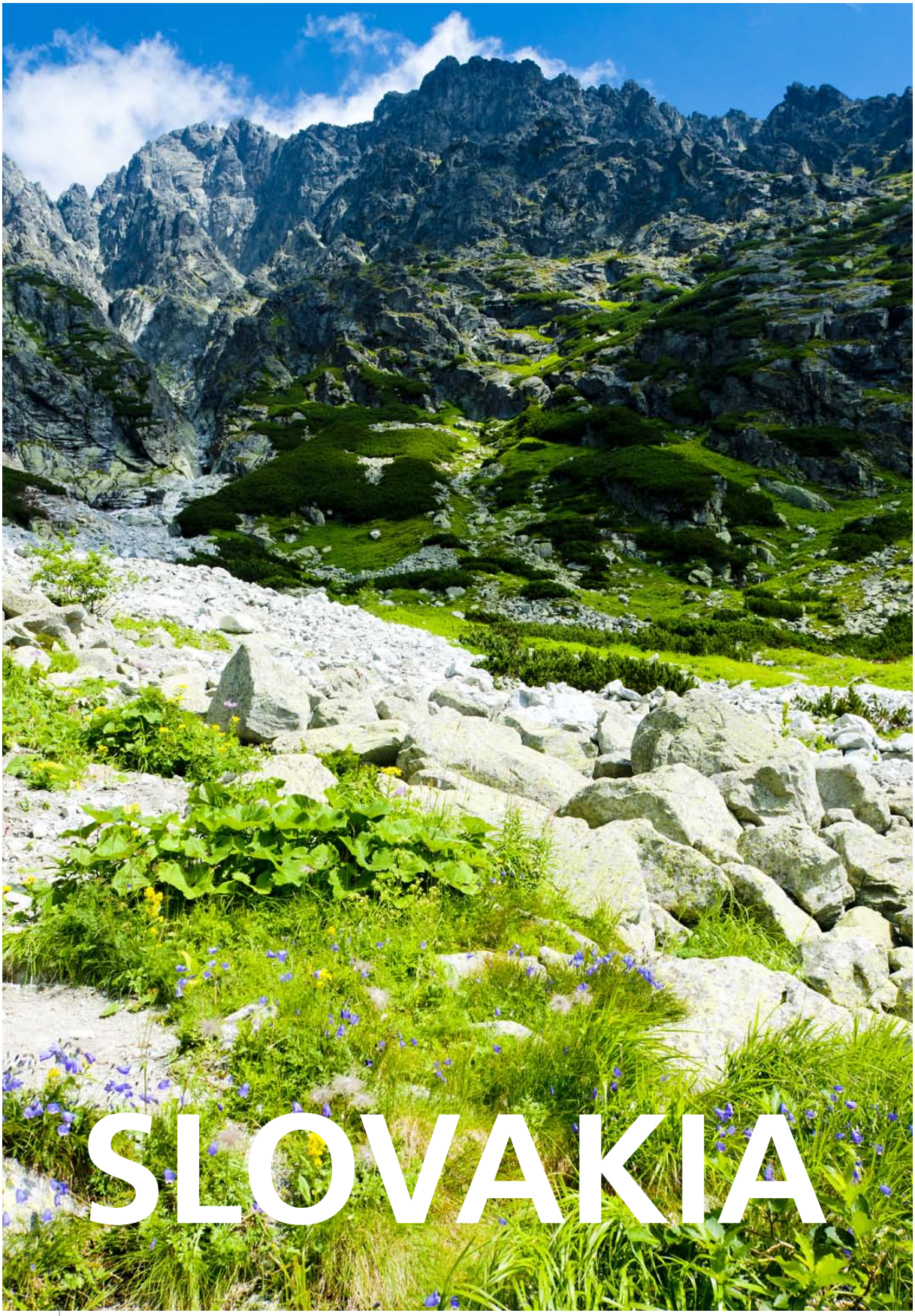
As co-owner of the subsidiary the signature of the general director was required for the resolution to liquidate the company. He put pressure on the parent company and only gave his signature after the assurance that the parent company would release him from all liability. An examination of the documentation determined that a financial accounting database did not exist or at least this – most likely with intent – was not presented to the appointed insolvency administrator.

In addition, in the liquidation process it was established that for a long time no pension and health insurance contributions had been paid and also no reconciliation with the tax authorities had taken place. As a result, additional costs to the tune of 20,000 euros were incurred and the parent company had to settle the outstanding claims of the authorities before the liquidation could be executed as the subsidiary no longer had any liquidity. The execution of the liquidation, however, was still not possible as the tax authorities continued to assert new claims against the shareholders.

What should one have done differently from the beginning?

This example also clearly shows how decisive a role the general director has in Russia. This position should always be very carefully selected. A participation in the subsidiary should only be made possible if there is an actual basis for trust. In addition, the establishment of a control system and of a transparent on-going (preferably on a monthly basis) reporting system is necessary. Any financing by the parent company should only be made based on specific, transparent calculations.

The management of the financial accounting required for commercial and tax matters and the on-going reporting should therefore preferably be left to independent, qualified experts who know the mandatory requirements at the subsidiary and can also act in keeping with compliance management in the interests of the parent company. High quality expert consultation is required in order to meet the local and international financial accounting standards.


SLOVAKIA

SLOVAKIA

Slovakia is known for its favourable geographical position in the heart of Europe and in spite of the negative effects of the international financial and economic crisis and despite a partial change in economic policy has been able to maintain its attractiveness to German investors. In particular this is thanks to membership of the European customs and currency union, growth which continues to be high in European terms, a relatively low level of taxation, well qualified and inexpensive workers and the well-developed infrastructure in the western part of the country. Higher taxes on company profits and the changed labour law has led to Slovakia losing some of its attractiveness for foreign investors, but Germany remains one of the most important trading partners of Slovakia with a number of large investors and also a large number of foreign medium-sized companies.

In spite of many common elements between the German and Slovakian legal systems there are also many differences, whereby in the following we would like to highlight just a number of interesting and useful peculiarities.

Thanks to the start-up of the central portal of the public authority (ÚPVS) in the internet (www.slovensko.sk) which enables uniform access to information and services of the public authority, the administrative process of the founding a company and the changes in the company which are subject to registration have along with other things been significantly simplified. The registration at this portal and the activation of an electronic key enable the registration at the commercial register and the trade licencing office directly from the company premises. The countersigned original documents no longer have to be presented in paper form, but are scanned in and sent via the portal to the authorities for processing.

As a result, since January 1, 2014 the registration application for the commercial register takes only two days to be authorised after presentation of all the required documents and allocation of the fee payment which is made by bank transfer. Furthermore, it remains possible to make applications in paper form. In Slovakia, Rödl & Partner for cost reasons also prefers to use the electronic form as in this case the fees at the commercial register are reduced by half and in the process at the trade licencing office in a number of cases are even cancelled.

In order to improve the quality of public services for citizens and companies, the law on electronic services from the public authority, the so-called eGovernment, came into effect on November 1, 2013. A component of eGovernment is also the obligatory setting up of an electronic letter box for public sector entities, legal entities and natural persons, entrepreneurs and subjects of international law which has to be activated in the course of 2015. Public sector bodies (including the tax and customs authorities) are then obliged to exercise their electronic public power and companies must also regularly check their electronic mail boxes as many

items will be sent to these mail boxes including summons, fines and if applicable other written documents from the authorities.

In Slovakian subsidiaries of German clients it is usual to grant discharge to the (in particular German) managing director. There is often dismay that the Slovakian legal system does not foresee a discharge of the managing director by the shareholders, whereby in fact discharge of liability in relation to possible claims for compensation on the side of the company are expressly forbidden. It is valid that the company can only dispense with claims for compensation after a period of three years as far as the shareholders' meeting agrees to this.

German clients sometimes assume that in the design of contracts claims for compensation can be excluded for some contract violations or that the damages can only be regulated for certain contract violations. A claim for compensation, however, is in principle only alterable by mutual consent if for certain contract violations a contract penalty has been agreed. Although a full exclusion of claims for compensation before the contract violation is not possible under Slovakian commercial law, but a part of case law allows certain limitation of indemnity for example through an upper limit or exclusion from certain types of damages as far as such a limitation does not bypass the law which prohibits the waiving of indemnity (e.g. a symbolic sum of money would not be permitted). To the extent that a contractual penalty was not agreed, the actual damage should not be fully excluded. In addition, it is valid that the court cannot reduce the loss incurred.

A German entrepreneur may be astonished to learn that in Slovakia since February 1, 2013 there are certain restrictions with regard to the agreement of due dates for receivables and in favour of the creditor. As far as monetary payment via instalments has not been agreed, the payment deadlines are in principle not longer than 60 days after the invoice has been sent or after the day of the performance of the creditor. The parties can only agree to a longer period for payment as far as such an agreement is not in major disproportion to the rights and obligations of the contractual obligations of the creditor with regard to interest on arrears. If an investigation after the performance of the creditor is to be carried out in order to determine whether the creditor has performed properly, the time period for fulfilment of the payment obligation of the debtor begins on the day after the conclusion of the investigation which has determined that the performance has been correctly carried out.

The agreement of a time period longer than 30 days required for the investigation after performance is allowed provided it is not in major disproportion to the rights and obligations of the contractual obligations of the creditor with regard to interest on arrears. This provision is mandatory and cannot be contractually excluded.

In Slovakia it is advisable to be particularly alert when purchasing real estate. We know from experience that it can constitute a risk to exclusively rely on the registrations included in the land register as is often the case with entrepreneurs, whereby later it may come to light that the property was acquired from a person who was not the owner. Double ownership is a typical phenomenon as a result of incorrect or missing proof of the acquisition of real estate during the socialist government of the past. Although the principle of trust remains valid in Slovakia (i.e. the registrations in the land register are worthy of trust unless proven otherwise), it is often the case that after the acquisition of a property a third person raises claims against the acquiring party (e.g. for inheritance reasons in connection with a former owner if the property was still listed under lot numbers in a historical registration (prior to the change of the land register system) or due to acquisition in a process according to the restitution laws which are conducted by a separate office (state land office) and are not visible in the land register). It may also transpire that the property is the subject of legal proceedings. If an acquisition of real estate is planned a complex examination of the relationships is definitely recommendable in order to discover possible risks.

In connection with the legal relationships relating to the rental of commercial space we repeatedly encounter the problem that the notice of termination for commercial premises with a fixed term is only possible according to legally permissible grounds which according to the predominant view are final, i.e. not extendible by contract or cannot even be changed by mutual consent. Accordingly, an extension of the grounds for annulment must be formulated as a cancellation of the contract, otherwise the parties are exposed to the risk that in the event of a dispute the extension of the contract grounds would not be recognised by a court of law. In addition, an entrepreneur has to assume that even if the legal grounds for termination are not included in the contract or are excluded, these will find application by law.

A further problem for the entrepreneur operating in the area of real estate is the fact that although with the disposal of a property the new owner takes the legal position of the former landlord, the tenant is entitled by law to terminate the rental contract within the period of notice to the next possible date of termination. The exercise of this right cannot be avoided by mutual consent in a contract and also cannot be punished by a contract penalty, whereby the waiving of this right is only possible after the tenant has changed. Accordingly, in connection with the disposal of properties which serve to generate rental income, such a waiver has to be fixed to be at the earliest on the day of the effectiveness of the sale.

Slovakian labour law has been mainly harmonised and the differences to German law are not serious. In connection with employment relationships, however, German companies are still not used to the exploitation of the institute of the workers' representatives in order to increase work efficiency and ultimately to reduce costs. Only with the participation of the workers'

representatives can the employer influence the introduced working time to any degree, e.g. the introduction of flexible time accounts, lower wage replacement for work restrictions on the side of the employer (e.g. lack of work).

In the course of exercising their activities in Slovakia, German entrepreneurs should take into account that in Slovakia the institute of liability for sales tax at the preceding sales tax level was introduced with effect from October 1, 2012. The customer (taxpayer) is liable for the sales tax (output tax) from the preceding sales level which is listed in the invoice of the supplier if the supplier does not pay the output tax or is unable to pay the output tax and the customer at the time when the tax liability was created should have due to reasonable grounds known or could have known that the tax would not be paid.

The sales tax law explicitly specifies which facts can be assessed to be reasonable grounds such as when the equivalent value for the performance is excessively high or low without economic justification, when the customer at the time when the tax liability is created is personally connected to the supplier by means of a legal entity or a shareholder, or when the customer has continued the transactions with a taxpayer where the grounds to cancel the registration have occurred and he has been published in a blacklist (list of persons maintained by the financial department of the Slovakian Republic). Reasons for the cancellation of the registration are, for example, if the company in the calendar year is repeatedly unable to fulfil its obligation to submit a tax return, if the company has repeatedly not paid its tax liability, or if the company is repeatedly not available at the domicile of the company.

As from January 1, 2014 sales tax payers have a further obligation to submit a so-called control report for the respective assessment period in addition to the tax return and the summary report which they already have to submit. This control report must include details about the tax obligation and input tax deduction and must be submitted exclusively using electronic means. This measure represents a further financial and administrative burden to taxpayers who use foreign financial accounting software without a module which supports the export of the control report in XML format.

The financial accounting standards in Slovakia are slowly being adjusted to the IFRS standard. IFRS does not define an exact system of accounts or structure of the annual financial statement. Despite the implementation in stages of IFRS elements in the Slovakian financial accounting there remain differences between the local financial accounting regulations and international standards. In contrast to international standards (IFRS) and the standard which prevails in Germany (HGB), the Slovakian regulations exactly define the system of accounts, the content of the individual accounts, the structure of the balance sheet, the income statement and the notes to the annual financial statement. This fact is often ignored by German investors

when they enter the Slovakian market especially with the introduction of standardised software which also includes the area of financial accounting and controlling. At some later date the company then has to adapt its software to the financial accounting requirements in Slovakia which is associated with not inconsiderable costs.

Practical examples

Auditing

Background facts:

A German manufacturer of components for the automotive industry does business in Slovakia with its 100 %-owned subsidiary. The parent company manages the strategic purchasing, marketing, logistics, development, controlling and IT for its production company in Slovakia. The company has decided to introduce standardised software to the whole company group which will also include the financial accounting. The company thereby plans to improve the efficiency of individual areas of the operational management, including the financial accounting. In the ordering process of the software in co-operation with the software supplier, the company included its own requirements for the management of the departments listed above and for the applicable regulations for financial accounting and preparation of the annual financial statement valid in Germany. The chart of accounts was set up to meet the requirements of the German commercial code with respect to financial accounting and the preparation of the annual financial statement. A system set up in the same way was introduced to the subsidiary in Slovakia. After the time-consuming and costly installation of the software the auditor of the subsidiary determines that the chart of accounts, the balance sheet and the income statement do not correspond to the applicable regulations in Slovakia. In contrast to the German commercial code, the Slovakian law governing financial accounting exactly defines the chart of accounts and structure of the balance sheet, the income statement and the notes to the annual financial statement.

What can be done now?

In order to make the software conform to the applicable regulations in Slovakia, the company has to contact the software supplier. The adjustment of the software to conform to the applicable regulations for financial accounting in Slovakia will, however, involve further costs.

What should one have done differently from the beginning?

The company could have discussed the adjustment of the software with regard to financial accounting with the advisors from Rödl & Partner already at the stage of placing the order to the software supplier. Then the complete course of the implementation of the new software would have been more efficient and with much lower costs.

Taxes

Background facts:

A German company with operations in the chemicals industry has decided to found their subsidiary X in Slovakia. In the course of company activities company X also concludes a number of contracts with Slovakian suppliers. One of the suppliers of company X was also company Y where pursuant to the Slovakian sales tax law grounds to cancel the registration occurred. Such grounds primarily include facts whereby the company during the calendar year has repeatedly not fulfilled its obligation to submit a tax return, has repeatedly not paid its tax liability or was not available at its domicile. The financial authorities of the Slovakian Republic placed company Y on the list of companies where grounds for cancellation of the registration have occurred, i.e. on a blacklist, and published this list on the web portal of the financial authorities.

Due to the fact that company X did not check its supplier, company X also continued with the execution of taxable business with company Y, although this company was already included in the publicly available blacklist.

In this case both conditions for the enforcement for liability for tax from the preceding sales level were satisfied, i.e. the supplier did not pay the tax office any output tax and at the same time the customer should or could have known that the tax from goods delivered to him in the domestic market is not paid. For this reason in an official notification the tax office ordered company X to pay the outstanding tax. Company X had to pay the tax amount listed in the notification within eight days to the tax office. The contract with company Y did not include a regulation for such cases and, if at all, company X is at the most left with the possibility of claiming compensation from company Y. As the case concerned a large order, the liability for tax from the preceding sales level had a considerable negative effect on the operations of company X.

What can be done now?

It is possible for company X to lodge an appeal against such a decision of the tax office within eight days after the notification is sent. Due to the fact, however, that the conditions of the institute for tax liability have been fulfilled, the appeal filed will most likely not be successful.

What should one have done differently from the beginning?

If company X when entering into business relations with a Slovakian supplier had taken expert advice at the beginning, it would have mostly avoided the respective inconvenience. Rödl &

Partner can help with checking the companies in the blacklist or with the drawing up of the contract conditions in order to minimise the financial risk from liability for tax from the preceding sales level.

Taxes

Background facts:

The German citizen and tax resident, Mr. Günther, has decided to engage in entrepreneurial activity in Slovakia with a newly founded company with limited liability (s.r.o.) and became the sole shareholder of this company.

The profit recorded by his company (s.r.o.) for 2013 was subject to the Slovakian corporation tax of 23 %. The profit share (dividends) which Mr. Günther subsequently distributed were not subject to further taxation in the Slovakian Republic as the shares distributed from profits realised after January 1, 2004 to persons with an interest in the assets of the distributing company are not subject to income tax. Mr. Günther then subsequently, as a citizen and especially as a tax resident in Germany, submitted his world income tax return in Germany in which as well as other income he also declared the distributed profits (dividends) from the area of Slovakia. As this profit share (dividends) was not subject to tax in the area of Slovakia, it was taxed in Germany.

Although Mr. Günther was able to supply information confirming that the profit share (dividends) was not liable for income tax in the area of Slovakia, and for this reason had erroneously assumed that this fact would help him to reduce his tax burden, the opposite was true. In the end, due to his choice of the s.r.o. as company form in Slovakia, after the taxation in Germany Mr. Günther was left with less of the distributed dividends than he first thought.

What can be done now?

If Mr. Günther had sought advice from Rödl & Partner before the start of his company activities in Slovakia in order to minimise his tax burden and after that use his investment capital more efficiently, the tax consultants under consideration of the fact that profit shares (dividends) are not subject to tax would have been able to recommend a business model better suited to reduce the tax burden such as, for example, a limited partnership (k.s.) where Mr. Günther would have participated as a limited partner.

As the legal form of the limited partnership can be viewed as a partly transparent company, the profit share of the limited partner according to Slovakian law is taxed with the shareholder and the share of the limited partner with the company. The profit share (dividends) paid out to the limited partner (Mr. Günther) already represent the appropriation of the profit after tax (the profit was namely taxed through the k.s.). The profit share is not liable to any further taxation as the dividends according to the prevailing law do not represent an item subject to tax.

As these dividends were already taxed on a lower level (in the area of Slovakia through the k.s.), the double taxation in Germany can be avoided through citation of the method of exemption subject to progression which in practice means that the income from dividends in the tax return of Mr. Günther in Germany will indeed be included, but only for the purpose of determining the progressive tax rate according to which the rest of his income is taxed.

What should one have done differently from the beginning?

The application of a transparent company structure in the area of the Slovakian Republic (k.s.) would have allowed the total tax burden of Mr. Günther to be incomparably lower than in the case of a non-transparent structure (s.r.o.). If Mr. Günther had discussed the founding of a company in the area of the Slovakian Republic with Rödl & Partner in advance, he could have avoided the negative tax effects on his person and would have been in a position much earlier to enjoy the tax advantages from the application of a semi-transparent company structure in the area of the Slovakian Republic.

Law

Background facts:

The supplier, company X, and the customer, company Y, have concluded a contract to deliver and install a production line. In the event of a delivery delay a contractual penalty was agreed, whereby all claims for compensation above the contractual penalty are excluded. The plant was correctly delivered in time and accepted by the customer. After about half a year of operation of the production line a component fails, whereby the defect is only determined after the manufacture of a certain number of non-conforming products.

After the defect is discovered and until the repair can be carried out, company Y has to immediately stop operation of the production line and also production on further linked machines. Although company X managed to remove the defect through the delivery and installation of a new component, due to problems with the production and delivery of the

affected component, however, the complete process to remove the defect lasted nearly four weeks. The production line was connected to further production lines which therefore also had to stop operation. Finally, company Y asserted a claim for replacement of the damages incurred as a result of the stop in production, for the actual damage caused by the production of non conforming products, and for the lost profit for the time period when the production line and connected productions lines were out of operation. The defence of company X was that in the contract the right to compensation was excluded and that company Y should claim the contractual penalty for delayed performance.

The court ruled in favour of company Y and awarded the complete amount of damages claimed. The basis for the ruling was that the damages were only excluded in the case of delay of the work provided by the contractor (the contractual penalty was agreed for this case and not for any other case). However, damages were not excluded for other cases of violation of contractual obligations (in this case with the removal of a defect within the scope of the guarantee) with reference to the legal regulation that the claims for damages arising from the infringement of contractual obligations cannot be waived.

What can be done now?

If the contract is concluded to be legally valid, in the case of a dispute the court can only rule within the framework of the law and the agreed regulations. After the event it is unfortunately not possible to reverse the facts. In order to pre-empt a legal dispute, clear and appropriate regulations must be determined before the conclusion of the contract.

What should one have done differently from the beginning?

Prior to conclusion of the respective business the company should seek expert legal advice. Although under Slovakian commercial law complete exclusion from claims for compensation prior to infringement of the contract is not possible, it is permissible to limit such claims to a certain extent in advance, e.g. through a contractual penalty, through the exclusion of consequential damages or loss of profit, or through introduction of a reasonable upper limit. With the support of Rödl & Partner the contract can be adapted to take the particularities of Slovakian law into account and to adapt to the case in question and as in this case to clearly and definitively agree the claims for compensation in order to avoid the situation that the client is faced with an unexpectedly large claim for compensation.

Fraud

Background facts:

Company X had a Slovakian managing director L who was entitled in the name of the company to act only in combination with a second managing director. The managing director and the company X have concluded a managing director's contract and also a contract of employment. The remuneration for employees should be authorised by a system introduced by the German shareholder. Due to dissatisfaction with the managing director the German shareholder dismissed the Slovakian managing director and now also wanted to end the employment relationship. The managing director drew up a supplement to his employment contract (backdated for the time period of exercising the function of managing director) immediately without obtaining the signature of the second managing director according to which he was entitled to a disproportionately high rate of remuneration compared to the previous amount of remuneration and immediately himself instructed the payment of the remuneration.

The German shareholder only later established that the remuneration was made without authority and therefore it was deducted from the next remuneration of L to the extent that L according to the opinion of the shareholder did not have a right. The managing director filed a suit against company X for the unauthorised deduction of the money. The court ruled in favour of the managing director and the company was obliged to repay the managing director even though the manner of acquiring the remuneration was fraudulent.

In its decision, the court did not assess the entitlement of the remuneration payment, but only the formal error which company X had made that with an employment relationship a one sided deduction from wages is not permissible (only for legal reasons which in this case were not present). In this case a deduction from wages would be possible due to a mutual written agreement which, however, had not taken place.

What can be done now?

The company can retroactively file suit against the managing director to realise repayment on grounds of unjust enrichment and apply for repayment of the unauthorised paid out remuneration and if applicable introduce criminal charges against the managing director on the suspicion that a fraudulent act has been committed. However, the costs incurred for the previous legal action, will not be reimbursed by L.

What should one have done differently from the beginning?

After irregularities are determined in the financial accounting, company X should have immediately contacted Rödl & Partner. Rödl & Partner would propose a suitable course of action to correct the named irregularities. In this case one could demand the conclusion of an agreement regarding deduction from wages and with a negative attitude of the managing director company X was able to take legal action regarding unjust enrichment.

Corporate (white-collar) crime

Background facts:

Company X has 100 employees. On the day when the wages are due company X has the financial funds available to pay the wages. The majority shareholder of company X is the German company Y, whereby the managing director of both companies is Mr. Jan. Shortly before the wages are due for payment in company X, however, company Y must also cover its liabilities, whereby the company does not have an adequate cash flow and the delay of company Y with the payment of its liabilities would be associated with high penalties. Due to the fact that in the past company Y had granted a loan to company X, Mr. Jan considers the possibility that company X could pay back the loan to company Y and that this would eliminate the risk of high penalties.

Mr. Jan has also taken the fact into account that company X recorded outstanding debts against its customers and assumed that these debts would be paid in a few days to company X. Due to this assumption Jan decided that the wages due for payment would be paid after receipt of the money paid by the customers of company X (i.e. not on the day when the wages were due, but with the assumed delay of a few days) and that he would pay back the granted loan to company Y. He then acted accordingly, i.e. one day after the wages were due for payment company X transferred the funds to company Y.

Although company Y had eliminated the risk of high penalties, the further assumption of Jan, however, did not come to pass that the customers of company X would settle their liabilities. The wages in company X therefore remained unpaid.

What can be done now?

The situation which has occurred must be dealt with immediately. The lawyers at Rödl & Partner are able to assess the danger of the respective circumstances and propose solutions.

The non-payment of wages can namely be viewed as a criminal offence, whereby the danger of recourse in particular is borne by the legal entity, which in our case is Mr. Jan.
In general it is valid that in each individual case it is necessary to immediately assess the facts (for example, if the company urgently requires funds to maintain its activity) and act accordingly in respect of the situation. Under certain circumstances, company X could namely "prefer" other payments instead of wages or also an additional wage payment could as a result remove the liability of a criminal offence.

What should one have done differently from the beginning?

Company X or Mr. Jan should have and were obliged to continually monitor and asses the financial situation of the company. In the case of any indication whatsoever of impending financial problems or a lack of cash flow Rödl & Partner recommends taking actions with extreme caution and to discuss the facts of the case with experts beforehand. Measures to reduce the risk of criminal law penalties, for example, in the case of non-payment of wages, always depend on the actual situation and the state of the company. The bad financial situation of the company may indeed be just of a temporary nature or may show signs of insolvency in the sense of the bankruptcy law. In the event the company is bankrupt (whether in the form of illiquidity or over-indebtedness) it is even more important to proceed with caution because in this situation the action of any payment whatsoever (including wages, taxes, contributions) represents a risk and can qualify as a criminal offence in terms of fraudulent preference.


SPAIN

SPAIN

Spain is currently the fifth largest economy in the European Union and is ranked 14th worldwide. The most important trading partners are Germany and France. In terms of Spanish imports, which in particular include vehicles and car parts, machines, electrical engineering and electronics, Germany is the supplying country with the largest volume, followed by France. After France, Germany is the second largest destination country for Spanish exports, whereby in particular vehicles and car parts, foods, chemical products, machines and electrotechnical products are exported. In 2012, German direct investments in Spain amounted to 1.4 billion euros. At the present time approx. 1,100 German companies have subsidiaries in Spain.

The economic crisis has had a strong effect on the Spanish domestic market and liquidity remains a problem for companies, although in the meantime due to reforms carried out there are signs of a recovery in the Spanish economy. As a reaction to the crisis companies in Spain are seeking to achieve success more and more through a considerable increase in internationalisation and increasing their exports.

An interesting point with regard to the founding of a subsidiary in Spain is that a Spanish Sociedad Limitada (S.L.), i.e. a company with limited liability, can already be founded with a minimum share capital of 3,000 euros, whereby a joint stock company (Sociedad Anónima, S.A.) requires a share capital to the amount of at least 60,000 euros. It should be observed that the full amount of the capital has to be paid in before the company is founded.

A further particularity in Spain is that the shareholders of a company are not shown in the commercial register unless the company is a sole trader. With the possible takeover of a company or with a joint venture, due to the lack of a publication of the ownership structure, it is therefore necessary to disclose the memorandum of association and all subsequent transfers of shares or shareholdings.

The company management of Spanish companies can be transferred to a sole managing director, to a number of managing directors entitled to sole or joint power of representation or to a board of directors. This includes the interesting possibility of appointing a legal entity as a managing director. This entity must then approve a natural person to represent the legal entity in the course of exercising its duties as managing director. Foreign managing directors have to have a so-called foreigner identification number (NIE) which can be applied for either at the police authorities in Spain or at Spanish embassies or consulates in Germany near to the place of residence of the applicant.

Spanish law does not recognise the granting of a general power of attorney. In order to grant full general powers, it is therefore necessary to individually list all of the authorisations to be transferred in a corresponding power of attorney document. The power of attorney has to be notarially certified and possibly also translated into Spanish by a state certified translator and – to the extent that they are certified by a German notary – accompanied by an apostille from Den Haag. General authorisations which authorise the execution of an undefined number of legal transactions are subject to mandatory registration in the commercial register.

If property is acquired in Spain it is interesting that this can be simply made by a privately written contract between the parties. Registration in the land register is only a bureaucratic formality and does not constitute conclusive evidence of ownership of title. Notarial certification only takes place when the purchaser expressly requests this in order to register the acquisition of the property in the land register or if the acquisition is to be financed by a loan secured by a mortgage. It is also worthy of note that in Spain it is possible to register rental relationships in the land register.

In Spain labour law is regulated in the employee statute (Estatuto de Trabajadores) and in individual laws which find application on special employment relationships such as contracts with management personnel or with outside sales personnel. Furthermore, it should be emphasised that tariff agreements are generally binding which means that their requirements must be complied with to the extent that a company falls into a collective bargaining area.

In the course of the termination of employment relationships it should be observed that a notice of termination on the side of the entrepreneur has to be justified in terms of disciplinary or objective reasons (this includes operational reasons) as the Spanish employee statute does not recognise ordinary dismissal with due notice.

The condition for termination without notice on disciplinary grounds is a serious and culpable breach of contract on the side of the employee which must be explained in the letter giving notice of the termination. The affected employee can make a complaint against unfair dismissal within 20 working days. An out of court arbitration process takes place prior to proceedings against unlawful dismissal. If there is no agreement the labour court decides whether the notice of termination was justified, not justified or void. In the case of an unjustified notice of termination the employer has – in contrast to Germany – the right to choose between the reinstatement of the employee or the payment of the legal redundancy compensation to the amount of 33 days' pay per year of company service with a maximum of 24 salary months (exception: workers' representatives). If the termination is void, e.g. due to an infringement of fundamental rights or discrimination, the employee must be reinstated.

Notice of termination for objective reasons is in particular permissible with the presentation of economic, organisational, production-related or technical reasons. The notice of termination must be expressed with a period of notice of 15 days and at the same time the employee must be paid the legal redundancy compensation to the amount of 20 days' pay per year of company service (maximum 12 salary months). If in the course of proceedings against unfair dismissal the notice of termination is declared to be unjustified, the employee is entitled to the legal redundancy compensation in the case of unjustified disciplinary notice of termination.

In relation to the tax obligations of Spanish companies, a number of particularities should be mentioned:

The registration of a company in Spain and the application for a Spanish tax number does not automatically lead to the issue of a sales tax identification number due to the fact that this is not the same number as the Spanish tax number. An express application of a sales tax identification number is required, whereby verification must be provided that the company is actually engaged in intra-community transactions.

Furthermore, it should be observed that the deadlines of the Spanish administration have in principle to be strictly adhered to. In Spain it is not possible to apply to extend the deadline to submit a certain tax return. It is only possible to agree to a deferment of payment of the tax liability.

The payment of taxes cannot be made by bank transfer because the Spanish state does not provide the appropriate accounts. The most common form of payment is payment to a bank which issues a number code which is given when the tax return is submitted or a direct debit mandate where the tax authorities have direct access to the account of the taxpayer.

The system from the Spanish tax authorities for electronic transmission is also surprising for foreign entrepreneurs. All notifications of the tax authorities are made to an electronic address of the company, whereby a communication in paper form is not made. Access to this electronic address requires either an electronic certificate of the company which can be applied for with regard to this purpose or through the issue of power of attorney to a third party who receives the electronic notifications on behalf of the company.

Foreign companies which distribute their products in the whole of Spain should observe that the Canary Islands constitute a special tax zone because they do not belong to the legal sales tax community and are therefore considered to be a third party country.

The managing directors of joint stock companies are obliged within three months after the closing of the financial year to prepare the annual financial statement which must be approved by the shareholders' meeting within six months after the closing of the financial year. The above-mentioned deadlines are mandatory and cannot be extended. Within one month of the approval of the annual financial statement it must be submitted to the commercial register. If a year has passed since the closing of the financial year without the submission of the annual financial statement to the commercial register, the company is penalised to the extent that until the submission has been made to the commercial register further registrations are not possible.

The annual financial statement has to be audited by an auditor provided the company does not fulfil 2 of the following criteria in 2 consecutive years:

- Total assets do not exceed 2,850,000 euros,
- the net amount of turnover does not exceed 5,700,000 euros, and
- the average number of employees during the financial year does not exceed 50.

The auditor of the annual financial statement has to be appointed by the shareholders' meeting before the end of the financial year to be audited for a time period which must be for at least three years and can be up to a maximum of nine years notwithstanding the possibilities of extension.

As well as the usual reasons for the liquidation of a company, for Spanish companies there is the particularity that a legal reason for liquidation exists if the net assets of the company due to losses is reduced to less than half of the share capital. The managing directors have to call a shareholders' meeting within a period of two months in order to make a resolution to carry out this liquidation or to introduce a different measure in order to rebalance the assets of the company. If the managing directors do not fulfil their duty to call a shareholders' meeting within the said period of notice, or do not apply for a dissolution of the company or as necessary declare insolvency of the company due to the fact that the company is illiquid, the managing directors are severally liable for the debts of the company which occur after this ground for liquidation is present as far as the shareholders' meeting has not taken place or there was no resolution to start liquidation within two months of the date of the shareholders' meeting.

In addition to the acceptance of a capital contribution without consideration, the increase or reduction of the capital or of a simultaneous execution of the aforementioned measures, the balancing of the assets can be re-established through the granting of a participating loan. In the case of a participating loan the lender receives a variable interest rate which orients

towards the development of the activities of the borrower. The criteria for the determination of this development can be the net income of the company, its turnover, its total assets or a different criterion to be agreed. In respect of the reestablishment of the balance in the equity of the company a participating loan is regarded as net capital.

Practical examples

Auditing

Background facts:

The Spanish subsidiary of a German company records a loss and finds itself with an imbalance of assets, i.e. due to above-mentioned losses the net assets of the company are reduced to less than half of the share capital. This represents a legal ground to liquidate the company. For the purpose of increasing the equity of the company and to re-establish the asset balance of the company, the German shareholders make a resolution to form a voluntary capital reserve.

When the resolution is presented to the Spanish financial accounting employee, he wants to post this amount according to the Spanish chart of accounts as a non-retrievable contribution of the shareholder.

What can be done now?

The Spanish chart of accounts understands the contributions of shareholders to be the provision of asset elements by the shareholder without a form of consideration. In order for the contributions to be seen as net assets of the company and therefore able to contribute to the improvement of the financial situation of the company, the contributions have to be non retrievable.

Due to the possibility of reintegration, a voluntary capital reserve according to the German commercial code will not lead to an increase of the net assets of the company.

What should one have done differently from the beginning?

If a shareholder contribution without consideration due to a lack of retrievability is not intended, there is the possibility of granting a participating loan in favour of the subsidiary. For such a participating loan the German company as lender receives a variable rate of interest which orients towards the development of the activities of the Spanish subsidiary as borrower. The criteria for the determination of this development can be the net income of the company, its turnover, its total assets or a different agreed criterion. In respect of the re establishment of the balance of the equity of the company, participating loans are viewed as net capital and are therefore suitable to compensate losses of the company.

Tax

Background facts:

The company Jamón Ibérico, S.L. is founded on March 25, 2010 and its financial year respectively ends December 31. In its first financial year, the income statement of the company records losses to the amount of 300,000 euros.

In July 2011 the company submits its corporation tax return for the financial year which closed December 31, 2010 with the following figures:

Accounting result	-300.000 euros
Regulation corporation tax	
Taxable amount	-300.00 euros
Tax rate	30 %
Tax amount	0 euros

In the financial year for 2011 the company begins to record better operational results and increases turnover such that a profit to the amount of 405,000 euros is recorded.

In the month of July 2012 the company submits the corporation tax return for the financial year for 2011 with the following results:

Accounting result	405.000 euros
Regulation corporation tax	45.000 euros
Provisional taxable amount	450.000 euros
Tax rate	30 %
Reconciliation with the tax amount of the previous year	-300.000
Taxable amount	150.000 euros
Tax rate	30 %
Tax amount	45.000 euros

In 2012, under consideration of the good results of the previous year, the company undertakes a bigger investment. The turnover, however, does not develop as expected and the company records a loss to December 31 to the amount of 1,000,000 euros. The shareholders' meeting therefore decides as from December 31 to end and liquidate the company.

In July 2013 the company submits its last corporation tax return for the financial year 2012 with the following results:

Accounting result	-1.000.000 euros
Regulation corporation tax	
Taxable amount	-1.000.000 euros
Tax rate	30 %
Tax amount	0 euros

In this last corporation tax return for the financial year of 2012, the company would like to retroactively apply for the repayment of the tax paid in the year of 2011 through the retroactive offsetting of the losses of 2012 with the profit of 2011.

What can be done now?

According to Spanish law retroactive offsetting is not permitted, therefore it is not possible to apply for the repayment of the tax paid in the financial year of 2011.

What should one have done differently from the beginning?

Spanish law only allows the offsetting of profits with losses from preceding financial years, but does not allow the retroactive offsetting of profits with losses made in the following years.

In the last three years of the business operations, the company only recorded a profit in the financial year of 2011. The consideration of all three financial years results in a total loss to the amount of 850,000 euros. Due to the Spanish regulations, however, the company is obliged in the financial year for 2011 to pay the respective tax because in this year a profit was recorded, though the losses from the preceding financial year were taken into consideration. For the year of 2012 there is, however, it is not possible to retroactively compensate the losses recorded in this year with the profit recorded in the financial year of 2011 and therefore to successfully achieve the repayment of the paid taxes.

Law

Background facts:

For a number of years a German company has been selling its products via a distributor in Spain. Due to the previous success the German company decides to acquire shares in the company of the distributor. Due to its many years of business relations and the supposed knowledge of the Spanish company the process of due diligence is not carried out.

After the shares are transferred, it turns out that the articles of association of the company require an enhanced majority for various decisions and as a result decisions cannot be taken without the agreement of the other shareholder.

Due to language problems the co-operation with the administration personnel of the Spanish company who partly have many years of service turns out to be difficult and as a result some employment contracts are to be terminated.

Furthermore, the legal relationship to an alleged free employee of the Spanish company is to be ended. After the notice of termination has been expressed, however, this worker goes before the labour court and complains that due to disguised self-employment he is to be seen as an employee of the company and therefore cannot be ordinarily dismissed.

What can be done now?

The change of the required majority can only be effected through a change in the corresponding articles of association.

According to Spanish law, a notice of termination must be justified through objective or disciplinary grounds, whereby an ordinary notice of termination does not exist. If, in the present case, a notice of termination is nevertheless expressed for an administration employee and this employee applies for protection against unfair dismissal, the notice of termination will be declared by the labour court to be unlawful.

The employer has the right to choose between the reinstatement of the employee or the termination of the employment relationship under payment of the legal redundancy compensation for the case of unjustified notice of termination to the amount of 33 days' pay per year of company service and for a maximum of 24 salary months. In the case that the company employee has a very long period of company service, the compensation can be correspondingly high.

If the apparently self-employed person succeeds proving before court the presence of a disguised employment relationship, he is also entitled to previously mentioned compensation due to unlawful notice of termination.

What should one have done differently from the beginning?

If the contents of the articles of association had been known as a result of due diligence carried out, in the process of the acquisition of the share in the company the obligation to accept the change to the articles of association could have been negotiated.

In respect of employment relationships, after an internal audit had been carried out in advance it could have been agreed that the employment relationships of the affected employees could have been ended before the acquisition of the share in the Spanish company or a guarantee for possible disguised self-employed persons could have been negotiated such that the seller is liable for any compensation to be paid including outstanding social security contributions.

Fraud

Background facts:

The wife of the general director of the subsidiary of a German company in Spain is also a shareholder and managing director of an own company. This company establishes parallel sales structures to the German subsidiary company. Services are also performed which are invoiced with excessive amounts. The Spanish general director feels safe as in Spain wives do not have the same family name. In an internal audit the invoices are questioned, but the family relationship remains undiscovered. The facts of the case only become clear after a tip is received from the workforce.

What can be done now?

In such cases a number of perspectives have to be presented.

The legal employment contract of the general director is subject to extraordinary termination. Here it is important that the facts of the case are comprehensively represented in the notice of termination. It is not permissible to add reasons afterwards.

Charges of unjust enrichment can be brought against the company of the wife, due to the fact that the service and the financial compensation are not in proportion.

Claims for infringement of anti-trust laws can also be asserted against the company.

Finally, criminal proceedings can be initiated against the husband and wife. However, here it should be taken into consideration that possibly the customers of the company may be called upon by the public prosecutor to give evidence.

What should one have done differently from the beginning?

This situation could have been avoided. On the one hand the compliance rules should have been published and on the other hand when suppliers are entered into the system the user rights should be restricted such that these facts would become known to the shareholders.


SWITZERLAND

SWITZERLAND

As a direct neighbour of the Federal Republic of Germany, Switzerland has links to Germany through largely sharing a common language and is also very attractive for German companies due to its sales market and also as a location for holding companies for reasons of tax optimisation. The macroeconomic conditions in Switzerland are similar to those found in Germany and in many cases are even more favourable. Despite the perceived high-price image of Switzerland, the country is characterised by a number of innovative commercial and labour law details.

The following remarks should provide an overview of which areas within the framework of financial accounting are available for possible investors "from the big canton" (i.e. Germany, notes the editor) in our neighbouring country and which ones have interesting features.

Commercial law (the Swiss code of obligations)

The principle in Switzerland that tax accounting should be based on commercial accounting

In terms of commercial law, since the German Accounting Law Reform Act in 2010 Germany has more or less abandoned the authoritative principle that tax accounts are generally based on financial statements. This principle, however, is still very much followed by our neighbours: For this reason there are a number of regulations which can apply to the Swiss trade balance according to the obligation law (in Swiss "OR") for the tax balance sheet such as for inventory, receivables and at the present time the more generous ("two-thirds") depreciation is granted for fixed assets in comparison to the German commercial code. The Swiss tax authorities thereby allow the formation of hidden reserves. In practice this means that companies preparing financial statements must maintain an internal list of hidden reserves and have to list the annual net changes in the notes. Thereby items can be booked to different balance sheet positions. Depending on the business model, in comparison to Germany here it is possible to establish hidden reserves which can be partly substantial as permitted by conservative balance sheet rules. This is allowed by the Swiss financial authorities.

Flexibility with financial accounting

The percentage of completion (POC) method, usually only allowed by the Anglo-American financial accounting standards which under certain conditions allows long-term manufacturing companies to realise profits already before so-called acceptance, is recognised by the Swiss obligation law in keeping with IFRS which means that here if the required conditions are met then valuation differences can be avoided. Such a possibility is only available to a limited extent under German commercial law as far as "partial realisation of profits" can be represented.

Restrictions with interim dividends

In many cases and countries there is a possibility that, for example, a German parent company can in advance, i.e. prior to the balance sheet date, request an interim dividend for example from a domestic subsidiary. This is not possible with Swiss subsidiaries. The financial statement must be approved by the shareholders' meeting and only then is it possible to approve an ordinary dividend paid to the shareholders or parent company. It is therefore recommendable if required as a bridging measure to conclude an intercompany loan agreement with the German parent company in order as required to provide the necessary liquidity at short notice to the parent company.

Comfort letter from foreign parent company in favour of a Swiss subsidiary

From the viewpoint of the parent company, this type of declaration is usual and widespread and in particular if the case in question concerns the founding of a new or start-up company which at the begin of its operations has not yet been able to generate a profit. In such cases in many countries in order to secure the status of a going concern the affected subsidiary receives a supporting comfort letter from the parent company which satisfies the requirements necessary to continue company operations.

Depending on the nature of the comfort letter, the parent company or group parent undertakes to guarantee the continuation of the subsidiary whether this is achieved through the provision of liquidity or through other measures. The advantage is that such a declaration made by the parent company in the first instance due to its commitment character need not require an immediate outflow of liquidity. In Switzerland these declarations are in principle and in particular when they are made by foreign shareholders not sufficient and are therefore in the case of a statutory audit requirement are considered in a critical light by the Swiss auditors.

Financial accounting for start-up costs

In future, start-up costs, capital increase costs and organisation costs may no longer be capitalised. From a tax point of view they are deemed to be a part of business expenditure. The extraordinary depreciation required according to commercial law of existing capitalised start-up costs, capital increase costs and organisation costs at the time of the first application of the new financial accounting law is regarded under tax law as business expenditure. In this respect, the Swiss obligation law conforms to international practice.

IFRS for German medium-sized "Mittelstand" companies and Swiss GAAP FER

While in the European Union after a long period of preparation a decision was finally taken in 2009 to adopt a standard for small to medium-sized enterprises (SME), the Swiss had introduced the pioneering Swiss GAAP FER as early as 1984 to a counterpart to Swiss obligation law and full implementation of the international financial reporting standards (IFRS).

While the Swiss obligation law primarily seeks to protect the creditor, the Swiss GAAP FER seeks to communicate a true and fair view of the assets, finance and income of the company. This therefore primarily satisfies the requirements of the potential recipients (e.g. banks, investors, etc.). Compared to other standards (IAS/IFRS and US GAAP) the Swiss GAAP FER impresses through simplicity, but is still able to set a good standard to provide figures which are accepted by the potential recipients.

The advantages of the Swiss GAAP FER are:

- Low complexity
- Standard recognised by shareholders and lenders
- Basis for the management of enterprises
- Expenses for adjustment remain reasonable
- Swiss regulations which correspond to the local expectations
- Application also possible for consolidated accounts.

The following provides a short overview of the framework of the Swiss GAAP FER:

The Swiss GAAP FER focuses on the financial accounting of small to medium-sized organisations and company groups in Switzerland. Small organisations have the possibility of only applying the framework and selected core standards. Medium-sized organisations are obliged to adopt the core standards and the remaining SWISS GAAP FER regulations.

The following are criteria for the application of the core standards:

- A balance sheet total of 10 million CHF.
- An annual turnover of 20 million CHF.
- An annual average of 50 full-time workers.

If two of the criteria in two consecutive years are not exceeded, the organisation may apply the core standards.

Certain publicly listed companies in Switzerland (only domestic standard, not the standards for investment and real estate companies) may apply SWISS GAAP FER, i.e. in these cases the regulations of the IFRS are not mandatory.

Disclosure

As far as a non-publicly listed group with parent company in Switzerland is subject to the preparation of group accounts there, these Swiss group accounts are not subject to disclosure. In the absence of an exemption regulation, German integrated sub-groups or companies on the other hand then have to do this in Germany.

Auditing

Audit scope: limited audit vs. regular audit in comparison to Germany

In contrast to Germany in Switzerland there is no legal regulation under obligation law with regard to the special audit scope of a "limited" audit.

This is a limited statutory examination according to an internal audit reference manual or standard.

This Swiss peculiarity can best be compared with the regulations of the accounting standard 900 of the Institute of Public Auditors in Germany whose subject matter consists of the "review of annual financial statements".

Furthermore, not all of the financial statements are subject to a statutory audit requirement, whereby if there are less than ten employees there is the possibility of an opt-out, i.e. the right to dispense with an audit.

In order to increase trust in the information contained herein there is the possibility of having a critical appraisal made on the basis of a plausibility assessment of an auditor.

In the following situations this is in principle possible:

- Published quarterly reporting or for example prior to a public listing where the effective date is more than four months after the last annual financial statement or consolidated financial statement.
- Small companies not subject to a statutory audit requirement where the shareholders and the company management are not identical.

In this case the type and scope of the audit actions are usually less demanding than the execution of an audit of the annual financial statement and are therefore associated with lower costs.

Although the review does not replace the legally prescribed audit of the annual financial statement, it does offer the possibility – depending on its orientation and assignment – of providing a certain security with regard to the significance of an annual financial statement or interim statement.

This is of particular interest for:

- annual financial statements of companies not subject to a statutory audit requirement (e.g. small joint stock companies) in order to obtain a certain degree of security regarding the annual financial statement,
- subsidiaries which have to be included in consolidated accounts,
- the audit of reporting packages, and
- the audit of individual balance sheet positions for shareholders or bank.

The conditions for a regular audit which is comparable to a statutory audit of the financial statement in Germany are such that in Switzerland a regular audit is mandatory when two of the following variables are exceeded in two consecutive financial years:

- a balance sheet total of 20 million Swiss francs,
- sales revenue of 40 million Swiss francs or
- an annual average of 250 full-time employees.

Special bodies of the audit authorities

In contrast to other jurisdictions, in Switzerland, for example, with the joint stock company the audit expert (not only the audit expert, but also the auditor or just simply the audit authority) is a "body" of the company in a similar way as the board of directors and shareholders' meeting. The audit authority of a Swiss company must therefore be selected in the course of a shareholders' meeting and registered at the competent registry office with presentation of the nomination acceptance declaration. The audit expert of a company is also officially published in the commercial register.

Practical themes under labour law

In a number of cases, Swiss labour law is regulated differently to the labour law in Germany. The following describes a number of differences between the respective regulations of the two countries.

Working time

The average weekly working time in Switzerland is 40 hours. The work is usually carried out on the five weekdays. A maximum of two overtime hours can be made per day. Overtime hours must be converted into free time. If this is not possible, the overtime hours must be remunerated with an increase of 25 % over the normal wage (for overtime hours this 25 % increase can be removed in a contract, but not, however, overtime hours which exceed the weekly maximum working time. The weekly maximum working time for office personnel, technical employees and sales personnel amounts to 45 hours and 50 hours for all other employees).

Wage payment in case of sick leave

If an employee is sick or has an accident, the employer is obliged to continue payment of the wages if the employment relationship is older than three months or if the employment contract is for a fixed term of more than three months. In the first year of service the wage must be paid for three weeks further and after that for a "reasonable further period". In the course of legal interpretations over the years different practices have developed. As a result, today there are in particular the Bern, Zürich and Basel scales. It is therefore recommended as required to already fix the amount of sick pay to be paid in the employment contract, or alternatively sick pay insurance can be taken out.

Notice of termination of the employment contract

In Germany, in all cases where companies have more than 10 employees there has to be a reason for termination, including for a "standard" notice of termination, which is frequently referred to as "for operational reasons". In this case the social selection procedure must be observed, i.e. the company must cancel the employment of someone which in terms of social aspects including family, age, duration of the activity or severe disability requires the least safeguarding. This selection is difficult and as a result many notices of termination can be contested. In Switzerland there is no comparable regulation. The employer does not require a reason for a "standard" notice of termination. It is only necessary to observe the termination date (end of the month) and the notice period (see below). There are only a number of reasons where the law does not allow notice of termination such as in the case of a pregnancy.

The notice for a "standard" notice of termination is also considerably shorter than in Germany. In the trial period it is only 7 days and after that 1 month. After a year it lengthens to 2 months, and after to 10 years to 3 months. There are no further extensions. In Germany after 10 years it would already be 4 months and after 20 years even 7 months.

Holiday days

The statutory holiday days are regulated much in the same way as in Germany. In Switzerland there is a statutory right to a minimum holiday period of 4 weeks which with a 5 day working week corresponds to 20 working days. Many collective employment contracts and standard employment contracts, however, guarantee a higher entitlement to holidays. At least two free weeks can be taken consecutively.

The German Federal Holiday Entitlement Act refers to at least 24 holiday days, but also this means that with a 5-day week there are only 20 holiday days. In the individual employment contracts in Germany, however, deviations are usually made in favour of the employee and at the present time the average is around 27.5 days.

Parental leave

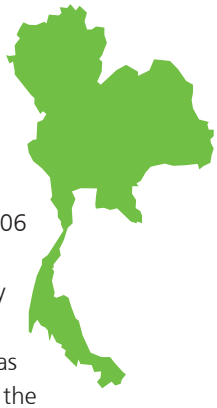
In Germany there is the possibility for both parents from the birth of a child until the child is 3 years old to take parental leave, whereby Switzerland completely lacks such a right. If a mother does not return to her place of employment immediately after the end of her maternal leave in Switzerland, she will lose her job, whereby the father practically has no possibility and is forced to take a holiday.

In Germany after the birth of a child a parental allowance is paid by the state for up to 14 months to the respective parent who takes parental leave which is currently usually 67 % of the net wage.

In Switzerland on the other hand the Federal Old Age and Survivors' Insurance (AHV) pays compensation to the mother for 14 weeks amounting to 80 % of the wage.

THAILAND

THAILAND



Due to its regional location and attractive investment conditions, the Kingdom of Thailand is an interesting location for foreign companies. Thailand has been a constitutional monarchy with a parliamentary system since 1932. Despite internal political disputes which have occurred since 2006 and in particular in 2010 lead to unrest in the capital city of Bangkok for a short period of time, Thai economic policy has remained stable and friendly to investors. The Thai currency is the Baht which in recent years has been very stable and in comparison to the euro has risen in value. The country has one of the strongest growing economies in south-east Asia. The system of the country is based on democracy and law, offers a domestic market of over 67 million consumers and has a strategic position with regard to the opening up of markets with dynamic growth in the Asia-Pacific region. An important role here is played by the membership of Thailand in the Association of Southeast Asian Nations (ASEAN), which continually pursues the objective of a uniform domestic market, the ASEAN Economic Community (AEC). This foresees the dismantling of customs and other trade barriers between the states of south-east Asia and the building up of a regional market with more than 500 million consumers. In this respect since 2010 the 6 ASEAN states (Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand) have removed nearly all customs duties.

Thailand has been negotiating an extensive free trade agreement with the EU since March 2013. The planned extensive agreement should serve to dismantle customs duties and non tariff trade barriers for goods and also cover other trading aspects such as services, investments, public procurement, competition and sustainable development and as a result in future the business prospects for German enterprises will continue to improve.

Legal forms of business und founding

Thai corporate law is based on German law. The legal forms which exist are comparable with the legal forms to be found in Germany. As a joint stock company Thai law recognises the private limited company and the public limited company and as business partnerships the unregistered ordinary partnership, the registered ordinary partnership and the limited partnership

Joint stock companies

Private Limited Company (Co., Ltd.)

The majority of foreign investors choose the Co., Ltd. which is a joint stock company comparable to the German GmbH. As such it can enter into binding contracts on its own

account, own property, acquire rights, and be a party to legal proceedings. Personal liability of the shareholders only exists to the extent that their share of the capital has not been fully paid in and is limited to the unpaid amount. Furthermore, the personal liability for financial obligations of the company is excluded. The company acts as a legal entity through its bodies (managing director und shareholders' meeting). The operative business is managed by one or more managing directors, who also represent the company externally.

There are a number of differences to German law in the founding phase. The Co., Ltd. has to be founded by at least three natural persons (so-called promoters), who respectively each sign for one share. Later on three shareholders must also always hold shares, whereby after the founding phase these can also be legal entities. In contrast to German law, a company with only one shareholder is not possible. In the foundation document, the promoters define at least the company, the address of the company in Thailand, the distribution of the company shares, the amount of the share capital and the exact company purpose.

The registration process begins with the reservation of a company name and the submission of the foundation document with the ministry of commerce. In principle, a minimum share capital is not required by law. However, the registration checks whether the registered capital is sufficient and appropriate for the intended economic activity. In addition, it should be observed that also with the application for investment grants, special business licences or work permits for foreigners the amount of the registered capital is relevant.

Public limited company (PLC)

In contrast, the PLC is designed for a wider distribution of shares. It is comparable to the German joint stock company (AG) and has its legal basis in the Public Limited Companies Act. The transactions of the PLC are managed by an executive board which must consist of at least five natural persons. At least half of the executive board members must be resident in Thailand. It is not relevant, on the other hand, whether the executive board members are themselves shareholders of the company. The executive board members represent the company internally and externally. The founding of the PLC must be made by 15 natural persons of which half must be resident in the Kingdom and who subscribe to at least 5 % of the capital. The company acquires legal relevance with the conclusion of the registration process. In the time thereafter the company must always have at least 15 shareholders. Provided the legal conditions are met, the PLC can be listed on the stock exchange. In comparison to the Co., Ltd., there are increased requirements with regard to financial accounting.

Business partnerships

Ordinary partnership

With an ordinary partnership at least two partners bind themselves by contract to achieve a certain purpose and for the promotion of this they make contributions in the form of money, non-cash benefits or services. Unless otherwise defined in the articles of association, all the contributions are deemed in principle to be equal. The shareholders have to be natural persons. The company purpose is not subject to further legal requirements and also for the founding there are hardly any formalities and no obligations regarding disclosure. In particular a registration is not required. Only the articles of association are required, whereby the scope and content is left to the partners. As a result the articles of association already exist when the partners mutually agree to take up the business activity, without the fixing of details beforehand in writing. The ordinary partnership is treated by the tax system as a unit. As a union of persons it is subject to its own form of income tax which is modified with regard to the possibilities of deduction compared to the income tax of natural persons, but is not subject to corporation tax.

Under company law, the ordinary partnership, comparable to the German partnership under the civil code (GbR), as a basic form of business partnership is a legal personality which is not different to its shareholders. Accordingly, all partners assume unlimited liability as joint debtors with their personal assets for company debts.

Registered ordinary partnership

The legal form of an existing ordinary partnership can be retrospectively changed through registration. With the registration a registered ordinary partnership is formed which itself is a legal entity, i.e. it can also be a party of a contract or a party of a legal dispute under its own name. It is therefore seen apart from its partners and becomes a legally independent unit. It mainly corresponds to the concept of the German open trading company (OHG). Concerning company management and external representation by the shareholders, the registration does not change the situation as defined by the non-registered ordinary partnership. However, the registration has an effect on the liability for company obligations. Although the partners continue to be subject to joint personal unlimited liability, the liability, in contrast to the ordinary partnership, is not primary. In fact there is only likely to be recourse to the partners if the company is in default.

Limited partnership

The limited partnership is a separate legal identity from its shareholders and acquires this status through registration. It is marked by the unique characteristic that the personal liability of shareholders can be limited to the amount of their contribution to the share capital. There must, however, in contrast to the Co., Ltd., always remain at least one shareholder with unlimited liability. The result is that there are two groups of shareholders, whereby one group is subject to unlimited personal liability and a second group is subject to limited liability. The structure is similar to the limited partnership (KG) under German law with its general partners and limited partners. The company management is exclusively reserved for shareholders with unlimited liability. However, if a shareholder with limited liability participates in the company management, then he loses his privilege of limited liability and his status changes to that of a shareholder with unlimited personal liability.

Joint ventures

According to the Thai Foreign Business Act (FBA), legal entities are considered to be foreign if at least half of the company capital is held by foreigners. Therefore, provided no promotion through the Board of Investment (BOI) is achieved or sought, a company form with a 51 % Thai interest is usually chosen in order to ensure that the company is assessed to be a domestic company and is not subject to restrictions. If the foreign partner, however, is to control the company, a preferential participation with differently weighted voting rights can be agreed.

Foreign exchange law

Foreign exchange trading is regulated by the bank of Thailand and may only be carried out by approved banks. Transfers to and from Thailand are not restricted with regard to value. Natural persons and legal entities may hold foreign exchange accounts at the approved banks.

Liquidation of the company

The private limited company is dissolved through the attainment of the company purpose, after a period which is fixed in the contract, through the determination of bankruptcy or through a corresponding shareholders' resolution. Furthermore, liquidation can be ordered by court if the registration authorities in formal proceedings cannot establish business activity of the company or the number of shareholders is below the legal minimum of three shareholders.

The public limited company is dissolved through a corresponding shareholders' resolution, a court order or the opening of insolvency proceedings. It remains, however, in the same way

as the private limited company in existence and able to act for the duration of the liquidation phase under the control of a liquidator.

The ordinary partnership is dissolved if the agreed duration or the company purpose is reached, or if a corresponding court order is served. Due to the character of the ordinary partnership as a partnership reasons for dissolving the company are also ordinary notice of termination, a legal incapacity, insolvency or death of a partner.

Regarding the liquidation of a registered ordinary partnership and of a limited partnership, the same applies as was already described for the ordinary partnership. A further reason for liquidation here is constituted by the insolvency of the registered ordinary partnership itself.

Real estate and acquisition of land

According to Thai law, it is in principle not possible for foreigners in the form of natural persons and legal entities to acquire property in Thailand. There are, however, a number of exceptions to this principle. For example, for foreign natural persons there is the possibility in connection with an investment in Thailand to acquire property for residential purposes. Under certain conditions, foreign companies can also acquire land. If a company is founded in an industrial estate or investment funds are granted by the board of investment, it is not possible to acquire land for the location of the enterprise.

Labour law and dismissal protection

The Thai labour market is able to provide an adequate range of workers in all industries and fields also including technical and management personnel. In comparison to the European standard, personnel costs can be described as remaining very low. According to the regulations of the labour code, the regular working time may not exceed 8 hours per day and 48 hours per week. In addition to Thai public holidays, the employee is released from the duty of working one day in the week. The claim to holidays for the purpose of recuperation depends on the duration of company service, but amounts to at least 6 days per year. Overtime hours on normal working days are remunerated with a factor of 1.5 times the normal wage, working on public holidays with a factor of 2 and overtime hours on public holidays with a factor of 3.

The taking on of employees who are not Thai nationals in principle depends on the issue of a work permit. Exceptions here are the requirement for a work permit for certain groups of persons (e.g. for activities in the area of education or art). The applicant must be in possession of a non-immigrant visa or of an unlimited residence permit. A decisive criterion for the issue of work permits is the capital resources of the company. According to the current reference

values, for each issued work permit a capital amount of two million baht is required. The relationship of foreign to Thai employees in companies should be at least 1 to 4. This is only a minimum requirement in addition to which depending on the industry and circumstances of the individual case further conditions will have to be fulfilled.

The notice of termination of an employment contract must be made in the written form and a notice period of at least one month complied with relating to the next salary payment. The minimum amount for a settlement payment is determined by Thai labour law depending on the duration of the employment, whereby:

- for a minimum of 120 days the payment is 30 days' pay,
- for at least one year 90 days' pay,
- for at least three years 180 days' pay,
- for at least six years 240 days' pay,
- for at least ten years 300 days' pay.

Practical examples

Auditing

Background facts:

A German production company with international operations maintains subsidiaries in a number of companies, and also in Thailand. In the course of time there is increasing evidence that the local managing director is alleged to have misappropriated money or goods. The accusations are made anonymously in a very polemic manner, but do contain a number of points which seem to appear believable.

What can be done now?

In principle, there is the possibility of reacting to these accusations with specific investigations undertaken by an auditing firm. An embezzlement audit would have to be carried out in the local subsidiary. However, this usually leads to the undermining or even shattering of the trust relationship with the local responsible persons. An alternative is offered by the possibility of reacting to the specific accusations in the course of a standard audit of the financial statement and to carry out selective investigative actions under the cover of a regular audit of the financial statement. After the appropriate knowledge could be established with corresponding usable evidence which confirms the anonymous accusations, there would be the possibility of expanding the investigations with regard to an actual embezzlement audit.

What should one have done differently from the beginning?

It is basically difficult to avoid such situations in a company with subsidiaries some distance away, as in particular anonymous tips due to bad feelings in the company may occur. Nevertheless it is conceivable that in countries where such accusations due to established structures are often not ill-founded, the above-mentioned assignment to audit the financial statement can always be extended to include specific investigative actions. As a result, one is continually in a position to react to such situations. The approach becomes the norm in the company in the company group and to a certain extent also has a preventive effect. Rödl & Partner offers such extensions to the usual audit within the framework of the international financial & performance audit.

Taxes

Background facts:

The German beverages company G would like to offer a new type of soft drink in Thailand for which it holds industrial property rights (patents, trademarks). However, it does not have its own distribution organisation in Thailand. Therefore G plans to produce and distribute the lemonade under licence from a Thai company. G also wishes to actively support the Thai partner through appropriate marketing measures and a local presence with the most important wholesalers.

After G has started to implement its plan, the company receives a tax assessment from the German tax office which also takes into account its business activities in Thailand. Furthermore, the financial accounting personnel establish that licence fees have not been transferred in full to the German bank account. After enquiries are made, G finds out that the co-operation partner has retained a withholding tax to the amount of 15 % of the payment.

What can be done now?

Rödl & Partner is assigned to examine how the business model can be improved. A number of aspects should be taken into account in the course of the analysis. First of all, all withholding tax statements from the past should be obtained from the Thai partner and then these possibly used for a modified tax return in Germany.

What should one have done differently from the beginning?

In future, a check should be made regarding the possibility of indeed founding a subsidiary in Thailand. In addition to the legal barriers to investments in Thailand, however, this check should also take into account that due to the low tax rate in Thailand German companies who pursue a so called passive activity abroad are subject to add-back taxation in Germany. In the present case in this respect it would be important to observe how high the shareholding of G is and the extent to which G participates in the activities abroad.

An business commitment abroad should be thoroughly planned and prepared in advance. The business plan must also consider the total tax burden in order to ensure that double taxation does not occur. Careful tax planning which takes into account the tax system of the respective destination country and also the German tax regulations can substantially reduce the tax costs.

Law

Background facts:

The German A-GmbH plans to found a distribution company in Thailand. The object of the business should be the retailing of electronic components. The German A-GmbH would like to maintain control of the company and therefore submits constitutional documents for the founding of a 100 % foreign invested limited company with the appropriate investment authorities. The application is rejected.

What can be done now?

In the structuring of a foreign investment, the restrictions with regard to the allowed ownership structure should be observed. This is true for Thailand, whose Foreign Business Act (FBA) foresees a majority interest for a non-foreigner for the named retailing activities, and is also true for most of the other countries in the ASEAN region. The application documents therefore have to be adjusted to fulfil the legal requirements for investments. This is possible through the placing of an application for an exception licence which in particular can be granted in connection with the distribution of high technology, or the payment of a certain minimum share capital which is required for exemptions to investment law. In practice, companies are frequently founded with a local majority shareholder whose voting rights are limited through the issue of preference shares. The rights to dividends can also be arranged using the same method. In this process, care should be taken to ensure that the local shareholder does not only take on the position of a trustee, which would be a violation of the FBA. As a result in this respect certain recognised threshold values in administration practice should be observed in order to acquire the business certificate which will allow the company to operate.

What should one have done differently from the beginning?

The issue of the distribution licence in Thailand depends on different points of the investment law, whereby it is important that they are taken into account before market launch. An exact examination of the ownership structure and other aspects such as the cost and duration to apply for a business licence for the relevant product groups therefore have to be included in the business planning.

Law / Administration

Background facts:

The German X GmbH offers service and consulting abroad. The company sends its employee A to Mexico for a limited project and the employee takes his own private second hand car to Mexico for the duration of the project. After the end of the project in Mexico the employee is sent to Thailand for a different project. The employee then hands over his personal items and the private car to a forwarding agent in Mexico, but does not declare the car.

After the Thai customs have received all the goods, they clear the car only on the condition that confirmation is provided that the car is exempt from duty. Otherwise the car will be sold by auction and could be repurchased by the original owner. There are no other options. The customs accordingly twice sets a deadline which expires to submit the documentation. If the deadline expires, after a total of three more months the forced auction will be carried out.

What can be done now?

Car imports, whether for new cars or for second hand cars, are frequently a problem in Thailand. The import duties are usually considerably higher than the new price of the car. Second hand cars are also taxed according to engine capacity and current market value using corresponding lists from the customs department. While for new cars in the case of a missing declaration it is a simple case of subsequent payment of the tax, this option is not possible for second hand cars.

Due to the fact that for the employee himself and also for his employer in this case there is no special agreement allowing exemption from duty, there remains only one possibility. He must wait for the notification of the official date of the forced auction and buy back the car at the auction with a corresponding bid. In addition, there would be further costs of storage and the administration fees from the customs. The meaningfulness of this action is decisively defined by the car type, age and equipment level, e.g. left-hand drive, the predicted demand for such a type of car in Thailand and the personal interest of the affected person in his specific car.
An alternative would be to send the car back to the country it came from. This procedure, however, is often not practical because the logistics, customs and storage charges and the import taxes in the country of origin are uneconomic.

What should one have done differently from the beginning?

In connection with imports to Thailand, it is recommendable to declare all goods as accurately as possible and at the same time to present all the required documents. This is the only way to at least reduce risks and long delays and demand of high charges by the customs authorities. In the end, also with a forced auction there is the risk that the car cannot be bought back or only bought back for an excessive price which means that the preventive measures would appear to be more attractive.

Fraud

Background facts:

German A GmbH owns a subsidiary in Thailand which it uses to distribute its products. The local managing director has the sole power of representation for the Thai company. In his contract of employment there are no regulations for restrictions. He is able to make transactions to an unlimited amount. At the end of a year and at the cost of the company he purchases electronic communication devices in significant quantities and later declares to have used these objects as promotional gifts for customers at Christmas time. Furthermore, he also makes the company pay for substantial travel costs. The latter, however, is made without the presentation of external documents, but merely with claims for travel expenses he himself has drawn up. Further proof is not provided by him. The company management of the parent company in Germany is certain that these actions constitute fraudulent or disloyal behaviour of the managing director according to the Thai criminal code and possibly also according to the German penal code. They would therefore like to dismiss their managing director as soon as possible, demand repayment of the lost money and introduce criminal proceedings.

What can be done now?

It is theoretically possible to start civil or criminal proceedings against the managing director. However, at least for civil claims definite evidence and documentation is required. Criminal proceedings may provide the opportunity to collect the corresponding evidence. If this is not successful and it is not possible to find other evidence, the civil proceedings against the managing director have no chance of success. In fact it is more likely to be the case that it will be necessary to pay the managing director a settlement to which he is in principle entitled. The shareholders' meeting which is called can essentially only decide to dismiss the managing director.

What should one have done differently from the beginning?

As far as it is economically viable, the contract of employment of a managing director should include a restriction of the power of representation. This regulation will not have an external legal effect, but in the event of inappropriate behaviour of the managing director it will enable action to be taken. Furthermore, in the case of serious misconduct a settlement would also not have to be paid. The stipulation of behaviour rules such as the obligation to provide proof of company costs and travel expenses is a suitable tool to enable the quick handling of any potential differences in an uncomplicated manner. Furthermore, a reliable controlling mechanism within the company should exist in order to discover such irregularities at an early stage.

Corporate (white-collar) crime

Background facts:

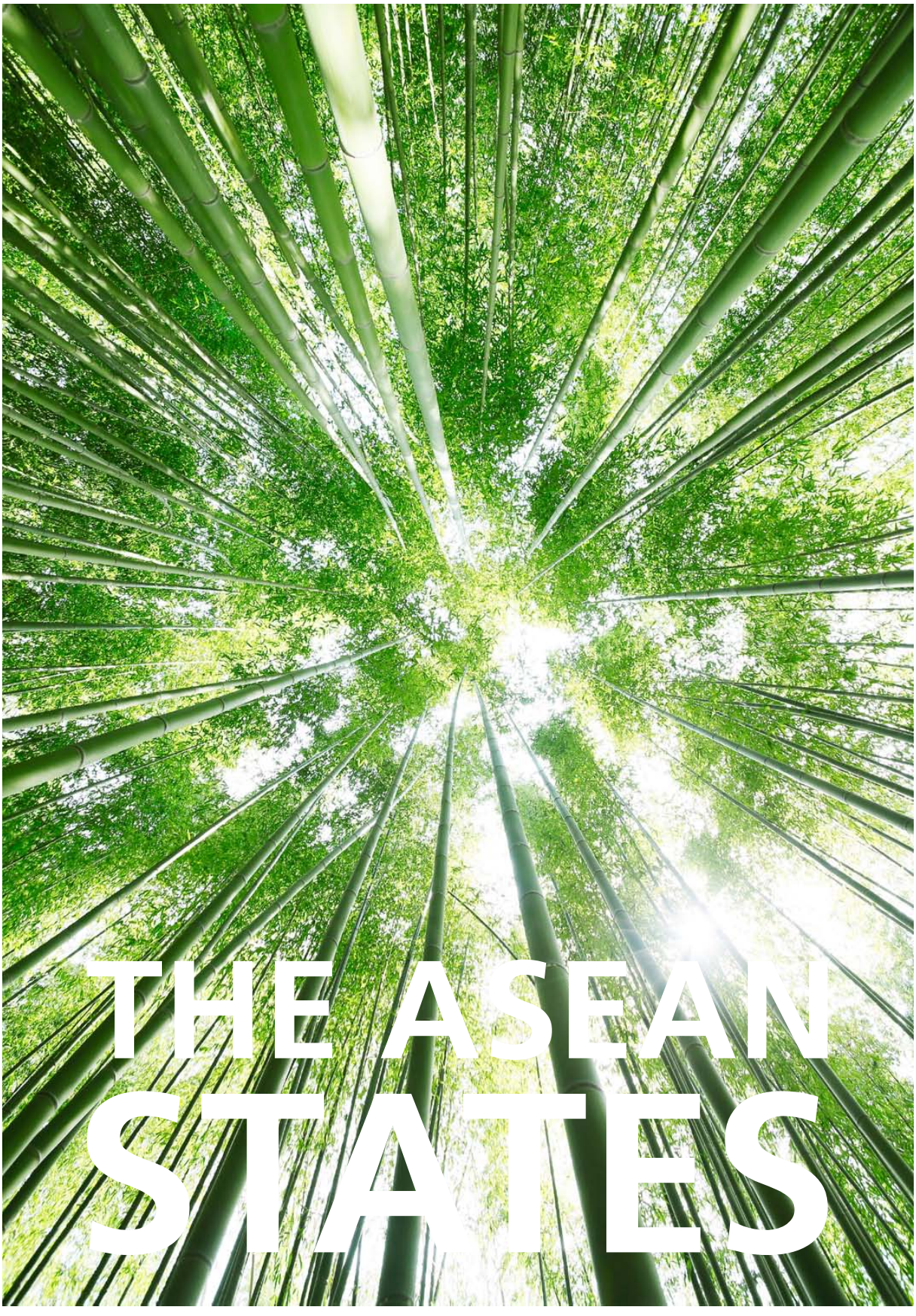
The company X GmbH would like to found a subsidiary in Thailand. In order to avoid coming under the scope of the Foreign Business Act and the associated complex licencing procedures for foreign companies, a Thai shareholder holds 51 % of the shares. A trust agreement is concluded between the Thai shareholder and the parent company. Later on there are irregularities with the Thai majority shareholder. He commits a breach of trust and without consultation carries out considerable structural changes in the company. Due to the fact that the German parent company only has 49 % of the shares and therefore in the shareholders' meeting can be outvoted on important decisions, it decisively loses influence on the subsidiary company. Now the initiation of legal action is considered against the Thai trustee.

What can be done now?

It is theoretically possible to start civil or criminal proceedings against the offending managing director. However, that will result in problems in connection with the trustee agreement concluded with the Thai shareholder due to the fact that this is not tolerated by Thai law and represents an attempt to circumvent the Foreign Business Act. As an alternative there is the possibility of an out of court settlement with the shareholder. In addition, liquidation by court order is to be considered, which, however, could have adverse consequences for the trustee as well as for the company itself.

What should one have done differently from the beginning?

In the planning phase to enter the Thai market, foreign investors should intensively consider the possibility of an authorisation procedure for a foreign business licence. This enables more freedom to structure the company shares including the foreign majority holding. If the procedure proves to be too lengthy or pointless, there is the possibility of founding a Thai company, whereby a Thai owner must have the majority of the shares. A trustee relationship is not permissible here under any circumstances. In order to avoid later conflicts, in such a constellation a call option can be assigned against the Thai majority shareholder. This allows the transfer of the shares at any time. In addition, the issue of preference shares can be used to arrange for voting rights and dividend distributions in a way which is acceptable for the German parent company but which weakens the position of the Thai majority shareholder without contravening the local regulations. A clear company structure according to the regulations in Thailand absolutely essential for a long-term business perspective where it is still possible to assert claims even if there is a dispute.


THE ASEAN
STATES

THE ASEAN STATES

The Association of South East Asian Nations (ASEAN), comprising the member states Malaysia, Philippines, Singapore, Thailand, Brunei, Cambodia, Laos, Myanmar and Vietnam) is becoming increasingly more important for European industry. From 2015 there are plans to establish the ASEAN Economic Community (AEC) which will result in a single domestic market of over 600 million inhabitants. Along with the already largely introduced introduction of preferential customs duties for most product groups, the free movement of capital and services and freedom to work in the zone is to be strengthened.

The extent to which an integrated economic zone can actually be achieved by 2015 remains questionable. Problems include economic disparity between the individual member states, partly strongly divergent national interests and foreign policy connections which will complicate efficient negotiations. The movement of goods is relatively well developed. The ASEAN Trade in Goods Agreement (ATIGA) came into effect already on May 17, 2010. ASEAN has also agreed a series of further free trade agreements, for example with China. The EU is currently negotiating a bilateral agreement with individual member states and in 2014 the agreement is likely to be ratified with Singapore.

Foreign investors from Germany and Europe will still have to deal with numerous pitfalls in the ASEAN business world. Provided a local content of 40 % is generated companies can indeed benefit from preferential customs duties, but this does not alter the fact that companies remain confronted with numerous non-tariff barriers of the individual states. Regarding a planned investment there, the extent to which the respective market is already open for the intended business activity should be exactly clarified in advance. This is because in many areas the national investment laws still include investment restrictions so that it is not necessarily possible to found 100 % foreign-owned enterprises. The most liberal is the business environment in Singapore where in comparison to the rest of the region there are only very few market entry restrictions.

In order to address these types of market entry problems, at Rödl & Partner local and German professionals in the area of investment and tax structuring and international commercial law work closely together. The practice-oriented and detailed planning under consideration of the legal and tax specialities of the respective country is a decisive factor for foreign investments in Asian projects. Speedy reactions to changes of the dynamic legal and tax systems in the region are absolutely essential to secure the medium-term and long-term potential for success of foreign business activities in the target countries of Southeast Asia.

Rödl & Partner offers clients customised solutions for their respective business project which along with joint venture structures also include the founding of 100 % foreign-owned enterprises by means of special licences or special forms of investment incentives. We can offer commercial and tax expertise at our locations and have extensive experience with the registration procedures and licence agreements. Since the end of the nineties Rödl & Partner has had its own locations with multi-disciplinary professionals in Singapore and Jakarta. In addition, own offices were opened in Thailand (Bangkok, 2006), Vietnam (Saigon [Ho Chi Minh City], 2007) and Malaysia (Kuala Lumpur, 2013). In parallel we have been working for many years together with local professional firms in the Philippines.

Practical examples

Auditing

Background facts:

A German company has a subsidiary in Malaysia. The subsidiary produces for the Asian market and also for the German parent company. The auditing firm was only assigned to audit the annual financial statement. The local commercial manager is the only local worker in the ERP system and has good knowledge of accounting issues and bookkeeping matters. He used this knowledge and lack of control by the German parent company for his own personal gain.

What can be done now?

The execution of an internal audit to clear up the resulting damage is appropriate. In addition, a more effective control system must be installed. Where the control should take place depends largely on the size of the subsidiary. If the subsidiary can or should not control the managing local personnel, then more control is called for by the parent company. This includes inspection of monthly reporting of individual orders and accounts and regular visits to the subsidiary. Furthermore, the function of the internal audit must be carried out regularly. The auditor can carry out this function as far as it is not a local company.

What should one have done differently from the beginning?

The qualified managing director/commercial manager at the subsidiary, who often becomes the main contact person for the German parent company, should also have been checked.

Tax

Background facts:

The commercial manager of a German company with the legal form of a GmbH would like to found a branch office in Singapore. The office will distribute machinery. He is happy that a private limited company can be founded for as little capital as one euro. A plan to optimise tax is not required. In the first two years the company makes a loss. The financing is made through long-term loans. As the father is 'fed up to the back teeth with the foreign adventure', he hands over the reins to a 'younger pair of hands' and shortly afterward transfers his shareholding over to his son. Then after the transfer has been made one opts for a repayment of waived loans with future profits. One is surprised to learn that in Singapore the reclassification of the loan is subject to payment. In the first year after the transfer a profit of one million euros is generated, which the son immediately has distributed. Later he is annoyed that in Germany he has to pay tax on this.

What can be done now?

In retrospect it is difficult to do something here. Taxes arise through actual facts which have been realised. Many companies exhibit naivety when they start a venture abroad without consideration of a mechanism for cross-border taxation. At the same time it is overlooked that the facts in a foreign country could be assessed differently than in Germany. German tax law is no role model for many countries, which can be often advantageous, but also can be disadvantageous. In this case one could consider not distributing the profits in Singapore. Before you do this you should restructure the company in Germany. With tax savings of possibly more than 200,000 euros the effort will be worthwhile.

What should one have done differently from the beginning?

First of all the accounts of the company in Singapore should have been cleaned up, i.e. the debt waiver should have been carried out before the transfer of the shares. As soon as the loss carried forward of the Singapore company had been used up – possibly after retention periods to be taken into account – the shares could have been transferred.

In Germany it should be documented that the debt waiver was made at customary market conditions. In particular, also the tax-related consequences of a gift should be taken into account as due to the removal of the debts the company in Singapore has risen in value. Finally, a check should be made whether the agreement to repay the waived loans with future profits is recognised by corporate law in Singapore or whether Singapore does not

permit such arrangements. Secondly, one should have considered beforehand whether the tax burden in Germany can be fine-tuned. For example, this could be achieved through a business partnership model. A commonly used form here is the GmbH & Co. KG because here, just as with the GmbH, the liability risk for shareholders is lower. But also here it is necessary to exactly check the local and German tax and legal arrangements as not every business partnership abroad is recognised as such in Germany and in the foreign country it will be partly necessary to enter the new legal ground of business partnerships.

Law

Background facts:

The German company U produces and distributes industrial adhesives worldwide and enters into negotiations with distributors to supply the market in Vietnam. However, U has considerable reservations with regard to jurisdiction in Vietnam and would prefer his foreign related contracts to be subject to German law. Therefore he changes his standard contract only slightly and declares that Germany is the legal domicile for all legal disputes. Later he is unable to enforce his rights against a defaulting contract partner.

What can be done now?

In particular with cross-border business relations procedural pitfalls have to be taken into account. There is no convention between Germany and Vietnam for the reciprocal recognition and enforcement of court rulings. The same is true for numerous other ASEAN states such as Indonesia or Thailand. This means that in principle German court decisions are not enforceable in Vietnam. It would only be conceivable to access the assets in Germany of the contract partner from Vietnam, but these generally do not exist. Therefore an international arbitration clause would be advisable for U.

What should one have done differently from the beginning?

When drawing up contracts to do business in Vietnam (as is true for almost all of the other ASEAN states) an international arbitration clause should be included in the contract. Like Germany, Vietnam is a member state of the New York convention on the recognition and enforcement of foreign arbitral awards of June 10, 1958. Consequently, decisions of an arbitration court can be enforced locally. In addition to the Vietnamese international arbitration centre (VIAC) which is based in Ho Chi Minh City, for contracts with reference to ASEAN in practice in particular the arbitration court in Singapore (Singapore International Arbitration Center, SIAC) is selected.


TURKEY

TURKEY

"There is an economic boom in Turkey!" This is the message we have become used to over the years the statement is based on facts.

Figures show that very many German investors want to benefit from the boom. As a result, Germany with a trade volume of 35 billion euros is one of the largest trading partners of Turkey. There are approx. 5,300 companies originating from Germany which in the meantime have established themselves in Turkey. Nevertheless, entry into the Turkish market should be well organised and planned.

In Turkey, companies with foreign capital have the same status before law as companies with domestic capital. This also means that authorisation, with a number of exceptions, is not required to found a company. The transfer of foreign exchange can be freely undertaken. There have been many changes to the law in the course of adjustment measures for EU directives. Accordingly, the commercial law which came into effect on July 1, 2012 had to be rewritten by more than 90 %. The new law is similar to German law.

There is a double taxation agreement between Turkey and Germany. The agreement gives German investors some tax advantages. The situation can, however, quickly lead to grounds that a branch office exists. The implementation of the agreement can vary in contrast to the conditions which are regulated in the agreement. For this reason the involvement of a consultant in this regard is considered to be indispensable. In the same way the report of the annual financial statement or the monthly or quarterly reports must be seen as essential items in order to have full control of the financial situation of the company. This is because the offence of negative equity can lead to liquidation of the company.

Furthermore, the registration of brands and patents is important. It is not sufficient if these enjoy protection in Europe. Prior to entry into the Turkish market the intellectual property of each product should be protected in Turkey. These formalities are processed at the Turkish patent office in Ankara.

The above-mentioned points indicate some examples where there is a possible risk in Turkey. It goes without saying that each case has to be examined on its own merits. Our consultants are available with their excellent German knowledge and qualifications in our law firm in Turkey and are happy to support German companies with legal and tax consulting and auditing. You can secure your entry into the Turkish market with us.

Practical examples

Auditing

Background facts:

The financial statements of a distribution company of a German industrial company in Turkey were audited and the audit discovered possible indications of irregularities concerning the actions of the managing director. This information was passed on to the company group in the usual reporting process and to the parent company. The parent company, however, decided not to act on this information.

In the current audit of the financial statement the indications became more apparent to the extent that it was proven that the managing director and the local financial accounting worker had made unfavourable contracts for the procurement of office equipment and IT (with closely linked individuals).

What can be done now?

Due to the immediate communication of these discoveries by the auditor of the subsidiary to the company group auditor, short-term measures are necessary from the parent company. In addition to legal measures, an investigation by an internal audit of the parent company has also to be introduced. A corresponding loss assessment has to be carried out.

What should one have done differently from the beginning?

Indications from a company group audit to the management of the parent company should generally be followed up. It can be assumed that the auditors of the subsidiary did not thoughtlessly communicate such information, but that the information is based on facts. If the parent company had immediately introduced an internal audit (possibly described as a regular examination) or required additional investigation actions by the local auditor of the annual financial statement, the damage could possibly have been reduced.

Auditing / Taxes

Background facts:

Some years ago the Saubermann GmbH founded a company in Turkey and appointed a managing director. At the beginning business went well and the control of the company management by Saubermann GmbH slackened. The Saubermann GmbH was satisfied and decided that an internal audit was unnecessary. However, high expense claims and complaints of suppliers gradually came to light. The Saubermann GmbH decided to commission Rödl & Partner to investigate. The investigation revealed a series of unpaid invoices and incorrectly paid taxes and social security contributions and other irregularities.

What can be done now?

Such a case usually calls for an internal audit with a wide frame of reference. In this case as well as the suspected irregularities already described it turned out that a part of the salaries had been paid illegally without declaration to the tax authorities and that the financial accounting had not been properly maintained. A quick decision was made to dismiss the managing director, the financial accounting was outsourced and irregular actions were corrected one after the other. The outstanding claims from suppliers were settled. All the employees received an employment contract and the salaries were paid to the full amount. It was unfortunately not possible to avoid payments for arrears and fines.

What should one have done differently from the beginning?

An internal control system and an annual financial statement report should have been established or prepared right from the start. The financial accounting should have been outsourced. Monthly or quarterly reports would have contributed to immediately determine and prevent the irregular activities. The tax consultants and auditors of Rödl & Partner are there to support you. The preparation of the annual financial statement report is made in great detail professionally in German or English.

Law

Background facts:

The Reinmach AG founds a joint stock company in Turkey. The chairman of the executive board takes over the Turkish partner. The chairman of the executive board had the authority to represent and obligate the company alone. In the audit of the annual financial statement it turned out that there were substantial credit debts of the company. Furthermore, it was established that a number of the leased cars were not used in the company. Two of the company cars were passed on to relatives of the chairman of the executive board for their private use.

What can be done now?

The holding of an extraordinary general meeting has to be quickly organised. At the general meeting the executive board is dismissed and a new one is appointed. The authority of the new board can be limited or legal transactions requiring consent can be defined.

What should one have done differently from the beginning?

Prior to the beginning of the partnership, a so-called shareholders' agreement should have been concluded with the Turkish partner. This would have listed all of the details of the partnership. The binding regulations of the articles of association of the company should not have been ignored. In addition, legal transactions which require consent should have been defined. The acceptance and granting of loans should have been defined as legal transactions which require consent.


UKRAINE

UKRAINE

The Ukraine is one of those countries which could become very significant for foreign investors.

The Ukrainian economy has a very high potential with a large sales market of 46 million inhabitants, a well educated population, fertile land (30 % of the black earth soils of the world) and oil, gas, and coal reserves. Apart from that, the Ukraine occupies a very strategic position between EU and Russia. Roughly 80 % of all gas pipelines in Europe pass through the territory of the Ukraine. In addition, the Ukraine is an important transit country between Europe and Eurasia.

The Ukraine aspires to EU membership in the near future. A decision here will depend on the signing of the association agreement.

Legal forms of business

According to Ukrainian law business partnerships and joint stock companies are possible as conceivable legal forms.

Business partnerships:

Full company (comparable with the German OHG)

In the full company the shareholders are liable with their personal assets for the liabilities of the company. The company has, however, in contrast to a German OHG, its own legal personality.

Company with additional liability

In this company form the shareholders are liable for the liabilities of the company not only to the extent of their contribution according to the articles of association, but also additionally with their own private assets corresponding to the amount of their shareholding. The foundation documents define the maximum liability amounts.

Limited partnership

The limited partnership is similar to the German limited partnership. It is a company where the general partners assume liability for the obligations of the company with their full assets and the limited partners only to the extent of their capital contribution. They are not involved in the company management.

The business partnership is not chosen very often as the company form in the Ukraine. It hardly offers the shareholders tax advantages, but is associated with high risks for personal liability. For these reasons joint stock companies are the most common legal forms in the Ukraine.

Joint stock companies

The company with limited liability

This is a "TOV" company in the Ukraine. The company is comparable to a German GmbH. The shareholders only assume liability for the obligations of the company to the amount of the value of their contributions. The company can be founded by natural persons or legal entities. A sole trader TOV is also possible in the Ukraine. Here there is, however, a restriction to take into consideration. The law prohibits that the founder of a sole trader TOV can also be a sole trader TOV.

In the Ukraine, the number of shareholders of a TOV company is defined by law. The number must not exceed one hundred persons. If the number of shareholders of a TOV company reaches one hundred, within one year the company must be converted into a joint stock company.

There are no legal regulations in the Ukraine which define the minimum amount of share capital. The share capital can also be increased at any time. Such changes are subject to registration with the state register. The share capital must be paid in within one year after registration.

Joint stock company (in the Ukraine called ZAT or VAT)

Differentiation is made in the Ukraine between two forms of joint stock companies, the private and the public joint stock company. In the private joint stock company the number of shareholders must not exceed one hundred persons. The shares of this type of company can only be offered privately. The public joint stock company may have an unlimited number of shareholders. The share capital here is divided between a certain number of shares which must have the same nominal value. The law stipulates a minimum amount of share capital. The share capital must not amount to less than a factor of 1250 of the minimum wage in the Ukraine. The minimum wage in the Ukraine currently amounts to 1147 Hryvnia. The share capital must therefore be a minimum of 1,433,750 Hryvnia. The shareholders of a public joint stock company assume liability for the obligations of the company up to half of the shares they hold.

Forms of activity for foreign investors

Foreign legal entities and natural persons can engage in economic activity in the Ukraine to an unlimited extent. Foreign investors can found new companies according to Ukrainian law or acquire shares in an existing Ukrainian company. In addition, it is also possible to open a representation or branch office in the Ukraine of a foreign company. In the Ukraine, domestic and foreign investors are free to act to exercise the business activity. A number of types of activity, for example, which are classified as particularly dangerous, require the issue of a licence which is obtainable from the respective ministry or other administrative bodies. The types of activity which require a licence are defined by Ukrainian law.

Labour law

Ukrainian labour law is relatively bureaucratic. Each foreign citizen who would like to take up an employment relationship in the Ukraine with a Ukrainian employer needs a work permit. On the basis of a work permit, a business visa is issued and after entering the country a residence permit is issued. The procedure leading to the issue of a work permit can be very lengthy. For example, a check is made of whether the same position cannot be taken up by a Ukrainian employee. In the Ukraine the working week amounts to 40 hours. The employee has by law a minimum of 24 days holiday per year.

Real estate and acquisition of property

The land reform is one of the most important reforms carried out in recent years in the Ukraine. The reform abolished the collective and state forms of ownership. The areas were divided into so-called lots (Paj). A lot is only a right to receive a piece of land with the equivalent area. The conversion of lots into right of ownership started in 2008 and up to the present time the greater part of the lots has been transformed into property.

In 2000 a moratorium took effect in the Ukraine which will only be lifted with the passing of two important laws concerning the "Property market" and "Land register". The law concerning "Land register" was signed by two presidents and on July 7, 2011 was adopted by the Ukrainian parliament. The law determines the introduction of the nationwide land register. The draft law for "Property market" has not yet been adopted.

The acquisition of agricultural land is strictly prohibited in the Ukraine for foreigners. Foreign citizens may acquire residential property and building plots which are not classified as agricultural land.

From the draft law for the "Property market" it is clear that the acquisition of agricultural areas by foreign persons will continue to be prohibited. An open agricultural property market is not planned at the current time. Foreign investors will continue to have the only option of leasing land for an investment. Of the 41.6 million hectares of agricultural land in the Ukraine, approx. 17.4 million hectares are leased out.

Foreign exchange law

In the Ukraine, the principle of freedom to carry out foreign currency operations is applicable for example to carry out transfers, purchasing of securities, purchasing of hard currency, etc.). This principle was restricted for a number of foreign currency operations. The restriction depends on whether the affected person is considered to be a resident or non-resident. Residents are natural persons who have their residence in the Ukraine. Legal entities are considered to be residents if they have their domicile in the Ukraine and were founded according to Ukrainian law. Non-residents are persons who are only temporarily staying in the Ukraine or who have their residence abroad. Legal entities are non-residents if they were founded and operate according to foreign law. According to the Ukrainian foreign exchange law foreign exchange transactions between residents and non-residents may only be carried out by banks which have been issued with the licence by the national bank of the Ukraine which permits the execution of such transactions.

The only means of payment in the Ukraine is the Hryvnia. In certain transactions between certain persons the payment can be made in a foreign currency. It should be observed that here an authorisation from the national bank of the Ukraine is often required.

Legal entities which are residents or non-residents can purchase or sell foreign currency for international transactions, but can only do this with the institutions which have licences issued by the national bank of the Ukraine. Foreign currency which has been purchased and which is not used for the obligations of the foreign partner within ten days have to be converted back within five days.

Natural persons who are residents or non-residents can also purchase or sell foreign currency with the institutions which have the licences issued from the national bank, whereby a person per day can only convert a maximum of 150,000 Hryvnia.

Tax law

Ukrainian law is frequently subject to changes. On January 1, 2013 in the Ukraine a wealth tax on residential property was introduced. The taxation is relevant for flats, residential houses and other residential property. The tax applies to natural persons and legal entities including non-residents who own residential real estate. There are plans next year to expand the wealth tax to include all types of real estate. The amount of the tax depends on the area of the residential property. For the taxation of natural persons the law foresees exemptions. In the Ukraine, the tax rate for the taxation of profits of legal entities currently amounts to 19 %. A sales tax rate of 20 % currently applies for sale transactions in the Ukraine. Special product groups are subject to various tax rates and exemptions. There were plans to reduce the tax on profits to 16 % and sales tax down to 17 %. The draft budget for 2014, however, does not include any such tax reductions. The changes will possibly only be implemented in 2015.

Practical examples

Auditing

Background facts:

A German company in the Ukraine operates in the field of waste disposal and for cost reasons has decided to take the cheapest local auditor to audit the annual financial statement because one believes that everything is under control in the Ukrainian subsidiary and in addition that the company has a very competent person in charge of financial accounting.

In order to ensure that he himself does not make a loss, the local auditor undertakes no audit actions whatsoever and confirms the financial statements without reading them and gives them his unqualified audit opinion.

This carries on for some time without incident until the company management discovers irregularities in the financial accounting. In addition, the social security authorities announce an audit.

What can be done now?

The audit by the social security authorities cannot be avoided. However, through a co operative approach it is possible to establish a good basis for possible negotiations concerning the social security contributions which have not been paid. In addition, a detailed internal audit has to be made in order to completely examine the financial accounting of the last years for errors and irregularities.

What should one have done differently from the beginning?

As a foreign investor it should always be clear that foreign companies have to take into account an increased requirement for controls and the associated costs. If the German company management is not aware of this, it will make decisions on cost cutting measures which can lead to considerable problems. For example, the competence of the financial accounting should have been checked much earlier by an independent and reliable auditor. In this respect Rödl & Partner is able to provide an auditor who has international expertise and experience, who through the auditing of the German parent company may already know your company and who is therefore able to carry out a cross-border audit. Rödl & Partner is also your contact person for the implementation, execution and/or control of your financial accounting on which you can depend.

Law / Fraud

Background facts:

A German company trading in building materials also has a large branch office in the Ukraine which has office space and a warehouse with goods to the value of 5 million euros. A Ukrainian managing director is taken on to manage the branch office and all the responsibility is transferred to the managing director while the German management formally withdraws. The trustworthy managing director therefore has a free hand. The managing director reports a few facts every now and then, but not regularly and not comprehensively. Representatives of the German company fly to Kiev once or twice a year to have a look at the situation, whereby there is no person in Germany who is responsible for the Ukrainian branch office throughout the year. The way in which the daily operations are organised and are run is of secondary importance as long as the branch office records a profit.

However, for some time now profits have gone down considerably and there is a suspicion that something is not right due to the fact that the reports of the managing director do not correspond to the available facts.

Indeed the managing director has in parallel founded an own company with a confusingly similar name and is now guiding the main business through this second company. In addition, the managing director has cancelled the rental contract in the name of the branch office and concluded the main rental contract with the second company. The Ukrainian branch office now only has a sublease contract. The German company now no longer has access either to its business premises or to its warehouse with goods to the value of several million euros. The customers think that the German company no longer operates in the Ukraine as they have been informed by the managing director about the closing of the Ukrainian branch office.

What can be done now?

The managing director has to be dismissed with immediate effect and a competent and reliable person chosen to take over the company management. In parallel the goods and important business documents must be secured to collect evidence in order to initiate civil and criminal proceedings against the managing director. The Ukrainian branch office also very quickly requires a new domicile and a tax registration.

In this case, Rödl & Partner fully "came to the rescue", transported the documents away, secured the goods with the aid of a court order and the police and assumed interim

management of the financial accounting and company management. As a result of all these activities carried out by Rödl & Partner it was possible to secure, consolidate and restructure the business.

The comprehensive support offered by Rödl & Partner in this emergency situation was possible through the availability of all the necessary legal experts and experts in the field of financial accounting which enabled Rödl & Partner to make a contribution to save the business operations of this company in the Ukraine.

What should one have done differently from the beginning?

As a foreign investor one should never blindly trust employees. A systematic control mechanism is also appropriate for an allegedly trustworthy managing director and is not assessed as a loss of confidence when it is applied regularly right from the start. In addition, a closely linked monitoring and control system should be introduced for the complete foreign branch office. Especially if there are no plans to send employees from the parent company to the Ukraine, it is absolutely essential to appoint a person who is responsible for the company in the Ukraine and who several times in the year will visit the subsidiary and report what he has seen with this own eyes.

Financial Accounting, Taxes

Background facts:

A company in the field of construction has a perfect product which enables the execution of renovation work particularly in old buildings after water damage without the need for breaking and masonry work. The brand name is only protected as a trademark in Germany. Initially German employees are used for the managing director and sales manager and in addition a Ukrainian employee with very good contacts is taken on for the operative part of the sales activities. It only takes a few pleasant trips and some visits to folklore evenings to persuade the management back home that the German employees are too expensive and completely unnecessary which is also true for the expensive financial accounting and reporting. As a result the personnel are replaced. The Ukrainian employee becomes general director, his son becomes the sales manager and a further member of his family takes over the financial accounting. This person cancels the recognised financial accounting program and makes all the financial accounting entries in Excel. In parallel he founds an own company, registers the brand at the Ukrainian patent office as his own and also registers the brand in a number of other important CIS countries. He carries out the same procedure with the internet domain. Due to the fact that

the liquidity goes down and the parent company now asks in connection with the financing where the revenues are, the managing director claims that the main customer (a large city in the Ukraine) has not paid.

Rödl & Partner is commissioned to take an internal review, whereby the results should lead to clear knowledge and clear measures. Nearly a year passes without any further developments. Then Rödl & Partner is asked to visit the customer (in the large Ukrainian city) and exert pressure to collect the amount which has now risen to 800,000 euros. The city treasurer is able to document each claim and prove that the full amount has been paid. Finally the investor realises that the family has built a large villa and continues to cheerfully distribute the services and products under the "protected" name. In addition, there is an additional demand from the tax authorities for unpaid import turnover tax on construction materials and goods for a three digit number.

What can be done now?

First of all the company management has to be taken over and the other family members are given notice of termination. The financial accounting has to be taken over and all the processes, as far as they are transparent, have to be reposted in order to prevent a tax prosecution. Furthermore, efforts must be made to contest the registrations of the trademarks and to have the internet domains deleted.

What should one have done differently from the beginning?

As a foreign investor, one should not have relied on the promises and advice of the local employees. One has to recognise that a combination of business and family is conspicuous. One should have been put on guard at the latest with the takeover of the financial accounting and the lack of information flow. In this case Rödl & Partner helped to clarify tax questions, to correct the financial accounting and to delete the domains.

UNITED KINGDOM

UNITED KINGDOM

Geography

The United Kingdom located in Northern Europe consists of England, Scotland, Wales and Northern Ireland, whereby Britain is the largest island in Europe. Business activity is characterised by international trade with London as an important financial centre. A good transport and communication infrastructure also make the United Kingdom an attractive location. The dependent territories of the Isle of Man and the Channel Islands are accountable to the British crown. However, as independent areas these are technically not part of the United Kingdom. The office for national statistics estimated that in 2010 the population of the United Kingdom was 62,262,000. The UK is well-known for its multicultural community.

Law

The British legal system depends on the country, whereby Scottish law applies in Scotland and English law applies in England and Wales. In contrast to Germany there is no constitution. The laws comprise statute law, case law and common law. All companies in the UK must adjust to the legal conditions of the respective country. As a member of the European Union, the respective countries of the UK are obliged to adapt their domestic laws to European law and enforce this.

Number of German companies in the UK

There are approx. 2,500 German companies with a domicile in the UK. Of these 350 alone are located in the region of the West Midlands which also includes Birmingham. Birmingham has a population of approx. 3.68 million residents and is the second largest city in England after London.

Legal forms of business and founding companies

In the UK, differentiation is made as in Germany between partnerships and joint stock companies. Business partnerships include a partnership which is similar to the German OHG or BGB structure. Furthermore, a limited partnership (LP) and the limited liability partnership (LLP) exist. The first can be compared to the German KG. The latter has no comparable form in Germany.

Business partnerships

Limited partnership

The limited partnership consists of a general partner and the limited partners together. The number of shareholders of a limited partnership is limited to 20. The company has to have at least one general partner. This can be a natural person. It is, however, also possible for the general partner to be a partnership or joint stock company according to English or German law. The general partner is exclusively authorised to manage and to represent the company. He is personally liable for the obligations of the company without limitation. Limited partners, as the description implies, are limited in their liability. They are only liable to the extent of their investment. They are excluded from the company management and representation of the company. Should they take on these, however, they are treated as the general partner and accordingly subject to unlimited liability. Regarding the choice of the company name of the LP there are no basic restrictions.

However, certain principles should be observed. In order to avoid mix-ups, the name should not be identical to the name of an existing company. There are also restrictions with regard to names which constitute a criminal offence, are deemed to be objectionable or are confusing and also such names which imply a connection to governmental offices or other public institutions including names which include certain judicial expressions such as insurance or trust which further require approval from the British department of trade and industry. In addition, the name must include the affix LP to indicate that it is a limited partnership. The company pays no taxes, i.e. it is not a taxable entity. The income of the shareholders is taxed. The company is therefore transparent for tax purposes. The profit is determined at the company level and then allocated to the shareholders in proportion to their participating interest.

Limited liability partnership (LLP)

This form of company is a combination of a partnership and a joint stock company. It has its own legal personality and is independent of its shareholders. The advantages are its own legal personality, taxation as a partnership and the organisational flexibility of a normal partnership as also here the regulations regarding the partnership apply and founding the company is therefore very simple. Two or more shareholders are required for the founding. The shareholders are not limited to natural persons. It is also possible to use a partnership or joint stock company as a shareholder.

The LLP is exclusively liable for the actions of the shareholders, whereby the shareholders are not mutually liable. The LLP itself is firstly liable for debts and obligations. The liability

of all the shareholders is limited to the value of their respective interest in the company. A written contract to found the company is not required. In contrast to the LP, at the end of each financial year the LLP must submit an annual return and the commercial balance sheet to Companies House. The obligation to submit must be observed punctually as a failure to meet the deadline will automatically lead to fines. Concerning the name of the company reference can be made to our comments regarding the LP. It is also possible to recognise here that the company is a limited liability partnership and must include the corresponding affix of LLP. The LLP is treated fiscally as a normal partnership and therefore does not have the same status as a joint stock company. The LLP is not subject to corporation tax.

Joint stock companies

With joint stock companies a differentiation is made between a private limited company by shares (Ltd.) which is comparable to a German company with limited liability and the public limited company (plc), comparable to the joint stock company.

Private limited company by shares

The company requires articles of association. The state secretary for economic affairs has drafted a sample articles of association for the private limited company by shares as far as the company does not wish to draw up its own articles of association. The memorandum of association which previously contained information about the company name, commercial objects, headquarters of the company, amount of the share capital, name and address of the shareholders is no longer a part of the articles of association. This information is now included in the articles. In the memorandum of association only the type of the company must be clearly stated and together with a declaration that this is the type of company the founders wish to create. Therefore although it is necessary to submit the memorandum with the founding, this only serves as a formality. It is possible to found a limited company with just one natural person who is then at the same time the managing director (director) of the private limited company. This is comparable to the sole trader GmbH company in Germany. It is usual for the articles of association to foresee more than only one managing director.

At least one of the managing directors must be a natural person older than 16 years of age. It is not necessary that this person is a British citizen. Furthermore, the managing director cannot due to a court decision be disqualified from such an activity. The appointment of a company secretary is no longer compulsory as a result of the revision to the companies act of 2006, but this can be regulated on a voluntary basis in the articles of association. The company secretary is the recording clerk of the company who ensures that the most important company regulations are observed by the company. A limited company can be founded with just £1. The

capital can be specified in any currency, i.e. also in euros, and may also consist of a number of currencies. The contribution can be made in cash and also in the form of goods or services. As regards the name, reference can be made to LP/LLP. Furthermore, it is a requirement that the name of the company ends with the word "Limited" or the abbreviation "Ltd" unless a special exception has been granted, whereby this is only possible for non-commercial purposes. The company must have an official address in the UK to receive official documents and correspondence. It is not necessary for this address, however, to be the same as the address of the headquarters. Therefore preferred addresses are the addresses of the respective law firm or auditing firm. The registered office must hold ready the documents of the company such as balance sheets, annual financial statements and information about the directors for inspection. The start of the financial year can be freely chosen, but always lasts for 12 months and Companies House must be informed.

Unless otherwise specified, the financial year begins with the founding of the company and ends with the last day of the month which is the anniversary of the founding of the company. At the end of each financial year the annual return and the commercial balance sheet must be submitted to Companies House. The obligation to submit should be carried out punctually as a failure to meet the deadline automatically leads to fines. If the submission is not made in the long term, the company can be removed from the commercial register and is then no longer considered to exist.

The private limited company is subject to corporation tax. Since 2012 the corporation tax rate has been 24 %. An exception here is for small companies whose profit is not more than Ł 300,000 in the year. These companies currently pay a rate of 20 %.

Public limited company (plc)

The public limited company (plc) is a joint stock company whose shares can be purchased by the public and which must have a minimum share capital of Ł 50,000. The share capital must be subscribed in pounds sterling or in euros, but may not consist of a combination of the two currencies. A quarter of the share capital must be paid in when the company is founded, which corresponds to Ł 12,500. The public limited company can be listed on the stock exchange. However, this is not compulsory. The public limited company must have at least two managing directors. At the same time these can also be the shareholders of the public limited company. The condition is that at least one director is a natural person older than 16 years of age.

If the directors are not shareholders, the public limited company must have at least one further shareholder in order to found the company according to the regulations. The company secretary has to be appointed. The shareholders are liable in principle only to the extent of

their contribution. The liability of the company itself is limited to the share capital. In the same way as the limited company, the public limited company has to have a registered office. As regards the name, the same is valid as mentioned above. It must be observed that also here the company name must end with the words "public limited company" or the abbreviation "plc".

Registration for tax

In the UK, subsidiaries in the form of a company with limited liability and branch office must be registered before the start of business operations. A branch office is in principle not an independent company, but is only a business extension of the activities of which are subject to the legal regulations of the other country. The registration for tax for the purpose of corporation tax must be made within three months after the start of business operations in the UK. If this deadline is not met, the company may be required to pay fines.

The registration is always made such that after registration at Companies House a few days later the tax office sends a form (CT41G) to the company. This form must then be filled in and returned within three months after the start of business operations. If the new company has not yet started business operations, the tax office must be notified within three months that the company is dormant and when the start of the business operations can be expected. A subsidiary which is subject to corporation tax is subject to tax in the UK for its complete income worldwide. For branch offices only the part of the income is subject to English corporation tax which was generated in the UK. If subsidiaries in the form of an LLP or an LP are founded, it is not necessary to register these for the purpose of corporation tax. These business partnerships are transparent for the purpose of tax. Only the shareholders behind the companies are liable to pay tax.

Real estate and the acquisition of land

In England and Wales there are two systems to transfer ownership of title. These are the registered system and the unregistered system. The difference between these two systems is the verification of ownership of the property to be sold which the seller has to provide to the purchaser. If an unregistered property is offered for sale, the seller has to verify his ownership through undisturbed possession over a time period of at least 15 years.

The registered system was introduced in order to avoid fraud and to simplify the process of buying and selling real estate. The registered system includes records in the register maintained by the land registry of transactions with regard to real estate. Plans are drawn up to verify the exact borders of the properties. The register also includes, for example, entries regarding rights of way through a neighbouring property and also mortgages. In principle, when making

a purchase a search of the register is made online to find information on the property to be acquired. When purchasing a property, particular note should be made of the legal principle "caveat emptor" or also information such as "buyer beware". The purchaser must then ensure that the property offered for sale is free of material defects and defects in title. The purchaser should initiate an investigation to this purpose which is usually carried out for the purchaser by a law firm or real estate agent prior to the contract phase and carried out a second time before the completion of the purchase. Such an investigation would include a structural survey to ascertain if there are any construction defects or other defects immediately at the beginning of the real estate transaction.

A seller of real estate in England and Wales is not obliged to disclose defects to property owned by him or any other problems. This is also valid for landlords. In England the purchase contract is called a transfer deed and must be signed by both parties and witnesses. The transfer deed is then sent together with other relevant documents to the land registry and then entered in the registry provided the documents are without objection.

Since 6 April, 2008 the acquisition and renting of commercial premises with an area of at least 500 m_{ϵ} requires an energy performance certificate. Since October 2008 this is also true for other buildings. In this respect, there are exceptions such as for buildings which are in a state ready for demolition. The responsibility to present such a certificate is with the seller or party renting out.

Labour law and dismissal protection

The labour law in the UK is similar to that in Germany. However, there are also variations here depending on the country which must be observed in connection with the hiring of local personnel. Codes of practice play an important role for labour law in the UK. If the regulations are observed by the employer and introduced in the company, the employer will have a relatively secure position in court. In legal proceedings, the courts always examine the observance of these codes of practice. Time-limited employment contracts are possible in principle. Time limitations or a chain of time limitations are possible up to a period of four years. If this time period is exceeded and there is no objective reason for the previous limitations, then the time-limited contract relationship is converted into an unlimited contract.

If such a case exists, the employee can demand a statement from the employer to confirm that the employment contract is now permanent or if this is not the case to explain why a time-limited contract is still to be assumed. The number of working hours per week is a maximum of 48 hours. Employees have a right to eleven consecutive hours without work in one period of 24 hours, to one day per week free of work and to a break of at least 20 minutes when

the working day is longer than six hours. For employees on night shift there is an additional restriction that the working time is limited to eight hours in a period of 24 hours. In the UK there is no legal regulation for treatment of overtime hours. A contractual regulation can be respectively concluded, but this is unusual in practice. A trial period of up to six months can be agreed in the contract. In practice three months are mostly agreed with the provision that depending on the contract performance of the employee the trial period can be extended by a further three months. During the trial period the period of notice for cancellation is one week, whereby here in practice also one to three months are usual. The contract parties are free to negotiate the amount of remuneration.

However, the remuneration must be at least the value of the statutory minimum wage. The statutory minimum wage for an employee older than 21 years of age is currently Ł 6.19 per hour. For employees between 16 and 17 years of age the remuneration must at the minimum be Ł 3.68 per hour and for employees between 18 and 20 the minimum is Ł 4.98 per hour. For trainees under the age of 19 or above 19 in the first year of the apprenticeship the wage must at least correspond to the statutory minimum of Ł 2.65 per hour. An employee has a legal right to holidays of 5.6 weeks per year, which amounts to 28 days. In this respect it is not required to observe a legal waiting period. It should be noted that the claim to holidays in the first year of employment only grows in proportion to the time worked. In the UK, statutory public holidays are added to the 28 days of paid holiday.

The employment relationship can be terminated by different means. This can be by means of a settlement agreement, through expiry of the contact, through grounds of frustration, dismissal by the employer and through notice of termination by the employee. A certain method to cancel the employment contract is not prescribed in the UK. Each termination is effective regardless of its legality. In the UK the illegality of notice to terminate the employment contract only has a bearing on possible existing rights to compensation.

During the notice period the employee has no right to continued employment. If the employment contract does not include a regulation regarding notice period, then the statutory minimum notice period is valid. Instead of observing the period of notice, the employer can also make a payment in lieu of notice (PILON). In the contract the employer can reserve the right to make a single payment to the employee for the remuneration due in the notice period.

In the UK differentiation is also made between different types of termination of the employment contract:

- wrongful dismissal: the worker is laid off without observance of the notice period
- unfair dismissal: non-observance of the statutory regulations regarding worker protection

- redundancy: dismissal due to operational reasons
- constructive dismissal: employee can hand in his notice if the employer has significantly neglected his contractual obligations. The termination is then deemed to have been made by the employer.

A termination of employment made without reasonable cause and resulting in the violation of the correct termination procedure is illegal. Permissible reasons are reasons due to the behaviour of the employee, operational reasons and reasons which are related to the ability and qualifications of the employee to carry out the activity for which he is employed, etc. A case of illegal dismissal can lead to different consequences. The employee has a right to further employment. If the employer rejects this, this can lead to a settlement to the amount of between 26 and 52 weekly wages. The employee also has the right to reinstatement. He is entitled to claim a settlement. If the dismissal is due to discrimination or whistleblowing, the claim to a settlement has no upper limit.

Practical examples

Auditing

Background facts:

The German automotive supplier X founds a sales company in the UK in the form of a limited company. The founding is executed by a local consulting company. In this respect, it is worth mentioning that the founding of a company with the legal form of a limited company can in principle also be managed by a small local firm of tax consultants. In the first financial year turnover amounts to 1 million GBP. In the following year turnover rises to 1.8 million GBP and in the third year turnover reaches 2.3 million GBP. In total, turnover in the first three years lies below the threshold value for a statutory audit of the annual financial statement in the UK for a turnover of 6.5 million GBP, a balance sheet total of 3.9 million GBP and 50 employees.

As far as two of the three criteria are satisfied in two consecutive balance sheet dates, in the UK a joint stock company (Ltd, plc) is subject to a statutory audit. These are criteria which are also valid in Germany and are derived from the fourth European directive. The shareholders were therefore under the impression that the company was not subject to a statutory audit requirement in the UK because the conditions for this were not fulfilled at any time. When the managing director of X Ltd. presented the annual financial statements of the last three years to the bank in the UK, the credit lines were terminated. In addition, the bank advised the authorities that the annual financial statements of the previous years had not been audited. As a result, the British Companies House thereupon initiated the cancelation of X Ltd.

On request the managing director and the shareholders learn that since its founding the company in the UK was subject to a statutory audit requirement. As well as the three named criteria, turnover, balance sheet total and number of employees a company in the UK is also subject to a statutory audit requirement as far as it is part of a company group and the group has exceeded the threshold values. The statutory audit requirement, however, could have been avoided provided the parent company had in the past given a guarantee for all obligations including financial and legal obligations.

What can be done now?

In order to prevent the cancellation of the company, Rödl & Partner is assigned to audit the annual financial statements of the last three years and to submit the audited annual financial statements to the British commercial register. At the same time Rödl & Partner is commissioned to prevent the cancelation of the company and to reregister the company again at Companies House.

What should one have done differently from the beginning?

When the company was founded the shareholders should have been informed that under certain conditions the company as a group subsidiary in the UK is subject to the statutory audit requirement and that with the observance of some conditions this statutory audit requirement could have been avoided. Given the facts, the choice of a supposedly inexpensive local consultant who was not familiar with the statutory audit requirement of group companies was a mistake which afterwards proved to be expensive. In addition to the audit fees, the company had to pay fines in the five-figure range as the annual financial statements submitted to the British commercial register were declared to be invalid.

Taxes

Background facts:

In England a waste-to-energy plant is set up by a limited company. In the plant various types of municipal waste are thermally recycled and disposed of. The resulting heat is used to drive a steam turbine.

The English limited company commissions a German company to build the facility. This company in turn commissions a German subcontractor with a system for the water treatment for the power plant. The system serves to provide drinking water and return condensates. Certain components have to be fitted by the German subcontractor at a certain time. In addition, the building first of all has to be completed. Only after that is it possible for the subcontractor to start fitting the components. The subcontractor has to be present for a week for the erection of the building. The fitting of the other components should take place at a time estimated to be two months later. The subcontractor continues to assume that the installation work will be completed in only nine months. For the installation process employees are sent from Germany to the building site in the UK.

Having reviewed section 5 par. 3 of the double taxation treaty between the UK and Germany on his own accord, the subcontractor assumes that the time allowed for the installation amounting to twelve months will not be exceeded and therefore a tax-relevant branch office will not exist in the UK. In this process, the subcontractor, however, only calculates the nine months for the installation work. The employees are paid from Germany and continue to pay income tax in Germany. A registration with the HM Revenue & Custom is not made for the employees or the building site as it is merely a branch office.

After the first week where the subcontractor was present at the building site there are delays and further work can only begin three months later. The installation work also lasts not for nine months but for ten months. In total it has therefore taken the subcontractor 13 months to realise the project.

What can be done now?

The time period of twelve months stipulated in section 5 par. 3 of the double taxation agreement was exceeded. The project of the German company has to be retrospectively registered as a tax presence at the British tax office. Furthermore, if the exemption limit is exceeded a registration for the purpose of corporation tax and sales tax (VAT) is necessary. In addition, the German company must have itself registered as an employer in the UK and the employees have to retrospectively pay tax on their income in the UK.

What should one have done differently from the beginning?

Prior to the start of the activity in the UK, the subcontractor should have obtained an expert opinion. Then the company would have been better able to assess the risk and have access to the following information.

According to section 5 par. 3 of the double taxation agreement between the UK and Germany, a construction site or installation project is only a branch office when the activity exceeds the duration of twelve months. If the duration exceeds twelve months, then this provision is retrospectively valid to the beginning of the installation work and not only after the time period has been exceeded. The twelve month period begins with the start of the construction work and also already with preparation measures.

The time period is deemed to be finished when the work has actually been concluded. In practice, this is frequently the acceptance date. If, however, there are defects which have to be subsequently removed, then this time period is also added to the installation period. Repair or other similar work which becomes known or takes place after the acceptance of the plant need not be calculated as far as it is carried out separately from the originally agreed work. Temporary interruptions, regardless of their cause and duration, are included in this time period. If a subcontractor is active for the principal contractor in such time periods, this time is included as well. It cannot be argued that the performance by a different person has caused an interruption to the work. Delays in the schedule by other trades are therefore not reason enough to put the twelve month time period on hold or lengthen the time period.

The 183 day regulation is only valid for the employees sent out when a branch office is not founded by execution of the installation work. Only then is this number of days to be taken into account. If a branch office is founded, income tax in England must be paid immediately and the subcontractor must be registered as an employer in England.

Law

Background facts:

Employer A, a subsidiary of a German GmbH, would like to part with its long-serving managing director X in the UK because he is not satisfied with the way he treats colleagues. Furthermore, X as managing director did not meet the agreed annual targets for two years in succession. A is also of the opinion that X at the age of 63 is too old for the young and dynamic company. X is a managing director registered at Companies House.

Employer A informs managing director X about this and offers to conclude a cancellation agreement with him. If X fails to agree, employer A notes in addition that he will be dismissed anyway due to the above-mentioned reasons. After this statement X agrees and A drafts a contract consisting of a single page which immediately ends the employment relationship.

After two weeks X has second thoughts and would now like to work for the company again or at least receive a settlement because he is of the opinion that the cancellation agreement is not effective and that the employment relationship was ended illegally. X files a legal action for wrongful and unfair dismissal. In addition, the lawyer commissioned by X advises that X is still the managing director of the company and that the termination does not influence this relationship.

What can be done now?

Employer A now has to quickly employ the services of a lawyer in the UK who will manage the defence.

What should one have done differently from the beginning?

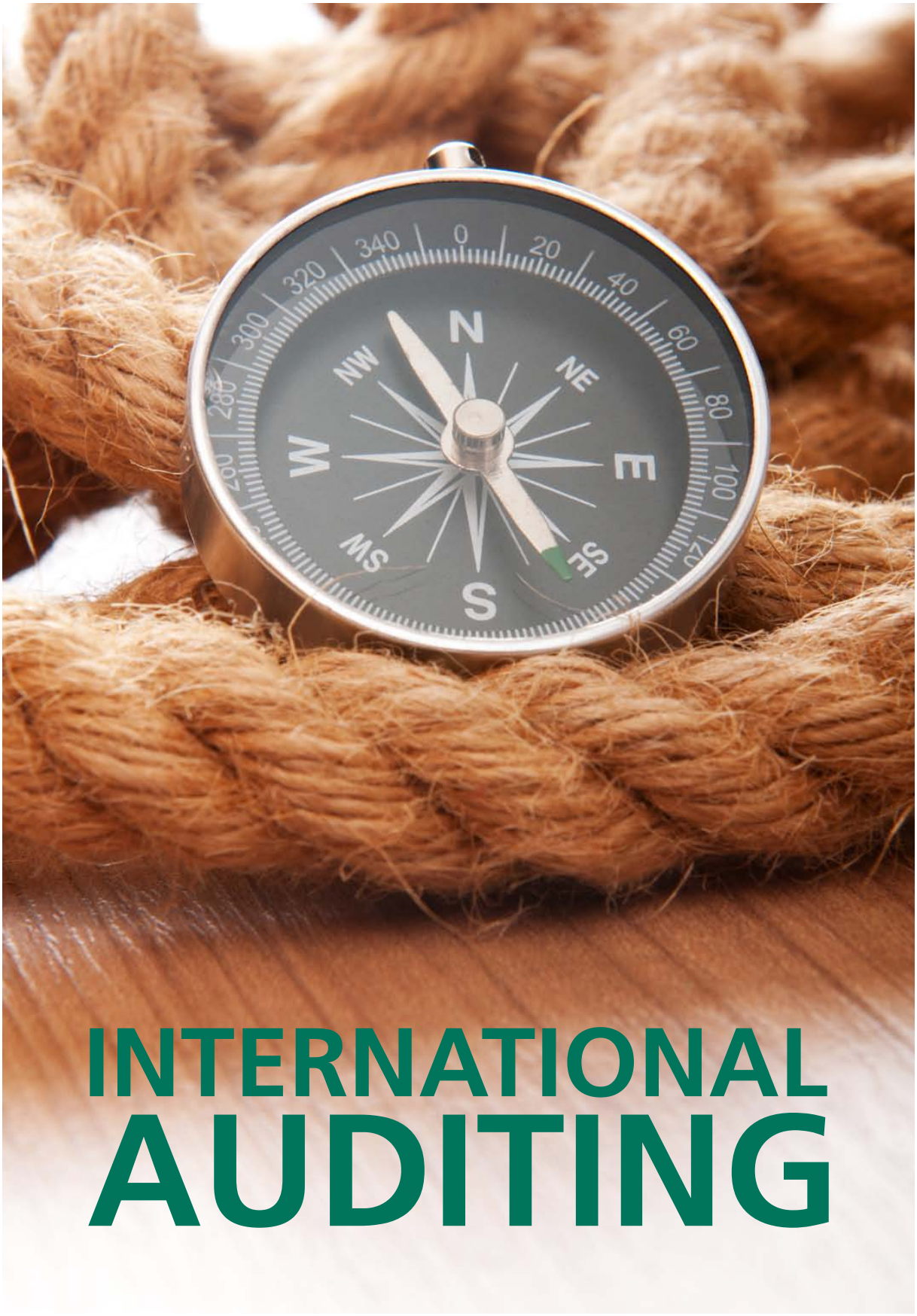
If a company does not have sound knowledge of the laws of the respective country relating to employment contracts and termination of employment, it is advisable to obtain the advice of an expert before generally ending an employment relationship with a managing director or an employee.

It should be observed here that the employment status as managing director and the position under company law as managing director registered in the commercial register must be treated as strictly separate. A notice of termination or a cancelation agreement has no influence on the position as registered managing director.

Furthermore it should be noted that a cancelation agreement in England is an extensive document which rejects the right to file legal action and where other post-contractual obligations are regulated. Furthermore, the cancelation agreement makes statements about settlements, outstanding payments and holidays not yet taken. Under English law a cancelation agreement is only effective when the employee was advised by an independent lawyer with regard to the contract. After the consultation, this lawyer must issue a certificate which confirms the consultation has taken place.

In addition, it should be observed the termination procedure in the UK is extremely formal and in the case of legal action the employee may receive a high level of compensation if the employment is terminated for reasons of age as this constitutes age discrimination. Right from the beginning this sensitive and explosive topic could have been avoided. In compliance with the termination procedure one could have included the failure to meet the targets as a reason for termination. Dissatisfaction with the treatment of colleagues is not valid as a reason to terminate the employment relationship and age can never be given as reason.

Furthermore, after the termination of the employment relationship, X is still the registered managing director. Here it is necessary in advance to check how he can be dismissed or how he can be persuaded to resign his position. The articles of association of the company should be examined to this end and note should also be made if other managing directors are registered in the commercial register.


INTERNATIONAL
AUDITING

Practical examples

Joint venture

Background facts:

A German medium-sized Mittelstand production company maintains a joint venture with a local partner in Brazil. The plan is to process the market in South America starting from a base in Brazil. In the course of time a number of changes in the joint venture contract are discussed. In a marginal change to the joint venture relationship a change of the regulations regarding the selling rights is foisted on the German company. The existing right of first refusal for the shares of the joint venture partner was withdrawn. The German company feels it is faced with removal of access to the further shares and therefore also to the business possibilities in South America.

What can be done now?

The German company must immediately obtain legal advice locally in Brazil. Measures have to be taken to prevent the sale at short notice of the company shares by the joint venture partner. Furthermore, a check must be made of the extent to which the previous change to the contract was wilfully made with a possible fraudulent intention in mind.

What should one have done differently from the beginning?

It is essential that each legal change to a joint venture contract with a foreign business partner is preceded by contact with a local legal advisor with corresponding knowledge of the subject matter and possible corresponding knowledge of the local business practices.

The sales office

Background facts:

A Mittelstand company maintains a number of small sales offices in the form of own subsidiaries in Europe. Due to the organisational structure of the group and the size of the individual companies the managing director of the parent company is also simultaneously managing director of the respective sales subsidiary companies.

Purely due to logistical reasons, the managing director is not able to adequately carry out his legal duties in the individual subsidiaries. As the subsidiaries are not well staffed, the basic principle of monitoring, i.e. the dual control principle and separation of functions is frequently not possible.

What can be done now?

Firstly, it is necessary from an organisational point of view to ensure a local and legally appropriate representation of the respective distribution company. The company management function must be transferred to a local representative of the company and also to the managing director of the parent company. Important decisions in principle require the joint signature of both managing directors. For this purpose, it is necessary to draw up a list of transactions which require joint approval.

Furthermore, in the course of an audit or separate commission from the subsidiaries explicit reference should be made to the weaknesses in the internal control system and the associated risks or possibilities of incorrect actions.

What should one have done differently from the beginning?

In connection with sales offices of a small size the question often arises whether the organisation of the local presence should be made in the form of an own subsidiary.
In particular in Europe the possibility of an integrated branch office structure should be considered. The representation of organisational and tax processes can also be improved under consideration of the tax advantages.

‘Money on paper’

Background facts:

A German Mittelstand company maintains a sales office as an own company in a neighbouring European country. The distribution company has existed for some time and has been very successful in its activity on a low level. It has accumulated a considerable amount of cash which, however, for various reasons was not distributed by the parent company. In recent years, the managing director was a long-serving employee of the parent company. Due to the low significance for the company group, the annual financial statement of the small distribution company is not audited, but support is provided by a local tax consultant to prepare the financial statement.

When the parent company decides to distribute the generated funds, it determines that the high cash reserves only exist on paper and that in recent years the managing director has invested the funds in dubious financial transactions with prospect of high returns. The result is a seven digit loss.

What can be done now?

In order to establish the facts, a special team consisting of auditors and lawyers, the so called white-collar crime team, is used. This team examines in detail whether civil and criminal proceedings can be brought against the former managing director.

What should one have done differently from the beginning?

Even small subsidiaries should in principle not be excluded from an audit of the annual financial statement. Essential audit actions such as the obtaining of bank confirmations should have been undertaken much earlier to indicate the non-existence of the liquid funds. Furthermore, there would have been the possibility in connection with the company group auditor of arranging specific investigative actions in the small subsidiary. For example, there is also the possibility of organising the obtaining of bank confirmations for subsidiaries which are not audited. Such easy, low-cost measures can possibly make a contribution towards avoiding a great deal of damage.

Closely-linked third parties

Background facts:

A German production company with international operations maintains subsidiaries in a number of countries, including India and Russia. As time passes there are occasional anonymous reports from the respective countries that the local managing director is involved in illegal activities and that the managing director in particular has used connections to third parties to his advantage and to the disadvantage of the company. The accusations are made anonymously in a very polemic manner, but do contain a number of points which seem to appear believable.

What can be done now?

In principle, there is the possibility of reacting to these accusations with specific investigations undertaken by an auditing firm. An embezzlement audit would have to be carried out in the local subsidiary. However, this usually leads to the undermining or even shattering of the trust relationship with the local responsible persons.

An alternative is offered by the possibility of reacting to the specific accusations in the course of a standard audit of the financial statement and to carry out selective investigative actions under the cover of a regular audit of the financial statement. After the appropriate knowledge is established with corresponding usable evidence which confirms the anonymous accusations, there would be the possibility of expanding the investigations with regard to an actual embezzlement audit.

What should one have done differently from the beginning?

It is basically difficult to avoid such situations in a company with subsidiaries some distance away, as in particular anonymous tips due to bad feelings in the company may occur. Nevertheless it is conceivable that in countries where such accusations due to established structures are often not ill-founded, the above-mentioned assignment to audit the financial statement can always be extended to include specific investigative actions. As a result, one is continually in a position to react to such situations. The approach becomes the norm in the company in the company group and to a certain extent also has a preventive effect. Rödl & Partner offers such extensions to the usual audit within the framework of the international financial & performance audit.

‘Paper is accommodating’

Background facts:

A German industrial company with international operations wishes to publish an accounting manual for its subsidiaries operating worldwide. This accounting manual must also include specific rules for the valuation of inventories.

After an intensive investigation it turns out that specific rules for the valuation of the inventories are frequently not applied and the local auditors of the annual financial statements had not adequately referred to the rules. The objective of uniform group reporting standards in the group was therefore not achieved.

What can be done now?

In order to ensure uniform group reporting standards, measures must be taken by the company and by the auditor of the annual financial statement.

The company must instruct its individual units abroad to comply with regulations, whereby this must be accompanied by training of the corresponding employees and the parent company must become familiar with the specific facts at the local level. At the same time the company group auditor must co-ordinate with the individual auditors of the annual financial statements to ensure that said auditors actually use the regulations of the group accounting guideline as a benchmark for their assessment. There must be explicit reporting on this theme. In addition, there is the opportunity of arranging a meeting for all those concerned in order to exchange experiences.

What should one have done differently from the beginning?

The facts of the case indicate that the implementation of uniform regulations worldwide will not happen on its own. The behaviour of the individuals in almost all cases in practice is not due to malicious intent or disregard, but rather a lack of understanding of the subject. Due to the frequent existence of different applicable regulations in the local offices, the necessity of adjustment to the parent company is not perceived to be absolutely necessary. In this respect it is important that the parent company informs the individual companies about this necessity and that the persons responsible for supervising the respective countries also become familiar with the specific implementation possibilities at the subsidiary and understand the associated problems.

Furthermore, the corresponding auditors of the annual financial statement at the subsidiary must be instructed about the necessity of ensuring the implementation. The securing of uniform group reporting standards according to specific regulations will not happen by itself, but requires a continual improvement process which requires the active participation of all those involved right from beginning.

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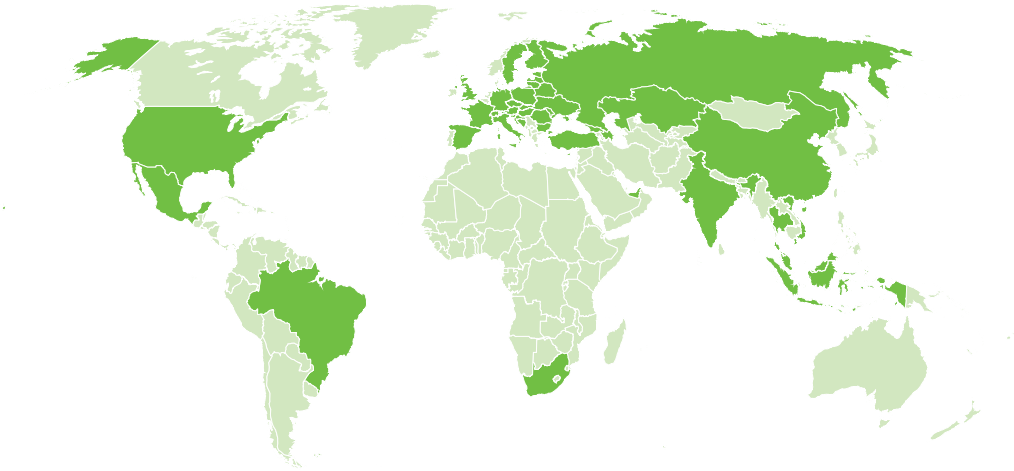


Financial accounting

more than just bookkeeping

Financial accounting –
more than just bookkeeping

The previous chapters and our practice examples can already be used without doubt to derive a host of measures to improve the control of subsidiaries abroad. Nonetheless we would like to complete the picture and briefly address our attention to financial accounting in Mittelstand companies. In particular, from the point of view of Mittelstand companies, the area of financial accounting is viewed as unspectacular. However, the area has a potential which is not to be underestimated in respect of improving the control of subsidiaries abroad.

First of all, we can take stock of the situation and outline the typical characteristics of financial accounting of the German Mittelstand companies:

- Traditionally, differentiation is made between the internal and external financial accounting. The internal financial accounting primarily includes cost and performance accounting, the income statement and frequently also the company planning. The external financial accounting is oriented towards financial accounting and the annual financial statement. Accordingly, here one finds the financial accounting and necessary auxiliary ledgers such as asset accounting, accounts payable/receivable and payroll accounting. In addition, there is frequently a marked materials management. Due to the interlacing of commercial and tax matters in financial accounting which was prevalent before the German Act on the Modernisation of Accounting Law (authoritative principle) the (external) financial accounting practice today is still strongly tax oriented.

- The internal and external financial accounting processes differ considerably in their structure and complexity. In the external financial accounting entries are booked according to entire operating costs, in internal financial accounting the so-called imputed costs dominate with a pronounced internal production cost allocation. The method of imputed additional costs is designed to improve the significance of the operative accounting. The imputed cost variables are frequently so complex that a transition of the result of the internal financial accounting to the result of the external financial accounting is only possible with a great deal of effort. Added to this there is a differentiated cost centre structure with complicated regulations for the coding of overheads.

- The result is a lack of a pronounced liquidity planning, whereby the monitoring of bank accounts and liquidity is more or less an isolated function and a systematic linking of liquidity planning between the external or internal financial accounting does not take place.

- The company planning exists in isolation next to the internal and external financial accounting and there is no integrated financial planning with regard to the balance sheet and income statement.

- Different programs are frequently used by the external and internal financial accounting and also for the maintenance of auxiliary ledgers, whereby a consistent, uniform ERP system is usually the exception.

- Financial accounting is largely carried out manually, based on paper. The degree of automation and digitalisation is low.

- In international operations, depending on the country different financial and auxiliary accounting methods are applied. There are no automated reporting interfaces for the financial accounting of the parent company.

- The reporting is mostly accomplished using Excel. The reports of the foreign subsidiaries are sent by email to the parent company.

- The consolidation, i.e. the preparation of consolidated group accounts is made manually using Excel or an own independent (consolidation) software.

- There is no binding group manual to achieve uniform group reporting standards.

- The focus of financial accounting is (even three years after the German Act on the Modernisation of Accounting Law) on the tax balance sheet.

- The financial accounting processes are not integrated in the central workflow of the other company processes, but are frequently isolated. The result in practice is a substantial deficit of information in the accounting department.

- In addition to internal and external financial accounting, over the years further commercial functions have developed organically such as controlling, treasury, planning, taxes etc. It is often not clear which set of data the respective departments are working with. The situation is aggravated by the fact that departments were historically created at different times without a binding definition of the content and scope of their tasks, whereby these are often influenced by the respective department head. The result is double structures and partly unclear assignment of responsibility leading to "organised irresponsibility". Overall the commercial field seems in need of continuous discussion.

- Monthly reports are not made available to the management before the middle of the month.

- The annual financial statement is often delayed far into the next financial year.

In total, the German financial accounting practice is obsessed with details, whereby the time factor is often not considered to be relevant for quality. The financial accounting is mostly managed with own personnel and outsourcing or partial outsourcing is not made or is partly only an option abroad.

› The main functions of a systematic risk management such as continuous monitoring measures in the form of systematic data analysis are not integrated in the financial accounting.

Overall, external financial accounting is rather seen as an annoying duty instead of an important element of the company control. One is often given the impression that the financial accounting has remained at the same technical level as 20 years ago. This picture is surprising especially in view of the commonly used modern production control systems and the high degree of automation in the production process. This is also true regarding the characteristic of lean production. While in the area of production and purchasing there is constant price pressure and the processes are maintained as lean as possible, the commercial department in total seems not to be subject to these requirements. That does not mean that the commercial department is overstaffed. In this respect there is a healthy awareness of cost. The criticism is more to do with the quality of the commercial processes.

In practice, the German Mittelstand financial accounting therefore differs considerably to the Anglo-Saxon financial accounting practice or the financial accounting in listed companies. Here the focus is not on financial accounting, but on the selective provision of the decision makers with relevant management information. Relevance refers to the usefulness of the information, i.e. all the information necessary for decisions has to be available at the right time. The factor of time is a decisive quality factor for the winning and processing of information. The following further features of modern financial accounting can be defined:

› There is just one financial accounting department. Differentiation is not made between internal and external financial accounting. A differentiation is made between management reporting and tax reporting. Management reporting is oriented to the recognised financial reporting standards such as HGB or IFRS, whereby tax reporting serves to comply with the tax obligations.

› Entire operating costs are always posted. There are no imputed costs. The cost and performance accounting is made on the basis of direct costing (calculation of profit contribution).

› The financial accounting is systematically integrated in the main workflow of the company. That begins with the ordering and production logistics and ends with sales or invoicing of the company's services. Naturally, all formation processes relevant for management regarding personnel and financial matters are integrated in the financial accounting.

- Financial accounting integrates financial planning and preparation of the balance sheet and result.
- Financial accounting is as far as possible automated and digitalised.
- The financial accounting systems are integrated throughout the group, often on the basis of a uniform ERP solution. All commercial analysis whether for the balance sheet, planning or profit and loss account use the same data.
- Monthly or quarterly reports are listed in the same quality as the annual financial statement, i.e. there are the corresponding time limits and continuous monitoring of devaluations, revaluations or additions to provisions for risk management.
- For the annual financial statement the possibilities of fast close can be exploited with the aim having the audited annual financial statement and consolidated financial statement available at the latest by the end of May.
- The co-operation with the auditor of the annual financial is systematic and continuous. Complex facts are discussed through the year. The audit is carried out with a strong business-process oriented focus.
- Risk management measures are systematically integrated in the financial accounting, i.e. for the inspection and monitoring of the correctness of the business processes. This includes, for example, automated data analysis (e.g. checking for unusual posting times, the synchronisation of creditor/debitor accounts with employee data, the automated plausibility check for travel expense accounting and much more). In the course of this data analysis the data protection regulations must of course be observed.
- There is a group accounting manual which defines binding rules for uniform group reporting standards for all subsidiary companies worldwide.

At this point, we would briefly like to address the subject of the group accounting manual in more detail. True to the motto of SMALL EFFORT – BIG EFFECT the use of the group accounting manual can result in numerous improvements in the control of foreign subsidiaries. Using a group accounting manual you create a regular and comparable pool of information which prevents a gradual loss of control. There is a clear action corridor for the accounting practices in connection with all business transactions and this therefore improves the objective view of the economic situation of the subsidiary company, whereby this counteracts the subconscious or conscious manipulation of figures or also concealment of the actual economic situation of

the subsidiary. In addition, the group accounting manual supports the consolidation process in the preparation of the consolidated financial statement. The group accounting manual clearly and openly documents all decisions to be made with regard to the schedule, assignment of responsibility and expertise, uniform group reporting standards and the processes of the intra-group exchange of information.

The group accounting manual is also not an attack on the culture of trust, but rather establishes clear rules for the management at the subsidiary. Alone for this reason each newly founded (foreign) company should be equipped from the start with a group accounting manual.

A group accounting manual should include the following points:

- A clear description of the tasks and responsibilities of the local financial accounting of the subsidiary with regard to content, scope and deadlines of the continuous financial accounting, the continuous reporting and further facts relevant for reporting
- Definition of the relevant group reporting standards (HGB, international standards (IAS/IFRS, US-GAAP))
- Description of tasks, content, deadlines and responsibilities for the preparation of the local annual financial statement and group reporting packages (HB II) for the consolidated financial statement
- Definition of the system and chart of accounts
- Description of all balance sheet and income statement items and the associated balance sheet and accounting policy (with the objective of standardising the approaches, disclosure and valuation options worldwide)
- Principles and methods for currency conversion
- Provision of all forms for the group reporting system (reporting packages)

The above descriptions demonstrate that in the area of financial accounting there are numerous effective levers to improve the control and monitoring of the business activities overall and in particular of foreign companies. German Mittelstand companies are well placed to systematically exploit this potential for improvement.

Rödl & Partner

How to stay in the driving seat

How to stay in the driving seat

The above information without doubt provides a striking insight into the shaky foundations of Mittelstand instruments used to control foreign subsidiaries. Some entrepreneurs will protest that many of the indicated risks are not present in his company and that the picture presented is therefore blown out of proportion. And how should a Mittelstand company limit such risks anyway? The introduction of bureaucratic structures as seen in large company groups, an inflated control organisation, and even the organisation of internal audits are out of the question for Mittelstand entrepreneurs. Shouldn't one simply accept the outlined risks, regardless of the extent they present in individual companies, as the entrepreneurial risk of doing business?

If the question is one of the production and marketing of sophisticated products, the answer is clearly that if it's no good, we will not produce abroad. The name of the company enjoys a high reputation which has to be protected with first-class products and services.

In commercial matters the answer is less passionate, although here the subject is the financial substance and therefore also the existence of the company. And just as Mittelstand companies in the fields of engineering and sales do not tolerate bureaucracy, also in the commercial field it is possible to establish highly professional and lean structures.

Essentially the following steps should be followed:

- Worldwide standardisation of the commercial tools
- Reduction to practical and necessary measures
- Extensive automation of commercial processes
- Open discussion of the risks

Standardisation of the financial accounting

The core area of the commercial activity is financial accounting and here the largest differences are typically between the companies at home and abroad. In particular, there are often differences between countries in the use of financial accounting as a starting point for figures.

Local financial accounting regulations are usually used to explain this. A much more valid reason, however, is provided by the different financial accounting cultures in the respective countries and companies. And it is possible to overcome these. An analysis of what is really essential and important opens up much more room for manoeuvre. First a check should be made of the frequently discussed valuation differences of the different countries to establish if the facts are even relevant. For example, the much discussed amount of goodwill is of no importance with self-founded companies abroad. Furthermore, an analysis is recommended of

the scope of valuations. For example, the costs of the development in many countries can be capitalised, but do not have to be (which is anyway much closer to the cautious approach of Mittelstand companies). As a rough guideline it can be established that many if not most of the relevant choices of valuation can be reduced to a common denominator.

And also the regulations regarding the chart of accounts which exist in a few countries do not represent a real barrier as modern systems allow the dual numbering of accounts and also limitless links between account numbers.

There are also large differences in cost accounting, although the freedom to standardise here is even greater. The legal requirements exist at best indirectly through the necessity of determining the manufacturing costs for the inventory valuation in the annual financial statement. As a matter of expedience the cost accounting should record such manufacturing costs which are sufficient for the accounting standards so that ideally the valuations can be adopted in the balance sheet without having to make an adjustment. An international standardisation of the balance sheet manufacturing costs is usually not really a problem. This is because usually the flexible areas of the financial accounting regulations are so well documented that a uniform international definition can be found. After this requirement has been met, the cost accounting can be organised worldwide completely to take into account the tax requirements of the company group.

The international standardisation of financial accounting takes courage, but ultimately the goal is to turn the traditional world of determining figures on its head. In many companies substantial resources are devoted to preparing figures from a financial accounting system primarily geared to local particularities more or less for the requirements of the company control in the group. However, it is much more efficient to enter the figures directly according to the control requirements of the group. And the few really individual requirements of each country are fulfilled with a low additional cost at the end of the year.

Important adjustments to local financial accounting are in particular valuation differences which arise compared to the German principle of caution. It is also not possible to standardise tax driven aspects. In most countries it is not necessary to channel these through the financial accounting for the whole year, but they can be listed at the end of the year in a special invoice. In terms of the group this is efficient and also enables transparency as it is visible which results from the business are economic and what effects result from the influence of the local financial accounting.

Important: first of all clean up the parent company

The name "parent company" already gives rise to speculation that after many head offices have decided to address the project of international standardisation they do tend to force their own systems on the foreign subsidiary. What is proudly called a rollout, can often end up a flop.

The financial accounting of German companies usually has to labour with a vast amount of accounts which are based on considerations from the middle of the last century. In those days the chart of accounts were set up before many companies had cost accounting and also material groups in the ERP systems did not exist. If one considers the access possibilities of today with ERP systems, then there are possibilities to get rid of some ballast. An examination of the chart of accounts reveals a further phenomenon that if an account has been created, usually for a person from the top management to have access to some special information, it is carried along until eternity. The large number of accounts in the parent company is already a significant cause of account determination errors. It would therefore be a waste of energy to make foreign colleagues understand this mammoth organisation. In short, before a rollout it is necessary to clean out the chart of accounts.

If the cost accounting is to be standardised worldwide, duplication of the domestic system should be avoided. This is because it is a German phenomenon that cost accounting has developed to become its own science and the connection between its result and the result of the financial accounting remains a mystery to many company managers. In this respect one can by all means learn from abroad. The items which are not present abroad may well with a comparable business model be superfluous at home. In total, we absolutely recommend that the first step is to examine the commercial structures and systems in the parent company and to put these in order.

Organisation of financial accounting as a management information system

The model for the organisation of a uniform international financial accounting has to be the core element the Mittelstand company uses to control its business. Usually each entrepreneur knows the rules for his business and which factors can influence or jeopardise his success. Sometimes he finds it hard, however, to represent these factors in a few key indicators. It is the art of the good businessman to offer assistance and represent the control concept in the financial accounting while taking into account the requirements for entrepreneurial control and also the legal financial accounting requirements – worldwide. In the end, an efficient business management and control system is also characterised by the fact that it is accessible and

comprehensible to the whole of the management and not only to persons with commercial qualifications.

Extensive automation of the commercial procedures

The representation of processes in an IT system is often viewed as the main step towards increasing efficiency. And indeed, if one considers the example of digitalised invoices, an important rationalisation step has certainly taken place, whereby a well introduced system already carries out the main tasks of checking invoices and allocation to an account automatically. In the course of a subsequent analysis by the controlling department the electronically stored documents are also available at the press of a button. The often tedious walk to the filing cabinet is now left out.

The apparent advantages of automation, however, should not hide the fact that the real rationalisation is the simplification of the process just as outlined in the passage above. Apart from that the thinning and streamlining of processes is a necessary condition to ensure that international standardisation can even be implemented.

In addition to increasing efficiency, the complete traceability of business transactions is a further advantage of IT solutions. If it is possible to successfully represent commercial processes without media inconsistencies in the IT system, these transactions will also be correspondingly better documented and traceable within the system. This is highlighted by the example that a receipt of an incoming invoice still issues a manual payment order to the bank because the electronic financial accounting and the actual payment order are separate. This means that the actual accounting process can be traced in the system, but that inspection of whether the payment was correctly made requires a personal look at the paper file which is hopefully complete, a traditional task of the audit.

Instead of that it is today possible without great cost that after the posting of an invoice the corresponding payment is triggered directly from within the ERP system, to send the payment via electronic banking to the bank and then using the same method to report back to the company from the bank that the payment has been made and then to post this information almost immediately. This removes the need for the unpopular filing process and everything is immediately documented in the IT system. This serves to limit the possibilities for errors and also removes the possibility of incorrect behaviour. The person who then consciously violates the rules of the installed system runs the immediate risk of being detected and identified.

As a preliminary conclusion one can say that standardisation and streamlining of commercial processes and their seamless representation in the IT system result in efficiency and

transparency. Efficiency because the figures are produced quicker, one does not communicate at cross purpose and standardised systems are easier to maintain. Transparency is established as one knows what a recorded figure really stands for and because the documents for the figures are fully available as and when required.

Guidelines, but the right way

In spite of a reluctance to embrace guidelines, each department has a number of rules which have to be observed. In particular in positions connected to essential and existential risks, one should not dispense with the formulation and enforcement of guidelines.

Such subjects are, for example:

- Signatory rules
- Financial transactions
- Protection of the data network
- Insurance

In principle, a guideline should only include what one is prepared to enforce. Therefore the motto "less is more" applies. In order to ensure that guideline can be enforced, they must be easy to understand, i.e. they must also be comprehensible to non-experts. Items which are not understood can hardly be enforced in the foreign subsidiary which is far away. And guidelines which are not enforced are not needed. These are facts which immediately come to mind for engineers on the subject of occupational safety.

Discussion about residual risk

It would be naive to believe that an automated financial accounting and a pair of guidelines will allow us to deal with all risks. It is therefore important within the organisation to make risk management an important theme. Of course risk management in Mittelstand companies must not be allowed to function as a cover up for the company management in relation to advisory boards and shareholders. It is more about creating a culture where there is open discussion about errors and risks so that this knowledge can be used in operative processes and perhaps even written down in guidelines.

Transparency and efficiency

In the previous sections it should have become clear that commercial risk management is not just the establishment of bureaucracy, but also about the organisation of efficient and

transparent structures. This enables the Mittelstand to reach a degree of professionalism which is cannot be achieved by larger company groups, as the number of the companies in Mittelstand company group is limited. In addition, new companies are not continually purchased and a different company disposed of. And finally the commercial department is not busy with some capital market reports. What the company knows is usually also available knowledge for the shareholders.

In other words, the presented measures are feasible for the Mittelstand and much more important is the fact that they are worthwhile because a high commercial quality and flexibility can be achieved with far less tools than in a large company group.

We must not, however, overlook the fact that the way to achieve this, at least in the initial stages, is not all that easy. And it is here that an international legal and auditing firm can provide good services. This is because often the companies themselves do not know the best course of action. Once they are informed about the possible options, the fear grows that their own system which luckily offers a degree of stability is at risk before the new solution has been understood. And one cannot hide the fact that such a project carried out properly can take some years to achieve. It is therefore recommendable to co-ordinate with auditing experts to draw up a clear project plan and to work together with the commercial personnel of the foreign subsidiary to slowly work through the plan. In addition to the activities described above, there is a further effective tool to monitor and control of foreign subsidiaries. This concerns the improvement of co-ordination with the auditor in the course of the audit of the annual financial statement.

Audit of the annual financial statement – an effective instrument to control the company

In the preceding chapters the role and possibilities of co-operation with the auditor regarding the improvement of the monitoring and control of foreign companies was touched upon several times. In the last section of our analysis we would like to look more closely at this area and demonstrate the potential for improvement which can be generated especially in connection with the audit of the annual financial statement. The advantage here is that particularly in Mittelstand companies a trusting co-operation over many years exists with the auditor. Due to a lack of pronounced staff departments, the auditor traditionally takes on an important function in the Mittelstand company as a respected consulting partner of the entrepreneur or company management in many questions concerning the management of the company. Due to the many years of experience in consulting and auditing the company the auditor has a good overview of the company and its structures, yet he remains a third party, i.e. he is not directly a member of the company management.

Together with his experience which is also the result of having audited other companies he can use his independent position without the big risk of being blind to the company's failings to be an advisor to the entrepreneur and an understanding sparring partner. In addition, there is the point that in the last 15 years, i.e. since the passing of the law on control and transparency within company activities, auditing practice, as a result of spectacular business collapses, has continued to develop intensively. As before, the modern audit of the annual financial statement includes the traditional elements of financial accounting, i.e. the items on the balance sheet and income statement, but in addition in particular there is the auditing of the internal control system, the risk management system, the IT and the characteristic business transactions of the business model. Then there is assessment of the quality of the management information system, the reporting and assessment of the continued existence of the enterprise. The audit of the annual financial statement thereby touches nearly all areas where in the previous chapters a potential for improvement was outlined with a view to the monitoring and control of foreign subsidiaries.

The following specific areas can be identified:

› Improvement of the quality of the information in the annual financial statement concerning the individual subsidiaries. The requirements for external financial accounting and auditing vary from country to country. For example, the content and scope of the preparation of the local annual financial statement varies together with the scope of the statutory audit requirement and requirements regarding audit reports. Bearing this in mind it is advisable to agree definite uniform reporting standards with the auditor of the annual financial statement including an understandable transition of the local reporting over to the group reporting (HB II). In addition, it should be agreed with the auditor of the annual financial statement that important business transactions are explained and the assets, financial position and result of operations of the subsidiary company should be thoroughly analysed.

› Reduction of the deficit of control and information resulting from the lack of internal audits through agreement of supplementary or additional audit actions which are additional to the "standard" audit of the annual financial statement. These audit actions can be concerned with the quality of the local management, the scope, content and application of the operations-related control instruments used in the subsidiary, the compliance of the business processes such as the conclusion of contracts with suppliers, customers or employees and a review of the security of important company assets such as real estate, buildings, machines, etc.

› Implementation of monitoring and preventive measures concerning corruption or fraud. This may include the following random audit actions:

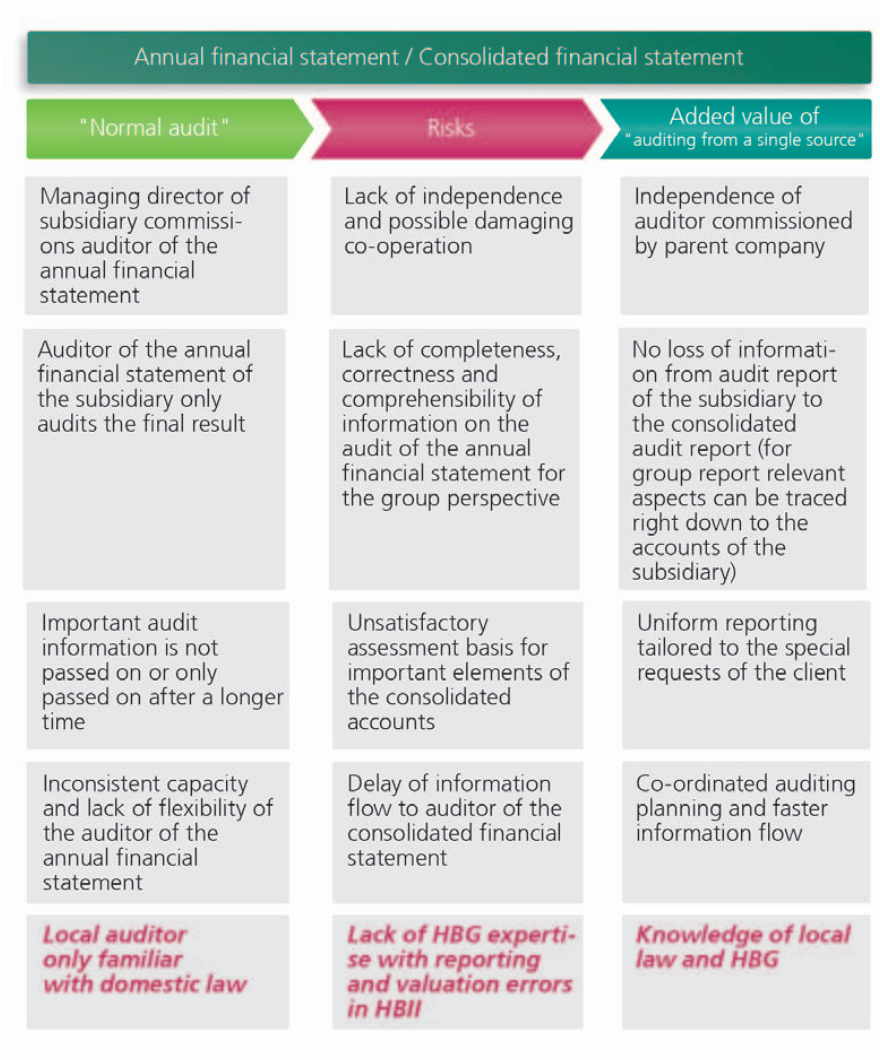
  » Correctness of travel expense claims of management personnel,
  » Appropriateness of remuneration structures for personnel,
  » Origin of contract partners in the area of purchasing,
  » Reliability of implementation of scrapping activities,
  » Scope of involvement of closely-linked persons in important transactions in the subsidiary,
  » Independence of important third party partners such as the notary.

As a result, it is possible to reduce or even remove numerous weaknesses in the monitoring and control of foreign subsidiaries through a "fine-tuned" audit of the annual financial statement. However, the execution of such a "fine-tuned" audit of the annual financial statement places high demands on the auditor of the annual financial statement. These primarily concern the availability worldwide of qualified auditors for the various tasks.

A further important aspect relates to the question of how a worldwide audit of the annual financial statement should be organised. Does it make sense that in each country different local auditors prepare the respective annual financial statement or are there good grounds for arguing in favour of a worldwide audit of the annual financial statement from a single source? As we have already established, the uniform assessment and valuation of the facts at the local and national levels (naturally under consideration of the particularities of the respective country) and the same level of knowledge with a continuous unhindered information flow between the parent company and subsidiary are important factors with regard to monitoring and controlling of foreign subsidiaries. These aspects are often made more difficult by the fact that the local audit of the financial statement and the audit of the consolidated financial statement are carried out by different companies.

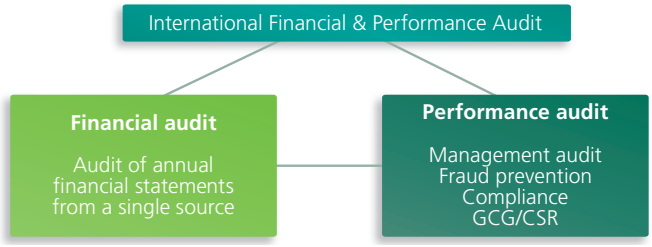
Therefore it makes sense to commission a single international auditor for the respective national financial statement and for the audit of the consolidated financial statement (or voluntary consolidated financial statement) as this will provide a uniform perspective according to HB I and HB II. This is the only way to uniformly assess in total business transactions, balance sheet and income statement items. If one separates the two functions of the local audit and the group audit, there is a risk that the auditor of the consolidated financial statement will depend too much on the results of the local audit, i.e. substantial questions will not be asked about its preparation. In addition, the information flow and the information speed is seriously compromised, without having to mention translations not carried out of the local reporting, which leads to a lack of information.

The following graphic illustrates this situation and shows the added value of the group-wide "audit of the annual financial statement from a single source":



The Rödl & Partner International Financial & Performance Audit

Against this background, in recent years we at Rödl & Partner have systematically expanded our auditing practice with an orientation firmly towards the requirements of German Mittelstand companies with international operations. This has resulted in our Rödl & Partner International Financial & Performance Audit.



Based on the understanding of the company gained through the audit of the annual financial statement and its legal and economic circumstances we integrate internal audit-like actions in the areas of management audits, fraud prevention and compliance in our audit activities of the annual financial statements. This allows the individual definition of the scope and depth of the audit to take into account the requirements of the client with a uniform approach worldwide.

The main auditing areas of such a performance audit can include the following:

The **Management audit** starts with the management culture of the company and taking into account the business model of

› the potential to improve organisational conditions and
› the available control and planning instruments

should identify, for example, the operative or strategic controlling and risk management system. In addition, prompt informative internal company reporting should be established with the company management.

Starting points here are the implementation of processes relevant for an internal control system such as

› the principle of dual control
› monitoring of liquidity and
› adherence to checklist of business transactions which require consent.

Corruption, embezzlement and other damage to the company assets are often only possible if existing internal controls are bypassed. Such weak points should be identified in the course of **Fraud prevention** audit actions before damage takes place.

Examples of audit actions for fraud prevention are

› audit of travel cost documentation,
› audit of actual existence of fixed assets,
› screening of borrowing business relations,
› audit of personnel accounts for irregularities with payments and
› audit of contract and service content with business partners, etc.

Compliance management describes the task of the company management to meet the legal, contractual or other obligations in the company through appropriate measures. In areas which are particularly sensitive for the respective company in the course of a compliance audit structures can be defined for a functioning compliance management system.

The observance of important legal and company requirements is checked using a compliance matrix. The individual points of the matrix should be sustainably ensured through contact persons and training sessions in the company. If required, the Rödl & Partner International Financial & Performance Audit can also include further audit elements such as corporate governance and corporate social responsibility.

The aim is to develop and implement an auditing profile which is suitable for the background of the respective client.

The argument of cost which is frequently mentioned by the local management of the subsidiary will not convince here due to the fact that a later clarification of any irregularities or even manipulations will cause costs which are considerably higher without mentioning the worst case of lasting non-pecuniary and pecuniary damage.

The Rödl & Partner International Financial & Performance Audit is a distinct and unique product. The basis for this range of services is the special structure of our company which for more than 30 years has lived a multi-disciplinary approach to determine its own form of internationalism. Our four areas of auditing, tax, legal and corporate consulting are not isolated from each other, but are inseparably interlocked. Many of our consulting and auditing products attain their special value through multi-disciplinary co-operation. A typical example of this is the International Financial & Performance Audit which is made possible through the co-operation of auditors, lawyers and IT consultants. Further examples involve legal, tax, financial, commercial, environmental due diligence services "from a single source" and our compliance services. The character of our international structure makes it clear that we are not a network of independent companies, but are based in Germany and present in 40 countries with our own branch offices. This gives us the same structure as our German clients with their international operations. We know how they tick and we are tuned in to their needs.

Authors

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Martin Wambach is a managing partner at Rödl & Partner.

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Martin Wambach is a member of the board of directors of the Sparkasse savings bank in Cologne/Bonn and is vice chairman of the institute of auditors in Germany.

Martin Wambach has made numerous publications in the areas of due diligence, company financing, risk management, investments and controlling.

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This work has a particular practical value through the professional combination of expertise and years of practical experience in the field of all our co-authors and colleagues. This is complemented by the readiness to address themes comprehensively and pragmatically. Our lived multi-disciplinary and mutual co-operation through branch offices and across national borders characterises the special spirit which makes us at Rödl & Partner so efficient and distinct.

Dear Colleagues, Many thanks to you that in spite of all your daily duties you have found time to engage in such demanding projects.

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Rödl & Partner is active with 94 wholly-owned branch offices in 43 countries. We owe our dynamic success to over 3,700 entrepreneurial-minded partners and colleagues.

We are distinct from the competition through our company philosophy and our approach to customer care, whereby we believe that the requirements of our clients cannot be divided into individual professional disciplines. In fact our multi-disciplinary approach is based on expertise in the respective business areas and combines these smoothly in multi-disciplinary, cross-border teams.

Rödl & Partner is not a group of lawyers, tax consultants, corporate consultants and auditors working in parallel. We work across all business areas in close co-operation. We are market oriented, think from the customer's point of view and assign project team members to achieve success and ensure that the targets of our clients are met.

"Each and every person counts" – to the Castellers and to us.

Human towers symbolise in a unique way the Rödl & Partner corporate culture. They personify our philosophy of solidarity, balance, courage and team spirit. They stand for the growth that is based on own resources, the growth which has made Rödl & Partner the company we are today. "Força, Equilibri, Valor i Seny" (strength, equilibrium, valour and common sense) is the Catalan motto of all Castellers, describing their fundamental values very accurately. It is to our liking and also reflects our mentality. Therefore Rödl & Partner embarked on a collaborative journey with the representatives of this long-standing tradition of human towers – Castellers de Barcelona – in May 2011. The association from Barcelona stands, among many other things, for this intangible cultural heritage.

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