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Client Information
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How can foreign investors structure an acquisition in Germany?

Share Deal vs Asset Deal

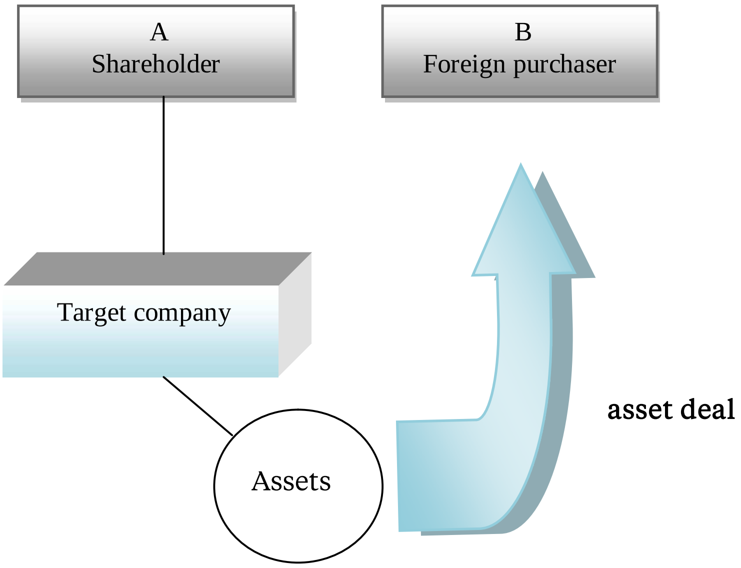
The acquisition in German companies can be structured directly as asset deal or indirectly by acquiring shares in a legal entity (share deal). The legal entities in Germany are generally organized as a limited partnership or as a corporation.
The different types of acquisition have significant impact on the economic situation of the seller and buyer.

Agenda:

1. Characteristics of the asset deal
2. Tax relevant issues of the asset deal
3. Characteristics of the share deal
4. Tax relevant issues of the share deal
5. Conclusion

Should you have any further questions which have not been covered in this overview or should you require tax advice, please feel free to contact us.

1. **Characteristics of the asset deal**



Where an acquisition is carried out by way of an asset deal, the purchaser acquires either all or single assets, e.g. real estate property, machines, office equipment, licenses and rights, contracts and liabilities of the company.

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Consequently the business activities will be continued under a new name in a different legal entity The purchaser can choose his favorite assets and transfers them to an existing or newly set up company (NewCo).

- Benefits
  - the purchaser knows exactly which assets he buys, single assets can be left out
  - no automatic transfer of rights, claims and liabilities

- Disadvantages
  - complex asset purchase agreement
    The asset purchase agreement requires detailed identification of every single asset and contract (e.g. all employment, contractual and other legal relationships need to be considered in the agreement)
  - transfer of liabilities
    The purchaser may be liable for debt or obligations initially incurred by the seller.
    - *sect. 25 para 1 German Commercial Code (HGB)*
    In case the existing business name is used by the purchaser, he may be liable for debts incurred by the previous owner. However such liability may be avoided by a disclaimer and by an entry in the commercial register.

- *sect. 75 German Fiscal Code (AO)*
The purchaser shall also be liable for taxes where tax liability is based on operation of the previous enterprise (especially trade tax, withholding tax, wage tax and value added tax). This liability may not be disclaimed.
- *sect. 613a German Civil Code (BGB)*
The existing employment agreements and therefore the liabilities resulting from the employment are transferred to the purchaser in case the transferred assets qualify as a business or a business unit.

- transfer of contracts with customers, suppliers and others
  The contracts with third parties remain in the selling company.
  Any transfer of such contracts requires the consent of the contractual counterparty. Negotiating a new agreement may result in the loss of attractive conditions.

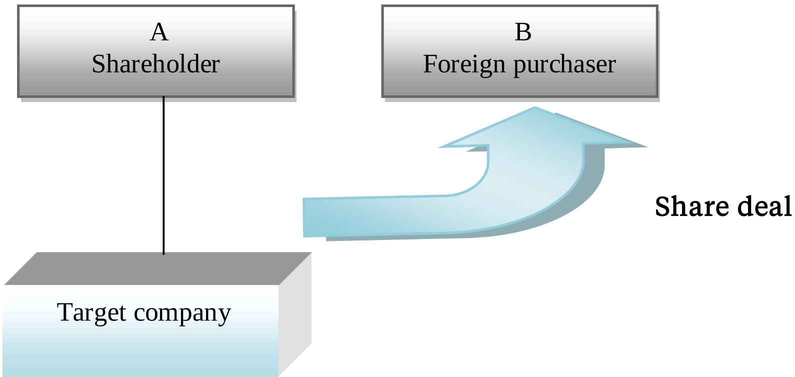
Result:
The asset deal is selected if the investor only wants to buy a division of the company or if the investor wants to limit the assumption of liabilities connected with the target company. For the benefit of the buyer, appropriate indemnification clauses, in particular regarding taxes, should be agreed on and escrow amounts to cover indemnification claims should be retained.

2. Tax relevant issues of the asset deal

Tax impact from the buyer's perspective

+ optimization by allocation of the purchase price on individual assets with a short remaining useful live
  Generally the parties of the purchase contract should agree on the allocation of the purchase price to the assets and liabilities transferred. The documentation of this allocation is the basis for an evaluation of the tax authorities if the allocation is appropriate.
  The transferred tangible and intangible assets are recorded at acquisition costs in the balance sheet of the purchaser.
  Any remaining excess of the purchase price which cannot be attributed to individual assets is recorded as goodwill and is amortized over 15 years from a tax perspective.
+ write-down of the acquisition cost
  The hidden reserves of the tangible moveable assets can be written off. The depreciation is based on the useful lives derived from the current official tax depreciation tables. Land and investments are not subject to any scheduled depreciation. The depreciation leads to a reduction in taxable profits of the purchaser.
+ deduction of borrowing costs from the income of the acquired business
  Taking the German interest deduction ceiling rule into consideration the borrowing costs can be deducted as business expense.
- real estate transfer tax
  The direct transfer of real estate triggers real estate transfer tax. The real estate transfer runs from 3.5% to 6.5%, dependent on the federal state.

3. Characteristics of the share deal



Where an acquisition is carried out by way of a share deal, the purchaser acquires either all or a part of the shares in the corporation or partnership (target company).

In the event that shares in a corporation or partnership are acquired, the carrying amounts of assets and liabilities remain unchanged at the target company. The liability for old obligations at a share deal are clearly regulated by law: With the sale of the company the "history" of the risk area is also passed on to the acquirer.

- Benefits
  - lean share purchase agreement
  - quick execution of the contract is possible
  - relativ simple determination of the object of the purchase contract
  - all contracts of the target company remain unchanged
  - the entire company is sold to the buyer; no empty shell company is left after the transaction

- Disadvantages
  - purchaser buys all liabilities and possibly unknown liability risks
  - legal resolutions of the previous board may be binding

Result:
The share deal is often selected for target companies with a stable financial perspective.

4. Tax relevant issues of the share deal

Tax impact from the buyer's perspective

a) In case that the *shares in a corporation* are acquired:
   - no step-up
     The book values of the assets and liabilities at the level of the target company remain unchanged => no depreciation of the purchase price
   - no depreciation of the shares
     A write down to the lower fair value of the share is not tax deductible for corporation income.
   - risk of forfeiture of tax loss carry forward
     According to sect. 8c German Corporation Tax Act (KStG), under certain conditions, a forfeiture of tax loss carry forwards at the level of the acquired corporation occurs. The forfeiture may be avoided, if the target company owns sufficient hidden reserves.
   + avoidance of real estate transfer tax
     No real estate transfer tax is triggered in case less than 95% of the shares are sold. Shares that are held directly and indirectly are summed in respect of the 95% threshold.

b) case that a *stake in a partnership* is acquired:
   + step-up
     The purchaser steps up the tax basis in a supplementary balance sheet (Ergänzungs-bilanz) to the extent that the purchase price exceeds the proportional book value of the assets. Please refer for the allocation of hidden reserves and the write down to the notes in chapter "*2. Tax relevant issues of the asset deal*".
   + avoidance of real estate transfer tax
     See above section 4. a).

5. Conclusion

From the purchaser's perspective the acquisition by way of an asset deal allows to use the depreciation potential. In contrast, from the seller's perspective the share deal is favorable, since only 5% of capital gains arising from the sale of shares in a corporation are taxable, if the seller is a corporation; 60% is taxable, if the seller is an individual.

From an economic point of view the overall tax result is exclusively relevant for the purchaser and the seller. In case the seller can realize the most tax-efficient option he may accept a lower purchase price. In the other case, if the purchaser can pursue the most tax efficient option the purchaser on the other hand may accept a higher purchase price.

The more hidden reserves and goodwill exist, in other words the more the purchase price exceeds the book values of the assets, the more important the depreciable amount for the purchaser will get. The benefit of the depreciable amount strongly depends on the allocation of the purchase price to the assets.

As a result, a careful review of the tax, legal and economic situation at the target company will help us to find the best solution for the purchaser regarding his acquisition.

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