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"Do you speak German?" – Challenges for foreign supervisory board members in German companies

One look at the annual reports of the DAX30 companies shows that the members of supervisory boards of Germany's leading companies are becoming more and more international. Only ten of the thirty companies in the index still have a majority of Germans on their supervisory board.

This trend will lead to more diversity in the decision-making processes of supervisory boards. Many combine this increasing internationalization with the hope for more strategic vision on supervisory boards and expect "better" decisions. In practice, this development frequently leads to uncertainty in many companies because the membership of foreigners in the supervisory board gives rise to legal questions only seldom discussed so far. Many foreign supervisory board members, in particular, struggle with language difficulties when they try to fulfill their – already demanding – duties as board members.

Our practice has shown that many of the arising uncertainties can be resolved by applying a couple of principles which we would like to present here.

- A lack of sufficient command of the German language is no legal obstacle for the electability of a candidate for the supervisory board.
- Whether the working language of the supervisory board may be determined with binding effect in the articles of association of a stock corporation is doubtful because such rules adversely affect the right of the board to organize its own matters. On the contrary, provisions on the working language in the rules of procedure of the supervisory board are unproblematic, and individual decisions of the supervisory board chairman are also possible.
- The chairman or, as the case may be, the supervisory board as a whole has discretion when deciding on the working language. It is not mandatory that German be spoken in the supervisory body. Such discretion is, however, exceeded in case of an arbitrary choice of language, for example if the stipulated working language is not spoken by any or only a few of the supervisory board members.
- Decisions of the supervisory board can be recorded in a language other than German. If, however, minutes have external effects (e.g. because they must be filed with the commercial register), a German translation may become necessary.
- It must, however, be possible for supervisory board members who do not have adequate knowledge of the relevant language to duly fulfill their obligations as board members. The company must therefore procure that the members are in a position

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to take notice of information received, to understand their content and to discuss it with other supervisory board members and the management board. Every member of the supervisory board who does not have sufficient command of the working language, can demand that the proceedings of the supervisory board be translated simultaneously into a language understood by her (however, not necessarily the language desired) and that her own contributions be simultaneously translated into the working language of the meeting.

- Each supervisory board member must be provided with translations of working documents (e.g. draft resolutions, drafts of agreements on transactions requiring approval) and minutes into a language understood by her.
- If all participating shareholders do not agree otherwise, general shareholder meetings of German companies are to be held in German. If participating supervisory board members do not have adequate command of German, the above comments on the engagement of interpreters and the translation of documents apply accordingly.

These principles show that supervisory board members have the rights, which allow them to duly fulfill their duties as board members, even if they do not have sufficient command of the German language. The responsibility for duly exercising these rights, however, remains with the supervisory board members themselves.

This applies in particular if the supervisory board's agenda provides for a resolution to approve management measures (e.g. the conclusion of an M&A transaction). It is then required by the members that they, based on reasonably sufficient information, make an entrepreneurial decision. The information is usually acquired on the basis of company documents and the direct contact to management board members, employees or advisors of the company. However, a member of the supervisory board must, if necessary, procure additional information to place her in a position to be able to duly assess a proposal for resolution. In light of this comprehensive duty, the rule: "No German? – No Excuse!" applies to decisions of a foreign supervisory board member made on the basis of insufficient or false information.

If you have any questions or wish to receive further information, please feel free to contact the authors.

New ISDA Protocol Addresses Uncertainty in Cross-Border Derivatives

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Since the Lehman bankruptcy and the financial crisis of 2008, regulators have been pushing for a brief standstill period upon the failure of a financial institution to allow regulators to find alternate counterparties for its derivative transactions. When Lehman filed for bankruptcy, counterparties on over 80% of its approximately 930,000 derivatives trades sought to terminate immediately their derivative transactions, creating havoc in the market. This termination right is permitted under the form agreements adopted by International Swaps and Derivatives Association, Inc. (ISDA).

To avoid a repeat of 2008, certain countries (including Germany and the U.S.) have adopted statutory resolution regimes (such as the Orderly Liquidation Authority created under the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010)*, which are essentially special insolvency proceedings for financial institutions, that provide countries with a framework to deal with large failing institutions. These regimes impose a stay (which may be only 24-48 hours) on counterparties from immediately terminating their derivatives transactions with the distressed entity or from foreclosing on its collateral. In addition, the Federal Deposit Insurance Corporation (FDIC) and the Bundesanstalt für Finanzdientleistungsaufsicht (BaFin) together with other regulators wrote to ISDA in November 2013, asking ISDA to revise the ISDA form documents to provide for a short term suspension of early termination rights and other remedies arising from the insolvency or other resolution proceedings of a financial institution.

Including this short term suspension within the ISDA form agreements will fill a hole in the protection the various special resolution regimes seek to provide to the distressed entity. Those regimes can stay attempts to terminate contracts when the distressed entity's counterparty is located within the regime's jurisdiction. However, counterparties located outside that jurisdiction may argue they are not bound by such rules. The gap in cross-border application of regimes' rules arguably gives foreign counterparties greater rights than those counterparties in the same jurisdiction as the insolvent entity.

To address this situation, ISDA created its ISDA 2014 Resolution Stay Protocol (Stay Protocol). An ISDA protocol is a multilateral mechanism that allows contract parties to implement various standardized amendments to covered ISDA master agreements and related credit enhancements. These amendments are automatically incorporated into agreements between parties that have agreed to "adhere" to a particular protocol, allowing the adhering parties to agree to contract changes intended to be the new standard in the industry without engaging in expensive and lengthy negotiations over the changes in connection with entry into every new ISDA contract.

The Stay Protocol amends the terms of covered swap agreements to "contractually

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recognize the cross-border application of special resolution regimes applicable to certain financial companies and support the resolution of certain financial companies under the United States Bankruptcy Code." By agreeing to adhere to the Protocol, counterparties opt in contractually to resolution regimes that stay and in some cases override cross-default rights that are included in derivatives contracts and which arise upon the entry of a bank or certain of its affiliates into some sort of liquidation or insolvency proceeding. Unlike other regimes, the US Bankruptcy Code does not stay or invalidate these default rights in derivatives transactions, and the Stay Protocol contractually creates these limitations for US entities.

ISDA announced in November that 18 major banks, including Deutsche Bank, agreed to adhere to the Stay Protocol, which becomes effective (except for the US bankruptcy provisions, which are effective only upon relevant US regulations being issued) on January 1, 2015. The Stay Protocol will provide clarity to adhering market participants in cross-border transactions and, if needed, provide breathing room to larger financial institutions that may find themselves in financial distress. Regulation of cross-border transactions remains a hot topic for regulators. The Stay Protocol will serve as a Band-Aid on these transactions until new regulations can be adopted in various jurisdictions making these restrictions on counterparty contractual rights in insolvency proceedings binding by statute.

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Federal Appeals Court Extends Liability for Customs Penalties to Individuals, and Perhaps also to Exporters and Foreign Suppliers.

In a remarkable decision which may now be on its way to the United States Supreme Court, the United States Court of Appeals for the Federal Circuit has extended liability for payment of Customs penalties to individuals who were not the importers of the products, but who were somehow involved in the import transaction. Until the decision, it was commonly believed that individuals were only responsible if they were the importers of record, or if fraud was involved (which requires malicious intent), or if they were aiders and abettors. The Federal Appeals Court in a unanimous decision, signed by all the active judges of the court, now says that anyone may be liable for those penalties if they participated in the importation.

The facts in the case were quite simple. The owner of several closely-held companies directed that the imports of men´s suits should be made to one of his companies. The value of the suits as invoiced did not contain an addition for the price of textiles the importer supplied the foreign manufacturer, thus reducing the dutiable value of the suits. The error was soon corrected by the importer, but $45,245.39 remained unpaid (but declared late by the importer). Customs imposed a penalty of $534,420.32 for this underpayment based on the importer´s and the owner´s gross negligence. Since intent, by definition, is not an element of gross negligence, the owner appealed, arguing that only importers – and not officers, agents, employees, or owners of the importer – may be liable for penalties. The owner´s argument has been the common understanding of the law, and at trial and appeal, the Government did not argue otherwise.

The appellate court held that anyone who introduces, or attempts to introduce merchandise into the United States, whether he/she/it is the importer of record is liable for Customs penalties. This means that now employees and officers of a company importing products are liable for penalties if they act negligently or grossly negligently. As a matter of personal protection and in order to avoid these penalties, owners, employees, and officers of importing companies must ensure that their companies have vigorous and effective trade compliance programs. Otherwise, these individuals (who have responsibility under the statute to supervise and control importations) will be responsible for enormous penalties, which in this case were in the hundreds of thousands of dollars, approximately 12 times the duty loss to the United States.

The case has another troubling aspect. Much of the decision was focused on hundred year old cases in which foreign manufacturers who supplied incorrect

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invoices or other documentation to Customs were also liable for Customs penalties. The clear implication of this case – if not its holding – is that foreign manufacturers and exporters, and their employees, agents, officers, etc., are also liable for U.S. Customs penalties if they act negligently or grossly negligently in directly or indirectly supplying U.S. Customs with information. For this reason, foreign suppliers to the U.S are no longer immune to U.S. Customs laws, and must also have vigorous and effective compliance programs.

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Statutory Minimum Wage in force in Germany as of January 1, 2015

After decades of controversial discussions, Germany will introduce a statutory nationwide minimum wage of 8,50 € an hour, about US$ 10,60. Germany is one of the last countries in the European Union to introduce a statutory minimum wage. Only Austria, Cyprus, Denmark, Finland, Italy and Sweden will continue being without a statutory minimum wage.

In the past, Germany had relied on a self-regulating system in which the great majority of wages had been set by collectively bargained agreements between unions and employer associations. Following reunification of East and West Germany, the picture has changed since a lower percentage of workers is actually covered by collective agreements.

What will be the most important changes starting January 1, 2015 ?

The statutory minimum wage applies to all employees, including interns as long as the internship is not one according to certain training regulations set by a college, university or the like. It is also not applicable to short-term internships of less than 3 months and some other exceptions have been established by law which have to be assessed on a case-by-case basis. Furthermore, the new law does not apply to young people under 18 years of age who did not yet complete their vocational training and to traineeships who fall within the federal apprenticeship scheme.

The minimum wage is mandatory and applicable to all industrial sectors nationwide. For overtime work certain exceptions may be agreed; provided, however, that the company and the employees agree on flextime wage records by which overtime can either be redeemed by compensatory time-off or, ultimately, by paying the statutory minimum wage.

The minimum wage act stipulates that a company which hires a subcontractor for the performance of certain works or services, can be held liable for the payment of the minimum statutory wage like a guarantor, in the event that the subcontractor does not honor its obligations under the law. This is of particular importance in the construction sector where one general contractor usually employs one or more subcontractors. The guarantee-like liability of the general contractor applies regardless of the general contractor's knowledge of a possible violation of the provisions on minimum wage.

The new law imposes on the employer documentation requirements in certain industrial sectors as well as for its employees who perform so called mini-jobs (average monthly salary of no more than 450,00 €). This applies namely to the construction sector, hotel and catering industry, passenger transport industry, shipping, transport and related logistics industry, in the property cleaning trade, and several others. The

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company has to make records of the beginning, the end and the duration of the daily work time. The records have to be kept for a minimum of two years.

Furthermore, the minimum wage act introduces specific obligations for foreign employers in the construction sector, hotel and catering industry, passenger transportation industry, shipping, transport and related logistics sectors, fair and amusement park activities, forestry enterprises, property cleaning trade, on companies involved in the assembly and dismantling of trade shows and exhibitions, and in the meat sector. All these foreign companies shall from now on register their employees with the competent customs authorities before these start to perform their work or services in Germany.

The minimum wage can be adjusted from time to time if the committee which will be established to that effect feels a need for it.

The introduction of the minimum wage has raised many concerns among German businesses, namely whether the relatively high minimum wage will not lead to abolition of jobs rather than adding to the employees' protection

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The new German Renewable Energy Sources Act (EEG 2014)

Background

The revised German Renewable Energy Sources Act (*Erneuerbare-Energien-Gesetz – EEG*) has come into effect on 1 August 2014. The aim is to integrate renewable energy into the market and grid and thereby to reduce the costs of the so-called energy turnaround (*Energiewende*) in Germany. To accomplish this, the federal government limits the annual extension of renewable energy plants and implements a fundamental change to the statutory tariff structure. The operators of new renewable energy plants will receive the statutory feed-in tariff only in exceptional cases. Instead, the direct marketing of energy generated by renewable energy plants is mandatory. Furthermore, the statutory feed-in tariffs have (partly) been reduced substantially.

Extension Corridors

The proportion of renewable energy shall increase to 40 to 45 percent of gross electricity consumption by 2025, to 55 to 60 percent by 2035 and to 80 percent by 2050. This staged increase shall be achieved by virtue of so-called extension corridors securing the controlled extension of specific energy plants:

- Offshore wind power: Extension limit of 6.5 GW until 2020 and 15 GW until 2030
- Onshore wind power: Annual extension of up to 2,500 MW net (consideration of shut-down plant capacity)
- Solar energy: Annual extension of up to 2,500 MW gross (no consideration of shut-down plant capacity)
- Biomass energy: Annual extension of up to 100 MW (gross)

Mandatory Direct Marketing

In order to better integrate renewable energy into the market, operators of new renewable energy plants are obliged to market their generated electricity directly. The EEG 2014 contains two ways of direct marketing:

(1) direct marketing with the purpose of receiving a market premium (subsidized direct marketing) or

(2) direct marketing without receiving a subsidy (other direct marketing).

The market premium consists of the fixed statutory value of the respective renewable energy plant minus its technology-specific monthly market value (effective monthly

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average of the hourly contracts at the spot market of the electricity exchange EPEX Spot SE in Paris for the pricing zone Germany/Austria in cents per kWh). Only the following exemptions from mandatory direct marketing exist:

(1) direct marketing is temporarily and exceptionally not possible. In this case, the operator receives a tariff in the amount of 80 percent of the respective fixed statutory tariff from the grid operator. This fee shall ensure investment and planning security for new plants on the one hand by guaranteeing a minimum remuneration for the generated energy. On the other hand, it shall – by subtracting 20 percent of the fixed statutory tariff – motivate operators to return to direct marketing as quickly as possible.

(2) Small plants

- Plants with a nominal output not exceeding 500 kW the operation of which commenced before 1 January 2016, and
- Plants with a nominal output not exceeding 100 kW the operation of which commenced after 31 December 2015.

Auction Procedures

From 2017 onward, the tariffs for renewable energy will no longer be fixed by statute, but instead will be determined on the basis of competitive auction procedures. In order to gain experience in this respect, auctions are to be carried out for open landscape solar plants (solar plants that are not installed in, on or close to a building or other facility). For this purpose, a nominal output of up to 400 MW annually will be tendered.

To which plants does the EEG 2014 apply?

The EEG 2014 applies to renewable power plants the operation of which commenced after 31 July 2014. It also applies to renewable power plants the operation of which commenced before 1 August 2014. However, for the purpose of protecting legitimate expectations, substantial provisions of the current EEG 2012, especially the provisions on the fixed statutory tariffs granted, apply to those existing plants the operation of which commenced before 1 August 2014. The same applies for plants the operation of which commenced after 31 July 2014 and before 1 January 2015 where the permit or approval for the respective plant was issued before 23 January 2014.

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Patent infringement in Europe – a statistic overview

As previously stated, there is a revolution going on in European Patent Litigation and Patent Prosecution due to the upcoming Unitary European Patent and the European Unified Patent Court. Very soon, there will be a single IP-court system competent for all member states of the European Union.

But up to now, a patentee has to face 38 different jurisdictions with 38 different rules of procedure and different substantive laws. On the other hand, only four member states of the European Community play a major role in IP-enforcement: Germany with around 2.000 cases per year followed by France with around 250 cases, Great Britain and the Netherlands with roughly 50 cases per year each. All the other member states are negligible. In these four countries, only four courts handle the majority of cases, namely the district court (Landgericht) Düsseldorf, TGI Paris, High Court of England and Wales in London and Hoge Raad in Den Haag.

It is therefore of interest to patentees to compare these courts with regard to their efficiency and quality.

One aspect of quality is the average duration of proceedings in the first instance. Here, Den Haag is fastest with around 15 months until the decision, followed by Düsseldorf with around 20 months. Paris brings up the rear with around 26 months.

Especially of interest is the win rate of patentees in the first instance. Here Düsseldorf shows a win rate of 52%, followed by Den Haag and Paris running shoulder to shoulder with around 45% and finally London with 32%. This last figure has to be corrected to some extent, since the British Court of Appeal very often turns the scales in favour of the patentee: in 57% of all cases, the Court of Appeal decided in favour of the patentee. If one looks at the ratio of revocation of first instance decisions by the next instance as another aspect of quality, one has to realize that the only exception is the British Court of Appeal: all the other second instances do not change the win rate of patentees significantly.

Summing up so far, the Landgericht Düsseldorf offers good opportunities for patentees at a moderate duration of proceedings. Considering the costs for an infringement suit, Düsseldorf extends its lead since these are very reasonable compared to British or French proceedings. Although depended on the special circumstances of each case, the unsuccessful party has to bear costs of only 40 to 50.000 Euros. This seems to be well known among non-German patentees: Düsseldorf sees around 66% of foreign plaintiffs each year.

On the other hand, the German jurisdiction has the bifurcal system, meaning that infringement and validity of patent are dealt with at different courts. A defendant has to file his counter claim for nullification of patent with the Federal Patent Court in Munich.

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Even if he does so, the infringement court in Düsseldorf is not obliged to suspend its proceedings. It actually suspends only 10% of the cases in which a counter claim is filed. This is an advantage for the patentee, although he may have to face severe compensation payments in case he won the infringement case but his patent is revoked afterwards to an extent that it does no longer cover the alleged infringing embodiment.

So, up to now it is reasonable for patentees to seek judicial assistance in Germany, if possible. Since the Unitary Patent Court is not yet available and its regulations will allow for seven years of parallel existence with national courts, it might still be a good decision to choose one of the mentioned four relevant IP-courts in the European Union.

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Discovery in International Arbitration – Are There No Limits?

One of the most significant differences between German and U.S. civil procedure is "pre-trial discovery." While it is a major part of U.S. litigation, German law does not provide anything even remotely comparable. Thus, to many German companies, one of the advantages of international arbitration has been the virtual absence of U.S.-style discovery.

But a dramatic development has taken place in recent years. Today, it is not unusual for parties to an international arbitration to engage in U.S.-style discovery, including "e-discovery." This can lead to the mandatory exchange of millions of emails – a costly and intrusive undertaking.

So, should German companies just abandon international arbitration altogether? Not at all. The parties to an international arbitration proceeding can legitimately limit the extent of discovery in their case in a number of different ways.

Arbitration Clauses Should Be Customized

The first and most important step is to include a carefully drafted arbitration clause. The clause should be tailored to the particular parties and subject matter of the contract. Clauses copied from other contracts and translations of clauses from other languages can contain hidden dangers and should be avoided.

Depositions, etc.

Certain U.S. discovery devices – depositions, interrogatories and requests for admission – are generally unknown in international arbitration and will, in all likelihood, not be authorized by an international arbitration tribunal. But German parties negotiating contracts with U.S. parties may want to consider expressly including this general rule in their arbitration clause.

Document Exchanges

Contract parties can draft an arbitration clause that limits discovery to documents that the parties will use to prove their case. The International Centre for Dispute Resolution, for example, suggests the following clause:

> *Consistent with the expedited nature of arbitration, pre-hearing information exchange shall be limited to the reasonable production of relevant, non-privileged documents explicitly referred to by a party for the purpose of supporting relevant facts presented in its case, carried out expeditiously.*

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Discovery in International Arbitration – Are There No Limits?

After a dispute has arisen, the parties can negotiate to limit the extent of their document exchange. They can also separately pursue this goal during the arbitration proceeding by, e.g.:

- Appointing arbitrators with a civil law background (as opposed to, for example, retired U.S. judges);
- Urging the tribunal to issue procedural orders that limit discovery;
- Limiting the substantive issues in the dispute by pre-discovery applications to dismiss particular claims;
- Moving to have certain parties (i.e., companies and individuals not covered by the arbitration clause) dismissed; and
- Constantly and consistently advocating to the tribunal against broad discovery as inconsistent with the traditional goals of arbitration as an "alternative dispute resolution" mechanism.

A Note of Caution

Before following the above strategy, however, German parties should consider whether, in their particular case, they may in fact need discovery, because they may not be able to prove their case (or defend against the adversary's claims) without the adversary's or a third party's documents.

Hypothetical: A German company sells parts to a U.S. company, which are then installed into a larger machine at the buyer's facility. This machine malfunctions and causes extensive damage to the buyer's facility. The buyer commences an arbitration against the seller, claiming that the seller's parts were defective and caused the damage. To prepare a successful defense, the seller may want to obtain documents showing that a part from a different supplier caused the damage, that the buyer's workers were not adequately trained to use the machine, or that the buyer's engineers had incorrectly calibrated the machine. Without such discovery, the German seller may be unable to show that there are alternative causes of the damage and, thus, be limited to arguing that its parts were not defective.

Of course, the time, effort and money spent on such discovery must be balanced against the financial exposure, etc. the German company faces if found liable. This requires a highly fact-specific analysis and can result in different strategies for different cases.

Conclusion

International arbitration is still a viable alternative to litigation in U.S. courts. But German

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Discovery in International Arbitration – Are There No Limits?

companies should (1) make sure their arbitration clause is tailored to each particular contract and (2) consider in each case whether, on balance, discovery should be actively pursued or vigorously resisted.

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Could YOU Be Personally Liable for Import Violations?

Compliance personnel and corporate officers beware. You may have thought that you were shielded from being held personally liable if your company has U.S. Customs and Border Protection ("CBP") import violations. Typical violations involve false statements of value, misstatements of quantity, improper classifications, false statements of origin, or false statements of qualification under a free trade agreement, *e.g.*, NAFTA or KORUS FTA.

In the September 2014 Federal Circuit Court of Appeals *en banc* decision in *Trek Leather,* the court found an individual personally liable under the penalty statute, 19 U.S.C. § 1592(a)(1)(A), for false statements of value, resulting in underpaid Customs duties.

Until this decision, *the importer of record,* which for commercial shipments typically is a corporation or other business, was seen as most susceptible to CBP penalties resulting from misstatements and omissions on import documentation. The statute has long provided that "no person" by fraud, gross negligence, or negligence may enter or attempt to enter merchandise into the United States by false information or material omission. However, *Trek Leather* makes it clear that "person" can mean a natural person, *i.e.*, a living, breathing, human being.

Even though Trek Leather, Inc. was the importer of record on the entries, the company's President and sole stockholder was held joint and severally liable together with the corporation for the additional duties owed on the entries plus interest as well as a civil penalty. In the case, a corporate officer was held personally liable, but personal liability could also be placed on compliance managers and other employees responsible for handling a company's trade transactions.

The decision establishes that an *individual* with knowledge of a violation, such as the undervaluation of imported goods, may be held liable for that violation whether or not the person is a corporate officer or shareholder.

The issue of personal liability raised in this case should serve as a reminder that companies must take the necessary steps to ensure that all personnel involved in the documentation of its imports and exports are reviewing and submitting accurate information to CBP. Whether it is an entry-level employee in charge of reviewing import documents or the President of a company who signs off on import documents, both may be held liable for any false statements or omissions, even if they were made without the intention to commit Customs fraud.

If an individual is found liable for an import violation, he will be responsible for paying the unpaid duties on the transaction at issue, and possibly, additional civil penalties from his own pocket.

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This may be a good time to review your company's trade transactions. One way for an importer to help prevent or minimize the likelihood of CBP issuing penalties for import violations is becoming a member of CBP's Importer Self Assessment Program ("ISA"), if the importer is not already a member. For importers that may not presently have proper compliance procedures required by CBP, installing ISA-qualifying procedures is essential and becoming a member of ISA is highly advisable.

The benefits to an importer that becomes a member of ISA include, but are not limited to:

1) entitlement to entry trade data, including analysis support from CBP;
2) access to consultation, guidance and training by CBP, if and when requested;
3) exemption from all comprehensive compliance audits;
4) penalty-free prior disclosures if/when the importer becomes aware of a violation; and
5) written notice and time to file a prior disclosure if CBP becomes aware of errors in which there in an indication of a fraudulent import violation, and an allowance of 30 days from the date of the notification for the importer to file a prior disclosure and correct the violation without penalty.

The lesson to be learned from *Trek Leather* is that, since individuals may not be shielded by the company for import violations, everyone should be more cautious in ensuring that the paperwork submitted to CBP is accurate and complete.

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Post-election perspective: Midterm elections and US-tax reform

The November 4 midterm elections have resulted in a shake-up on Capitol Hill that will put Republicans in charge of the legislative agenda — including tax policy — in the House and the Senate when the 114th Congress convenes in January.

While the election results place control of both chambers of Congress under one party, it is less clear whether they remove enough of the impediments that can block the passage of major legislation such as tax reform. Pending leadership changes on the congressional taxwriting committees, the complexities of the Senate's procedural rules, and the fact that Democrats still control the White House for the next two years are all factors that make it difficult to determine whether the GOP can move significant tax bills through the legislative process and get them to the president's desk in the near term.

Unfinished business for the current Congress

Nontax issues that could consume floor time during what is expected to be a relatively compressed post-election legislative session include passage of a continuing resolution to fund government operations and action on executive branch and judicial nominations. The most pressing tax issue facing lawmakers now is legislation addressing the future of the research credit, bonus depreciation, and dozens of other temporary tax deductions, credits, and incentives that expired at the end of 2013.

The Senate Finance Committee in April approved a two-year extension (through 2015, retroactive to the end of 2013) of most — but not all — of the expired tax provisions, with an eye toward giving Congress more time to evaluate each provision and determine whether it should be extended permanently or stricken from the tax code as part of a future tax reform effort. Although the legislation was approved in the Finance Committee with bipartisan support, it has not received a vote on the Senate floor due to a dispute over a process for offering amendments.

Across the Capitol, House Republican leaders opted to move permanent extensions of discrete extenders provisions rather than another broad temporary package as Congress has done in the past. Since May, the chamber has approved separate bills that would permanently extend the research credit, bonus depreciation and the election to accelerate AMT credits in lieu of first-year bonus depreciation, increased Sec. 179 expensing limits, the reduced recognition period for S corporation built-in gains tax, the above-the-line deduction for qualified tuition and related expenses, tax-free distributions from individual retirement plans by individuals age 70-1/2 and older for charitable purposes, special rules for contributions of capital gain real property made for conservation purposes,

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the enhanced deduction for charitable contributions of food inventory, and the basis adjustment to stock of S-corporations making charitable contributions of property.

The House's "permanent extenders" strategy was advanced by Ways and Means Chairman Camp as a way of building the budget baseline to make tax reform a less expensive proposition for a future Congress.

Exactly how the two chambers will reconcile their competing approaches to extenders is currently unclear. Nevertheless, given the bipartisan support for addressing these provisions, it can be anticipated that most will be extended for the two year period 2014 and 2015. A few might be made permanent (such as the research credit), and it is possible that a very select few are not extended at all, making this something that bears close watching.

Looking ahead to 2015: Can tax reform move forward?

Republicans have long called for an overhaul of the federal tax code and their victories in the midterm elections arguably give them a stronger hand in shaping tax reform proposals in the new Congress. Moreover, tax reform is one issue that — in general terms, at least — enjoys support in both parties and at both ends of Pennsylvania Avenue. If each party wants to use 2015 as an opportunity to show that Washington is capable of governing, the stated interest in tax reform by Democrats and Republicans and the spadework that has been done to this point — for example, Ways and Means Chairman Camp's discussion draft, his bipartisan efforts with former Senate Finance Committee Chairman Baucus last year to educate lawmakers and the public on issues in tax reform, and current Finance Chairman Wyden's comprehensive tax reform proposals from 2010 and 2011 — could help propel the issue forward. Whether tax reform can advance in 2015 or will remain mired in partisan and procedural disputes will become clearer as the new congressional session unfolds in 2015.

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How German (and European) VAT impacts US companies

When US companies deal with value-added tax (VAT) challenges in Germany and the rest of Europe, whether newly established or well established, they often fall into the same avoidable traps. These traps include the assumptions that VAT is similar to US sales tax or GST (it is not), and a belief that VAT does not apply to non-European businesses (it does). Sometimes, it is a combination of both.

Unlike most other taxes, no physical presence in Germany is required to become VAT liable or to be charged with VAT. Therefore, the cost benefit of a cross-border business transaction should always take into account any potential VAT impact. It is important to remember that businesses are supposed to be VAT tax collectors, not tax payers. VAT is an end user tax, and businesses are not intended to serve as end users.

What is VAT?

Contrary to what many people believe, VAT is not the same as US sales tax. Although both VAT and sales tax are consumption taxes, it is good to realize that where sales tax is collected on retail sales at the time of sale to the final consumer, VAT is imposed on all sales in a supply chain involving the production and distribution of goods and the provision of services for consumption within the territory of the European Union (EU). Hence, both goods and services are subject to VAT and where there is consumption of these in the EU, there is a business (irrespective of the place of principal seat) liable to charge VAT.

In a supply chain VAT can never accumulate and paying VAT over VAT is prohibited. The 'end user' pays VAT and the business charging it acts as the collector. Since a business cannot be considered as an end user, businesses can reclaim VAT paid on purchases.

On the one hand, a business that is liable for VAT should pay VAT collected from end users to the tax authority, and on the other hand a business can reclaim any VAT paid to suppliers and on import of goods at the same time. In other words, VAT should not create a cost of doing business.

When US companies encounter VAT

When doing business in Germany and the EU a company will deal with VAT: when selling something, the company will have to charge the customer with VAT and when buying something the company will be charged with VAT.

US companies often encounter VAT when undertaking activities such as:

- importing goods into Europe for onward supply in the EU
- (importing and) holding an inventory of goods in a European location

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How German (and European) VAT impacts US companies

- selling electronically delivered software, games or music to private individuals in Europe
- operating a local sales and marketing subsidiary and
- importing evaluation units for demonstration and subsequent sale

What do we see in practice?

In practice a lot of questions arise in relation to the importing of goods, the possibility of submitting VAT refund requests and compliance obligations.

As aforementioned, VAT should not result in a cost when doing business. However, to achieve that result it is important to manage compliance regulations and the cash flow effects, too, since VAT may not always be recovered quickly. Some key considerations from a compliance perspective are:

- Incoming invoices should meet all requirements for VAT; the payment of incorrectly charged VAT is an important issue and may result in non-reclaimable VAT.
- Outgoing invoices should correctly state the VAT amounts; incorrectly stated invoices may lead to complicated and lengthy discussions with the local tax authorities and/or payment of VAT without the ability to on charge that VAT to the customer (from a commercial perspective).
- Having a proper administration that includes all incoming and outgoing invoices, import documents and documents that record border crossing supplies of goods.
- Meeting filing deadlines (to avoid penalties).
- An ERP system that is aligned with the European VAT requirements.

Conclusion

For US companies doing business in Germany and the rest of Europe, VAT can sometimes be difficult to understand and implement and becomes time consuming to comply with retroactively. Nevertheless, VAT is manageable when dealt with proactively beforehand. To safeguard that, it is important that the balanced VAT system (payment of VAT on sales/deduction of VAT on purchases) is correctly integrated in the business models and internal administration systems of companies.

In both existing and new situations, it has never been more important to make the time to examine the company’s VAT structure and put in place operating procedures that will enable maximization of VAT recovery, cash flow and avoidance of penalties for non-compliance.

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Reporting Certain Transactions Involving U.S. Corporations or German GmbH (or AG) – Frequently Overlooked Filing of Form 5472

Recently there have been a proliferation of Internal Revenue Service notices asserting late filing penalties for Form 5472 – „Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business“. Such penalties are $10,000 per form per failure to file or per late filing.

In the U.S./German context these situations frequently occur if

(1) a U.S. corporation is at least 25%-owned by a German company or individual, or,

(2) if a German corporation (e.g., GmbH or AG) is doing business in the U.S. without a U.S. subsidiary corporation, i.e, with a branch („permanent establishment“).

If either of these U.S. or German corporations in above scenarios (1) or (2) had a reportable transaction with a foreign or domestic related party, it needs to file Form 5472, which is a mere information tax return.

A related party is any direct or indirect 25% foreign shareholder of the reporting corporation and any person who is related to the reporting corporation or to the 25% foreign shareholder of the reporting corporation (within the meaning of IRC Sec. 267(b) or 707(b)(1)). „Related party“ also includes any other person who is related to the reporting corporation (within the meaning of IRC Sec. 482 and the related regulations), but does not include any corporation filing a consolidated federal income tax return with the reporting corporation.

A reportable transaction is any type of transaction listed in Part IV of Form 5472 (e.g., sales, rents, loans, etc.) for which monetary consideration (including U.S. and foreign currency) was the sole consideration paid or received during the reporting corporation’s tax year. In addition, a reportable transaction includes those listed in Part IV, if any part of the consideration paid or received was not monetary consideration, or less than full consideration was paid or received (reported in Part V). Transactions with a U.S. related party (as identified in Part III), are not required to be specifically identified in Parts IV and V.

A reporting corporation is not required to file Form 5472 if, e.g., it had no reportable transactions of the types listed in Parts IV and V of the form, or, if it is a foreign corporation that does not have a permanent establishment in the U.S. under an applicable income tax treaty and timely files Form 8833 („Treaty-Based Return Position Disclosure“).

Frequently overlooked are also, for example, situations where a German GmbH owns a building in the U.S. and leases it to a related U.S. corporation. In this case, Form 5472

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is required to be filed for both the GmbH and the U.S. corporation. The fact that the transactions are reported on the U.S. corporation's Form 5472 does not alleviate filing Form 5472 with the GmbH's tax return.

In addition, a German GmbH which is a partner in a U.S. partnership that engages in reportable transactions must report its percentage share of the reportable transactions on Form 5472. It is unclear whether a foreign partner with related party transactions with the partnership itself is required to file Form 5472, however, it is recommandable filing Form 5472 pre-emptively.

Note that the Form 5472 filing requirement also exists in a sceanrio, where a Limited Liability Company (LLC) having reportable transactions with its German owners has elected to be treated as a corporation for U.S. tax purposes, or where a GmbH & Co KG doing business in the U.S. has made a check-the-box election to be treaed as a corporation.

AHK German American Chambers of Commerce Deutsch-Amerikanische Handelskammern

DE INTERNATIONAL The German Chamber Network

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