



Private Equity

in 33 jurisdictions worldwide

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Formation and terms operation

1 Forms of vehicle

What legal form of vehicle is typically used for private equity funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

Legal vehicle

German corporate law offers a number of different legal forms that may be used as vehicles for LBO funds. These forms comprise stock corporations, companies with limited liability (GmbHs) and limited partnerships. The preferred and, typically, most appropriate form is a limited partnership. The partnership is formed in accordance with the provisions of the German Commercial Code. Its general partner is typically structured as a company with limited liability pursuant to the provisions of the Limited Liability Company Act. The investors subscribe for limited partnership interests and become limited partners of the partnership. The advantages of the partnership over any other form of vehicle are as follows:

- the accession of new investors as limited partners is uncomplicated and cost-efficient;
- the assignment of interests in the partnership does not require notarisation;
- the limited partnership agreement that establishes the partnership and usually contains the commercial terms is not available to the general public;
- a partnership that is not engaged in a trade or business for German tax purposes is fully tax-transparent and, as such, the partnership is not subject to taxation at its own level. The investment return may generally be expected to be received as a capital gain by the investors;
- distributions by the partnership are not subject to withholding tax or any other deductions;
- 40 per cent of the carried interest received from a partnership that is not engaged in a trade or business for German tax purposes is tax exempt at the level of German-based carry-holders; and
- the rights of limited partners are limited to certain information rights.

A specific investment company exists (*Unternehmensbeteiligungsgesellschaft*) that is covered by a law (*Gesetz über Unternehmensbeteiligungsgesellschaften*, the UBGG). The majority of LBO funds in Germany does not make use of this particular form. Therefore, this chapter does not refer to the UBGG and its requirements for the specific fund vehicles formed under its scope. In addition, the *Wagniskapitalbeteiligungsgesellschaft* (WKB) has been introduced as a new regime for venture capital funds, but has very limited relevance in practice yet.

Legal personality

The partnership has a legal personality separate from the limited partners. The partnership itself owns the partnership assets. It can assume liabilities and may be a party to judicial proceedings, either as claimant or as defendant.

VAT and trade tax (if applicable) are imposed at the partnership level. Trade tax can generally be avoided however. With respect to income tax, the partnership is transparent and income tax or corporate income tax is assessed at the level of the partners of the partnership (see question 16).

Legal consequences for limited partners and investors

The German Commercial Code stipulates that limited partners are liable for the debts of the partnership up to the liability amount registered with the commercial registry of the partnership. In practice, generally only 1 per cent (or less) of the capital commitment subscribed for by the limited partner is registered as the liability amount with the commercial registry. This is to keep the registered capital element and the related liability as small as possible. If a capital contribution in the respective amount has been made and has not been paid back, the limited partner assumes no further responsibility for liabilities of the partnership in relation to third parties.

A limited partner who joins the partnership is liable for the partnership's debts existing as of the date of his or her subscription, subject, however, to the general limitations described above.

Legal consequences for the general partner

The general partner is liable for all debts and obligations of the partnership without limitation. As the general partner itself is normally a company with limited liability, its liability is restricted to its assets whereas its shareholders' liability is generally restricted to the amount of the registered share capital of the general partner.

Legal consequences for the manager

The management of the partnership may be structured in one of the following three ways:

- Under the statutory legal concept of a limited partnership, the general partner, acting through its appointed managing director, represents the limited partnership. The liability of the managing director of the general partner is not only stipulated in the contractual terms of his or her employment agreement, but is also based on the Limited Liability Company Act. The standard of care owed by the managing director is that of a prudent business person. This level of care first applies from the managing director towards the general partner. The liability of the general partner towards the partnership follows the same principles, whereas the partnership agreement may stipulate further duties.
- To avoid a 'deemed business', at least one limited partner is appointed as managing limited partner of the partnership. The German Income Tax Act provides that a limited partnership is deemed to be in business due to its legal structure and regardless

of the activities conducted by the partnership if its general partner is a corporation and only such corporate general partner is vested with management authority. The duties of the managing limited partner towards the partnership are defined in the partnership agreement.

- A manager from outside the partnership may be appointed. The manager's duties are exclusively dealt with by a contractual arrangement.

2 Forming a private equity fund vehicle

What is the process for forming a private equity fund vehicle in your jurisdiction?

Forming a limited partnership

A limited partnership under German law is formed by a partnership agreement between the general partner and the limited partners. A partnership comes into existence upon the execution of the partnership agreement. To obtain limited liability protection for the limited partners, however, registration of the partnership, its partners and the respective liability amounts with the commercial registry is necessary (see below). A limited partnership is therefore often established and registered with one initial limited partner and a general partner (which is an already established and registered limited liability company). The investors as additional limited partners are then admitted to the limited partnership subject to their registration with the commercial registry. The partnership agreement does not need to be notarised (but notarisation is necessary for the filing of the partnership and its partners with the commercial registry and for the formation of the general partner in the form of a limited liability company).

Registration process

To register a limited partnership certain filing formalities have to be fulfilled. The filings have to be made with the commercial registry at the local court of the partnership's statutory seat.

The form must be signed for and on behalf of the limited partners and the general partner. Their signatures must be notarised by a notary public. If notarisation takes place outside Germany, a notary public is generally required to provide an apostille in accordance with the Hague Convention. Entities must provide proof of their valid existence and the due representation by the signatories. Filing of the partnership agreement is not required.

Expenses and fees for the notarisation of the application to the commercial registry and the registration fees are fairly small and generally do not exceed €2,000.

Ongoing obligations

Any changes to the registered information must be filed with the commercial registry in notarised form. This includes information about the identity of the general partner and the limited partners, as well as increases or decreases of the liability amounts registered for the limited partners.

The partnership and the general partner have to pay a fee to the Chamber of Industry and Commerce. They are also required to set up annual financial statements to be filed with the commercial registry (and published in the electronic Federal Gazette) and to file annual tax returns.

Service providers

A notary public will normally be instructed to assist with the registration process. Financial statements and the tax returns are typically prepared by a tax adviser or CPA.

Minimum capital requirements

There are no minimum capital levels relating to the liability amounts of the limited partners. The general partner, however, must have a minimum registered capital of at least €25,000. If a newly introduced corporate legal entity is used, the *Unternehmensgesellschaft* (UG),

the minimum capital is €1. There is, however, no practical experience with this new legal entity yet.

3 Requirements

Is a private equity fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary, and how is that requirement typically satisfied?

The partnership has to maintain an administrative office at its principal place of business. It has to keep proper books and records. Tax authorities have the right to inspect the books and records of the partnership at any time. If the commercial registry has reason to believe that the partnership or its general partner may not have an administrative office at their principal place of business, the court can initiate official inspections.

Typically, the principal place of business of the partnership is at the offices of the general partner or the managing limited partner. This is where the books and records should be kept and a certain level of office administration should be available.

4 Access to information

What access to information about a private equity fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

The records maintained at the commercial registry are accessible by the general public. This includes the identity of the investors, their liability amounts and – since the liability amount is typically expressed as a percentage of the capital commitments – their capital commitments. Such disclosure can be avoided by interposing a nominee as direct limited partner, to hold and manage its limited partner interest for and on behalf of the investors as beneficiaries. The partnership is required to file its annual financial statements with the commercial registry and to publish them in the electronic Federal Gazette.

The partnership agreement is not filed with the commercial registry. Accordingly, the commercial terms agreed between the partners remain confidential.

The articles of association of the general partner are filed with the commercial registry and are available to the general public.

The commercial registry can ensure that the partnership meets its obligations in respect of filing the information described above by imposing fines for any failure to do so. It can also impose other measures of enforcement. If the annual financial statements are not published in the electronic Federal Gazette until the end of the following year (eg, until 31 December 2010 for the financial year 2009), the partnership will be fined.

5 Limited liability for third-party investors

In what circumstances would the limited liability of third-party investors in a private equity fund formed in your jurisdiction not be respected as a matter of local law?

In principle, liability in relation to the partnership is limited to the capital commitment subscribed for. Liability in relation to third-party creditors of the partnership is limited to the liability amount registered with the commercial registry. If this amount has been paid into the partnership, then such liability ceases to exist. A limited partner is treated as general partner for the period of time between admittance to the partnership and registration of the limited partner with the commercial registry. Thus, a limited partner could be held liable in respect of liabilities to third parties if it is admitted to the partnership – at the time of subscription or in case of a transfer – prior to its registration with the commercial registry. Otherwise, there are generally no circumstances in which the limited liability of limited partners would not be respected as a matter of German law.

6 Fund manager's fiduciary duties

What are the fiduciary duties owed to a private equity fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction, and to what extent can those fiduciary duties be modified by agreement of the parties?

Parties can modify or exclude liability for certain duties. Such clauses will, however, be subject to a very strict interpretation by the relevant courts to protect the interests of the partnership and the limited partners.

The limited partners have access to the partnership books and accounts and to any necessary information that will enable them to evaluate the accuracy of the accounts. These rights may not be restricted. The manager must treat all limited partners equally. The concept of different side letters for individual limited partners, often used in other jurisdictions, is disputed and requires in-depth review in each individual case.

7 Gross negligence

Does your jurisdiction recognise a 'gross negligence' (as opposed to 'ordinary negligence') standard of liability applicable to the management of a private equity fund?

The management, comprising the general partner or the managing limited partner or both, must (by law) apply the standard of care of a prudent business person (see question 1). The management must in particular keep the books and records, prepare the statutory accounts and file the tax returns of the LBO fund.

Partnership agreements of LBO and other private equity funds typically contain a provision that restricts the liability of the general partner and the managing limited partner to gross negligence and wilful misconduct. It is disputed in legal literature, however, whether such a restricted standard of liability can be applied as between the partners of a partnership.

8 Other special issues or requirements

Are there any other special issues or requirements particular to private equity fund vehicles formed in your jurisdiction? Is conversion or redomiciling to vehicles in your jurisdiction permitted? If so, in converting or redomiciling limited partnerships formed in other jurisdictions into limited partnerships in your jurisdiction, what are the most material terms that typically must be modified?

Issues or requirements

Unless stated otherwise in the partnership agreement, transfer of partnership interests is, by law, only possible with the consent of all the partners. Usually, the partnership agreement provides that the partnership interests are transferable with the general partner's or the managing limited partner's consent.

Redomiciliation

To be converted, a foreign partnership needs to be re-established under German law. Typically, the foreign partnership agreement will require some adjustments (eg, approval of the accounts may not be delegated to the manager as is customary in partnership agreements in some foreign jurisdictions).

9 Fund sponsor bankruptcy or change of control

With respect to institutional sponsors of private equity funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the private equity fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the private equity fund's sponsor?

The insolvency of the sole general partner of a German limited partnership triggers the automatic dissolution of the partnership unless a

successor is appointed. Other events described above (eg, change of control) typically trigger certain legal consequences under the partnership agreement of the LBO fund (ie, suspension of the investment period). Since the management of an LBO fund is generally still regarded as an unregulated activity in Germany, there are no direct regulatory implications of the bankruptcy, insolvency or restructuring of the LBO fund's general partner or manager.

Regulation, licensing and registration**10 Principal regulatory bodies**

What are the principal regulatory bodies that would have authority over a private equity fund and its manager in your jurisdiction, and what are the audit and inspection rights available to those regulators?

Providing professional advice to a fund in respect of investments in financial instruments requires a licence that must be obtained from the German Federal Financial Supervisory Authority. Currently, such licence is generally not required if a partner manages the affairs of the partnership in a managing partner capacity. Sub-advisory activities may not require a licence depending on the particular circumstances.

11 Governmental requirements

What are the governmental approval, licensing or registration requirements applicable to a private equity fund in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

No governmental approval, licensing or registration requirements are applicable to an LBO fund in Germany.

12 Registration of investment adviser

Is a private equity fund's manager, or any of its officers, directors or control persons, required to register as an investment adviser in your jurisdiction?

An LBO fund's manager, its officers, directors or control personnel are generally not required to register as an investment adviser in Germany if they provide management services in a managing partner capacity and not on the basis of a separate investment advisory or investment management agreement.

13 Fund manager requirements

Are there any specific qualifications or other requirements imposed on a private equity fund's manager, or any of its officers, directors or control persons, in your jurisdiction?

As long as the LBO fund's manager is not required to obtain a licence (see question 12), no specific qualifications or other requirements are imposed on an LBO fund's manager or any of its officers, directors or control personnel.

14 Political contributions

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a private equity fund's manager or investment adviser or their employees.

There are no such rules in Germany which would particularly apply to a private equity fund's manager or investment adviser or their employees.

15 Use of intermediaries

Describe any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a private equity fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities.

There are no such rules under German laws. This might be due to the fact that investments of public pension plans and other governmental activities in private equity funds are rarely seen in Germany.

Taxation**16 Tax obligations**

Would a private equity fund vehicle formed in your jurisdiction be subject to taxation there with respect to its income or gains? Would the fund be required to withhold taxes with respect to distributions to investors? Please describe what conditions, if any, apply to a private equity fund to qualify for applicable tax exemptions.

Taxation in Germany

If structured as a partnership that is not engaged in a trade or business, the fund vehicle is neither subject to German income tax nor German trade tax. Any income derived by the partnership is immediately allocated to its partners and taxed at the level of the partners in accordance with the rules of the tax regime applicable to the respective partner.

Withholding taxes

There are no withholding tax implications at the level of the partnership itself. Withholding tax implications may arise from the underlying investments made by the fund. For example, Germany – subject to applicable tax treaty provisions – generally imposes withholding tax on dividends.

Tax exemptions

The transparent tax treatment of partnerships means that, in respect of a limited partnership that is not engaged in a trade or business, tax exemptions are not required.

17 Local taxation of non-resident investors

Would non-resident investors in a private equity fund be subject to taxation or return-filing requirements in your jurisdiction?

If the LBO fund is structured as a limited partnership not deemed to be in business and not engaged in business activities for German tax purposes, non-resident investors are generally not taxed on capital gains realised by the LBO fund and they are not required to file tax returns in Germany. Subject to the provisions of applicable tax treaty law, dividends and certain interest income derived by the LBO fund from German portfolio investments may be subject to German withholding tax. Interest income derived from (shareholder) loans to the underlying portfolio companies is not subject to German withholding tax. A refund or an exemption or a reduction of withholding taxes is subject to certain filing procedures.

18 Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a private equity fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

Obtaining a ruling

It is desirable to obtain a ruling from the German tax authorities with respect to the tax treatment of an LBO fund vehicle formed in Germany in order to obtain an increased level of comfort in respect of its tax treatment. German tax authorities are, however, reluctant to

grant tax rulings unless certain elements of the structure are unclear. If the tax treatment of the structure or of certain elements is unclear, it is often recommended to obtain a binding tax ruling.

Special tax rules for German resident investors

There is no special treatment of investment returns from an LBO fund. The allocable share in the income of an LBO fund is taxed at the level of German resident investors in accordance with the general rules applicable to the respective investor and the respective type of income (eg, capital gains, dividends and interest income).

19 Organisational taxes

Must any significant organisational taxes be paid with respect to private equity funds organised in your jurisdiction?

Apart from the registration fees mentioned in question 2, there are no significant organisational taxes required to be paid with respect to LBO funds organised in Germany.

20 Special tax considerations

Please describe briefly what special tax considerations, if any, apply with respect to a private equity fund's sponsor.

Carried interest

In July 2004, the Act for the Promotion of Venture Capital came into force in Germany. This Act implemented a special tax treatment of carried interest. Under this Act, carried interest (which becomes payable only when the investors' contributions have been repaid in full) paid by a fund partnership which is neither deemed to be nor engaged in business-type activities is treated as income for services rendered and it is 40 per cent exempt from German income tax. The effective rate of income tax will be approximately 28.485 per cent. It is likely, however, that the tax authorities may not apply the new carried interest legislation if the fund partnership is deemed to be in business or engaged in business activities from a German tax perspective. Furthermore, it is not clear whether the new carried interest legislation applies to carried interest derived from a fund that is structured as a corporation and on the level of recipients of carried interest in a corporate structure.

21 Tax treaties

Please list any relevant tax treaties to which your jurisdiction is a party and how such treaties apply to the fund vehicle.

Germany has entered into tax treaties with most OECD member states and a number of other states. Such treaties do not generally apply to a fund vehicle structured as a (tax transparent) partnership, but directly to its partners. If the fund vehicle is structured as a corporation, such tax treaties will generally apply to the corporate fund vehicle itself.

22 Other significant tax issues

Are there any other significant tax issues relating to private equity funds organised in your jurisdiction?

In general, no special rules apply to the taxation of LBO funds. The income derived from an LBO fund structured as a partnership is taxed in accordance with the general tax regime applicable to the investor. Due to a change of the administrative practice of German tax authorities, for LBO funds structured since the beginning of 2008, the management fee payable to the managing partner of such LBO fund is subject to German VAT regardless of whether such management fee is structured as a priority profit share in the balance sheet profits of the respective partnership.

Selling restrictions and investors generally**23 Legal and regulatory restrictions**

Describe the principal legal and regulatory restrictions on offers and sales of interests in private equity funds formed in your jurisdiction, including the type of investors to whom such funds (or private equity funds formed in other jurisdictions) may be offered without registration under applicable securities laws in your jurisdiction.

LBO funds are usually marketed to investors through private placements. There are no material restrictions in this respect. Under the revised Sales Prospectus Act and the regulations thereunder, there are also no material restrictions – regardless of whether the LBO fund is publicly offered – if the minimum subscription amount equals at least €200,000.

24 Types of investor

Describe any restrictions on the types of investors that may participate in private equity funds formed in your jurisdiction (other than those imposed by applicable securities laws described above).

Regulated companies, such as insurance companies and pension funds, have certain restrictions when investing in an LBO fund; for example, they have to reserve complete flexibility to dispose of their partnership interest to the extent that they invest out of their premium reserve stock or out of their other committed assets.

25 Identity of investors

Does your jurisdiction require any ongoing filings with, or notifications to, regulators regarding the identity of investors in private equity fund (including by virtue of transfers of fund interests) or regarding the change in the composition of ownership, management or control of the fund or the manager?

The details of a transfer of a partnership interest must be filed with the commercial registry. The identity of the limited partner is, therefore, public. As LBO funds are currently not regulated, there are no filing requirements with any regulatory or similar authority.

26 Licences and registrations

Does your jurisdiction require that the person offering interests in private equity fund have any licences or registrations?

No licence or registration requirements exist yet in respect of a person offering interests in an LBO fund structured as a partnership. This may change after implementation of the draft EU Directive on Alternative Investment Fund Managers (AIFM) into German domestic law.

Update and trends

One important issue German LBO funds are currently facing is the application of VAT to domestic private equity fund structures in Germany. Otherwise, the industry is waiting for the finalisation of the EU Alternative Investment Fund Managers (AIFM) Directive and its implementation into German domestic law, which is expected to make the management of private equity funds a regulated business and will thus potentially bring a tremendous change to private equity practice in Germany.

27 Money laundering

Describe any money laundering rules or other regulations applicable in your jurisdiction requiring due diligence, record keeping or disclosure of the identities of (or other related information about) the investors in private equity fund or the individual members of the sponsor.

Unlike the United Kingdom, there are no specific rules relating to money laundering for LBO funds. The general rules of the Anti-Money Laundering Act of 29 November 1993, which implemented the European Union Money Laundering Directive, apply as amended. These rules require confirmation of the investors' identity (eg, passports for individuals, commercial registry excerpt for entities) and further records of such documents must be retained. Exemptions are available.

Exchange listing**28 Listing**

Are private equity funds able to list on a securities exchange in your jurisdiction and, if so, is this customary? What are the principal initial and ongoing requirements for listing? What are the advantages and disadvantages of a listing?

In practice, and with very few exceptions, LBO funds in Germany are not structured as stock corporations and are not listed.

29 Restriction on transfers of interests

To what extent can a listed fund restrict transfers of its interests?

The German listing rules make it practically impossible to restrict the transfer of securities.

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Participation in private equity transactions

30 Legal and regulatory restrictions

Are funds formed in your jurisdiction subject to any legal or regulatory restrictions that affect their participation in private equity transactions or otherwise affect the structuring of private equity transactions completed inside or outside your jurisdiction?

With the exception of certain regulated markets, for example investments in insurance companies or banks and certain other financial institutions, funds formed in Germany are not subject to any specific legal restrictions that affect their participation in LBO transactions or otherwise affect the structuring of LBO transactions consummated inside or outside Germany. Usually, the investment scope is only limited by the investment guidelines or investment restrictions of a contractual nature under the partnership agreement.

31 Compensation and profit-sharing

Describe any legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund and, specifically, anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund.

There are no specific legal or regulatory issues that would affect the structuring of the sponsor's compensation and profit-sharing arrangements with respect to the fund or anything that could affect the sponsor's ability to take management fees, transaction fees and a carried interest (or other form of profit share) from the fund. Currently, priority profit allocations to the managing partner of a German partnership are no longer regarded as VAT-exempt by the German tax authorities.

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