



# COUNTRY PROFILE, GERMANY

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## Introduction and Country Background

Germany is the most populous country in the EU

### Key Facts

Capital - Major Cities	Berlin - Cologne, Hamburg, Munich, Frankfurt am Main, Leipzig
Area	357,021 km <sup>2</sup>
Population	82.12m (08-2008 estimate)
Languages	German
Currency	EUR (Euro)
Telephone Code	+49
National/ Bank Holidays	2009 - 1, 6* Jan; 10, 13 Apr; 1, 21* May; 1, 11* Jun; 15* Aug; 3, 31* Oct; 1*, 18* Nov; 24-26, 31 Dec
Bank Hours	8:30 - 16:00/18:30 Mon-Fri
Business Hours	8:00 - 17/20:00 Mon-Fri
Stock Exchange	Deutsche Börse
Leading Share Index	DAX (Deutscher Aktienindex)
Overall Share Index	DCAX

\*Not observed in all areas

Germany had for some years one of the highest unemployment rates in the EU before its 2004 expansion, although it has declined in 2007

### Economic Performance

	2005	2006	2007	2008
Exchange Rate - EUR/USD <sup>1</sup>	0.803	0.797	0.7296	0.6799
Money Market Rate (%) <sup>1</sup>	2.11	2.18	4.08	2.603
Consumer Inflation (%) <sup>2</sup>	1.9	1.8	2.5	1.9
Unemployment Rate (%) <sup>3</sup>	10.6	9.8	8.4	7.4
GDP (EUR billions) <sup>4</sup>	2,124	2,187	2,242	2,283
GDP (USD billions) <sup>5</sup>	2,645	2,744	3,073	3,358
GDP Volume Growth (%) <sup>2</sup>	0.8	3.0	2.5	1.9
GDP Per Capita (USD)	32,086	33,345	37,383	40,890
Current Account (% of GDP)	5.2	6.1	7.6	7.3

Sources: International Monetary Fund, European Central Bank

<sup>1</sup> Period average

<sup>2</sup> Year on year

<sup>3</sup> Per annum (seasons adjusted)

<sup>4</sup> Constant prices: index, 2000=100

<sup>5</sup> Per average exchange rate

Angela Merkel is the first female Chancellor of Germany, and the first woman to lead Germany since it became a modern state in 1871

### Government

In organizing its work, Parliament needs to comply with only a few constitutional provisions and legal regulations (e.g. the Federal Electoral Act, the Act on the Legal Status of Members of the German Bundestag) and can otherwise, in line with the principle of parliamentary autonomy, organize its work as it sees fit.

#### Legislature Regime

Federal Republic comprising 16 states (Länder). The parliamentary structure is bicameral:

- The Federal Council (Bundesrat) is the body under the Federal Republic of Germany that represents the interest of the Länder (federal states). The Bundesrat has 69 members appointed by the states. The Bundesrat co-decides federal laws that afflict Länder competences, but German constitution commentators do not consider it a parliament or a chamber of the parliament. The only federal parliament in Germany is the Bundestag.
- The Federal Assembly (Bundestag) consists of 614 members elected for a four year term via a combined simple majority / proportional representation system. The next election is scheduled for 27 September 2009.

#### Head of State

Horst Köhler, Federal President (Bundespräsident) since May 2004. In accordance with Germany's parliamentary system of government the presidency is limited by a mixture of law and convention to being a ceremonial position. A federal convention elects the Federal President every five years. On May 22, 2008, Köhler announced his candidacy for a second term as president. The Federal Assembly's next presidential election is scheduled for May 23, 2009.

#### Header of Government

Angela Merkel, Federal Chancellor (Bundeskanzler) since November 2005. Head of the Christian Democratic Union (CDU) since 2000. Merkel is the first female Chancellor of Germany, and the first woman to lead Germany since it became a modern state in 1871.

After the inconclusive result of the 2005 German federal election, in which neither of the major parties could form a majority government, the leaders of the Social Democratic Party (SPD) and the CDU/CSU agreed to form a grand coalition with CDU leader Angela Merkel as Chancellor. Merkel is preceded by former Chancellor Gerhard Schröder, of SPD, who will not participate in the cabinet, but has arranged for SPD to hold 8 of 16 cabinet seats.

#### European Union

Since its foundation in 1951 (the European Coal and Steel Community).

## Banking Environment

Frankfurt am Main is Germany's financial centre and also one of the world's largest

### Overview

#### Introduction

German bank's business with non-residents has expanded far more rapidly than their business with domestic customers. In particular foreign lending saw double-digit annual increases over the last few years. But despite the dynamic development of international operations, the focus of German banks' activities remains in Germany. Around 78% of assets and 80% of liabilities (allowing for the banks' bearer debt securities held by non-residents) are vis-à-vis domestic customers.

The major German commercial banks are heavily exposed in the corporate sector as it is custom in the industry to both extend funding and hold share capital. As a result, in the beginning of the 20th century German banks have been under pressure due to the fact that the corporate sector's operating profit was weak while at the same time the stock market was close to collapsing.

Meanwhile, the publicly owned federal state banks were subsidised by their owners, i.e., the respective federal states. However, a ruling from the European Commission obligates the federal state banks to pay back an amount totalling more than 3 billion euros. Furthermore, it can be expected that the regulations on ownership, which effectively prevent the big commercial banks from taking over the federal state banks, will be scrutinized by the Commission and hence might be lifted. Further, all Landesbanks in Germany have had the opportunity to fund themselves at zero weight (no margin on interest rates), giving them a competitive edge on financing products. This has changed, effective June 2005.

In terms of total assets the big banks have a market share of nearly 20%. Even though the number of banks and branches has decreased over the years, and will probably continue to do so following the financial turmoil in 2008, the German banking sector is not that concentrated. No other country in the European Union has such a fragmented banking market. All in all, further consolidation in the German banking sector can be expected, despite the fact that the commercial banks have initiated a number of large acquisitions during 2008. Nonetheless, Germany's problem is that any banking consolidation is likely to run into opposition from regional authorities, who have a say in the running of savings banks networks.

#### Sector Figures

According to the Deutsche Bundesbank, as of February 2009, there were 1,977 domestically incorporated credit institutions in Germany, continuing the gradual downward trend of bank consolidation in the country. The breakdown into various categories is as follows:

- Big banks - 5
- Commercial - 272
- Regional and other commercial banks - 164
- Branches of foreign banks - 103
- Landesbanken - 10

Savings banks - 434  
 Regional institutions of credit cooperatives - 2  
 Credit co-operatives - 1,197  
 Mortgage banks - 19  
 Building and loan associations - 25  
 Special purpose banks - 18  
 Foreign banks - 150  
 Banks majority-owned by foreign banks - 47

Collectively the public sector banks have the largest market share measured in terms of total assets; nearly half of the German banking market in the hands of the public sector.

Frankfurt am Main is Germany's financial centre, although it trails behind London and Paris in significance on many fronts even though foreign bank numbers in Germany have increased over the past few years as more and more foreign banks establish in Frankfurt. Almost all of the foreign banks - hereof the majority of all the global leaders in cash management - are represented in the centre of Frankfurt am Main.

#### Recent Years

The group of savings banks (Sparkassen-Finanzgruppe) are undergoing transformation. A number of federal state banks are forming co-operation schemes with the savings banks to create one business group and obtain a group rating. Besides this vertical form of co-operation the industry has also seen mergers involving federal state banks, most notable between Hamburgische Landesbank and Landesbank Schleswig-Holstein, now HSH Nordbank AG. Further, in June 2005, the German Landesbank Norddeutsche Landesbank (NORD/LB) established a joint venture with DnB NOR of Norway, to establish a Baltic/Nordic bank.

The "big banks" have also been undergoing a transformation of their own. Postbank was partially privatised in 2004, thereby joining the ranks as a big bank and expanding the category from four to five banks. Deutsche Post retained a controlling stake of 50% plus one share until September 2008, when 30% of this was sold to Deutsche Bank for €2.8 billion. Deutsche Bank has first option on a bid for the remainder of Deutsche Post's holding.

Commerzbank announced in August 2008 that it would acquire Dresdner Bank for €9.8 billion from Allianz, the large German insurer, thereby shrinking the number of big banks back to four. The takeover is aimed at creating a credible rival to take on Deutsche Bank, which is a leader in the German retailing banking market, and Allianz will become the largest shareholder of Commerzbank with a stake of nearly 30 percent.

In October 2008, following the liquidity crisis in financial markets, the German banks and the Deutsche Bundesbank agreed to provide a credit line of €30 and €20 billion, respectively, to lender Hypo Real Estate, one the largest mortgage lenders in Germany. Via several steps, Hypo Real Estate was granted further framework guarantees by the German Financial Markets Stabilisation Fund (SoFFin) in February 2009, taking its total state funding to €52 billion. On 17 April 2009, SoF-

Fin tendered an offer to take over Hypo Real Estate by buying and creating shares that would raise its equity stake to 90%. On 24 April 2009 the HRE governing boards recommended that shareholders approve the offer by the rescue agency. By that date, government support for the company had reached €102 billion. Under a new law passed in March, the government could force the sale if shareholders reject it.

With regard to the overall impact on the German banking industry, some consolidation is clearly needed, and both Commerzbank and Deutsche Bank will increase their market share with their acquisitions. But the savings banks and co-operative banks will not see much impact in the near future, and still have more than 50% of the German deposit base, and closer to 70% for savings deposits.

It is notable that the sale of two of the big five private banks (HVB, Commerzbank, Deutsche Bank, Postbank, Dresdner Bank) has been to two institutions from the same list, rather than having a foreign bank such as Santander gaining a foothold in the market. Santander was one of the bidders for Postbank. HVB is already foreign-owned, being part of the Italian UniCredit group. Foreign buyers wanting to access the German market have been confined to smaller deals. Also in 2008, Crédit Mutuel of France acquired the Citigroup German retail network for €4.9bn, with Citigroup needing to raise cash because of the subprime crisis. And SME lender Deutsche Industriebank IKB was sold to US private equity house Lone Star after running into trouble related to big subprime asset-backed securities losses.

According to the Bank of Settlements, an international organisation of central banks, Icelandic borrowers owe German banks some \$21 billion, as of end-June 2008. The amount is far ahead of the \$4 billion that is owed to British banks, illustrating how disproportionately large the amount German banks have loaned out to Iceland, whose credit bubble burst in October causing the Icelandic state to take over the country's three largest banks. In fact, Germany is behind 1/3 of all loans to Iceland. Furthermore, Germany is also the most exposed to two of Europe's most fragile economies, namely Spain and Ireland, which taken together owe German banks \$500 billion dollars.

#### Sector Wide Agreements

In 2005, the EU reached political agreement on the proposed directive for new capital-adequacy rules, known as Basel II, which is implemented in Germany.

The Deutsche Bundesbank, being the central bank of the Federal Republic of Germany, is an integral part of the ESCB

## Central Bank

### Background

Germany's Central Bank is the Deutsche Bundesbank (or in short "BuBa") and was established in 1957. The decision-making body of BuBa is the Executive Board, which consists of the President, Axel A. Weber (since 30 April, 2004), a Vice-President, and 6 other members. BuBa has a strong position in the banking industry due to its far reaching responsibilities and is the most influential member of the European System of Central Banks (ESCB).

The new Bundesbank Act, which came into effect on 30 April 2002 - made as a consequence of the bank being part of the ESCB - has given the Deutsche Bundes-

bank a new structure. Now BuBa has 9 regional offices (formerly known as Federal State Central Banks, LandesZentralBanken), which oversees one or more federal states and 61 branches (plus 10 operating units) covering all of the Federal Republic<sup>1</sup>.

The Act states the responsibilities of BuBa: "The Deutsche Bundesbank, being the central bank of the Federal Republic of Germany, is an integral part of the ESCB. It shall participate in the performance of the ESCB's tasks with the primary objective of maintaining price stability, shall hold and manage the foreign reserves of the Federal Republic of Germany, shall arrange for the execution of domestic and international payments and shall contribute to the stability of payment and clearing systems." To pursue its main objective of price stability BuBa is an institution totally independent of the political system. The bank is only obliged to support Germany's general economic policy "as far as possible without prejudice to its tasks as part of the ESCB" as stated in the Bundesbank Act.

#### Currency

The European Central Bank (ECB) has the sole right to approve the issuance of euro banknotes within the euro area. Banknotes may be issued by the ECB and the national central banks.

#### Responsibilities

The following five areas of business are at the centre of the Deutsche Bundesbank's strategic activities:

- Price stability in the euro area and implementation of monetary policy measures in Germany
- Supervision and ongoing development of the international monetary and financial system
- Stability of payment and clearing systems
- Cash supply
- Banking supervisory tasks

National and international tasks are:

- Participation in banking supervision
- Statistical tasks (collection, compilation and publication of economics statistics, balance of payments)
- Fiscal agent (government's fiscal agent, account management, payment transactions, issuing business, advisory service)
- Advising the Federal Government on monetary policy issues
- Portfolio management (of the pension reserves for Federal civil servants), asset management for the Monetary Stability Foundation
- Arbitration unit for credit transfers
- Representing Germany in the IMF, representation in international bodies (G7, G10, G20, OECD, BIS, EFC)
- Technical central bank cooperation
- Economic Research Centre

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<sup>1</sup> The branches of BuBa supply banks and public authorities with cash and process cashless payments. They also provide local credit institutions with direct access to central bank credit (federal securities).

- General press and public relations matters

The Deutsche Bundesbank's significant role in banking supervision includes issuing regulations, on-site audits and assessments of the institutions' capital base and risk management procedures (through its nation-wide offices) and management of crisis. The measures taken by the Federal Financial Supervisory Authority (BaFin) are based on the findings of BuBa.

## Financial Authorities

The principal task of the Federal Ministry of Finance is shaping fiscal policy

### Ministry of Finance

The principal task of the Federal Minister of Finance is shaping the fiscal policy pursued by the federal government and the underlying orientation of its economic policy. The aim of the federal government's tax policy is to secure the state's financial resources.

The Ministry of Finance's (Bundesministerium der Finanzen) three overriding objectives in its approach to economic and fiscal policy are:

- Growth and unemployment
- Sustainable policy
- Social justice, including inter-generational
- Predictable policy
- Internationally involved in the EU

The main goal of BaFin is to ensure the proper functioning, stability and integrity of the entire financial system in Germany

### Federal Financial Supervisory Authority (BaFin)

In 2002 the organisations responsible for supervising banks, insurance companies and securities trading merged into the Federal Financial Supervisory Authority (BaFin, short for 'Bundesanstalt für Finanzdienstleistungsaufsicht'). BaFin operates only in the public interest. Its primary objective is to guarantee the proper functioning, stability and integrity of the German financial system.

While the Deutsche Bundesbank maintains overall supervising responsibility, BaFin controls individual regulatory measures directly vis-à-vis the institutions. These include:

- Issuing licences, monitoring activity and closing of institutions
- Setting out instructions for carrying out banking business and providing financial services including keeping up a fair competition and protecting the customers
- Securing the solvency of the institutions
- Securing the integrity of the entire German financial system

BaFin supervise around 2,080 banks, 730 financial services institutions, 630 insurance undertakings, 26 pension funds, 6,000 investment funds and 78 investment companies (as of January 2008).

### Association of German Banks (BDB)

The BDB represents around 220 banks and 12 associations

The Association of German Banks (Bundesverband deutscher Banken, BDB) represents the interests of around 220 private commercial banks and twelve member associations operating at federal state level.

The Association informs its members about current political and economic devel-

opments affecting the banking sector. Further, the German Banks Association serves as a contact point for parliament, ministries and authorities regarding all banking issues. Moreover, the Association cooperates domestically and internationally with other organisations and it informs the public on behalf of its members. Finally, the association handles private customer's complaints through an ombudsman and administers the deposit protection scheme, which offers customers of the member banks a full deposit protection.

All in all, five organisations for the banking industry co-operate through The Central Credit Committee (ZKA, Zentraler Kreditausschuss). Besides BDB, the members are the Association of Co-operative banks, the Association of Public Banks, the Association of Savings Banks and the Association of Building Societies.

## Legal & Regulatory Issues

Financial transactions are deregulated but central bank reporting remains

### Introduction

Under the European Single Market's objective of free movement of capital, German regulations have been harmonised with the rest of the EU, e.g. within Money Laundering. As such the market for financial transactions is deregulated. However, since Central Bank reporting requirements for transactions between residents and non-residents remain, Germany is not the ideal place for maintaining master accounts, e.g. larger Euro cash pooling schemes.

Residency is defined by location or effective management

### Resident and Non-Resident Status

A resident company is defined as a company whose legal seat or place of effective management is located in Germany.

Account ownership is independent of residency

### Account Ownership

Any type of account can be owned by a resident as well as a non-resident company.

Regulations allow for cash pooling services

### Cash Pooling Regulations

- Cash concentration and notional pooling are allowed domestically as well as cross-border
- Cash pooling across legal entities, but within the same group, are allowed under certain circumstances
- Resident and non-resident companies can participate in the same cash pool, but Central Bank reporting requirements must be adhered to, and tax withholding regulations must also be observed and incorporated in the yearly tax computation
- The German legislation allows for multicurrency cash pooling. It is not widely offered by the banks, though

A wide variety of account types are available with cross-border payment fees regulated at the EU level

### Account Types and Charges

- Current accounts can be held in all exchangeable currencies and are offered with or without overdraft limits
- EUR accounts are convertible into foreign currency
- Interest rates can be either fixed using a basic rate of the bank or based on a market rate (e.g. FIBOR) less a spread
- Account maintenance fees will normally apply but are negotiable
- Lifting fees (per mille of transferred amount) are to a large degree still levied in Germany. For customers with larger business volumes it should be possible to avoid such fees, though

Payment Fees

A flat fee will be charged for domestic payments – a per mille charge (see above) could be charged for foreign payments. Following the EU regulations on cross-border transfers in EUR, from 1 July 2003 the charge for a cross-border transfer of up to 12,500 EUR must be equivalent to the charge for a domestic payment in EUR. The increase to a maximum of €50,000 took effect on 1 January 2006. The payer must provide the receiver's International Bank Account number (IBAN) and the receiving bank's Bank Identifier Code (BIC, the SWIFT code). If such information is not provided – or the information is wrong – an additional charge will be levied.

No FX controls apply

## FX Controls

The Euro flows freely but the European Central Bank can intervene or coordinate an intervention with the members of the European System of Central Banks (ESCB) in order to stabilise the exchange rate. There are no exchange controls.

Reporting is required for statistical purposes

## Central Bank Reporting Requirements

Minor adjustments were made to the Central Bank reporting requirements following the 62<sup>nd</sup> Regulation amending the Foreign Trade and Payments Regulation, which came into force on 1 July 2004. Still, the regulations apply to natural and legal persons who have their normal place of abode, place of residence or domicile in Germany.

Payments received from or made to non-residents must be reported if they exceed 12,500 Euro or the equivalent<sup>2</sup>. Each payment must be reported, but reporting can usually be done via the electronic banking applications offered by the banks.

Further, on a monthly basis German residents have to report claims and liabilities against non-residents if the sum of either of the before mentioned items exceeds five million euros or the equivalent. Banks report to the Central Bank on a monthly basis. In general, the Central Bank uses the data to establish the Germany's balance of payments and for the European Monetary Union.

Legislation is in place to prevent money laundering

## Money Laundering

Germany successfully implemented the Third EU Money Laundering Directive on 13 August 2008 through the Gesetz zur Ergänzung der Bekämpfung der Geldwäsche und der Terrorismusfinanzierung (Geldwäschebekämpfungsergänzungsgesetz - GwBekErgG). The Act came into force on 21 August 2008. The directive builds on existing EU legislation and incorporates into EU law the June 2003 revision of the Forty Recommendations of the Financial Action Task Force (FATF), the international standard setter in the fight against money laundering and terrorist financing. The Directive is applicable to the financial sector as well as lawyers, notaries, accountants, real estate agents, casinos, trust and company service providers. Its scope also encompasses all providers of goods, when payments are made

<sup>2</sup> Exempted are payments received for exported goods, payments made for imported goods and payments and repayments of loans and deposits with an agreed maturity of up to twelve months. Further, there are special reporting requirements for cross-border direct investments as well as for shipping companies and credit institutions.

in cash in excess of 15.000 EUR. Those subject to the Directive need to:

- Identify and verify the identity of their customer and of its beneficial owner, and to monitor their business relationship with the customer;
- Report suspicions of money laundering or terrorist financing to the public authorities -usually, the national financial intelligence unit; and
- Take supporting measures, such as ensuring a proper training of the personnel and the establishment of appropriate internal preventive policies and procedures.

The Directive introduces additional requirements and safeguards for situations of higher risk (e.g. trading with correspondent banks situated outside the EU). For the sake of clarity, the existing 1991 Directive, as amended in 2001, will be repealed and replaced by this Directive, upon its effective entry into force.

A Financial Intelligence Unit has been set up in the Federal Criminal Investigation Office (Bundeskriminalamt) - the responsible body for pursuing acts of crime within Money Laundering - to enhance the evaluation capacities and focus on 'New Medias'.

E-signature legislation is in place

## Regulations Applicable for Electronic Transactions

Electronic signatures are equivalent to handwritten signatures under German law. The German Electronic Signatures Act implements the EU Directive on electronic signatures into national law. Further, the public-private "Signature Alliance" (Signatur Bündnis) was founded on 3 April 2003 with the goal of 'promoting the use of electronic signatures in Germany. The alliance's vision is that all citizens will be able to use a SigBü (Signatur Bündnis) Card with as many applications as possible that require an electronic signature'. The partners of the alliance have agreed on a set of common standards, implemented in 2005. The partners include a variety of providers of e-government and e-commerce services hereunder ministries, bank associations and large banks.

## Market Dominant Banks

Eight German banks are among the world's largest ranked by assets

### Introduction

Many German banks are among the world's top 50, ranked by asset (see e.g. BankersAlmanac.com). The largest, apart HVB, are all domestically controlled. HVB (HypoVereinsbank) was acquired by Italy's UniCredit in November 2005, at the time the largest cross-border European take over. As mentioned above (see Banking Environment) structural changes in the big banks have been announced during autumn 2008. Deutsche Bank has acquired 30% of Postbank and Commerzbank has acquired Dresdner Bank. The market dominant banks are described below.

Market Dominant Banks per 31 Dec. 2008

Bank	Assets (USD <b>b</b> )
Deutsche Bank	3,238
Commerzbank (incl. Dresdner Bank)	919.5
HypoVereinsbank <sup>1</sup>	674
DZ Bank	*633
Postbank <sup>2</sup>	340

<sup>1</sup> Part of the UniCredit Group whose assets total EUR 1,536 mil.

<sup>2</sup> 30% owned by Deutsche Bank.

\* 31 Dec. 2007

Note: Figures are total group consolidated assets in billions USD.

Source: Banks' annual reports.

Germany's largest bank

### Deutsche Bank

With more than two trillion euros in assets, Deutsche Bank offers financial services in 72 countries throughout the world. The bank is a leader in the private segment in its home Germany. Ranked by revenue and profits, Deutsche is one of the largest investment banks in the world. The bank "competes to be the leading global provider of financial solutions for demanding clients creating exceptional value for its shareholders and people".

Deutsche Bank comprises three group divisions: corporate and investment bank, private clients and asset management, and corporate investments. Over half of its 80,000 employees work outside of Germany, although more than half of the banks branches (1,981) are in Germany.

In September 2008, Deutsche Bank acquired nearly 30% of Postbank from Deutsche Post's for €2.8 billion. Deutsche Post retained a 50% plus one share stake in Postbank after privatising half of the bank in an IPO in 2004. Deutsche Bank has first option on a bid for the remainder of Deutsche Post's holding while Deutsche Post can force Deutsche Bank to buy the remainder of its share in Postbank at a lower share price than that announced in the deal.

Deutsche Bank said the move would not result in the closure of any branches or job cuts. Postbank has Germany's biggest branch network (850) with almost 15 million customers. The acquisition will allow Deutsche Bank to almost double its German client base, which currently stands at about 10 million. "Deutsche Bank's and Postbank's service offering is highly complementary with attractive opportunities for cross-selling of financial products," a statement released by Deutsche Bank said.

The second largest bank covering most segments

### **Commerzbank (including Dresdner Bank)**

Commerzbank is Germany's second-largest bank and one of the leading banks in Europe. Roughly 41,600 employees, 14,050 of them active outside Germany, look after roughly 8.5 million private and business customers and more than 535,000 corporate customers worldwide.

Commerzbank became one of Germany's largest banks upon its acquisition of Eurohypo - Europe's largest institution specializing in financing real-estate and public-sector projects - in 2005. In August 2008 Commerzbank agreed to acquire Dresdner, Germany's third largest bank, for €9.8 billion from Allianz, the insurer. Commerzbank and Dresdner attempted a merger of equals in 2000, but talks failed after disagreement over price. The takeover now is aimed at creating a credible rival to take on Deutsche Bank. Allianz will become the largest shareholder of Commerzbank with a stake of nearly 30% and continue to distribute insurance products through Commerzbank. As part of the transaction, Commerzbank sold Allianz parts of its asset management business for €700m. Allianz paid €24bn for Dresdner in 2001, hoping to cross-sell financial services to its customers but instead found its share price under stress as Dresdner became embroiled in the sub-prime crisis.

Following the takeover, the conglomerate's business areas primarily include commercial banking, retail banking, and mortgages. In contradiction to Deutsche Bank's acquisition of Postbank, Commerzbank anticipates making €5bn of cost savings by 2012 by cutting jobs, from nearly 70,000 combined down to 41,600m and freeing up capital from Dresdner's investment bank. The bulk of the redundancies will be made in Germany, by closing Dresdner's Frankfurt head office and by integrating the firms' back office and IT systems. Some 300 retail branches were closed, resulting in the total network of retail banks falling to 1,200.

Commerzbank sees itself as an efficient provider of financial services for private and business customers as well as for small to medium-sized companies (Mittelstand), but it also serves numerous major corporates and multinationals. For each of its core target groups, it aims to be the 'best bank'.

Germany's second largest retail-bank

### **HypoVereinsbank (HVB)**

The change in the once seemingly immovable big bank structure in Germany took on a cross-border dimension in November 2005 when HVB's board (HypoVereinsbank operates under the HVB Group name) opted for a pan-European strategy via

its merger with Italy's UniCredit.

The UniCredit Group is one of the largest banking and financial services organisations in Europe with strong local roots in 22 European countries and leading positions in Austria, Germany and Italy. As of April 2009, the bank had a network of 10,200 branches. Its international network is made of branches, representative offices and small banking subsidiaries in 27 other countries worldwide. The bank has some 40 million customers and more than 174,000 employees.

UniCredit has adopted a divisional business model. Its goal is to fully leverage the bank's network by generating value in all of the businesses in which it is involved and by capitalizing on growth opportunities as they occur.

HypoVereinsbank is one of the largest private banks in Germany with approximately 23,000 employees, 631 branches and over 4 million customers. The bank concentrates on European retail (private banking and asset management) and corporate customer business, which they supplement with customer-oriented capital market activities.

DZ Bank acts as the central bank for more than 1,400 co-operative banks

## DZ Bank

DZ BANK (Deutsche Zentral Genossenschaftsbank) was formed through the merger between the two co-operative banks GZ-Bank and DG BANK in September 2001. The bank acts as the central bank for more than 1,400 co-operative banks (Volksbanken and Raiffeisenbanken). DZ Bank serves three-quarters of all co-operative banks in Germany. The co-operative banks are not only DZ Bank's most important customers but also its shareholders.

The primary customers for DZ Bank are private clients and small and medium-sized businesses. The bank's international reach is limited to the world's major financial centres.

Denmark's largest bank, it serves customers out of its Hamburg branch

## Danske Bank

Danske Bank has had operations in Germany since 1985. Its Hamburg branch is responsible for the bank's activities in the country. It services commercial customers in Germany, offering a broad range of banking products and services that include financing for working capital and investments, risk management, trade finance and cash management.

Measured by total assets, the Danske Bank Group is the largest financial enterprise in Denmark and one of the largest in the Nordic region offering services in banking, mortgage finance, insurance, leasing, real-estate brokerage and asset management. The vision of the Group is "One platform - exceptional brands" and its mission is to be "the best local financial partner". In total, the Group serves 5 million retail customers and a large number of public sector and institutional organisations. Some 2 million customers use the Bank's online services.

In the mid 1990s it expanded its operations into the rest of Scandinavia, and in

2005 via acquisition in the Republic of Ireland and Northern Ireland, marking its first move out of Scandinavia. In November 2006, the Danske Bank Group acquired the Sampo Bank Group, for approximately USD 5 billion in cash. Sampo Bank is Finland's third-largest bank with a market share of 16% and 121 branches; subsidiaries in Estonia, Latvia and Lithuania; and a recently acquired bank in Russia.

## Clearing Systems

There are two inter-bank payment settlement systems in Germany

### Overview

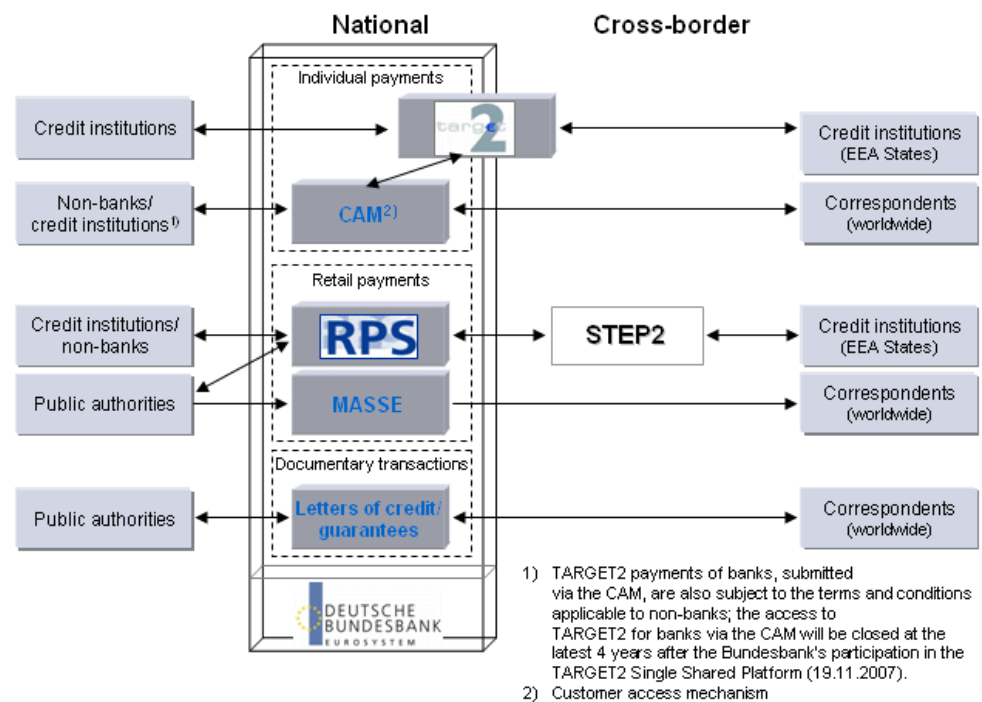
The Deutsche Bundesbank is the backbone in the provision of clearing and settlement services in Germany. The bank provides a number of payment clearing systems and is responsible for the issuance of sort codes (Bankleitzahlen) in support of electronic clearing.

Germany's national TARGET-linked RTGS system, RTGSplus, ceased operations at the end of Friday 16 November to coincide with Germany's migration to TARGET2.

The Retail Payments System (RPS) facilitates settlement of paperless as well as paper-based bulk payments. Both of these settlement systems are neutral in terms of competition and available to banks. Further, the Deutsche Bundesbank supplies a neutral giro network for all types of banks. The network is available to the banks and their giro account holders through the Deutsche Bundesbank's 61 branches.

In addition, the savings banks and the co-operative banks have their own respective central payment clearing networks, based on bilateral agreements. These networks are linked to the Deutsche Bundesbank. Cross-network payments are cleared either on a bilateral basis or through the Deutsche Bundesbank. Urgent payments are usually effected by the TARGET2 system.

The graphic below gives an overview of the payments systems available:



Germany acceded to TARGET2 on 19 November 2007

## High Value Clearing — TARGET2

The pan-European RTGS system, TARGET, migrated to a single shared platform (SSP) called TARGET2 making the 16 decentralised RTGS systems of individual Eurosystem countries and the ECB's payment mechanism (EPM) obsolete. The changeover took place in three migration waves, starting 19 November 2007 and ending 19 May 2008 (15 September 2008 is reserved for contingency needs).

Germany's national TARGET-linked RTGS system, RTGSplus, ceased operations at the end of Friday 16 November to coincide with Germany's migration. Germany acceded to TARGET2 in the first wave on 19 November 2007 with Austria, Cyprus, Latvia, Lithuania, Luxembourg, Malta and Slovenia. The Swedish Central Bank and the Bank of England will not migrate to TARGET2. The Deutsche Bundesbank developed and operates TARGET2's SSP (Single Shared Platform) alongside the Banque de France and Banca d'Italia.

- Participation: options include direct and indirect participation, "addressable BICs" and "multi-addressee access" to the system, also known as "technical BIC access". Direct participation criteria for TARGET2 is the same as for the current TARGET system. Only supervised credit institutions established within the EEA can become indirect participants.
- Transaction types: focus on large-value payments related to inter-bank operations
- Price indication: between €0.125 and €0.80 depending on type of participation.
- Operating hours: the operational day in TARGET2 will be longer than that of the current TARGET system. TARGET2 will start the new business day on the evening of the previous day. The night-time window will be available from 19:30 to 6:45 the next day, with a technical maintenance period of three hours between 22:00-01:00. Daytime hours for customer payments 07:00-17:00 CET with the day ending at 18:00 + 30 minutes for the use of standing facilities on the last day of a minimum reserve period.
- Transaction details: Direct participation: For the exchange of payments information, TARGET2 will use the SWIFTNet FIN service, while the SWIFTNet services "InterAct", "Browse" and "FileAct" will be used for information and control services.

CMS is the standard access for non-banks to Germany's two interbank payment systems and used for correspondent banking to settle foreign currency payments

## CMS

The Customer Access Mechanism, CAM, (in German HBV, Hausbankverfahren) is not a system in itself but rather fulfils two functions. First, it is the standard access for non-banks to TARGET2. Second, it is used for the Deutsche Bundesbank's correspondent banking in order to settle incoming and outgoing euro and foreign currency payments to the clearing systems. The CMS process is used for incoming as well as outgoing cross-border payment instructions in any convertible currency, which is not suited for TARGET2 or RPS via EBA's STEP2. CMS is based on the typical correspondent bank set-up with nostro and loro accounts.

The Deutsche Bundesbank upgraded EMZ to process SEPA-compliant credit transfers from 1 January 2008 and will upgrade it to process SEPA-compliant direct debits by 2009.

- Participants: Normally the same as for Target2 access in Germany including indirect participants
- Transaction types: Foreign payment instructions in Euro and any convertible currency, incoming and outgoing. Outgoing instructions are processed using RTGSplus or the Euro Link System (ELS). Incoming instructions are also delivered via RTGSplus Target2 or ELS as SWIFT domestic follow-up payments
- Operating hours: The same as RTGSplus
- Clearing cycle details
  - Incoming CMS instructions that cannot be effected by crediting a foreign currency account are converted into Euro forwarded in ELS (unless they are intended for a direct or indirect Target2 participant). Such transactions are debited to the sender's account on day 2 and settled between the counterparties and the Deutsche Bundesbank
  - Outgoing instructions in Euro are credited to the Deutsche Bundesbank's counterparty's account on the same day. Instructions in foreign currency are settled on day 2 debiting the sender's account and settled between the counterparties and the Deutsche Bundesbank
  - Payment instructions are normally send via SWIFT but can also be submitted in other electronic formats and even by voucher

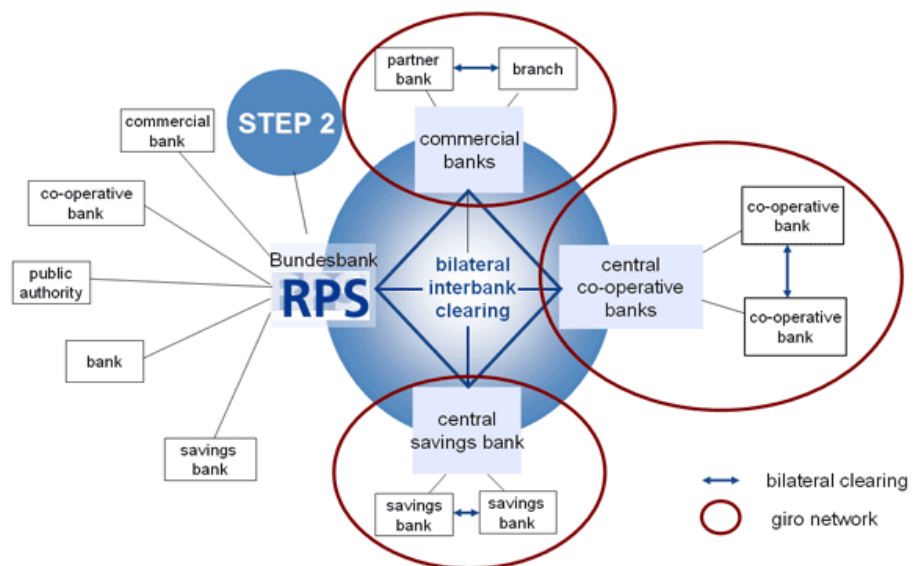
RPS (EMZ) is a bulk payment system for non-urgent retail payments

### Low Value Clearing – RPS

RPS (in German EMZ, Elektronischen MassenZahlungsverkehr) is a bulk payment system for non-urgent retail payments. RPS can be used for credit transfers, cheque collection and direct debit collection. Since 9 January 2006, the Deutsche Bundesbank is also offering a SWIFTNet access.

Around 700 credit institutions and other Deutsche Bundesbank account holders, such as public authorities, use RPS and submit about 9 million orders each day (equivalent to an amount of €8 billion), roughly 40% of which are credit transfer orders and around 60% collection orders (direct debits and converted cheques). Besides the reasonable transaction prices, the submitters also benefit from float-free settlement. The gross-settlement procedure used in RPS prevents the payment beneficiary from incurring any credit risk.

Since 26 January 2009, the Bundesbank has also been supporting the Electronic Banking Internet Communication Standard (EBICS), which is now the standard in both France and Germany.



- Participants: More than 200 directly participating Germany banks, and more than 5,000 indirect participants
- Transaction types: domestic credit transfers, direct debits and cheques as well as cross-border credit transfers. All transfers must be denominated in Euro. There are no amount limits on credit transfers and direct debits
- Pricing indication: Data records of domestic (RPS) and cross-border (STEP2) payments submitted by electronic data media or by data telecommunication are subject to a transaction fee of €0.08, €0.05 or €0.03 per data record, depending on whether those participants submit up to 100,000, up to 250,000, or more than 250,000 payments per month.
- Operating hours: Settlement takes place around the clock
- Clearing cycle details

RPS has three processing windows for electronic transactions:

- Payments submitted between 7:00 and 20:00 (credit transfers) or between 7:00 and 21:00 (collection items) are processed in the evening processing window. The amounts of the credit transfers are blocked on the submitters' accounts from 19:00 on the submission day, allowing for freely available marginal lending facilities. The blocked amounts are debited from the accounts on the next business day. Similarly, payment orders are not credited until the business day following the submission day, which ensures float-free settlement.
- Orders which are submitted via data telecommunication between 20:00 and 7:00 (credit transfers) or between 21:00 and 9:00 (collection items) are processed in the two morning processing windows. As account holders cannot otherwise access their accounts during this period, the relevant counter values are not blocked. The payments are recorded and made immediately on the morning of the processing day.

There are two cheque clearing procedures:

- BSE: The paperless cheque collection procedure (BSE, Belegloser

Scheckinzugsverfahren) is for cheques below 6,000 Euros drawn on domestic credit institutions. The first collecting institution must - besides inspecting the cheque - truncate the cheque. Subsequently, the total cheque amounts are electronically collected via RPS or the banks' own giro networks. Error prone cheques are transferred to the large-value cheque collection, the GSE procedure.

- GSE: Through the GSE (Grossbetrag Scheckinzugsverfahren) procedure domestic cheques in excess of 6,000 Euros are processed. The Deutsche Bundesbank performs the electronic conversion enabling the values to be processed via RPS. In addition, the original cheques are sent to the banks on which they are drawn.

\*In addition to domestic payments, since 3 November 2003, it has also been possible to send cross-border euro payment instructions up to a value of 12,500 Euros via RPS as the Deutsche Bundesbank has linked the RPS to the EBA's (European Bankers Association) STEP2 system.

## Payments & Collections Methods & Instruments

Credit transfers account for the vast majority of payments in value terms

### Introduction

Credit transfers account for the vast majority of the payments and continues to grow. Cheque volumes are rapidly declining while card payments are increasing. However, within consumer payments cash is still extensively used.

Note that the 2007 data on payment instruments reflect the fact that the system for reporting payment statistics in Germany has been enhanced. As a consequence, the 2007 data for Germany are not directly comparable with the data reported in previous years.

Banks in Germany have been implementing SEPA (Single Euro Payments Area) standards for EUR-denominated payments. The country's banks now only issue SEPA-compliant debit cards (since 1 January 2008) and also now offer pan-European SEPA credit transfers (since 28 January 2008). SEPA direct debits however will not be available until 1 November 2009 at the earliest.

#### Volume of Transactions (millions)

	2005	2006	2007	% change
Debit cards	1,982	2,026	1,736	-14.3
Credit cards*	390	409	340	-16.9
Credit transfers	6,713	7,262	5,177	-28.7
Direct debits	6,662	7,363	6,903	-6.2
Cheques	107	108	82	-24.1
<b>Total</b>	<b>15,854</b>	<b>17,212</b>	<b>14,238</b>	<b>-17.3</b>

#### Value of Transactions (EUR billions)

	2005	2006	2007	% change
Debit cards	121	124	106	-14.3
Credit cards*	37	39	30	-23.4
Credit transfers	31,141	31,719	47,105	48.5
Direct debits	3,371	3,665	9,127	149.0
Cheques	516	603	399	-33.8
<b>Total</b>	<b>35,186</b>	<b>36,150</b>	<b>56,767</b>	<b>57.0</b>

\* Includes delayed debit cards.

Note: Percentage change calculated from 2006-2007

Sources: ECB Statistical Data Warehouse

Card payments continue to see increased growth, although growing less slowly than other

### Card Payments

A number of factors, such as shrinking unemployment figures, a strong (and solvent) government and a buoyant economy, contributed to the pessimistic climate in

## payment forms

Germany turning positive. Spending has reached an unprecedented high since the turn of the decade, despite the higher rate of VAT. Use of electronic cash in the form of the ec-card is growing and is widely accepted, with an increasing number of terminals now EMV-compliant. Meanwhile, credit cards (a term that in Germany usually denotes the charge card) remain the more unusual means of payment, used principally for travel and hotel bookings. Cash remains the most popular method of payment in Germany, with an estimated three-quarters of all payments made in cash. There were over 68,000 ATMs.

More than 119 million payment cards were issued at year-end 2007 able to be used at 56.6 million payment terminals. Specifically there were 94.5 million debit cards, 11.6 million delayed debit cards, and 2.6 million credit cards. The credit card market in Germany still has considerable potential for expansion, as the German Banking Federation (BDB) confirms that for consumer purchases, Germans still largely use their overdraft facility, "Dispokredit", which offers lower interest rates. Another alternative to the credit card is to take up a small loan offered by a bank, not necessarily the consumer's own bank. In terms of retail payments, the share for "credit cards" (primarily charge cards) remained static in 2007, while in e-commerce, cards with revolving credit are virtually unknown. The main debit card issuers are Maestro and the leading banks. Germany migrated to a Chip & Pin-code based system to enhance security in 2004.

The only electronic purse card in Germany is GeldKarte, developed and jointly maintained by the German banking industry. Over 74 million e-money cards are outstanding. The number of cards grew rapidly when most of the German banks automatically reissued most of their eurocheque-cards and bank customer cards, and now when issuing their new debit cards, with the GeldKarte chip. The card can be topped up with electronic money up to €200. A total of approximately 600.000 acceptance points is available to GeldKarte users on a nationwide basis. It is expected that the number of cards with the GeldKarte chip will increase strongly in the future — as cards can be topped-up via the internet since 2006 and additional services have been or will be introduced such as electronic ticketing, digital signatures and bonus programmes. The average amount paid is just under €3 and the average amount loaded onto the card is around €54. There were more than 6 million loading transactions. Transaction volume increased in 2008 to 49 million and value increased to 148 million euros, an increase of 25% and 42% respectively.

Credit transfers in value terms are the most common means of payment

### Credit Transfers

Credit transfers are, as can be seen from the table above, by far the most common way of transferring funds in Germany. Urgent, high-value domestic and European payments in Euro are processed via Target2. The cut-off depends on the customer relation but can be extended up to 17:00. Most payments are instructed electronically (via an electronic banking system) but paper-based instructions are also accepted. There is no lower limit to amounts. Low-value, bulk payments are carried out via RPS. The majority of all supplier payments, wages and salaries are processed under this scheme. The customer cut-off for sending payment instructions is usually one hour before closing of the evening processing window, i.e. at 19:00. Instructions are forwarded to the banks' electronic banking systems. There is no lower or upper amount limit.

Direct debits are widely used and in volume terms were the most frequent payment form until recently

### **Direct Debits**

Direct Debit through RPS is a widely used payment method for settling of recurrent payments like telephone and electricity bills. Two types exist – preauthorised and non-preauthorised by the payer. It is possible to reject a non-preauthorised Direct Debit up to six weeks after it has been debited to the account of the payer.

Cheques volume continues to decline

### **Cheques**

German consumers' use of cheques dropped dramatically after 2001, mainly due to the expiry of the eurocheque guarantee. The drop in the total volume of payments in the same period could indicate that the consumers have substituted the use of cheques with cash rather than with cards. Cheque volume dropped some 66% from 2001 to 2005, though saw a strong value increase in 2006. Cheques are rarely used for business-to-business payments.

## Electronic Banking

The banking industry's electronic banking builds on the same bank independent platform, Multicash

### Introduction

The use of online banking by both retail and corporates increased substantially during the last decade, totalling more than 35 million online accounts. Private customers account for around 45% of the total.

Germany has a long tradition within electronic banking as the entire banking industry builds on Multicash, a bank independent platform. Multicash is rendered by an independent software-provider, Omikron Systemhaus. The system provides multi-bank access and supports multi-bank formats. The industry-wide accepted functionality is either imbedded in the banks' proprietary electronic banking systems (EBS), provided by the banks to the customers as a generic Multicash solution. Multicash is offered as both a PC-based system and as a web-based system. Hence, the competition within EBS solutions is centred on providing value-added features like cash forecasting or netting solutions.

Web-based solutions are becoming more and more advanced

### General Functionality of EBS Offerings

Many banks have shifted the focus from PC based electronic banking systems to web-based platforms. The services offered through the web include payment transactions, account information, inter-company netting solutions, FX dealings and information etc. Even though the web-based solutions are becoming more and more advanced, a number of banks still maintain sophisticated PC-based tools/services.

Host-to-host solutions are supported

### EDIFACT / Host-to-Host Solutions

The corporations growing effort of streamlining payment processing is supported by a number of German banks. Host-to-host solutions are provided for domestic as well as international payments.

Various e-payment providers operate in Germany

### E-payments

In general, micropayments are offered by a lot of regional and 'global' players. Such solutions usually rest on two important prerequisites: 1) Prepayment and 2) Settlement via debit or credit cards. However, the banking industry backed GeldKarte (mentioned above) expects to increase its market share since as of 2006 the cards can be topped-up via the internet.

E-invoicing is not widespread

### E-invoice / EBPP

A number of the leading banks provide EBPP (Electronic Bill Presentment and Payment) solutions via the web; usually through sub-contractors though. This form of invoicing is not widespread yet. EBPP is expected to pick up pace following the SignatureAlliance's initiative within electronic signatures (see above).

## Cash Pooling Solutions

There are many reasons that make Germany a less attractive environment for pooling

Notional pooling is offered by the major cash management banks

Domestic cash concentration is widely used

On a cross-border basis notional as well as cash concentrating pooling schemes are offered

### Introduction

Germany is a less attractive environment for pooling of resident and non-resident cash balances given: the Central Bank's reporting requirements, the fact that lifting fees are still levied to some extent (although usually not a problem for large corporations), and some tax challenges that have yet to be overcome.

### Notional Pooling

Notional pooling on a domestic basis is offered by the major cash management banks. The solutions offered to avoid co-mingling of funds include interest enhancement / interest apportionment schemes and more rarely, pure interest netting. Such solutions all retain the autonomy of the individual participant and distribute the benefit of the set-off of balances according to agreement with the bank. As the bank cannot set-off the account balances in its own books a spread between the debit interest rate and the credit interest rate will be charged.

### Cash Concentration

Domestic cash concentration in the form of (primarily) zero or target balancing is widely offered and used in Germany.

### Multicurrency and Cross Border Pooling

On a cross-border basis notional as well as cash concentrating pooling schemes are offered, with the primary tool for pooling being zero-balancing. However, two factors put limits to the co-mingling of resident and non-resident funds: 1) lifting fees (a per mille charge) applied to foreign payments, although a diminishing factor for larger corporations; 2) the Deutsche Bundesbank's reporting requirements on transactions as well as month end balances above a certain threshold.

Cash pooling solutions across currencies are usually not part of the services offered by the major cash management banks. However, some of the more sophisticated banks do offer such solutions, domestically as well as cross-border.

Other means of optimising liquidity is via inter-company netting.

## Tax Issues

Tax information is general and individual advice should be sought

Tax liability is determined by place of effective management or headquarters

The aggregate corporate tax burden is around 30%

The trade tax base is taken from the (corporate) income tax base and then modified by certain additions and deductions set out in the Trade Tax Act

### Introduction

The following tax information, last updated by PricewaterhouseCoopers in April 2009, should be considered general and individual advice should always be sought.

### Tax Liability

A company is considered resident and thus fully liable to tax in Germany if it has its statutory seat or place of management in Germany. Resident companies are subject to tax on their worldwide income whereas foreign companies are liable to tax on German-sourced income only.

Partnerships are treated as transparent entities for (corporate) income tax purposes but are themselves liable for trade tax, except for certain non-trading partnerships.

### Tax Rate

The corporate tax rate is 15%. A solidarity surcharge of 5.5% is levied on the corporate tax. Depending on the local rates as determined by each municipality, the average effective trade tax rate ranges between 14% and 15.2%. Hence, the average effective overall tax rate for a German corporation falls in the range of 29.83 to 31%.

Moreover, subject to certain conditions, partners of a partnership may opt to tax current profits left in the business at a flat rate of 28.25% (plus solidarity surcharge of 5.5%). This new rule applies for the first time for business year ending in 2008. Subsequent draws are subject to a further "recapture" rate of 25% (plus solidarity surcharge of 5.5%).

### Tax Base

In general, taxable profits are determined based on the profit and loss accounts prepared in accordance with German accounting principles, taking into consideration differences between German accounting and taxation principles. Certain business expenses are fully or partially not deductible for (corporate) income tax purposes (e.g. income taxes, entertainment expenses, interest) whereas certain profits are fully or partially tax exempt (e.g. dividends, capital gains from the disposal of shares). The trade tax base is taken from the (corporate) income tax base and then modified by certain additions and deductions set out in the Trade Tax Act.

The fiscal year corresponds to the calendar year unless a different fiscal year is elected.

Companies are required to prepay part of the corporate tax, solidarity surcharge and trade tax during the assessment period, in general, according to the tax due in the previous year. Any underpaid tax is payable after filing the corporate/trade tax return within the period determined in the tax assessment notice, usually within one month after the tax assessment notice has been sent to the taxpayer. A tax assessment notice is deemed to have reached a German taxpayer three days after the assessment notice has been mailed by the tax authorities, unless the taxpayer has actually not received the assessment notice or has actually received it after the deemed receipt. Interest on unpaid corporate/trade tax generally begins to run 15 months after the end of the income year in question. The interest rate amounts to 0.5% per full month and interest payments are generally not deductible for tax purposes. Any overpaid tax is compensated under the same procedure (e.g., interest period and rate).

Fixed assets acquired on or after January 1, 2008 are to be depreciated straight-line. Depressive depreciation for movable fixed assets (previously abolished with effect from January 1, 2008) has been allowed again for these kinds of assets acquired after December 31, 2008 and before January 1, 2011. The yearly depreciation percentage may not exceed two times the depreciation that would be applicable using the declining method and in no case may exceed 25%. Individually usable capital assets acquired on or after January 1, 2008 costing individually € 150 or less must be deducted in the year of purchase. Such assets costing more than € 150 but no more than € 1,000 are to be added to pools which are deducted on a straight-line basis over five years. Any depreciation recapture in connection with the sale of an asset will be subject to tax.

Restructurings, i.e., mergers, divisions, transfers of assets and share for share exchanges may generally be carried out on a tax-deferred basis, provided specific conditions are met. The German Reorganisation Tax Act provides for tax-deferred treatment for a variety of transactions even within the EU and European Economic Area ("EEA"), i.e., in case the transferor or transferee has been incorporated in the EU or EEA and has its seat as well as its place of management in an EU member state or the EEA in the time of the transfer. In case of an individual, the domicile or residence shall be relevant.

Tax losses can be carried forward without any time limitation for corporate/trade tax but in consideration of the German minimum taxation rule

### **Tax Losses**

Tax losses up to EUR 511,500 can be carried back one year for corporate tax purposes but not for trade tax purposes. They can be carried forward without any time limitation for corporate/trade tax but in consideration of the German minimum taxation rule. Under the German minimum taxation rule, the maximum annual income to be offset with losses brought forward is limited to EUR 1 million plus 60% of the taxable income exceeding EUR 1 million. In other words, losses brought forward will not shelter 40% of the annual income exceeding EUR 1 million from immediate taxation.

Loss carryforwards may be wholly or partially lost on direct or indirect changes of control in a corporation.

The direct or indirect transfer of more than 25% but no more than 50% of the

shares or voting rights in a corporation to one acquirer, a person(s) related to the acquirer or a group with common interests within five years results in a pro-rata loss of any tax loss carryforwards. The direct or indirect transfer of more than 50% of the shares or voting rights in a corporation to one acquirer, a person(s) related to the acquirer or a group with common interests within five years results in a 100% loss of any tax loss carryforwards.

Non-deducted interest expense carryforwards under the interest capping rule (see below) are also subject to the loss forfeiture rule.

Group tax consolidation can be established

## Tax Consolidation

A German tax group (so-called Organschaft) for corporation and trade tax purposes if a parent company (corporation managed and controlled in Germany, trading partnership or certain foreign persons with a registered German branch) owns more than 50% of the voting rights in a subsidiary (German corporation) from the beginning of the business year of the subsidiary..

Additionally, a profit and loss pooling agreement (so-called Ergebnisabführungsvertrag) must be concluded and executed respectively between the controlling company (parent company) and the controlled company (subsidiary) for a period of at least five years. The tax group for corporate and trade tax purposes can be implemented at the beginning of the subsidiary's fiscal year only if the required profit and loss pooling agreement is registered with the commercial register by the end of that fiscal year.

If these prerequisites are met, any operating profits or current losses of the subsidiary will be allocated directly to the parent company and the net amount will be subject to taxation in the hands of the latter. Pre-Organschaft losses of a subsidiary cannot be used by the parent company and are thus suspended for the duration of the Organschaft.

Taxation of dividends applies to some extent

## Inbound and Outbound Taxation of Dividends

For corporate tax purposes, dividends received from either a domestic or foreign subsidiary or affiliate are generally tax exempt at the level of the German corporate shareholder, irrespective of shareholding and holding period. An exemption from trade tax is available only if certain additional requirements are met (e.g. minimum shareholding of generally 15%, minimum holding period, activity test for foreign non-EU/EEA based subsidiaries). Besides the domestic participation exemption many of the German tax treaties also provide for an exemption of dividends from corporate and trade tax, albeit under individual circumstances and preconditions.

However, 5% of dividends received are deemed to be a non-deductible expense and as such are subject to corporate and trade tax in the hands of a corporate recipient. Therefore, the dividend participation exemption is effectively only 95%. In return, any other expenditure such as interest expense linked to domestic or foreign shareholdings is generally deductible for corporate tax purposes even though the corresponding income is virtually exempt; effective January 1, 2007, this principle

is in certain cases no longer valid for trade tax purposes.

Notably, the above-mentioned 5% add-back of dividends received to taxable income does not occur within an Organschaft on the grounds that in this case by virtue of the laws a profit transfer rather than a dividend occurs.

From 2009 onwards, German domestic law provides for a 25% withholding tax plus 5.5% solidarity surcharge thereon (aggregate 26.375%) to be levied on dividends and other profit distributions. However, companies subject to German tax as non-residents are entitled to a refund of 40% of the withholding tax (i.e. 40% of 25% equals 10% resulting in an effective withholding tax rate of approx. 15%). When the recipient is a non-German resident, most double tax treaties generally reduce the withholding tax rate. Partial exemption certificates from withholding tax would need to be obtained.

Germany has implemented the EU Parent Subsidiary Directive in domestic tax law and therefore does not withhold tax on dividends paid to EU corporate shareholders where a shareholding of 10% has been held for a minimum of 12 months. Germany has also enacted the amended EU Parent Subsidiary Directive into domestic law.

Under the German anti-treaty/anti-directive-shopping rule, a foreign company would be entitled to full or partial treaty or EU Directive relief from withholding taxes even if it has direct shareholders who would not be entitled to the same relief if they received the income of the foreign company directly, if the following criteria are all met:

- i. there are economic or other important non-tax reasons for the interposition of the foreign company;
- ii. the foreign company derives more than 10% of its gross income from own commercial activities. The latter does not include income that the foreign company generates from the pure administration of its own assets (such as shareholdings) or from activities that have been outsourced to other parties. Opposed thereto, where the foreign company actively manages its shareholdings, income should be accounted for as 'good' income for purposes of the 10% test; and
- iii. the foreign company has its own business infrastructure (e.g., office, communication framework, employees) enabling it to participate in the business community.

Any organizational, economic or other attributes from companies that are related to the foreign company will be disregarded. The rule shall not be applicable to a foreign company if there is substantial and regular trading in its main class of shares at a recognised stock exchange or if the German Investment Tax Act applies.

The rule as explained above applies to dividends and royalties paid after December 31, 2006. Starting in 2009, it will also apply to the 40% refund of withholding tax to non-resident corporations.

The European Commission has challenged Germany's anti-treaty/anti-directive-

shopping rule on the grounds of discriminatory treatment of outbound dividends. The discrimination issue arises because the withholding tax charged on dividends may lead to outbound dividends being taxed at a higher rate than domestic dividends. For this reason, the outcome of the procedure should be monitored by companies resident in the European Union or the European Economic Area.

Capital gains are exempt from taxation, however, certain exemptions from this general rule might apply

## Taxation of Capital Gains and Losses on Shares, Bonds, Debts, Receivables and Financial Contracts

Capital gains realised on the sale of domestic and foreign shareholdings held by a corporation - even through a partnership - are exempt from both corporate and trade tax (no threshold or holding period must be met). However, there are certain exemptions to this general rule (e.g. for banks).

Notwithstanding the above non-taxation of capital gains, 5% of the capital gains are deemed to be non-deductible expenses for tax purposes. Any other expenses linked to the sale of domestic or foreign shareholdings are generally tax deductible. This is applicable to capital gains recognised on both the sale of the shares and the liquidation of subsidiaries.

Due to the exemption of dividends and capital gains from German taxation, write-downs in the values of investments and capital losses realised on the disposal of participations in foreign and domestic companies are in general not allowable deductions for tax purposes. The same applies to merger gains or losses. Moreover, losses arising in connection with certain inter-company loan receivables (such as from write-offs of receivables) are, under certain conditions, no longer tax deductible, if, inter alia, the lender holds or has held more than 25% of the shares in the borrower (so called "significant shareholder"), or the lender is related to a significant shareholder.

CFC taxation applies though EU/EEA companies can potentially avoid this in draft legislation

## CFC Taxation

A German parent company has to include CFC income of a foreign subsidiary in its German income tax return if:

- more than 50% of the ordinary shares with voting rights in the foreign company are directly or indirectly held by German residents (to the extent, the foreign company receives low-taxed income with investment character (e.g. interest income), a shareholding of 1% or even lower may be sufficient);
- the income at the level of the foreign company is passive. Passive income is anything not explicitly defined in the Foreign Tax Act as "active". The latter includes income from manufacturing, trading, rendering services, some forms of licensing and renting, and certain foreign holding company income plus dividend distributions as well as recognised capital gains; and
- the foreign corporation is subject to a low income tax rate in the state where it is resident or where it has its place of effective management, which will be the case if the effective tax burden computed according to the German tax rules is less than 25%.

The Annual Tax Act 2008 implemented the principles of the Cadbury Schweppes

decision of the European Court of Justice into domestic law. Thus, there is no income inclusion at the level of the German shareholder, if

- the taxpayer can prove that the foreign company has its seat or place of management within the EU or EEA and carries out an actual commercial business within that area, and
- the EU Mutual Assistance Directive or a comparable exchange of information clause under a double tax treaty applies.

The new legislation is applicable for financial years beginning after December 31, 2007.

No tax has to be withheld from interest paid to non-residents on ordinary loans

## Withholding Tax

No tax has to be withheld from interest paid to non-residents on ordinary loans, i.e., loans that are not secured by real property, registered ships or similar rights. Moreover, most double tax treaties concluded by Germany provide that interest income may only be taxed in the jurisdiction where the recipient has its place of residence.

For royalties, a general withholding tax rate of 15% plus 5.5% solidarity surcharge thereon (effective 15.825%) applies to payments to non-residents. However, the withholding tax rate may be lowered or eliminated under respective double tax treaties.

The Interest and Royalties Directive applies to interest and royalty payments made between 'associated' companies within the European Union from January 1, 2004 onwards. Within the meaning of the Directive, associated companies are (i) parent companies and their subsidiaries and (ii) subsidiaries of the same parent company. Accordingly, a company can apply for exemption from German withholding tax on royalties. For payments to fall under the exemption, the creditor of royalties must be i) a company or permanent establishment within the EU, ii) associated with the German debtor company, iii) subject to corporate tax in the EU and iv) of a type listed in the annex to the Directive. Additionally, the applying company has to file an application with supporting information and receive those payments for its own benefit and not as an intermediary for some other person. The exemption is not granted when royalties are paid by or to a permanent establishment located in a third country of a company of a EU member state and the business of the company is wholly or partly carried out through that permanent establishment.

All inter-company transactions must take place at arm's length

## Transfer Pricing and Thin Capitalisation

According to German transfer pricing rules, all inter-company transactions must take place at arm's length. Written documentation must be prepared and presented to the German tax authorities on request in accordance with specific documentation rules. The transfer pricing documentation has to be supplied within 60 days (in the case of significant and extraordinary transactions within 30 days) of a request by the German tax authorities. Non-compliance with the documentation requirements may have severe consequences (fines, penalties etc.).

In case of a transfer of functions (including opportunities and risks), a valuation needs to be performed for the whole "Transfer Package". According to the new rules, the valuation needs to consider the effects to both the transferor and the transferee, i.e. needs to include the potential synergies created for the transferee.

The interest capping rules limit the tax relief for net interest expenses

## Interest Capping Rules

The interest capping rules limit the tax relief for net interest expenses to 30% of the taxable income before (net) interest expense, taxes as well as depreciation and amortization. Interest disallowed under the interest capping rules can be carried forward indefinitely and increases the interest expenses in subsequent years.

The interest capping rule is not applicable if one of the following three alternative exceptions is met:

- i. The interest capping rules will not apply if net interest expense (i.e. after deduction of any interest income) does not exceed EUR 1 million.
- ii. The interest capping rules will also not apply provided that a German company under review is not part of a consolidated group of companies and provided that its finance and business policy is not determined in line with other businesses.
- iii. This exception will, however, not be available to a company under review where more than 10% of the net interest expense is made on loans from a shareholder owning more than 25% of the shares in the company, from a person related to such a shareholder or from a third party with recourse to such a shareholder or person related to such a shareholder. Based on explanatory notes "recourse" will mean any possibility of recourse and is not restricted to back-to-back financing arrangements.
- iv. An escape clause from the interest capping rules is also available where a company under review is a member of a group. Under this escape clause, interest expenses are fully deductible for tax purposes under the condition that the debt-to-equity ratio of the business as per the business's IFRS stand-alone financial statements does not exceed the debt-to-equity ratio of the audited accounts under IFRS of the largest consolidated group (with an allowed variation of 1%). German GAAP/GAAP of an EU member state used in the consolidated accounts for financial accounting purposes could be used where no IFRS accounts are available. US GAAP consolidated accounts could alternatively be used where neither IFRS nor German GAAP/GAAP of an EU member state consolidated accounts are available. Equity of the company under review is the statutory equity amended by additions and reductions, especially the reduction by the amount of investments in subsidiaries.

However, this third exception is not available to a consolidated company where more than 10% of the net interest expense of any member of the consolidated group is made on loans from an unconsolidated shareholder owning more than 25% of the shares in a company of the consolidated group or from any other harmful party as described above for unconsolidated companies.

No duties apply

### **Capital or Stamp Duties**

There is no capital or stamp duty when establishing a German company or upon the transfer of shares in a German company, nor is there duty on the transfer of, e.g., goodwill and assets.

The standard VAT rate is 19%

### **VAT and Payroll Duty**

VAT is levied on the supply of goods and services at a rate of 19% (reduced rate of 7%, e.g., for food). Certain services are VAT exempt, e.g. insurance and reinsurance, certain financial services. VAT exempt activities reduce the right to deduct input VAT relating to the activities.

A tax group can also be established for VAT purposes. In addition to the financial integration of the subsidiary, VAT law requires organisational and economic integration of the subsidiary into the parent. Where an Organschaft is successfully established, parent and subsidiary are viewed as one entrepreneur for VAT purposes.

Employers withhold income tax on wages

### **Employer Obligations – Tax and Social Security Withholdings**

Employers are required to withhold income tax on wages. Employers are also liable for contributions to compulsory health insurance, a supplementary pension fund and payment of work and accident insurance (combined rate of approx. 20% to 24% of cash and benefits in kind). Such contributions are generally deductible for corporate and trade tax purposes.

## Source and Contacts

Sources used for this country profile

### Sources

Central Bank (Deutsche Bundesbank)	<a href="http://www.bundesbank.de">www.bundesbank.de</a>
Anti-Money Laundering, RA A. Diergarten	<a href="http://www.antigeldwaesche.de">www.antigeldwaesche.de</a>
The Signature Alliance	<a href="http://www.signaturbuendnis.de">www.signaturbuendnis.de</a>
Association of German Banks	<a href="http://www.germanbanks.org">www.germanbanks.org</a>
Die Bank (Banking industry magazine)	<a href="http://www.die-bank.de">www.die-bank.de</a>
Federal Financial Supervisory Authority	<a href="http://www.bafin.de">www.bafin.de</a>
Frankfurt a. M., Chamber of Commerce	<a href="http://www.frankfurt-main.ihk.de">www.frankfurt-main.ihk.de</a>
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Federal Statistics Office	<a href="http://www.destatis.de">www.destatis.de</a>

Contact Danske Bank for cash management services

### Danske Bank Contacts

See [www.danskebank.com/corporate](http://www.danskebank.com/corporate) for contact persons.

Tax information provided by PricewaterhouseCoopers

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Market research provided by CaRisMa Consulting

### Country Research

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