



Establishing a U.S. Subsidiary of a German Parent Corporation

Schiff Hardin LLP maintains a team of bilingual lawyers concentrating on the special legal problems of German, Swiss, and Austrian companies doing business in the United States through licensing, joint ventures, subsidiaries, or branches.

March 2004

Prepared by:

Richard E. Lutringer
t 212.745.0820
rlutringer@schiffhardin.com

Hans F. Kaeser
t 212.745.0818
hkaeser@schiffhardin.com

SCHIFF HARDIN LLP
623 Fifth Avenue
New York, New York 10022
t 212.753.5000
f 212.753.5044

www.schiffhardin.com

This memorandum sets forth the steps required to establish a U.S. subsidiary of a German corporation. Although the Limited Liability Company and the Limited Partnership are briefly described below, this memorandum is primarily devoted to the formation of a Corporation, the most commonly used form of entity for U.S. subsidiaries of German corporations.

General Considerations

There is no national corporate law in the United States governing privately held corporations. Each state has its own form of corporate law, which permits an entity to be formed that insulates the shareholders from liability for debts of that entity. There is no requirement that a corporation be formed in the state in the United States where the subsidiary has its headquarters (*i.e.*, no Sitzprinzip).

Most of our corporate clients incorporate in the state of Delaware because of its well-developed corporate law, as well as cost and convenience factors (*e.g.*, on an expedited basis it is possible to register a corporation in one day). In almost all instances, the total state and federal corporate income tax burdens do not materially differ depending on the state of incorporation. There is no need to have employees or set up any operations in Delaware. There are a number of corporate service companies, which regularly act as local statutory agent of Delaware corporations. It is, of course, possible to form a corporation in the state where the subsidiary's headquarters are to be located, but it is not unusual for there to be higher administrative costs and delays and sometimes unusual local statutory provisions which are not beneficial to shareholders.

Forms of Corporate Entities

Corporation

Similar in structure to a German AG. It permits unlimited classes of capital stock, profits are taxed at the corporate level, and shareholders pay taxes on dividends, unless wholly or partly exempt (*e.g.*, as part of a consolidated corporate group similar to "Schachtelprivileg" or by tax treaty).

Limited Liability Company (LLC)

Somewhat similar to a GmbH, but U.S. federal tax law (and most states) permits an LLC to elect partnership tax treatment (*i.e.*, to be taxed as a Personengesellschaft) while maintaining the limited liability of the owners. Very flexible structure and often used for joint ventures of two corporations.

Limited Partnership (LP)

Similar to Kommanditgesellschaft. Requires at least one general partner, and other partners may be limited partners, whose liability is limited to their share of the partnership. Taxation at the partner level, not at the partnership level.

Forming a Corporation in Delaware

Name

With very few limitations, a corporation's name can be any name that is not confusingly similar to another existing corporation's name or a registered trademark. Must include the designation "Corporation", "Corp.", "Inc", but can use any other designation that indicates the corporate status (even "AG", for example).

Capitalization

A corporation must have common shares and may have any number and type of preferred shares with different rights from the common shares. Generally, a 100% owned subsidiary has only common shares at the time of formation.

The certificate of incorporation (Satzung) of subsidiaries usually authorizes 3000 common shares, with minimal (often \$.01 per share) or no par value, per share. The number of shares issued to the shareholder will normally be much less, often 100 shares, the balance being held in reserve for future capital increases. Unlike Germany, there is no specific requirement of minimum capital. However, to avoid a creditor's claim that the corporation was thinly capitalized and that, as a consequence, its corporate status should be disregarded (*i.e.*, Durchgriffshaftung), to satisfy tax authorities, and most likely, a lending institution's loan covenants, once the corporation is organized, the debt/equity ratio should be reviewed, and, if necessary, a portion of funds advanced as a loan by the parent can be converted to capital by board of director's resolution.

Purpose

In general, no need to be specific in the Certificate of Incorporation as to industry or line of business. Certificate can state that the corporation is formed "for any lawful purpose". Only in a few areas, such as engineering and banking, do special provisions apply.

Other Provisions

It is not uncommon for a Certificate of Incorporation to have additional provisions limiting the personal liability of

directors, as well as technical corporate matters that can simplify future reorganizations.

Filing

Usually the lawyer who drafts the Certificate of Incorporation signs it as the “Incorporator”, and then arranges for the filing with the office of the Secretary of State in the state of incorporation.

Post-Incorporation Procedures

Incorporator

The Incorporator adopts by-laws (Statuten) and names the initial member(s) of the Board of Directors.

Board of Directors

A corporation is managed by a Board of Directors and Officers. Under Delaware law the Board may have as few as one member and its role is similar to an Aufsichtsrat in Germany. At the Board’s organizational meeting (or by unanimous written consent), the Board sets the price and number of shares to be sold to the parent company and, if applicable, other shareholders, appoints the officers, approves bank credit and loan agreements and the registration of the corporation for tax and jurisdictional purposes in other U.S. states where business is to be conducted.

Officers

At a minimum, a President and Secretary (often the corporation’s outside lawyer is named Secretary in order to maintain the appropriate corporate formalities). Most corporations also have at least one Vice President and a Treasurer. Whether the President is also called the Chief Executive Officer (CEO) and if another officer (e.g. Vice-President- Finance or Treasurer) is also called a Chief Financial Officer (CFO) is usually determined by the By-Laws.

Tax Registration

An officer of the Corporation must file for an employer identification number (“EIN”) with the Internal Revenue Service prior to commencing business.

Federal Filings

Within 45 days after the investment, a notification form (BE-13) must be filed with the U.S. Department of Commerce, Bureau of Economic Affairs for statistical purposes.

Raising Additional Capital From Third Parties

The sale of securities (stock or debt) to officers, employees, or other third parties in the U.S., whether through an initial public offering (IPO) or otherwise is highly regulated by states and also by the Federal Government through the Securities and Exchange Commission (SEC). Specific exemptions apply, but each case should be separately reviewed to determine whether prospectus and/or registration is required.

Frequently Asked Questions:

What are the costs of forming a Delaware Corporation?

Delaware State Fees (2004)

Filing of Certificate of Incorporation-	\$ 89.00
Annual Statement	- \$ 20.00
Annual Franchise Tax	\$ 30.00
	(if no more than 3000 authorized shares)

Corporate Agent Fees

\$250-\$500 depending on level of service.

Legal Fees

Depending on the complexity of the corporate structure and the amount of time spent reviewing alternatives with the parent company, legal fees are normally in the range of \$1,000 - \$1,500 for organizing the corporation, not including fees based on the time required for preparing a non-routine organizational meeting, share issuance and, if necessary, bank loans and preparation or review of reporting forms.

Is it required that a U.S. citizen be a director or stockholder?

Except for certain regulated industries (e.g., airlines, broadcasting, and certain defense areas), there are no nationality requirements for officers, directors or stockholders

May share certificates be issued without a named owner (i.e. bearer shares)?

Unregistered bearer shares are not permitted in Delaware and most other states, although shares may be held in the name of a custodian as long as it is fully disclosed for tax purposes.

Are all officers, directors and shareholders listed in a public filing office?

There is no comprehensive source of information such as a German Commercial Register (Handelsregister). The names of principal officers are filed in many states, including Delaware, on an annual basis. Except for certain regulated industries, the identity of shareholders of a privately held corporation are not a matter of public record.