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High growth companies and how to fund them – a real driver of economic growth?

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The working session in Prague is entitled "*High-growth companies and how to fund them – a real driver of economic growth?*" In the working session we plan to address funding alternatives for high-growth companies (i.e. companies with significant annual growth over time); opportunities and challenges that both entrepreneurs and investors may encounter in your jurisdiction. The working session will also look at corporate governance issues in connection with investments in high-growth companies. This questionnaire mainly concentrates on these two topics in relation to high-growth companies, but will also cover commercial and regulatory opportunities and constraints.

1. CORPORATE FINANCE – FUNDING ALTERNATIVES

1.1 Which financial instruments are typically used when investing in high growth companies; ordinary shares, preference shares, convertibles, warrants, stock options, debt instruments such as bonds, hybrid instruments such as participating debentures etc.?

As a general rule, high growth companies often turn to equity capital provided by venture capital companies and/or business angels. Due to the lack of any collateral, debt financing is usually not an alternative for high growth companies, at least not in their early phase of development.

In addition, mezzanine capital is increasingly being used for co-financing along with venture capital. This form of financing typically takes place as a subordinated loan with an equity kicker. The equity kicker enables participation in the success of the company. Other hybrid financing instruments such as loans with conversion rights or silent participations are also gaining importance in Germany.

1.2 Please elaborate on the pros and cons of the instruments used (ref. 1.1 above)

1.2.1 Equity capital

Share participation is the most direct form of investment. As a co-owner of the company, the investor also takes the insolvency risk of the company as equity capital is junior to debt capital. For the entrepreneur, share participation means the loss or dilution of voting rights associated with a loss of entrepreneurial freedom.

An investor participating in a limited liability company (*GmbH*) often assumes “preference shares” to which numerous co-management rights are usually attached. The specifics of these special rights are subject to the free disposition of the shareholders as long as they do not conflict with mandatory law. In this context, an equity investor will often be granted (i) more voting rights than it would be entitled to according to its capital participation (*Mehrstimmrechte*) and (ii) a liquidation preference which, in the event of an exit, would lead to a preferential satisfaction from the sale profits compared to other shareholders.

1.2.2 Hybrid financial instruments

Mezzanine capital is supposed to fill the gap between standard loans and genuine equity capital sharing some of the characteristics of both debt and equity. Mezzanine capital ranks behind senior bank loans but ahead of equity investors’ dividend, sale and liquidation claims. It is usually structured as debt (typically an unsecured and subordinated loan). Thus, it prevents the investor from having a say in the company and protects the ownership structure against dilution.

However, the entrepreneur is subject to duties to inform/report to the investor for the duration of the allocation of capital. From a risk perspective and due to the subordination of the mezzanine capital, the greater the amount of senior debt and

the smaller the equity capital base, the greater will be the risk taken by the mezzanine capital provider.

The most frequent forms of mezzanine financing in Germany are the following:

- Subordinate debt

Subordinated loans are junior to other external financing facilities. Due to the greater risk involved with the subordination, these loans are subject to a higher interest rate, which is generally composed of a base interest rate and a risk or incentive premium.

- Loan with profit participation

These instruments are a debt-like form of financing provided by shareholders. They grant both a fixed base interest rate and a profit-related amount of interest. The advantage for the company is that the interest rate is lower than that for bank loans and is adapted to the success of the company.

- Loans with conversion rights

Loans with conversion rights (also called convertible loans) enable the creditor to convert debt into equity. If no conversion occurs, the loan will carry annual interest and be returned at maturity. A general advantage for both sides is that convertible loans can be very easily combined with future financing rounds, making financing by way of convertible loans feasible at any growth phase.

- Silent participation

Silent participations are share participations that remain unknown to third parties. Shareholders are entitled to certain rights of control pursuant to section 233 German Commercial Code, which in practice are frequently expanded further by contract. Participation in the profit is mandatory, while liability in the loss is optional and often excluded. The advantage of a silent participation for the entrepreneur is that the company is granted equity capital, thus improving the equity ratio; on the other hand, the entrepreneur does not have to relinquish as much control over the company as a regular share participation would require.

1.3 Are there any regulatory constraints to the instruments used (ref. 1.1 above)?

There are certain legal constraints on the different types of financial instruments. These limitations depend on the individual circumstances, in particular the legal form of the target entity and the investing entity, the overall financial situation of the participating entities and the number and type of shareholders of the target entity.

The following gives an overview of such legal constraints for the most common legal forms in Germany: the limited liability company (*GmbH*) and the stock corporation (*AG*).

1.3.1 Limited liability company (*GmbH*)

With a GmbH, certain constraints result from the capital maintenance

requirements set out in section 30 German Limited Liability Company Act. According to these provisions, a company may not repay its registered share capital to its shareholders. Any allocation to the shareholders that would cause the equity to fall short of the registered share capital or that is made when the equity is already below the registered share capital is prohibited. This restriction does not only apply to a straightforward payment of cash to a shareholder but also to a transaction with a shareholder in which the company renders a performance but does not receive sufficient value in return, contravening the arm's length principle, or to the creation of security interests in the GmbH's assets for third party claims against a shareholder or a shareholder's claim against a third party.

Moreover, if any financial instruments are deemed to be shareholder loans, they will be treated as equity capital. Claims for repayment would therefore have the lowest rank possible in the event of an insolvency of the company (section 39 (1) no. 5 German Insolvency Statute).

1.3.2 Stock corporation (*AG)*

The capital maintenance rules for stock corporations (*AG*) are even stricter: Section 57 (1) sent. 1 German Stock Corporation Act explicitly prohibits contributions being repaid to shareholders. Interest may neither be promised nor paid to shareholders. Prior to the dissolution of the company, only the balance sheet profit may be distributed among the shareholders.

1.4 Is crowdfunding a funding alternative in your jurisdiction? How wide is the practice? If at all, please describe pros and cons.

Crowdfunding can be an alternative to secure financing of a start-up company. In contrast to funding from business angels or venture capital, crowdfunding capital is provided in small amounts by a large number of people. As a donation-based type of funding, it is mostly used to finance innovative, but small projects with a limited duration such as films, music, games, literature and theatre.

Equity-based crowdinvesting can be a more useful fundraising tool for start-up companies. It is also an internet-driven platform, gathering small amounts of money from a large number of people. Unlike crowdfunding, crowdinvesting is reward-based, thus enabling a company to encourage more people to invest in its ventures.

2. INVESTORS VIEWPOINT – OPPORTUNITIES AND CONSTRAINTS, LEGAL AND COMMERCIAL

2.1 Who are typical investors into a high growth company in your jurisdiction? Sources of funding (i.e. founders-family-friends, angel investments, venture capital investments, private equity)

The main players investing in high growth companies in Germany are business angel investors, venture capital companies and, to a smaller extent, private equity firms.

2.1.1 Business Angels

Financing by business angels has become increasingly important, particularly for high-growth sectors such as information technology, multimedia and life sciences. This "intelligent capital" is invested primarily in the early stage of the entrepreneurial development of a company so that the investors will be able to participate in the value growth of the company or exert influence on the development of the company by providing know-how in a timely manner. The main characteristics for such investments are proximity and a relationship of mutual trust between the entrepreneur and the investor.

In Germany, there are several networks with a strong regional character which serve as a contact point for start-up-companies in search of capital. The website "www.business-angels.de" of the *Dachverband Business-Angels Netzwerk Deutschland e.V.* (BAND) functions as a central access point to the activities in the German business angels market.

The financing volume provided by a business angel typically ranges from EUR 50,000 to EUR 1 million. Larger sums are also possible, but are usually obtained only in cooperation with other business angels or venture capital companies.

2.1.2 Venture Capital

As a general rule, and unlike regular private equity companies, venture capital is used to finance companies in their early phase of development. However, while business angels are primarily active at the very beginning of the formation stage, venture capital companies usually only invest once this initial phase has been completed, and with a larger financing volume.

Pursuant to the German Private Equity and Venture Capital Association (*Bundesverband Deutscher Kapitalbeteiligungsgesellschaften* - BVK) (www.bvk-ev.de), the main group of venture capital firms (approx. 42.5 %) are "captive investors", i.e. dependent on banks or insurance companies which participate in the investment. Another group which is approximately as large, but very heterogeneous, consists of independent and private investment companies. Although banks are also important investors in these companies, they do not exert an active influence over the fund management companies.

According to a recent statistic of the BVK, venture capital investments comprise approximately 14 % (EUR 674 million) of the total investments by private equity firms in the amount of EUR 4.678 billion in 2013.

2.1.3 Private Equity

Unlike business angel or venture capital investments, private equity is primarily injected in later phases of development to support the company's expansion.

2.2 Is there a typical size of the investment into a high growth company in your jurisdiction?

The size of an investment varies depending on the particular circumstances of the individual case, notably the nature of the investment (e.g. long-term/short-term) and the period of growth in which it is carried out. Another important factor is whether investors are natural persons or legal entities, what kind of risk they are prepared to assume and whether they are granted information and control rights. Further considerations are the expected rate of return and the requirement of collateral.

2.3 Describe the process of documenting the investment

The implementation and realisation of a venture capital or angel investment will usually comprise the following steps (whereby the specific contractual structure is determined by the specific investment form involved and can therefore vary significantly from the below described steps):

- An investor will typically require a first impression of the start-up on the basis of a business plan and additionally carry out an extensive due diligence examination in order to be able to evaluate the existing company or the entrepreneurial concept from an economic, tax, financial and legal point of view.
- In a term sheet, the parties to the investment will then document the key points of the envisaged participation (envisaged holding, volume of the investment, valuation of the company, etc.). These major points should be negotiated and agreed upon very conscientiously, since in the course of negotiating the subsequent participation agreement, the parties generally are not willing to deviate from the key points agreed upon in the term sheet.
- In the participation agreement, a comprehensive list of representations and warranties is generally agreed upon by way of an independent guarantee (*selbstständiges Garantieversprechen*). The structure will largely correspond to the list of representations and warranties in standard share purchase agreements. In order to ensure that the entrepreneur actually uses the funds provided to increase the going concern value of the company, the agreement may provide for a "milestone financing". Under this mechanism, the financing capital is not immediately paid in full in the course of the capital increase, but rather gradually in several instalments. Each further payment tranche is contingent upon the achievement of certain interim targets (milestones). This procedure is known as "staging".

  If the company is a GmbH, the participation agreement will have to be notarised.
- In the shareholder agreement, the venture capital or angel investor is granted far-reaching control, information and codetermination rights.

- The articles of association are newly adopted and managing director service agreements are concluded.

2.4 Are there incentive schemes for investing into high growth companies?

In Germany, the government has adopted several measures to promote the financing of high growth companies. These are the most relevant measures:

2.4.1 Venture capital grant for private investors

Since May 2013, the Federal Ministry of Economics and Technology *(Bundesministerium für Wirtschaft und Technologie)* has offered a grant of 20% of the total investment for business angels investing in start-up companies in innovative sectors. The investor must provide the company with at least EUR 10,000. The grant is limited to a maximum of EUR 50,000 per investor and year. For each company, shares with a value of up to EUR 1 million per year can be subsidised.

2.4.2 ERP-Startfonds

The *ERP-Startfonds* was jointly set up in early 2005 by the Federal Ministry for Economic Affairs and Energy *(Bundesministerium für Wirtschaft und Energie)* and the government-owned development bank KfW (*Kreditanstalt für Wiederaufbau*). The KfW participates in small innovative technology companies of the commercial industry with start-up funding. A requirement for KfW participation is that another investor participates in the company as lead investor with at least an equal investment volume and the obligation to manage KfW's participation on the basis of a cooperation agreement. The investment may amount to up to EUR 5 million per company and a maximum of EUR 2.5 million for each 12-month period. Multiple financing rounds are possible.

To date, a total of 821 contracts have been executed with the help of the *ERP Startfonds*. More than 370 technology companies have been subsidised with a volume of approximately EUR 380 million.

2.4.3 State guarantees *(Landesbürgschaften)*

In accordance with the guidelines in force in the relevant Federal State, Federal States assume guarantees toward credit institutions domiciled in the EU in order to secure loans for companies. These guarantees have the objective of enabling the financing of projects that economically merit state aid and are commercially viable.

State guarantees cover a maximum of 80% of a potential default on the loan, while the remaining liability will be borne by the investor. Collateral is only provided by the borrower in the amount available.

2.5 Any instruments referred to in section 1 preferred from the point of view of an investor? Why? Would the answer differ if the investor is international or domestic?

From an investor’s point of view (international or domestic), hybrid financing instruments seem to be the most popular investing methods. This is due to their balance between equity capital, which is subordinated in the event of insolvency, but effective due to the control over the business, and debt capital, which lacks control over the company, but has a higher rank in an insolvency situation.

3. ENTREPRENEUR’S VIEWPOINT – OPPORTUNITIES AND CONSTRAINTS, LEGAL AND COMMERCIAL

3.1 Which company form is most popular?

As a general rule, venture capital investors usually provide equity capital only if the company is a corporation *(Kapitalgesellschaft)* and the liability is thus limited to the assets of the company (cf. section 13 (2) German Limited Liability Company Act and section 1 (1) sent. 2 German Stock Corporation Act). As mentioned above, the most popular corporations in Germany are limited liability companies (*GmbH*) and stock corporations (*AG*).

3.1.1 Limited liability company (*GmbH*)

In practice, GmbHs are the most common type of corporation. They come into existence upon registration in the Commercial Register (*Handelsregister*) (section 7 (1) German Limited Liability Company Act) and have a statutory minimum share capital requirement of EUR 25,000 (section 5 (1) German Limited Liability Company Act). The organisational structure has two levels: the shareholders’ meeting and the managing director(s).

Since 2008, German legislation also provides for an entrepreneurial corporation, the *Unternehmergesellschaft*. This is a type of GmbH which requires a minimum share capital of only one Euro. However, in order to protect legal transactions, such a GmbH must attach the suffix “*Unternehmergesellschaft* [or *UG*] *(haftungsbeschränkt)*” to its company name, indicating the low equity level. In return for the low capital requirement, section 5a (3) German Limited Liability Company Act requires that the annual net income, if any, be allocated to a statutory reserve in order to build up equity in the long term.

3.1.2 Stock corporation (*AG*)

AGs are the most strictly regulated types of German corporations. The minimum share capital is EUR 50,000 (section 7 German Stock Corporation Act). The organisational structure has three levels: the general meeting (*Hauptversammlung*), the supervisory board (*Aufsichtsrat*) and the management board (*Vorstand*). The supervisory board is a mandatory body that supervises and controls the management board. The shareholders only have limited shareholder rights through the general meeting.

In order to make this legal form attractive for small and medium-sized companies, the legislature has deregulated the Stock Corporation Act by removing certain restrictions on the provisions which are permissible in articles of association. In practice, however, the formation of AGs is still relatively rare. Generally, AGs are

brought about by changing the form of an existing company (in most cases a GmbH) to an AG by way of conversion (*Umwandlung*).

Due to the possibility of listing on a stock exchange and a relatively uncomplicated change in shareholders, AGs are well suited for raising equity capital. However, raising equity on the stock exchange only represents a realistic financing alternative for a small number of start-up companies which have already proven to be successful and sustainable businesses.

3.2 What sectors are most preferred by high growth companies in your jurisdiction (information and communications technologies, biotech, etc.)?

High growth companies are mainly found in the telecommunications, media and technology sectors, as well as in the dynamic fields of internet, e-commerce and life sciences. They usually have a strong technology and research orientation with high capital expenditure.

3.3 Are there incentive schemes for entrepreneurs incentivizing high growth companies?

The number of accelerator programs that have been offered in Germany is still low, but on the increase. Business accelerators include Seedcamp, the Telefonica subsidiary Wayra and the German Silicon Valley Accelerator. The latter seeks, with the help of the Federal Ministry of Economics and Technology, to enable young German companies to gain footing in the U.S. In 2013, Microsoft Ventures Accelerator opened a branch of its worldwide start-up support program in Berlin.

Additionally, there are around 400 incubators in Germany. These institutions support technology-oriented (preferably innovative) start-ups and young companies and are at the same time meant to boost the regional economy. For the most part, they are sponsored by municipalities or cities (increasingly also with the participation of the private sector or universities). Incubators have proven themselves as an effective economic development instrument in Germany for almost 30 years. They are linked nationally through the ADT *Bundesverband Deutscher Innovations-, Technologie- und Gründerzentren e.V.*, as well as on the Federal State level. The services offered include, among other things, advising on the planning, formation and building up of the start-up, assistance in finding capital, as well as providing low-cost and flexible leased spaces (office, laboratory, production sites) in attractive locations and infrastructure.

3.4 Any instruments referred to in section 1 preferred from the point of view of an entrepreneur? Why?

From an entrepreneur's point of view, debt capital would be the most favourable form of investment. In this scenario, the entrepreneur remains in control of both the day-to-day business and the strategic goals of the company, but still benefits from the financial liberty that the funding provides. The financial reality of high growth companies is, however, dominated by external equity or hybrid financing, while pure debt capital only gains importance toward the end of the growth phase.

Equity financing by way of venture capital participation or an angel investment can also represent a sensible and efficient instrument for increasing the equity capital, thereby paving the way for further financing rounds.

Ultimately, mezzanine capital is a very suitable financing instrument because due to its flexibility in structuring, it can be adapted to fit any profit-risk situation.

4. CORPORATE GOVERNANCE – CONTROL ISSUES

4.1 In a typical investment into a high growth company, whether a loan related investment or equity investment, how much control would a typical investor take? And what is of particular importance to an entrepreneur? In particular, please elaborate on the following terms from the perspective of your jurisdiction and practice:

Generally speaking, information and control rights are negotiable within any financing round. Investors that are in a stronger position than the entrepreneur will therefore be able to negotiate a deeper and more extensive conveyance of information than investors that are not as strongly positioned. Typically, the structuring of the investor's position is based on the risk assumed by the investor, so an investor providing equity capital will have more codetermination rights than one providing loan financing.

From an entrepreneur's point of view, the most important point when structuring the participation agreement is to ensure that the commitment of the management does not lead to an impairment of its necessary entrepreneurial freedom in the day-to-day business. As a rule, it will also be in the investor's interest for entrepreneurs to have sufficient leeway to realise their ideas. When drafting the covenant not to compete, particularly in the post-contractual sphere, entrepreneurs should ensure that they are not unreasonably hindered in their further advancement.

The following measures are usually provided for in the participation agreement:

4.1.1 Anti-dilution measures

The investor has an interest in protecting its investment against a dilution of its ownership if later financing rounds are based on a valuation lower than its own original participation ("down rounds"). This is accomplished by the inclusion of a dilution protection clause in which the original shareholders undertake that, in the event of a down round, they will transfer shares to the original investor free of charge (usually by granting unilateral subscription rights to the original investor to acquire new shares at their nominal value). The extent to which the original investor may acquire new shares depends on the content of the dilution protection clause. The most advantageous anti-dilution protection for the investor is what is known as the "full ratchet method". With this mechanism, the investor is put in the position as if it had itself participated in the favourable valuation of the down round in full, enabling it to maintain the stake it originally had in the initial investment. The original shareholders, on the other hand, would prefer a weakened

method, e.g. a calculation of the average price of the two financing rounds ("weighted average method").

4.1.2 Rights of first refusal, drag along and tag along rights

Shareholders of a venture capital financed company have a great interest in preventing intrusions by undesired shareholders along with the associated change in the ownership relationships. By agreeing upon contractual pre-emption rights in favour of the existing shareholders, the free transferability of shares to third parties can be limited up to the realisation of an exit.

Other typical contractual rights in favour of the investor are drag-along rights. A drag-along right enables the investor to force the other shareholders to join in the sale of the company. So that he can then offer a 100 % stake to the potential buyer. In order to protect the other shareholders, the drag-along right is normally only granted subject to certain conditions precedent or linked to a qualified majority shareholder resolution. It may also depend on the achievement of a certain minimum valuation. In the case of a GmbH, such an agreement on an obligation to a share transfer must be notarised pursuant to section 15 (4) German Limited Liability Company Act.

The opposite of a drag along right is the tag along right which is used to protect a minority shareholder. If a majority shareholder sells its stake, the minority shareholder has the right to join the transaction and sell its minority stake in the company at the same terms and conditions as would apply to the majority shareholder.

4.1.3 Protective provisions

A decision to invest in a high growth company is based to a considerable extent on the engagement of the founder team as well as the technology involved. In order to ensure the commitment of the management and founder team, a participation agreement will usually provide that founders who terminate their engagement prematurely or breach the terms of their service agreement or the shareholder's agreement will lose their participation in whole or in part (good leaver/bad leaver provisions).

The participation agreement also provides that patents and intellectual property rights must be contributed to the company by the founding shareholders. Entrepreneurs must also undertake to leave all future inventions relating to the corporate purpose with the company. Additionally, it is reasonable to anchor these provisions with a covenant not to compete in the articles of association.

4.1.4 Information rights

Shareholders' statutory rights to be informed by the management (section 51a German Limited Liability Company Act, section 131 German Stock Corporation Act) are usually not sufficient for the investors. The structural information gap which exists between the investors and the company or its management is therefore usually bridged by an agreement on special information and control

rights, e.g. including the obligation to submit monthly business evaluations as well as to present a quarterly report and an annual planning no later than 30 days after the end of the current year.

4.1.5 Deadlock resolution

In order to resolve possible deadlock resulting from differences in opinion or conflicts between the investor and the company, it is advisable to include a provision on dispute resolution in the participation agreement. In practice, some typical options have been developed, such as granting a power of final decision to either one party or the other (on a rotational basis if appropriate). It would, however, appear preferable to delegate the right to make the final decision to an expert arbitrator whose decision will be binding on the parties under the participation agreement.

4.1.6 Board seats/observer rights

Investors typically secure their influence over the management of a GmbH by stipulating in the rules of procedure for the management (*Geschäftsordnung*) certain measures which require their consent. They also establish an advisory board (*Beirat*) to which they delegate one or more members.

In the case of an AG, shareholders are granted the right to designate supervisory board members by force of law. In order to avoid being outvoted, investors will typically secure their nomination with an obligation of the other shareholders in the participation agreement to vote for the members nominated by the investor. Although the right to appoint supervisory board members can also be provided for in the articles of association, this is often avoided, since it leads to an unwanted disclosure. Additionally, the rules of procedure for the supervisory board can provide that individual supervisory board resolutions require the consent of the members designated by the investor.

5. EXIT STRATEGIES AND TIME HORIZON

5.1 Type of exit which is most common (sale to venture capital/private equity firms/funds, trade sale, write-off, initial public offering)? Typical transaction length?

Trade sales and sales to other venture capital/private equity companies are the most frequently used exit vehicles in Germany. In the first half of 2013, the overall volume of divestments amounted to EUR 5,730 million, 25.48% of which (EUR 1,460 million) involved secondary purchases and 23.56% (EUR 1,350 million) trade sales. Furthermore, 14% derived from divestments on the stock exchange. The time frame for a venture capital investment generally varies from three to seven years.

5.2 How are new investors dealt with in your jurisdiction? How would the issues set out in section 5 above be dealt with? Are initial investment and

shareholders' agreements/shareholders' agreements upheld in the next round, or new agreement is entered into?

In addition to the merger control provisions of the Act against Restraints of Competition (GWB), there are further restrictions on acquisitions under the Securities Acquisition and Takeover Act (WpÜG) as well as the Foreign Trade and Payments Act (AWG). Moreover, the articles of association or partnership agreements may restrict the transfer of shares in such companies in order to protect shareholders against the existing shareholder structure being changed against their will. It may therefore be stipulated that a transfer of shares to a certain person will not be valid unless it is approved by the management board, supervisory board or shareholders and partners. In the case of an AG, such a restriction would be valid only in respect of registered shares issued by the company.

A private company may also issue new shares by way of an IPO (initial public offering). This process is closely regulated and requires the disclosure of certain information. As only stock corporations are allowed to sell shares to the general public, a limited liability company would first have to be transformed into a stock corporation. The new investor is then subject to certain notification obligations for listed stock corporations pursuant to the Securities Trade Act and the Securities Acquisition and Takeover Act.

A new investor entering the company is not automatically a party to the shareholders' agreement. Although it is possible under German civil law for the new investor to accede to the existing agreement (*Vertragsbeitritt*), this mostly applies to situations in which the existing investor remains in the company. As later stage investments typically entail a lower risk and the framework conditions change with each round of financing, the new investor and the company will most likely renegotiate the individual terms, such as the rate of return and the information and control rights. They will therefore enter into a new shareholders' agreement rather than transfer the original one (*Vertragsübernahme*).

6. REGULATORY ISSUES

6.1 Any tax implications (positive or negative) that a high growth company encounters in your jurisdiction?

In the case of German corporations, profits are taxed regardless of whether they are distributed or retained. The profits are in principle subject to corporate income tax and trade tax. The uniform corporate income tax rate is currently 15% plus 5.5% solidarity surcharge thereon, leading to a combined rate of 15.825%. The applicable trade tax ranges between 7% and 17.2% (typical average rate 14% to 17%) depending on the respective municipality in which the corporation has its place of management and other permanent establishments, if any.

Dividend income received by a German corporation (from both resident and foreign corporations) are in principle 95% exempt from corporate income tax, provided that the German corporation holds 10% or more in the other corporation

as from the beginning of the calendar year. For trade tax purposes, the exemption only applies if the German corporation holds at least 15% as from the beginning of the relevant assessment period.

Capital gains realized by a German corporation from a sale of shares in domestic or foreign corporations are effectively 95% exempt from corporate income and trade tax.

Losses of German corporations may be carried back to the preceding fiscal year up to an amount of EUR 1.0 million for corporate income purposes (not for trade tax purposes) and carried forward indefinitely for corporate income and trade tax purposes. However, the utilization of tax loss carry forwards for corporate income and trade tax purposes is limited to the minimum taxation rule: Tax loss carry forwards could be offset against income up to EUR 1.0 million without restriction, but only 60% of the income exceeding EUR 1.0 million could be offset against loss carry forwards.

The deductibility of interest expenses of German corporations is limited by the interest barrier rules (Germany's thin capitalization rules). As a general rule, the net interest expenses (excess of interest expenses over interest income of the financial year) of German corporations are deductible in the financial year of expenditure only up to 30% of the businesses tax accounting-based EBITDA (so called "interest barrier"). Non-deductible interest expenses can be carried forward to subsequent financial years and can be deducted in subsequent years, however only within the limits of the interest barrier rules. Furthermore, an EBITDA carried forward could be generated if the net interest expenses of the fiscal year are lower than 30% of the EBITDA. In this case, the difference between the net interest expense and the EBITDA could be carried forward and used in the following five years when the net interest expenses exceeds 30% of the current year's EBITDA. The limitations of the interest barrier rules does not apply where (i) the annual net interest expenses are less than EUR 3 million (threshold), (ii) the corporation is not part of a group of companies (stand-alone clause) or (iii) it can be demonstrated that the equity ratio of the borrowing corporation is at least equal to the worldwide group's equity ratio (escape clause). With respect to a German corporation held by a corporation the last two exemptions above only apply if no harmful shareholder financing is in place.

To the extent that the interest expenses of the German corporation is deductible for corporate income purposes, 25% of the deducted interest expenses would be added-back to the trade tax base and would insofar not be deductible for trade tax purposes.

If the German corporation has controlled foreign subsidiaries any passive income of such subsidiaries in low or no-tax jurisdictions will be attributed to the German corporation for tax purposes if it holds directly or indirectly more than 50% of the subsidiary (lower ownership percentages apply where the low-taxed subsidiary generates passive investment income). Passive income includes *inter alia* income from leasing and letting of real estate, income from licensing or from borrowing

capital. A jurisdiction is regarded as low-tax jurisdiction if the income of the subsidiary is subject to an effective tax rate of less than 25% in the respective jurisdiction. The German corporation can under certain requirements apply for a credit for any taxes paid on the attributed income of its subsidiaries.

Dividend distributions by a German corporation would generally be subject to withholding tax at the level of the distributing corporation at a rate of 25% plus 5.5% solidarity surcharge thereon (overall 26.375%), with a general possible 40% refund for non-resident corporations, leading to an effective rate of 15.825%. The withholding tax could be reduced to a lower percentage or could fully be avoided/refunded under a Double Taxation Treaty or the EU-Parent-Subsidiary-Directive, however, subject to the strict substance requirements of the German anti-treaty-shopping rules.

The taxation of the distribution at the level of the shareholder depends on whether the shareholder is a corporation, a partnership or an individual person. The withholding tax withheld by the corporation would in principle be offset with the final corporate income or income tax burden of the shareholder within its annual corporate income tax or income assessment and would factually be refunded, to the extent the withholding tax withheld was higher than the actual taxes owed with respect to the dividends. Something different applies to individual shareholders, who hold their shares in their private assets. In this case, the withholding tax of 25.375% is final.

6.2 In addition to any of the issues set out above, any other regulatory incentives or constraints with respect to high growth companies? Any constraints deriving from obligation for local participation in a high growth company? Co-investment obligation? etc.

German law does not stipulate that the participation of a foreign investor in a German company is only possible with the simultaneous participation of a German investor.

However, an acquisition by a non-EU investor of a participation in a German company which leads to a voting rights share of at least 25% can be prohibited by the Federal Ministry of Economics and Technology or granted subject to conditions. These measures may only be adopted in order to safeguard the public order or security of the Federal Republic of Germany (sections 55 (1), 56 (1) and 59 (1) sent. 1 Foreign Trade and Payments Ordinance).

7. OTHER

7.1 Please elaborate on any other issues relevant to your jurisdiction with respect to high-growth companies which have not been discussed in responses to earlier questions (if any).

Nil.