KPMG

Business in Germany

Insights for Foreign Investors

Foreign Direct Investment
Top Destination Germany

Brexit
How your UK holding might be affected

Early bird
EU audit reform, the German way

June 2016

www.kpmg.de

Germany is a safe bet

Dear Reader

Europe is in uproar. Will Britain vote to leave the European Union? If it does, it will be the first country to do so and the economic repercussions will be serious. While it may not trigger the disintegration of the European Union as a whole, as some might fear, companies should definitely have their Brexit strategy ready.

That aside, the European Union continues to define the economic framework. Last week, the EU audit reform came into effect. We took a closer look at the German implementation of this regulation.

Despite the spectre of global recession, Germany is proving to be economically vibrant with strong showing in the first quarter. This resilience explains its attractiveness for foreign investors, in particular why more and more Chinese capital is flowing into the country: in a billion-dollar bid, Chinese home appliance maker Midea is attempting to take over the German industrial robot maker KUKA. And unsurprisingly, this is just one of many examples of investors buying into the ‘Made in Germany’ concept.

Much less predictable will be the European Championship. I clearly hope that our national team can win the title, but I rather doubt that we can match Spain’s achievements of being World and European Champions at the same time. Good luck, nonetheless!

Andreas Glunz
Managing Partner
International Business
KPMG, Germany

Content

01 Current Data

Economics Corner: Snapshot Germany

The German economy remains on a stable growth path despite increasing global risks. In contrast to previous years, growth is not primarily driven by expansion of exports but by domestic consumption due to rising real wages and low unemployment.

MAY INFLATION

0.1%

Source: German Federal Statistical Office, 06/2016

EUR / USD

1.13

Source: ECB, 14/06/2016

EUR / CNY

7.42

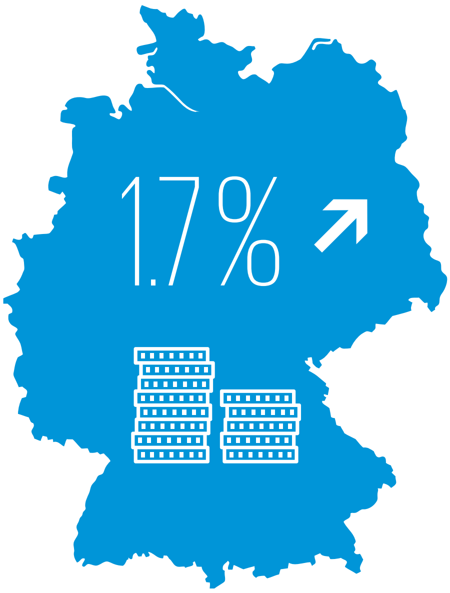
Source: 14/06/2016

APRIL EXPORTS

104.3m

Source: German Federal Statistical Office, 06/2016

2016 GDP GROWTH EXPECTATION



Source: Oxford Economics, 05/2016

APRIL IMPORTS

78.7 m

Source: German Federal Statistical Office, 06/2016

GREENFIELD INVESTMENTS IN GERMANY Q1 2016 COUNTRY RANK

#5

Source: fDi Markets, 05/2016

APRIL UNEMPLOYMENT RATE

JOB 4.2%

Source: German Federal Statistical Office, 05/2016

NUMBER OF THE DAY

1,620

GERMAN WORLD MARKET LEADERS

The structural strength of the German economy is its strong base of small and medium-sized enterprises. Being world market leaders in small, mostly technical, niches, they shape the excellent image of products "Made in Germany". Among them Herrenknecht AG, who successfully cut through the Swiss Alps to help build the Gotthard base tunnel – the world's longest tunnelling project (2x57 km).

Source: Encyclopaedia of German World Market Leaders 2015

02 Foreign Direct Investment

Foreign Direct Investment: Top Destination Germany

Germany is one of the world's top destinations for foreign capital. A new KPMG analysis confirms continued interest of foreign investors with further potential for future growth.

Foreign capital has never been this active in Germany. Recent data list close to 1,500 M&A and Greenfield projects per year. Germany ranks third as the world's most important destination for foreign capital, as *KPMG's Business Destination Germany* analysis reveals. Yet the influx of capital may grow stronger.

Total deal value almost doubled over the last two years to a record high of around USD 60 billion spent on German assets. Year to date data by Thomson One indicates that the number of M&A transactions will remain at that high level.

Viewed over the past five years, most investors are from the US in terms of M&A and Greenfield projects. Switzerland is a distant second, with the UK following closely. France and the Netherlands rank fourth and sixth, respectively. China comes in fifth, thanks largely to a steady rise in M&A deals.

A Chinese taste for German industry

Chinese investments focus on traditional German sectors such as machinery, automotive and other heavy industry. In addition, Chinese acquisitions include a range of German Mittelstand (small and medium-sized) companies that are often among the world leaders in their market. These companies are perfect targets for Chinese investments: they possess valuable skills, knowledge and efficiency. However, many of those German companies are family-owned and are reluctant to sell to foreign investors. Yet the lack of successors at some family businesses may provide opportunities to gain a foothold in Germany, the latest example being KUKA and the takeover bid by the Chinese home appliance maker Midea.

New investment opportunities triggered by Industry 4.0

Another window of opportunity is presented by the economy's transition to the new world of digitization 'Industry 4.0' requiring additional funding. This is a great chance for both financial as well as strategic investors with spare cash to become part of 'Made in Germany'.

The German manufacturing industry in general is highly attractive for foreign investors. Half of the top ten M&A target industries since 2010 belong to this particular sector. Additional trending sectors include Real Estate and Start-Ups.

Germany will see even more capital flowing in. Its central location in Europe, its power base of over 1,500 world leading companies in the manufacturing and industrial space, its highly skilled labor force with an ability to learn, adopt and innovate, its focus on product quality, trust and reliability, and last but not least its safe and pleasant living environment will continue to attract investors from around the world.

For further information, please contact: Andreas Glunz, Managing Partner, International Business, KPMG, Germany, aglunz@kpmg.com

03 The Brexit Strategy

Are you prepared? UK holdings of international companies might be affected by a limitation of free movement of goods, services, capital and labour in the aftermath of a Brexit.

On 23 June, the world will turn to Great Britain and its referendum. If the British vote ‘leave’, they will be the first country ever to exit the EU. Polls indicate a close race between the ‘leave’ and ‘stay’ campaign, so multinationals with a holding company in the UK should be aware of legal changes that might influence their business after Brexit.

Brexit will have several impacts on UK holdings

If the UK votes to leave the EU on 23 June, negotiations about the future relationship between the parties may last up to two years, according to the Lisbon Treaty. The UK would hence exit the EU no earlier than in the second half of 2018, more likely in the beginning of 2019. Additionally, any treaties between the EU and third countries will lose validity for Great Britain and need to be negotiated afresh between the UK and these countries. This may last several years, as negotiations between the EU and Canada or the USA regarding CETA and TTIP demonstrate.

Currently, a sizeable number of European headquarters of international corporates is located in Great Britain in the form of holding companies. The extent of the impact of a Brexit on the European business and investment strategies of these companies would depend on negotiations between the UK and the EU.

Would the UK still be the best location for European holding companies?

Until now, headquarters in Great Britain offered several advantages to international companies: the country’s language facilitates international business processes, and favourable tax regulations together with free entrance to the EU capital, service, labour and goods markets help maximise profits.

However, some of these current advantages might turn into disadvantages. The possible introduction of withholding taxes on dividends, interests and licences may cause higher overall taxation costs in the UK compared to EU member states. Increasing costs for financial services may also put pressure on profits and a restriction in the free movement of labour could lead to additional administrative expenditures to manage international business processes.

International companies should hence evaluate whether their current European strategy with a holding company in the UK managing the remaining European branches needs to be adjusted. In case of a Brexit, relocating the holding company to a country within the EU may turn out to be beneficial.

Post-Brexit Scenarios of the UK–EU relationship

Remain	Leave		
Remain in the EU	**Membership of EEA (like Norway)**	**Membership of EFTA but not EEA (like Switzerland)**	**Other alternatives**
- Reformed EU membership based on the draft EU deal negotiated by David Cameron in February 2016 - No fundamental change to UK tax laws - Certain UK derogations from EU law	- Participation in the EU internal market but no access to EU Free Trade Agreements ('FTAs') - Member of EFTA - Free movement of goods, services, people & capital - Not part of EU VAT area - Certain priciples of EU law apply in relation to regulation & employment	- Participation in intergovemental organisation promoting free trade - Participation in EFTA free trade agreements - Not part of EU VAT area - Negotiation of a bilateral trade agreement with the EU	UK leaves both EU and EEA and: - Enters into a customs union with the EU (like Turkey) OR - Negotiates a new free trade area OR - Becomes an independent member of the World Trade Organisation

For further information, please contact:
Oliver Dörfler
Head of Country Practice United Kingdom, KPMG, Germany
odoerfler@kpmg.com

04 It's all about rotation

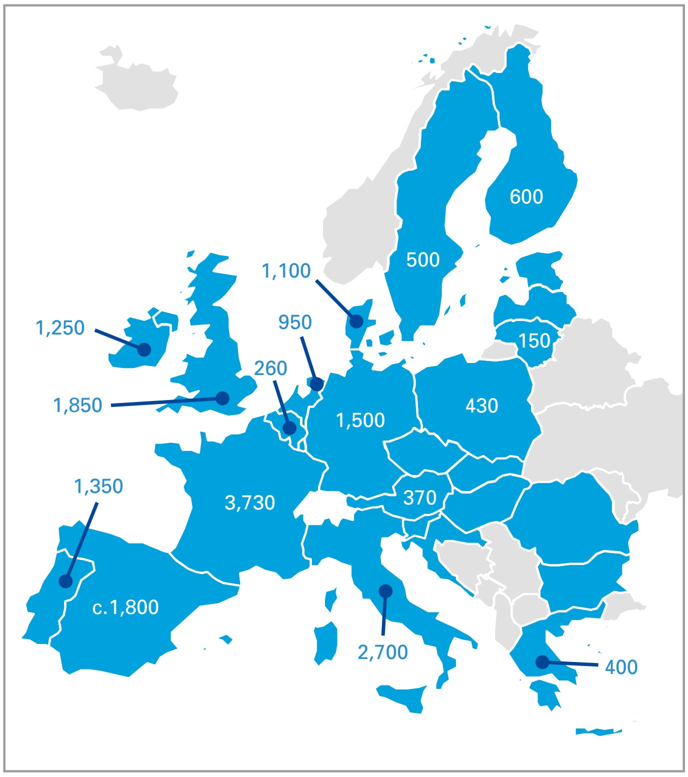
EU Audit Reforms Come Into Force

A few days ago the European Union (EU) audit reforms came into full effect. These reforms affect many subsidiaries of international companies in Germany as well as their respective parent companies.

Since June 17, 2016, the EU audit reforms have imposed mandatory audit firm rotation and prohibited certain non-audit services for an EU company that is determined to be an EU Public Interest Entity (PIE). Furthermore, the audit reforms increase the audit committee's role and affect its composition. Non-audit services must be pre-approved by the PIE's EU-based audit committee.

It is estimated that there are over 23,000 PIEs in the EU and that the EU Audit Reform in Germany triggers over 6,000 subsidiaries of these EU PIEs. The full effect of the EU audit reforms will not be known until all EU countries have finished incorporating the reforms into their national laws. However, the tendering activity for audit services has already significantly risen in some European countries, and is expected to remain high for the next years.

For Interactive map of Member State legislation click *here.*



Number of EU PIEs impacted by EU Audit Reform
Source: KPMG Research

Although Non-EU companies are not directly subject to the audit reforms, they may be affected if they have an EU PIE entity in their chain of control. This could occur if one of their subsidiaries or parent is domiciled in an EU country and:

a) Has debt or equity securities that trade on an EU-regulated market;

b) Is a credit institution or engages in insurance activities; or

c) Has been designated as a PIE by an EU country because of its size or significance.

Companies may face reduced choices given the limited number of auditors that can actually meet the multiple independence requirements while having the requisite expertise and geographic coverage. Duplicate audit committee pre-approvals of non-audit services may be required. Other jurisdictions such as India and Brazil have, or are considering, similar measures, making this an increasingly complex regulatory environment for multinational companies to navigate.

All companies with an international footprint need to start monitoring the consequences of the reforms on their filings, operations, and transactions.

Implementation of the EU Audit Reform in Germany at a glance:

Germany has already passed its own national version of the EU legislation – and is taking a rather liberal approach to its implementation.

- **Definition of a PIE:** Companies listed on a regulated market, banks and insurance companies
- **Mandatory audit firm rotation:** banks and insurance companies have mandatory rotation periods of 10 years; for all other PIEs, the initial period of 10 years can be extended by a further 10 years following a tender or by 14 years for a joint audit
- **Restrictions on non-audit services (NAS):** Germany has chosen to permit tax and valuation services, however it is particularly banning aggressive tax planning services by the auditor
- **Cap on non-audit services:** 70 per cent cap on the fees of permissible NAS.

For further information, please contact:
Robert Kuntz
Partner, International Business, KPMG, Germany
rkuntz@kpmg.com

05 Meet the locals

Because cuckoo clocks run differently

Over the centuries, Germany has unified with many statelets. This still finds expression in the fact that Germany is a federal state composed of 16 Bundesländer. The regional differences not only make the country culturally rich but also economically very diverse and essentially the economic powerhouse in Continental Europe. Our experts will introduce you to the specifics and advantages of their region. We start with Berlin and Frankfurt.

Berlin Region »

Berlin is a buzzing city with its 3.5 million inhabitants. Being the capital, this is where major political decisions are taken not only for Germany but also for Europe. It has become a very cosmopolitan city which harks back to its cultural and economic creativity. The unemployment rate is now half what it was ten years ago. KPMG's regional head Frank Wiethoff explains what he finds impressive about Berlin.

For further information, please contact:
Frank Wiethoff
Regional Head East, KPMG, Germany
fwiethoff@kpmg.com

Frankfurt Region »

The Rhine-Main Metropolitan Region, with its total population of about 6 million, is one of Germany's top economic centers. Frankfurt at its heart has its focus on financial services and is home to Germany's number one stock exchange, the European Central Bank (EZB) and the largest German airport, making it a logistic hub. KPMG's regional head Holger Kneisel shows you around Frankfurt and invites you to see its regional specialties.

For further information, please contact:
Holger Kneisel
Regional Head Central, KPMG, Germany
hkneisel@kpmg.com

06 German Business Etiquette

A successful business day in Germany

Like every culture, Germans have their own peculiarities. Here are a few hints on how to champion a business trip to Germany.

Your meeting with your new business partner is scheduled at nine. Being aware of how much Germans value punctuality, you arrive at the meeting on time. If you are running late, inform your partner as soon as possible and best have a good excuse – although there aren't many. Tardiness will discredit you under virtually all circumstances, even if it's only five minutes.

You shake hands with the most senior person, working your way down. Greet your counterparts with a firm handshake and eye contact. Address them by their last name, 'Herr Schulz', 'Frau Müller', and make sure to include the title where applicable: 'Doctor Meier' works for either sex.

Very likely your counterpart will start the conversation with a bit of small talk, asking you if you arrived alright or how long you will be staying. A few words about the weather suffice. Time is money.

You present yourself in a thoughtful, straightforward fashion, which your dark suit and next to no accessories reflect. Logic and information count over show. The bluntness with which your partners talk about challenges and critical issues doesn't surprise you at all. You answer accordingly and say what you mean for the sake of reaching a reasonable deal. Likely they ask for time to think your offer through. This is fine with you, knowing that they might need approval from some higher level and that they will certainly get back to you.

At lunch you get to know each other better. You respect their privacy and start by elaborating on the latest results of the European Championship. Talking about the global business environment is fine too, but you stop short on becoming too political. Also you respect their privacy – not only by literally keeping your distance, but also by avoiding personal topics. Once everyone has been served, you wait for the Guten Appetit and reply with the same words. Leaving nothing on your plate, you part with a handshake, feeling confident that you have blended in well.

For further information, please contact:
Joachim von Prittwitz
Senior Manager, International Business, KPMG, Germany
jprittwitz@kpmg.com

07 Key Events

KPMG Seminars: Current Focal points in Transfer Pricing 2016
27 June – 21 July 2016, Various locations »

Rheingau Music Festival
18 June – 27 August, Wiesbaden Area »

KPMG Real Estate Fund Conference 2016
30 June 2016, Frankfurt am Main »

Bayreuth Theatre Festival (Bayreuther Festspiele)
25 July – 18 August 2016, Bayreuth »

International Consumer Electronics Fair Berlin (Internationale Funkausstellung IFA)
02 – 07 September 2016, Berlin »

Munich Oktoberfest
17 September – 03 October 2016, Munich »

IAA Commercial Vehicles Fair Hannover
22 – 29 September 2016, Hannover »

Frankfurt Book Fair
19 – 23 October 2016, Frankfurt am Main »

6th Annual KPMG Global Power & Utilities Conference
08 November 2016, Brussels »

That special event

One of the most important events this summer is the **European Championship** in neighboring France. Many Germans will gather in bars and public spaces to collectively watch their squad advance to the next round. Most German companies have special arrangements should their working time coincide with important games.

The most popular screens will be set up in front of the Brandenburg Gate in Berlin. This is also the place where the team was welcomed when it brought home the World Trophy from Brazil two years ago. The last European title was won 20 years ago.

For all those not into football these are tough weeks, as getting around is tricky.

08 Three Questions

... to DIW President Marcel Fratzscher

1 In your view, what are key growth sectors in Germany? Germany's main economic strength is its industrial sector, which has a number of highly competitive export companies. Automobiles, machinery, pharmaceuticals and chemicals are four of the sectors that have shown a remarkable success and been the main drivers of economic growth in Germany in recent decades.

2 Which characteristic of the German market distinguishes it the most from other international markets? Germany has a unique economic structure. Its success hinges on highly innovative mid-sized companies. These companies are often family-owned and have a long-term orientation. They have proven to be remarkably resilient and flexible, in particular during the global financial crisis and the subsequent European crisis. As a result, Germany's economy has recovered quickly and unemployment has continued to fall.

3 Which cultural site or event in Germany would you recommend as a must see? The richness of Germany's culture has been less evident internationally than that of many of its neighbors. Berlin and its many cultural events, including the Berlin Film Festival, are highlights no visitor should miss.

Interview with Prof. Marcel Fratzscher, Ph.D, President of DIW Berlin (German Institute for Economic Research), Professor of Macroeconomics and Finance at Humboldt-University Berlin, and Member of the Advisory Council of the Ministry of Economy of Germany

A short German lesson

Leistung, die – is a neat word that stands for performance, achievement, capacity, output and efficiency. Accordingly, it plays an important role in German business thinking, in which everything and everybody is measured. *Leistung* is also used for power in physics as well as for payments made by insurances, for example. The verb is *leisten*.

Common sentences:
Die Leistung stimmt.
– The performance is good.

Das kann ich mir nicht leisten.
– I cannot afford that.

Our Publications

Useful insights for doing business in Germany

Business Destination Germany Investment decisions are tough. Germany offers a wide range of opportunities. This analysis shows why now is the best time to become part of 'Made in Germany'. »

Investment in Germany This guide provides you with a comprehensive overview of the German business and legal environment, including economic facts, legal forms, subsidies, tariffs, accounting principles and taxation. »

German Tax Facts App Everything you need to know about taxes for companies, investors and employees all combined in one smart and handy app. Now available at the *Apple App Store* and *Google Play Store*. »

German Tax Monthly German Tax Monthly provides information on the latest tax developments in Germany, focusing on foreign investors and selected topics of interest in daily international business. *Subscribe*

Transfer Pricing Review Transfer pricing is at the core of international trade within multinationals. This document provides you with the most important facts on transfer pricing rules in Germany. »

Contact

KPMG AG Wirtschaftsprüfungsgesellschaft

Andreas Glunz*
Managing Partner, International Business
T +49 211 475-7127
aglunz@kpmg.com

Joachim von Prittwitz
Senior Manager, International Business
T +49 30 2068-4195
jprittwitz@kpmg.com

If you would like to receive this or other KPMG newsletters, please *subscribe here*.

Feedback to Editorial team:
Business in Germany

www.kpmg.de
www.kpmg.de/socialmedia

* Responsible according to German Law (§7 (2) Berliner PresseG