CLIFFORD CHANCE

Newsletter
Hotel Group
November 2011

Investment in the Hotel sector in Germany by HK and China-Mainland based Investors

Key Issues

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I. Introduction

Following a time where hotels were largely owned and/or operated by smaller chains and individual owners or operators, large international hotel chains and international investors are becoming more and more visible in the European hotel markets (but are still less present than e.g. in the US). The past two decades were marked by large hotel real estate portfolio transactions and significant sales from operator owners to investors (specialty funds, pension funds, investment funds, etc.) together with a stronger focus of both operators and investors on prime locations – a number of hotels in less attractive locations were converted into housing for the elderly, offices, condominiums, etc.

As a result of the financial crisis, certain hotel portfolio transactions had to be restructured. Currently, demand for hotel properties from both investors and operators is again increasing in those markets that quickly recovered from the economic downturn. Recent studies show that the market expects hotel properties to provide above average returns:

The global volume of hotel transactions increased significantly, to an estimated year-end US$21.5 billion in 2010, a 125.0% increase over the 2009 volume. In 2011, the global activity in hotel transactions is expected to gain further momentum, increasing in volume by 30.0% to 40.0% in 2011, to reach approximately US$30 billion, although this remains well short of the US$120 billion seen in 2007 and would only represent a return in transaction volumes to

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2004 levels.[1]

As regards Germany, the described market up-turn is driven by the following factors which should also provide an attractive perspective for hotel investments in the medium term:

- Germany sports top locations in the heart of Europe; Frankfurt regarded as financial and logistics center
- Modern and international trade centres across the country: Munich, Frankfurt, Düsseldorf, Hamburg, Berlin, …
- Increasing number of visitors, both business and tourist, from Asia, in particular from China
- Stable economic climate
- Reliable legal environment
- Historically low real estate market prices
- Historically low interest rates for financing
- Outstanding infrastructure
- Financing available also for foreign investors to acquire real estate

II. Key features of contractual schemes for hotel investments

The structures and contractual arrangement for individual hotels and/or hotel portfolios follow the internationally known schemes. When going into detail, there are certain legal requirements that need to be adhered to and may require deviations in a particular case, but usually do not result in a completely change of the principles.

As also seen on the international market, ownership of the hotel is often separated from ownership of the FF&E and the operations. Hotel contract types vary from pure franchises over leases, management agreements and more recently hybrid contractual structures, often influenced by accounting principles and requirements of the hotel owner and/or operator.

Usually, there is not one single hotel contract, but a variety of contractual arrangements covering various items of a hotel investment such as the construction and lay-out of the hotel, the branding, (central) purchasing and sales services, additional services like spa and parking areas.

[1] "Global Hotel Transaction Volumes to Increase 30% – 40 % in 2011," hospitalitynet.org, 1 December 2010.

III. Main taxation issues

Although not a low tax country, it seems to be fair to state that Germany offers a comprehensive and competitive system of company taxation. The average tax burden on companies is less than 30 percent. In some regions of Germany, due to a locally variable rate of trade tax, it is under 23 percent.

In Germany, companies are usually taxed on two levels: local and federal levels. Companies are subject to income taxation. Corporations – such as the stock corporation (AG) and limited liability company (GmbH) – are subject to German corporate income tax (*Körperschaftsteuer*). In contrast partnerships – such as the *Kommanditgesellschaft* (*KG*) or the *offene Handelsgesellschaft* (*oHG*) – are not subject to German corporate tax themselves, but the profits generated by these partnerships are taxed on the level of the individual partner(s). At the partner's level the profits can be subject either to corporate income tax (in case the partner is a corporation) or to the partner's personal income tax (*Einkommensteuer*) (in case the partner is an individual). Furthermore, all business operations – corporations and partnerships alike – are subject to the trade tax (*Gewerbesteuer*), which is imposed by local municipalities (i.e. the town or city where the company is based).

In summarized terms, there are several important tax types which are relevant (in particular for corporations), including:

Tax type	Rate of tax
Corporate income tax Solidarity surcharge (*Solidaritätszuschlag*)	15% on the taxable profits of the company 5.5% on the corporate income tax due (the corporate income tax and solidarity surcharge amount to a total of 15.825%)
Trade tax	Average tax rate: 14% (the actual tax rate can differ depending on the municipality where the company is located)
Withholding tax	25% (on dividend payments); this tax rate might be reduced to 10% based on the double taxation agreement (DTA) concluded between mainland China (not valid for Hong Kong and Macau) and Germany.

Value-added Tax (VAT)	19%; 7% applies to certain consumer goods and everyday services (such as food, newspapers, local public transport but also hotel stays)

IV. Visa regulations & residence in Germany

Germany distinguishes between three different types of residence permits:

i. Visas (Schengen visas and national visas)

ii. Residence permit

iii. Settlement permit

A visa authorises the holder to enter and stay in Germany for a temporary period (up to 90 days per six-month period from the initial date of arrival), a residence permit or settlement permit, however, authorises the holder to stay longer than 90 days per six-month period or to work on a self-employed basis or as an employee in Germany.

- Visa Regulations

In general, non-European and non-treaty foreigners require a visa for stays in Germany. A visa is not required for semi-annual visits of up to three months for nationals of those countries for which the European Community has abolished the visa requirement. The Citizens of Mainland China will need a visa to enter Germany. The visa waiver applies to holders of SAR passports (Hong Kong and Macao Special Administrative Region passports).

Under German law (section 71 (2) of the Residence Act), responsibility for issuing visas lies with the representations of the Federal Republic of Germany, i.e. its embassies and consulates-general. In principle, the Federal Foreign Office is not involved in decisions on individual visa applications, nor does it have any knowledge of the status of individual applications being processed by the missions.

- Residence in Germany

In the case of longer stays (more than 90 days), the sole distinction that is still made is between (temporary) residence permits and (permanent) settlement permits. First-time entry into the country still requires a visa for Germany (national visa), which is then converted into a residence or settlement permit once the holder has arrived in the country. Temporary residence permits are issued for the purposes specified in the Act (education or training, gainful employment, international law, humanitarian, political or family reasons). Permanent settlement permits are issued if a foreigner has possessed a residence permit for five years and meets the additional requirements (secure income, no criminal record, adequate command of the German language, etc).

If a foreign investor wishes to establish a business in Germany, a Schengen or national visa would be sufficient for most steps which are required to establish a business in Germany, including:

- The conclusion and notarization of the articles of association of a company
- Application for entry in the commercial register (through a German notary)
- Trade registration
- Other preparatory activities during the business establishment phase (such as opening a bank account or the conclusion of rental agreements)
- Negotiations and the conclusion of contracts with business partners

But, establishing a business in Germany with a Schengen visa or national visa is no guarantee for the subsequent grant of a residence permit. It will always be necessary – corresponding to the intended business activities in Germany – to apply for a residence permit for the purpose of self-employment or regular employee purposes in advance.

Business operators who are from non-EU countries and who manage their company on location in Germany as a self-employed person require a residence permit for the purpose of self-employment. This is generally issued if positive economic effects are to be expected from the investment project and the financing is secure. As a rule, these conditions are considered to be fulfilled if:

- at least €250,000 is invested, and
- at least five new jobs are created.

If this is not the case, a residence permit can be issued subsequently following an individual assessment of the investment project. A residence permit for the purpose of self-employment is limited to a maximum of three years. If the investment project is successful (and success and sustenance appear to be secure over the long term), after three years it is possible to issue a (permanent) settlement permit.

Hotel management - highly qualified employees

Foreigners considered as "highly qualified foreign employees" which can well be the case for the upper level of the hotel or hotel company management – depending on size – can be granted a settlement permit from the outset. Highly qualified persons are defined as including:

- ➢ scientists with special technical knowledge
- ➢ teaching or scientific personnel in prominent positions
- ➢ specialists and executive personnel with special professional experience and an annual salary of at least €66,000 (€55,800 in the federal states of the former East Germany)

V. Employment law and social security system

Germany has different models of employment, providing investors with flexible employment solutions – especially in the initial phase of the business. There may be fixed-term, temporary employment, "Mini" (also known as 400 euro jobs) and "Midi" jobs (also known as low salary jobs, a monthly salary of, on average, €400.01 to €800.00).

Basically, the level of the salary or wage in Germany can be negotiated freely between the employer and employee/employee representative body. There is no general or uniform minimum wage.

However, binding minimum wages have been specified for a few sectors only and in six federal states, collective bargaining agreements for the hotel sector have been declared generally binding. Furthermore, a minimum wage is in force for temporary agency work.

The following principal German employment laws are designed to ensure employee protection and co-determination of the work force in business matters:

- Dismissal Protection Act (*Kündigungsschutzgesetz*)
- General Equal Treatment Act (anti-discrimination provisions, AGG) as well as principle of equal treatment (*Gleichbehandlungsgrundsatz*)
- Social security provisions (namely unemployment, health, nursing care and pension insurance), and protection of disabled employees (*SGB I – X*)
- Pensions Improvement Act (*BetrAVG*)
- Working Time Act (*Arbeitszeitgesetz*)) and Holiday Act (*Bundesurlaubsgesetz*)
- Part-time and Time Limitation Act (*Teilzeit- und Befristungsgesetz*)
- Works Constitution Act (*Betriebsverfassungsgesetz*)
- Co-Determination Act (*Mitbestimmungsgesetz*)
- Collective Bargaining Act (*Tarifvertragsgesetz*)
- Data Protection Act (*Bundesdatenschutzgesetz*)

In contrast to some other industrialised countries, the core social security in Germany is collectively financed by means of a process of redistribution. The German social security insurance system consists of:

- Health insurance
- Pension insurance
- Unemployment insurance
- Nursing care insurance
- Accident insurance

Social security contributions are more or less shared equally by employer and employee. They correspond to approximately 21% of the employee's gross wage. Only the costs for accident insurance are exclusively borne by the employer.

VI. Foreign investment control in Germany

In general there are no restrictions as to investments into Germany and most of the other Western European countries.

There may be notification requirements for foreign investors and the possibility for the governmental authorities in case of assets/companies of major national importance to object to a sale to a non-European investor, e.g. in Germany:

- Foreign Exchange
  - ➢ If a foreign investor holds more than 50% (indirectly) and/or 10% (directly) of shares or voting rights in a German company with a balance sheet total of more than €3 million, key information of the company must be reported to the German Federal Bank (*Bundesbank*) for statistical purposes.
  - ➢ Subject to some exemptions, cross-border payments exceeding €12,500 have to be notified to the German Federal Bank.
- General Investment Approval
  - ➢ The Federal Ministry of Economics and Technology has the right to review and prohibit or restrict the direct and indirect acquisition of stakes exceeding 25% of the voting rights in a domestic German enterprise by Chinese investors. Investors have to notify such investment to the Ministry.
  - ➢ The approval requirement is not limited to any particular sector, but investments in public infrastructure (such as telecommunication and energy networks, facilities and operations, gas and water infrastructure, ports and airports, railway services as well as public services with

strategic importance, e.g. air traffic control) are most likely subject to review in the future.

- If no clearance certificate has been issued by the Ministry, and the Ministry has not issued an objection within 1 month upon notification, the clearance certificate is deemed to be granted.

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