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11 Reasons Why German and U.S. Investors Should Devote Their Energy to Turkish Renewable Energy in ‘11

Prominent German companies (such as EnBW, EWE and RWE) and U.S. companies (such as AES and GE) have already taken significant positions in the Turkish energy sector. The three governments also cooperate closely on both traditional and renewable energy matters. U.S. Exim Bank has identified Turkey as one of its priority countries in renewable energy, and Germany is one of the leading countries supporting the Nabucco natural gas pipeline project transiting through Turkey. Given Turkey’s emerging status in the renewable energy sector, as well as the leading roles played by Germany and the U.S., there is significant potential for further cross-border transactions in this area.

Earlier in 2011, Turkey enacted new feed-in tariffs and other incentives for renewable energy projects. Since Turkey has been heavily dependent on imported fossil fuels, this regulatory development was widely welcomed. Turkey has ample renewable energy resources – the largest geothermal energy potential in Europe, more solar energy potential than California, and compelling potential in wind and hydraulic energy.

The new incentive package will come into effect on December 1 this year. Here are 11 significant legal and financial benefits for German, U.S. and other foreign investors.

1. New feed-in tariffs are applicable for the first 10 years of an eligible plant’s operation. The rates are (in $/mWh): hydraulic (73); wind (73); geothermal (105); solar (133); biomass (133).

2. The new law introduces incremental price incentives (in addition to the feed-in tariffs) for generators that use certain domestically manufactured components in their projects. These incentives are available for 5 years after a project commences operations, and range from $4 to $35 per mWh according to the type of facility and the domestic component used.

3. There will be a convenient pooling mechanism for making payments to renewable generators. Utilities buying power from a generator that has opted for the incentive package must make their payments directly to a pool managed by the state-run Market Financial Settlement Center. Funds are then distributed from the pool to renewable generators according to the amount of electricity they have sold.

4. All renewable generators enjoy priority in grid connection by the state-owned and private electricity transmission companies.
5. Turkey is moving towards a well-organized market for the sale of electricity. As an alternative to bilateral contracts, there will be a “day-ahead” market – a market for the purchase and sale of power to be delivered the following day.

6. Renewable projects enjoy certain monetary incentives for using state-owned land. The permit costs, rent and costs of gaining rights of access and usage of state-owned land are subject to an 85% reduction where the property is used for a renewable energy project. If a forest region is so utilized, the sponsor is exempt from paying certain fees.

7. Renewable energy projects will be protected from urban development. State-owned land cannot be allocated for zoning or development plans that adversely affect renewable energy resources.

8. Renewable generators may benefit from expedited expropriation. Under extraordinary circumstances or upon a determination of the Council of Ministers, certain public authorities may carry out an expedited expropriation whereby a competent court determines the consideration within 7 days. The energy regulator is one of these public authorities, and it is permitted to expropriate privately-owned land upon request of a generation or distribution license holder.

9. Renewable generators continue to be exempt from 99% of the one-time licensing fee as well as from annual license fees for a certain period of time.

10. Turkey’s new Commercial Code will come into effect in July 2012. The new code completely overhauls and modernizes Turkey’s commercial legal landscape, and it is expected to be more investor-friendly and pragmatic in its operation.

11. Turkish policy makers have set aggressive goals for renewable energy over the next decade. These include realizing all of Turkey’s entire hydro potential, increasing total installed wind capacity to 20GW, bringing online 600MW of geothermal capacity, encouraging solar and other forms of renewable energy, and establishing a carbon trade exchange, all by 2023. More regulatory support for renewable energy is likely during the effort to reach these goals.

These are only some of the reasons why investors would be well served to focus their energy on Turkey.
Grid Expansion: An Opportunity to Invest in German Energy Infrastructure

The German government has recently decided to fundamentally change Germany’s electricity generation policy and set the goal to generate electricity almost exclusively from renewable energy sources by the year 2050. This means that the existing power grid will need to be expanded significantly to accommodate the distribution of renewable energy sources across Germany and the necessity to connect new offshore wind farms to the grid. Just to meet the energy objectives set for 2025 more than 2,200 miles (3,600 km) of high voltage power lines will need to be added. By 2020 the projected capital costs of this transmission infrastructure will add up to approximately 10 billion Euros; not including the costs associated with the development of essential energy storage technologies.

Although the next phase of grid expansion is already at hand, the most pressing tasks have neither been sufficiently planned nor funded. Adding even more pressure to the situation is Germany’s recent decision to phase out nuclear power. The resultant gap in energy supplies has to be filled by increasing the amount of electricity generated by using fossil fuels, such as coal and natural gas. These, however, are also scheduled to be phased out by 2050. Therefore, the developments in the German energy market promise a number of interesting investment opportunities whose outcome will largely be determined by the regulatory framework.

The Basics of Energy Regulation in Germany

The expansion and operation of power grids is heavily regulated and carried out under the supervision of the Federal Network Agency (Bundesnetzagentur) and the respective regulatory bodies of the individual federal states. The regulatory regime promotes high-capacity infrastructures and efficient infrastructure investments. The regulatory framework makes return on private investments in energy infrastructure more predictable; but only with the investor’s ability to navigate the complexities of that framework.

Since 2009 the operation of German power grids falls under a regime of incentive regulations set forth in the Energy Act (Energiewirtschaftsgesetz), the Ordinance on Incentive Regulation (Anreizregulierungsverordnung) and the Ordinance on Power Grid Usage Fees (Stromnetzentgeltverordnung). In addition grid operators are bound by individual revenue-caps (Erlösobergrenze). A grid operator able to reduce its cost of operation below the revenue-cap during a given regulation period, may keep the respective margin. Through this mechanism grid operators are incentivized to reduce their costs as much as possible, while guaranteeing them a fixed rate of grid usage fees. The aforementioned rules provide numerous instruments enabling the Federal Network Agency to increase investment incentives. In particular, the agency is empowered to
Grid Expansion: An Opportunity to Invest in German Energy Infrastructure

freely determine interest rates on equity capital for up to one regulatory period as well as to authorize investment budgets. In 2009 the agency raised interest rates on equity capital for new facilities from 7.91% to 9.21% before taxes. In 2010 the agency authorized investment budgets of 5.4 billion Euros for grid expansion projects. Beyond that, further legislative measures were enacted to increase the attractiveness of investments in the upcoming grid expansion. For instance, in the Federal Network Agency's process of determining investment budgets the inclusion of flat rate operating costs was optimized. Although these abstract numbers give grid operators a sound basis to calculate their rate of return, the lack of transparency of the proceedings before the agency's decision bodies, where the specific and definite grid fees are negotiated, is the subject of frequent criticism by grid operators. Only recently the German Federal Supreme Court ruled that the decision-making of the Federal Network Agency regarding certain price-determining details has been unlawful. The agency is anxious to identify and remedy existing weak points, which are negatively affecting the ability to analyze investments. Therefore, further modifications and amendments to the system of incentive regulation are expected in the near future which in all likelihood will make investments in power grids even more attractive.

Regulatory Conditions and the Way they Create Economic Value within M&A Transactions

Regulatory specifications and their application by authorities and courts affect a company’s ability to access the market, its market share, its total revenue and profit and therefore determine a company’s value. In this respect the above-mentioned changes to the regulatory framework also have an effect on M&A transactions. In particular, prior to any acquisition of an interest in a power grid operator a detailed public law-focused due diligence should be conducted in order to identify potential regulatory risks. Such risks should be anticipated and accounted for in the purchase agreement, for instance by implementing rescission rights, price adjustment mechanisms (e.g. staggered purchase price) or earn-out clauses. Legal conditions, which are important for the economic success of the target company (e.g. the lawfulness of fixed equity capital interest rates or the approvability of investment budgets), should be verified before the sale and purchase agreement is concluded.

The recently adopted legislative framework is breaking new legal ground. Despite the uncertainties, the German energy sector is facing exciting developments. Whether or not investors will be able to seize the opportunities such developments have to offer largely depends on a profound knowledge of the energy market paired with in-depth legal expertise in the areas of regulation and M&A. The energy sector has an ongoing need for investments. With that in mind, the upcoming power grid expansion in Germany provides very attractive opportunities for US investors.
Tax Opportunities from investing in Renewable Energy in the USA

A recent report by the World Watch Institute found that during 2010, renewable energy accounted for about half of the new electricity capacity added globally. The U.S. alone reported that about 10.9% of their domestic primary energy production was from renewable energy sources. To promote economic development and the creation of jobs, Federal, State and Local governments offer financial incentives to recruit or cultivate the production of renewable energy and the manufacturing and development of renewable energy systems and equipment. These incentives commonly take the form of tax credits, tax exemptions, rebates, low interest rate loans and grants.

They may apply to several industries including the renewable energy sector, however, a few states target specific technologies, such as wind or solar. These credits and incentives may be designed not only to promote the establishment or expansion of manufacturing operations, but also to support research, development and commercialization efforts. They are typically designed as a temporary measure to support industries that require a significant initial capital commitment with the hopes they become self-sufficient after the sunset period.

Until recently, the cost of installing energy-efficient and renewable energy systems and equipments was a major drawback for consumers looking to become environmentally friendly. For example, Federal programs can assist to defray up to 30% of the qualifying cost – including installation, for consumers who choose to install energy-efficient and renewable energy systems through the issuance of a cash grant or tax credits along with a reduction in the depreciable basis of the qualified property.

Add to these savings the various state tax credits and rebate programs, and the cost of installing new energy-efficient or renewable-energy systems could be significantly reduced. The state tax credit programs will vary from jurisdiction to jurisdiction but they offer personal and/or corporate investment tax credits to help offset the expense of purchasing and installing solar energy equipment. Tax credits range from 10% to 50% of project costs, with maximum credit limitation of $35,000 for residential systems and up to $60 million for commercial systems.

Currently around twenty states and the Commonwealth of Puerto Rico offer incentives targeting the recruitment and/or development of the renewable energy sector. State programs may offer as much as $25 million in tax credits and incentives to a company that builds a new manufacturing facility. Most grants and loans are on the order of $1 million or so, while tax credits range from 5% to 50% of construction or other eligible investment costs, others may be worth up to 100% of corporate taxes or new state tax revenues.
However, businesses looking to begin an operation in the United States should keep in mind that they are not limited by the credits and incentives, state and local jurisdictions may have other programs available to further sweeten the pot. But with any federal, state or local funding, provisions are incorporated by these agencies within the funding agreements or tax credits and incentives eligibility rules to encourage project success as well as to protect their investment. For example, programs may contain minimum thresholds for job creation, product output and investments made. In some cases, failure to meet these project goals and terms may result in repayment of the credits and incentives awarded.

The competition to entice businesses to locate their operations within the United States has intensified in the last couple of years as the economy forced many businesses to either shut down or leave. States are upping the ante with lucrative incentive packages expanding current programs to increase the benefits available. We have experienced many businesses requiring assistance with identifying tax credits and incentives opportunities available. To identify which opportunities a business may be eligible for requires an analysis of a business’ operational attributes, which include where it is or anticipates locating, whether it is hiring new employees and the types of capital investments it seeks to make.

It is imperative that a business performs this due diligence prior to executing any lease or purchase agreements as this may limit the credits and incentive available. Companies must keep in mind that to receive the maximum benefit, businesses must know how to properly position themselves and sell their projects to state officials.
Assessing Arbitration as a Tool of Dispute Resolution

It is well understood that conventional litigation in the United States is expensive and potentially time-consuming. Under the circumstances, alternative dispute resolution by mediation and arbitration offers itself as an attractive alternative.

Mediation by one or more mediators is non-binding. It is not without cost, however, and can entail extensive preparation and investment in time. When it succeeds, it is time and money well spent. Arbitration, too, on the surface, seems to be an enticing option. It promises a speedy, final and relatively inexpensive procedure for dispute resolution. In actual practice, its alluring promise is not always achieved and the parties may regret foregoing the normal litigation process.

Arbitration always takes place pursuant to a contract, either for a current disagreement or for future disputes. Compulsory arbitration of future disputes initially encountered strong opposition from some courts as illegal derogation of the judicial process. Today contracts for arbitration of future disputes receive strong support from the courts. However, a contract to arbitrate, just as any other contract, must meet the test of enforceability and may itself engender much litigation by proponents and opponents.

Assuming a valid contract to arbitrate, lay parties may be unhappily surprised at the formality of the procedures in some arbitration and the cost and the time expended. The frequently touted advantages of informality, speed and low cost are too often more articulated than realized. Nonetheless, one objective of arbitration, the non-appealability and finality of the decision, for better or worse, is one attribute of the process which is more frequently achieved. In many arbitrations, the arbitrator or arbitrators render written decisions in which they state the reason for the decision, either briefly or in detail. On the other hand, in many cases, prompted by the desire to discourage appeals, the award consists solely of the recital of parties, dates, place of the hearing and a one-sentence statement of the decision.

The Federal Arbitration Act, which governs issues of appealability, sets forth several specific grounds for appeal of arbitration awards: (1) an award “procured by corruption, fraud, or undue means”; (2) evidence of “partiality or corruption in the arbitrators”; (3) arbitrators engaged in misbehavior by refusing to consider material evidence, refusing without cause to postpone a hearing, or other acts that prejudiced one of the litigants; or (4) where the arbitrators “exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.” The courts enunciate that the right of appeal will be granted rarely and only for clear evidence of existence of one of the grounds. Nevertheless, reversals of awards can take place under the statute. For example, an award which finds a party in non-
Assessing Arbitration as a Tool of Dispute Resolution

compliance of a contractual term, but then imposes a duty not within the contract, will be vacated, as will the arbitrators’ failure to take evidence from a party or their failure.

Arbitration contracts frequently incorporate rules of organizations such as the American Arbitration Association but they may be tailored to contain specified limitations or particularized requirements such as, for example, requiring the arbitrator to state the reasons for the award.

Experience has shown that arbitration can be a useful tool. However, parties should be cautious in their reliance on simple arbitration provisions, such as “all disputes are subject to arbitration,” found in many contracts containing proposals or confirmation of orders, invoices or shipping documents.
Commercial Real Estate There is No Standard “Good Guy Guarantee”

If your entity has limited liability, such as a limited liability company or corporation, it is likely that, unless your entity is a national chain or a Fortune 500 Company, at the end of preliminary discussions regarding the terms and conditions of your entity’s commercial lease, your broker will tell you that the landlord requires the “standard good guy guarantee.”

The broker then typically explains that this simply means that since your entity has limited liability, the landlord requires an individual or business entity of substance to guarantee the obligations of the tenant under the lease, but only for as long as the tenant stays in possession of the leased premises, thereby making the tenant a “good guy”, i.e., one that can assure the landlord that the tenant will comply with all of its lease obligations during the period that the tenant actually occupies the leased premises.

As the tenant’s representative, you think that such an arrangement sounds fair and you agree to identify to the landlord an owner or other principal of the tenant or its corporate parent who will provide such guarantee. You believe that, after all, it’s only fair that the landlord receives the benefits to which the landlord is entitled, at least until the leased space is returned to the landlord.

Commercial tenants, and their brokers, should be aware that there is no such thing as a “standard good guy guarantee.” It is best that the scope of such guarantee be limited and agreed upon before the proposed lease and guaranty are drafted. The failure to do so, can lead to significant financial loss and risk, as well as lost opportunity time.

Though the typical commercial tenant believes that the good guy guaranty covers only the payment of monthly installments of base or fixed rent, and perhaps periodic recurring tenant contributions in the nature of real estate taxes or operating expenses, initial drafts of most proposed good guy guarantees that we have seen cover all of the obligations of the tenant under the lease. Such obligations include all rent and additional rent. Most leases define additional rent as all sums of money, other than base rent or fixed rent, which shall become due and payable from tenant to landlord. Included might be the obligation of the tenant to indemnify the landlord against losses and damages, including uninsured liabilities of the tenant to the landlord, and the cost of restoration of the leased premises to the condition they were in on the date of the lease.

Accordingly, it is important that at the outset of lease discussions, or at least no later than the first time the tenant learns that the landlord will require a good guy guarantee,
Commercial Real Estate There Is No Standard “Good Guy Guarantee”

A prospective tenant and its broker define and limit the scope of any good guy guaranty. Otherwise, your attempts to limit your personal liability by having formed an entity with limited liability and having the entity sign a lease, may fall short and the good guy guaranty will continue to expose the guarantor, in most cases a principal of the tenant, to significant obligations under the lease.

If you would like to learn more about this or other important U.S. employment topics please do not hesitate to contact us by email or telephone: ERNST & LINDER LLC, Marcus A. Ernst, 212-488-1668, ernst@el-law.com; Michael W. Melinger, 212-488-1773, melinger@el-law.com.
New York Property Can Trigger New York State Tax on Global Income

In the United States, taxation of income for individuals is not only a federal matter. The states are also entitled to impose taxes on income and the majority of states in the USA have made use of this power. In New York State, for example, residents are taxed on their global income while non-residents are “merely” taxed on their state source income.

Due to this fact, the classification as either a resident or a nonresident is crucial and can have a heavy impact on one’s tax burden. In this regard, two recent New York State tax court decisions have the potential to change the rules of the game how to classify taxpayers in residents respectively nonresidents (Matter of Barker, DTA No. 822324, N.Y.S. Tax App. Trib., Jan 13, 2011 and Matter of Gaied, DTA No. 821727, N.Y.S. Tax App. Trib., Jun 16, 2011).

Generally, taxpayers are considered to be New York State residents if they are domiciled in this state. Domicile is defined as the place you intend to have as your permanent home. It is the place you intend to return to after being away.

However, even if the individual is not domiciled in New York State, resident status can also accrue from both (a) maintaining a permanent place of abode and (b) spending all or part of more than 183 days in New York State. In general, a permanent place of abode is a residence (a building or structure where a person can live) permanently maintained, whether owned or not. New York State further modifies this statutory residence by stating that the permanent place of abode had to have existed for “substantially all of the tax year” which as a general rule is 11 months or more.

The question in the Matter of Barker was whether or not a permanent place of abode was maintained. The taxpayer, Mr. Barker, was clearly domiciled in Connecticut where he lived with his family and where his social life took place. He commuted to New York City every work day, where his Manhattan-based employer maintained an office, thus spending more than 183 days in New York. For recreational purposes, he also maintained a vacation home in the beautiful Hamptons in New York State where he spent three weeks during the respective tax year.

With respect to the vacation home, the New York tax authorities argued that Mr. Barker obtained a permanent place abode because the home could be used all year long. In agreement with this appreciation, the Tribunal held that “it is well settled that a dwelling is a permanent place of abode where, as here, the residence is objectively suitable for year round living and the taxpayer maintains dominion and control over the dwelling”. Surprised by the fact of maintaining a permanent place of abode and thus qualifying as New York State resident for income tax purposes, Mr. Barker faced an additional tax bill of $1.06 million because not only his income derived from
his Manhattan employer was subject to tax but also all of his other income such as interests and dividends.

In another case, the Matter of Gaied, the Tribunal takes this even further. In this case, a New Jersey domiciled taxpayer owned a house in New York nearby his New York-based work (so the 183 day test was met). Mr. Gaied’s parents resided in this house; however, he paid all of the repair and maintenance costs. Mr. Gaied kept no personal items in this house such as a bed and stayed there, contrary to Mr. Barker, only on occasion and on the couch.

The tax authorities claimed that even on these facts a permanent place of abode was maintained in New York. The court agreed with the authorities and held that “where a taxpayer has a property right to the subject premises, it is neither necessary nor appropriate to look beyond the physical aspects of the dwelling place to inquire into the taxpayer’s subjective use of the premises”. As a result, Mr. Gaied was deemed a New York State resident and therefore had to tax his global income in New York.

All in all, taxpayers with secondary residential units in New York State should be alerted and actively plan their property to avoid any unpleasant tax surprises.
IRC Section 954(c)(6): Same procedure as last year(s)? Same procedure as last year(s)!

From a distance IRS Section 954(c)(6) looks like another narrow technical and complex rule. If one looks closer at this provision it is by far more than that. IRS Section 954(c)(6) is one of the most important exceptions to the general subpart F regime that requires a U.S. shareholder of a Controlled Foreign Corporation (CFC) to immediately take into account passive income of the CFC (comparable to the German provisions in the so-called “Außensteuergesetz”). Originally introduced with limited effect for only three years in 2006 IRC Section 954(c)(6) seems to have become immortal.

The last time the provision was extended was in late December 2010 when it was extended retroactively to the beginning of 2010 and through 2011. With the looming of the next expiration date on the horizon a new discussion round has already started with the goal of a final extension or at least another year of extension of this provision (see H.R. 2735, introduced on August 8, 2011 by U.S. House Ways and Means Committee member Charles W. Boustany Jr.).

Under U.S. tax rules, a U.S corporation is subject to tax on its income and its shareholders are not subject to tax on the corporation’s earnings and profits until the corporation’s income is distributed to them or they sell their shares. In the case in which a U.S. shareholder invests in foreign assets via a corporation in a low-taxed country he would be able to enjoy the low tax in the foreign country without any U.S. taxation until the earnings and profits are brought back to the U.S. (so-called “deferred taxation”). In order to avoid such deferral in certain situations U.S. Congress put the subpart F rules in place.

The purpose of these rules is to prevent a deferral and to provide for immediate taxation in case of certain types of income in foreign “base” companies located in low tax jurisdictions. Income that is targeted by the provisions is mainly passive investment income (i.e. interest and royalties) and income derived from transactions between related parties (in general income that is highly moveable and which could easily be shifted from one country to another). IRC Section 954(c)(6) now provides for an exception from this general rule and restores the general deferral for U.S. tax purposes.

The provision (also called “look-through” rule) provides that dividends, interest, rents and royalties paid from a CFC which is a related person shall not be treated as falling under the subpart F rules to the extent it is attributable to income of the payor which is not subpart F income (and therefore active income). Briefly stated, if the underlying income which generates the payment of the dividend, interest, etc. is “active” income, then IRC Section 954(c)(6) kicks in and restores the general
deferral rule. In addition, if the underlying “active income” is effectively connected with the conduct of a trade or business within the U.S. then IRC Section 954(c)(6) is not applicable.

To illustrate how IRC Section 954(c)(6) works, imagine the following example: A U.S. corporation has two subsidiaries, one in Country A and one in Country B. The subsidiary in Country A is engaged in an active trade or business and subject to a tax rate of 30%. The subsidiary in Country B receives interest from its sister company in Country A and is subject to a nominal tax rate of 2%. While making the interest payments the subsidiary in Country A should get a deduction; the interest income in Country B should be subject to a low tax rate. From an overall perspective such a structure would lead to a reduction of the combined effective tax rate for the group.

Under the general subpart F rules the interest income of the subsidiary in Country B would be subject to tax in the U.S. irrespective of whether the earnings & profits are brought back to the U.S. via a dividend (no deferral) and lead to a 35% tax in the U.S. So under the general rules the structure would not be very tax efficient. Under IRC Section 954(c)(6) the taxation in the U.S. would now be deferred because the interest income results from the active trade or business income of the subsidiary in Country A.

The same result as in IRC Section 954(c)(6) is provided for by IRC Section 954(h) (so-called “active financing exception”) in the area of the active conduct of banking, finance or similar businesses.

Taxpayers should follow the discussion about the extension of IRC Section 954(c)(6) and IRC Section 954(h) closely and consider alternative strategies in order to avoid the application of the subpart F rules in these structures.
2010 Estate Tax Guidance Issued by IRS

In 2001, the Economic Growth and Tax Relief Act repealed the estate tax for individuals dying in 2010 as well as doing away with the step-up in basis rules, which were replaced with a modified carryover basis regime. There was much speculation in the intervening years regarding how the law might be revised and with passage of the Tax Relief Act of 2010, the estate tax was restored, with a $5 million per decedent exclusion and a maximum rate of 35%, as well as reinstating the step-up in basis rules. Adding to the confusion, the new Act allows an executor the choice of being subject to the estate tax or choosing to elect a zero estate tax and a modified carryover basis.

The Internal Revenue Service recently released long awaited guidance in Notice 2011-66. To elect out of the estate tax for 2010, the executor needs to file Form 8939 by November 15, 2011. The notice also discusses rules concerning the Generation Skipping Tax, which for 2010 has a tax rate of zero.

An original filing of Form 8939 can be amended or revoked, but it must be done by the due date above and is irrevocable. The executor not only elects out of the estate tax on Form 8939, but must report and value all property (except for cash and IRD items) and affirmatively select which assets get an allocation of carryover basis, up to $1.3 million (larger in some cases). Certain gifts made within three years of death are also included. Within 30 days of filing the above form, the executor needs to provide an information statement to each legatee, whether they get basis allocated or not.

One specific approach barred by the notice prevents an executor from filing an estate tax return (Form 706) along with a provisional Form 8939, the latter meant to take effect only if the estate tax exclusion amount of $5 million is exceeded. An example of this would be an estate where one of the assets held by the decedent at death was a closely-held business interest valued at $3 million that was later adjusted on audit to $7 million, thus pushing the estate into a taxable position. In other words, the executor can't backstop the estate tax return filing with an election out of the estate tax if an adverse situation presents itself.

Revenue Procedure 2011-41 discusses safe harbor basis rules for a decedent’s zero estate tax election in 2010. If the zero estate tax election is made, basis in property is determined only for property acquired from a decedent. Property must be owned by the decedent at death and must be acquired from the decedent. Even though property was owned by and acquired from a decedent, it still may not be eligible for the allocation of basis, e.g., property acquired by the decedent within 3 years of death via gift or inter-vivos transfer for less than full consideration and certain stock in US tax favored companies with international activities.

The amount of basis increase equals the aggregate basis increase amount of $1.3
2010 Estate Tax Guidance Issued by IRS

million plus certain loss carryovers and unrealized losses. These include capital losses, net operating losses and unrealized losses under IRC Sec. 165. In addition, spousal property up to $3 million can be allocated to property the surviving spouse acquires from the decedent, if the property is qualified spousal property (e.g., outright transfers or by QTIP, qualified terminal interest property, whether held in trust or not).

Basis can be allocated on an individual property basis up to the fair market value of the property at death. For example, basis can be allocated to one share of stock in a company or all the shares of stock in a company held by a decedent. The normal rules for determining fair market value apply, and appraisals are required. Special rules exist for community property.

In summary, if the executor harbors any doubts that the decedent’s estate holds an asset that is subject to a reevaluation on audit that would result in a higher appraised value and cause the estate to be placed in a taxable position that is in excess of the $5 million exclusion, then the likely best choice would be to elect the zero estate option even though it means giving up some basis increase along with a corresponding higher income tax liability in later years. The time value of money savings of avoiding a large estate tax payment today would likely outweigh the benefit of a reduced future income tax.
One concept of foreign withholding often overlooked at the partnership level can provide relief from cash flow restrictions if the foreign partner qualifies and takes action: The “Withholding Tax on Foreign Partners’ Share of Effectively Connected Income” rules under Section 1446 can trigger withholding on income at the highest marginal tax rate (35%) unless the ‘Good Driver Rule’ applies and withholding requirements can be eliminated or reduced.

**Background**

If a domestic or foreign partnership has effectively connected taxable income (ECTI) that is allocable to a foreign partner, then the partnership must withhold the proper amount of tax. A partnership (or the withholding agent) is responsible for the withholding and reporting requirements. A partnership must determine whether a partner is a foreign partner, and whether the partner is classified as a corporate or noncorporate partner. This is done by obtaining the appropriate withholding certificates from the partners (For example, a nonresident alien would submit Form W-8BEN).

When a partnership, domestic or foreign, has effectively connected taxable income for any tax year, and any of this income is allocable to a foreign partner, the partnership is required to withhold tax on that partner’s distributive share.¹ The amount of the withholding tax is the applicable percentage for the effectively connected taxable income of the partnership that is allocable to the foreign partner. The applicable percentage depends on the corporate or noncorporate status of the foreign partner.² The applicable percentage is the highest rate of U.S. tax to which each foreign partner is subject.³

The partnership is allowed to take into consideration the highest tax rate applicable to the effectively connected taxable income of a noncorporate partner.⁴ Thus, the applicable withholding rate on long-term capital gain allocable to a noncorporate partner would be 15%.⁵ However, if using the preferential rate depends upon the partner’s status as a corporate or non-corporate taxpayer and documentation is lacking to properly establish such status of a partner, then the partnership must compute and withhold tax under Code Sec. 1446 on the partner’s portion of the income or gain using the highest applicable tax rate (35%).⁶

**Reduced or Eliminate Withholding-The Good Driver**

Introduced by the Temporary Regulations as the “Good Driver Rule”, Form 8804-C can be used by a foreign partner who chooses to provide to a partnership a certification under Regulations section 1.1446-6 to reduce or eliminate the partnership’s withholding tax obligation under section 1446 (1446 tax) on the partner’s allocable share of effectively connected taxable income (ECTI) from the partnership.

The foreign partner uses Form 8804-C to certify to the partnership that it has certain partner-level deductions and losses that can reduce or eliminate the 1446...
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A partnership that receives a Form 8804-C from a foreign partner may consider the form in calculating, paying, and reporting the 1446 tax due with respect to the ECTI allocable to the foreign partner. A partnership may consider, in whole or in part, a Form 8804-C received from a foreign partner to reduce or eliminate the 1446 tax withheld and paid with respect to that partner based on the deductions and losses certified by the foreign partner on the Form 8804-C.

The certificate is valid only for the partnership tax year for which it is submitted, although it can be submitted at any time during the partnership year. The certificate applies to the partnership’s next installment payment period after Form 8804-C is received by the partnership. The certificate is required only for the first installment period for which it is considered by the partnership unless an updated Form 8804-C is required because information needs to be corrected.

1 Code Sec. 1446
2 Code Sec. 1446(b)(1)
3 Code Sec. 1446(b)(2)
4 Reg. §1.1446-3(a)(2)(ii)
5 Reg. §1.1446-3(a)(2)(ii)
6 Reg. §1.1446-3(a)(2)(ii)
IRS Tier I Issue – US Withholding Tax on Payments to Non-Residents

The Internal Revenue Service (“IRS”) classifies withholding of US tax on certain income paid to foreign recipients and the accompanying reporting obligations as a Tier I issue. Tier I issues are issues that pose the highest compliance risk across industries and accordingly, the IRS focuses its examination resources on such issues. A recently published Internal Revenue Manual provides revenue agents with procedures to follow when auditing companies on their withholding and related reporting obligations.

All US entities making payments to foreign persons have reasons to be concerned about the increased IRS focus, and many multinational companies may historically not have had a full appreciation of their US withholding and reporting responsibilities.

In general, US withholding agents must report US sourced payments to non-US payees that are fixed or determinable, annual or periodic on Form 1042-S and the taxes withheld from such payments on Form 1042. Typical payments that fall within the withholding tax obligation category are licensing fees, rents and royalties, pension, interest and dividend payments, director’s fees and certain payments for services.

The US withholding tax rate is 30%, but is often reduced under income tax treaties between the US and the jurisdiction of residence of the non-US payee. If a non-US payee wants a US withholding tax agent to withhold US tax at the reduced treaty rate or not withhold tax as the withholding tax rate under the applicable income tax treaty is reduced to zero, the US withholding tax agent will typically require a Form W-8 from the foreign payee. With this form, the foreign payee basically certifies non-US taxpayer status and treaty eligibility.

The top 10 items US companies that make payments to foreign related and unrelated parties need to know about are:

1. The IRS has made withholding and reporting a Tier I issue.
2. US companies making payments to non-US members of the group are withholding agents.
3. A withholding agent is liable for any tax that it should have withheld but did not withhold.
4. The withholding and reporting process is a multiple-step process during which withholding agents need to (i) identify their foreign payees; (ii) identify the payments made to foreign payees that may be subject to US withholding tax.

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1 IRM 4.10.21 (“US Withholding Agent Examinations – Form 1042”).
2 Note that in addition a US Taxpayer Identification Number is generally required to avoid withholding.
withholding tax; (iii) identify whether such payments are from US sourced income; and (iv) either withhold taxes at a rate of 30% or obtain appropriate documentation to reduce or avoid withholding (e.g., because of a reduced withholding tax rate under an income tax treaty and the eligibility of the payee for the reduced withholding tax rate).

5. All payments to non-US residents are subject to these rules.

6. Payments to non-US residents are presumed to be from US-sourced income absent sufficient documentation providing otherwise (i.e., the US payor must withhold the 30% tax unless paperwork is in hand to reduce or eliminate the obligation).

7. To obtain a Form W-8 from every foreign payee may not be the best solution, because a US Taxpayer Identification Number is required to avoid withholding. Many non-US residents may not have applied for a US Taxpayer Identification Number.

8. The implementation of appropriate procedures in the past may not mean that a withholding agent is currently in compliance. Every US business should have procedures in place to ensure current compliance with its withholding tax, reporting, and documentation obligations.

9. Tax attributes, such as net operating losses of the withholding agent, cannot be used to offset withholding tax liabilities.

10. US withholding agents can cure their potential withholding tax liabilities if they identify their issues and correct them before an IRS examination begins.

Many companies are currently in the process of reviewing their procedures for withholding and reporting; and, designing future procedures to ensure compliance with their withholding and reporting obligations. In addition, companies are reviewing payments to foreign payees that were made in the past to ensure that they complied with their withholding and reporting obligations.

Identifying and addressing any exposure areas should be a top priority for any US business that makes payments to foreign related or unrelated parties as such payments could be subject to withholding and reporting obligations.
Relief from withholding tax on dividends and certain forms of investment income – A view on the German and the U.S. rules

Germany:
Pursuant to Section 50 d, para. 1 of the German Income Tax Act in conjunction with the double taxation treaty Germany / US (DTT), the Federal Central Tax Office (Bundeszentralamt für Steuern) is responsible for granting relief from German withholding tax on dividends. In Germany, withholding tax of 25% respectively is collected on dividends. Foreign recipients (creditors) of this type of capital income are to be granted total or partial relief from withholding tax pursuant to the DTT. This usually takes place by way of a reimbursement procedure. The full amount of withholding tax is initially retained by the domestic obligor and paid to the relevant tax office. At the request of the foreign creditor, the Federal Central Tax Office then refunds the excess tax paid. An exemption procedure whereby the debtor can omit a tax deduction from the outset may also be possible under certain circumstances in cases of major shareholdings. This only applies if the creditor of the income is a legal person. A foreign corporation can receive a reimbursement so the withholding tax will finally be reduced to 15% plus Solidarity Surcharge.

Who is entitled to apply for a refund under Section 50 d, para. 1 of German Income Tax Act? Natural and legal persons who are not resident in Germany but resident in the US are entitled to apply. US applicants need a certificate of residency (Form 6166). This form can be obtained from the IRS.

The DTT reduces the withholding tax rate to 5% if the creditor is a corporation that holds at least 10% in a German corporation. If the shareholding is lower than 10% or the shares are held by a non-corporate person the withholding tax on dividends is limited to 15%.

S-Corporations (IRC Sec. 1361) or LLCs that have tax transparent status as shareholders in German corporations are not entitled to the reduced rate of 5%. The applicable rate will be 15% as long as the shareholders of this S-Corporation / LLC are residents according to the DTT. This status should be checked in the process of planning a pay out of dividends.

United States:
The IRS Statistics of Income Division notes that in 2008 the U.S. reported paying $68.8 billion in dividends and certain forms of investment income to German residents. This represents more than 10% of the total income paid to all countries that year.
Due to statutory exemptions and the DTT, most investment income paid to German residents is exempt from (or subject to a reduced rate of) U.S. withholding tax.

In general, dividends and certain forms of investment income received by foreign persons from U.S. sources are subject to tax at a rate of 30 percent. This tax is collected by withholding at the source of the payment.

Withholding is required unless the withholding agent (i.e., the person making the payment) can establish that the beneficial owner of the amount is eligible for an exemption from withholding or a reduced rate of withholding under a DTT.

It should be noted that the United States imposes tax on the beneficial owner of income, not its formal recipient. Therefore, under the general rules, a German KG that is tax transparent for German purposes will be viewed as an intermediary and each KG partner is treated as the beneficial owner of the KG’s income.

A German resident seeking to obtain withholding tax relief must certify to the withholding agent, under penalty of perjury, his German residence and eligibility for an exemption or reduced rate. This self-certification is made on the relevant IRS form (Form W-8BEN).

To the extent that the withholding agent deducts and withholds an amount, the withheld tax is credited to the German beneficial owner. If the agent withholds more than is required, the excess may be refunded if the German resident files a timely claim for refund.

In contrast to the withholding tax rules described above which focus on tax compliance of foreign persons, the Foreign Account Tax Compliance Act (FATCA) provides a new reporting and withholding regime aimed at U.S. persons with offshore accounts. Under FATCA, payments to Foreign Financial Institutions (FFIs) will be subject to a new withholding tax of 30 percent unless the FFI enters into and complies with an information reporting agreement with the IRS. This new law takes effect in 2013.

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Reducing Operational Risk in Customs and International Trade Transactions.

The most common mistake made by companies involved in international trade is to reduce or postpone legal costs until confronted with an audit or investigation by U.S. Customs or another federal agency. This course of conduct is almost always shortsighted, and results in increased operational costs to the company. As a result, in recent years compliance programs for customs and international trade matters have become mandatory for all companies involved in international trade.

U.S. Customs requires that all companies involved in international trade be in “informed compliance” with U.S. Customs and international trade laws. If a company violates those laws it is subject to extreme penalties, always exceeding the revenue loss to the government. Frequently, those penalties are in excess of the value of the merchandise itself; repeated violations can bankrupt even large companies, and are devastating to mid-size and smaller companies.

But if a company is in “informed compliance” with those laws, it is usually immune from penalties, and must pay only any revenue and interest it was obligated to pay under the law. A company is in “informed compliance” with the laws if it institutes and complies with a regulatory-compliance program. This means that a customs and international trade professional should implement a program which ensures the company’s compliance at every step of the import and export process. Most importantly, the company should classify its products properly, correctly declare the value to Customs (including all assists provide by the importer to the manufacturer, royalty payments, and buying commissions paid by the importer), and properly determine and declare the country of origin.

In the case of merchandise transferred between related companies, the importer has the obligation of documenting for its records that the price declared to Customs is not affected by the relationship of the parties, and/or is equal or similar to the price between unrelated parties for the same merchandise exported from the same country to the U.S.

A good regulatory compliance program begins with a professional’s review of the company’s import and export operations to understand how the business works. Second, together with management, the professional creates an import compliance handbook, clearly setting out the obligations of each member of the company’s import and export team to ensure that each item imported or exported is properly declared to Customs, and that all requirements are met. Third, both management and those involved in import and export, should regularly be trained in the import and export requirements, and in the procedures in the compliance handbook. Fourth, the company should conduct periodic internal audits to ensure that their products are classified,
Reducing Operational Risk in Customs and International Trade Transactions.

valued, and declared correctly, and that the procedures outlined in the compliance handbook are being followed. Fifth, and importantly, in areas of doubt, the company should either obtain a Customs ruling or an opinion of counsel as to how to proceed. In either case, if the company follows the Customs ruling or opinion of counsel, it is usually immunized from penalties. The difference in the two procedures is that a Customs ruling also prevents Customs from seeking unpaid duties and interest; an opinion of counsel only immunizes the company from penalties, but not duties or fees which should have otherwise been paid.

A customs and international trade compliance program is not limited to customs issues, but should apply to other agencies as well. This includes proper procedures to be followed in the importation and exportation of regulated products such as food and drugs (FDA), consumer product safety (Consumer Product Safety Commission), restricted animals, antiquities, works of art, etc. On the export side, the compliance program should cover export licenses, dual-use products, payments abroad, and foreign corrupt practices. U.S. companies do not regularly think of these areas, yet the federal government is very active in compliance-enforcement in them, and severely penalizes violations, even to the extent of criminal prosecution and imprisonment. A regulatory program instills consciousness of the existence of these laws at every level of the company and promotes compliance and good practices.

The main benefit of these compliance programs is the avoidance of penalties, but almost always, the inevitable by-product is greatly reduced operational costs in the form of reduced duties. Following these procedures ensures that the company will find the correct and lowest rate of duty, the lowest legal declared value, the least expensive way to assemble an article from the customs point of view, etc. Without a regulatory program, such cost-saving measures would rarely be investigated, much less implemented.

A regulatory compliance and internal-audit program is not expensive and can easily be added to already existing regulatory programs in the financial and human resources areas. All companies, even the smallest, have such programs, and adding customs and international trade to these programs is a marginal cost, while the actual monetary returns almost always greatly exceed those costs.

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Recent Decisions Limit Claims Against Foreign Corporations, But Not U.S. Discovery Rules

Ever since Aerospatiale, litigants have used U.S. federal discovery rules against a foreign corporations. Societe Nationale Industrielle Aerospatiale v. United States District Court, 482 U.S. 522, 544 (1987). In Accessdata Corp. v. ALSTE Techs. GmbH, 2010 WL 318477 (D. Utah Jan. 21, 2010), for example, defendants objected to disclosing e-mails based on the German Data Protection Law. Id. at *1. The court cited Aerospatiale, holding that “it is well settled that [blocking] statutes do not deprive an American court of the power to order a party subject to its jurisdiction to produce evidence even though the act of production may violate that statute.” Id. at *2.

Recent developments outside the discovery context, however, have made foreign corporations hopeful that U.S. discovery may be curtailed. The imposition of more robust pleading requirements have allowed for dismissal of implausible complaints. See Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570 (2007). Courts have also cut back on federal causes of action. Koibel v. Royal Dutch Petroleum Corp., 621 F.3d 111, 145 (2d Cir. 2010) (restricting corporate liability for alleged international law violations under the Alien Tort Statute); Morrison v. Nat'l Australian Bank Ltd., 130 S. Ct. 2869 (2010) (disallowing Rule 10b-5 federal securities fraud claims against foreign corporate defendants where the security was purchased on a foreign exchange); Cedeño v. Intech Group, Inc., 733 F. Supp. 2d 471 (S.D.N.Y. 2010) (applying Morrison to limit reach of RICO).

It would be wrong, however, to conclude that these substantive decisions will lead U.S. plaintiffs to abandon efforts to seek U.S.-style discovery against foreign corporations. Indeed, such discovery appears to be on the rise. There are at least two reasons why this might be the case.

First, in the wake of Morrison, plaintiffs have increasingly turned to U.S. federal courts to assert foreign law claims. In one notable example, lead plaintiffs’ in securities litigation against Toyota recently amended their complaint to add claims under Japanese securities laws to represent a sub class of investors who purchased Toyota stock overseas. See In re Toyota Motor Corp. Sec. Litig., Consolidated Complaint, 2010 WL 3940921 (C.D. Cal. Oct. 4, 2010) at Count III (alleging violations of Article 212 of Japan’s Financial Instruments and Exchange Act). As courts restrict the use of certain U.S. laws against foreign corporations, one can expect an increase in foreign law claims in U.S. courts, and thus more U.S.-style discovery against foreign corporations.

Second, even if Morrison results in more claims against foreign corporations into foreign tribunals, there will be an increased drive to obtain discovery through U.S. courts for use in those proceedings. This can be done using 28 U.S.C. § 1782, which
allows a federal district court to order discovery in aid of a foreign proceeding. See Hereaeus Kulzer GmbH vs. Biomet, Inc., 633 F.3d. 591 (7th Cir. 2011). Indeed, anecdotal evidence suggests such discovery will not cease. At a May 2011 gathering in Frankfurt, Germany attended by practicing lawyers and judges (which the author attended), one judge was asked if he would permit evidence gathered in the U.S. to be used even if it could not have been gathered in Germany. “That may be true,” the judge responded, “yet here it is in front of me, why should I ignore it?” Lawyers everywhere should take note.

Recent Decisions Limit Claims Against Foreign Corporations, But Not U.S. Discovery Rules
Buying a Business? Don’t Get Bitten by the Hidden Risk of Successor Liability

Thinking of buying a company or all the assets of a business? Done your due diligence? Convinced that the company or the assets are free of liabilities, liens and claims? Think that, because you are buying assets and not the shares of the company, you are not responsible for injuries and damage from business conducted by the seller prior the sale? Well, think again.

Successor Liability

In an effort to prevent reasonable claims from going uncompensated, courts have developed a number of theories under which “successor liability” will be imposed on the purchaser of a company or its assets. These theories result in liability for damages from events that occurred before the acquisition and that the purchaser had nothing to do with, even if the purchaser acquires only assets.

When the sale of a business formed as an entity (a corporation, for example) simply continues its business, as is the case in a merger of two entities, or the sale of all shares or a controlling interest in the purchased entity, the sale is effectively invisible to third parties. In that case, courts generally hold that the post-acquisition business is the same as the pre-sale business; therefore, the new owners of the post-acquisition business are liable for injuries sustained and damage done prior to the sale even if the claim is made after the sale.

Courts generally reach the same conclusion where the business, even if not formed as a corporate or similar entity, is exactly the same before and after the sale, though under new ownership. Additionally, a minority of states recognize a “product-line exception” to the old rule that where a purchaser buys only assets, the purchaser is not liable for injuries and damage from business conducted pre-sale. This exception imposes strict product liability on the buyer when the seller manufactured products sold to the public and the buyer continues manufacturing those products.

Insurance Policies

If, after digesting the successor liability problem, you sit back content in the thought that the insurance policies covering the pre-sale business will cover events occurring before and after the acquisition, think again.

Under current law, in the case of sales of shares and any type of merger, the seller’s insurance policies are generally deemed transferred to the new owner. However, in the case of sales of assets, there is a split of authority in the courts. In the majority of states, the courts have held that where the purchaser has successor
Buying a Business? Don’t Get Bitten by the Hidden Risk of Successor Liability

liability for claims from the seller’s business, the purchaser is entitled to use the seller’s liability insurance coverage under “occurrence” policies for pre-acquisition claims even if there are anti-assignment provisions in the seller’s insurance policies. California is representative of a minority of jurisdictions holding that when a purchaser of assets has voluntarily assumed the seller’s liabilities under a written contract an anti-assignment provision contained in the seller’s liability insurance policy will be enforced. Under this holding, the purchaser of the seller’s assets will not be able to access the seller’s liability insurance for protection against the burden of successor liability without the insurer’s express consent.

Quick Tips

• Investigate what liabilities might come with the company or assets you are purchasing, and address those actual and potential liabilities head on.

• Negotiate a risk allocation between seller and buyer for post-acquisition claims relating to business conducted by the seller prior to the sale.

• Check the insurance policies, if any, that cover the seller’s business conducted prior to the sale.

• Discuss continuing coverage with the seller’s insurance carriers to determine whether or not they will provide coverage for post-acquisition claims from the pre-sale business.

Although none of this can guarantee a risk-free acquisition on the question of successor liability, it can go a long way toward reducing surprise and disappointment once the deal is closed.

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Class Actions – Umstrittener Nutzen von Sammelklagen in den USA

Class Actions sind in den USA seit Ihrer Einführung in die Prozessordnung im Jahr 1966 ein beliebtes Rechtsinstrument in großen Verbraucher-, Kapitalanlage-, Umweltschutz- und Produkthaftungsfällen, das in Deutschland bislang keine Entsprechung kennt.


Üblicherweise werden Class Actions in den USA von einem oder mehreren Klägern erhoben, die für sich selbst und im Namen aller weiteren Geschädigten einer Klasse als sog. „Lead Plaintiffs“, bzw. „Class Representatives“ auftreten. In vielen Fällen sind Anzahl und Identität der vermeintlichen weiteren Geschädigten gar nicht bekannt.


1. **Numerosity:** Die Klasse der Kläger muss so groß sein, dass Einzelklagen nicht praktikabel wären. Hierbei ist nicht nur die absolute Zahl der möglichen Einzelklagen von Bedeutung, sondern auch die Schwierigkeiten, die eine konkrete Zusammenstellung der einzelnen Kläger zu einer „Streitgenossenschaft“ logistisch und operativ mit sich bringen würde.

2. **Commonality:** Es müssen in rechtlicher oder tatsächlicher Hinsicht „gemeinsame“ Streitpunkte vorliegen.

3. **Typicality:** Die Klage der Class Representatives muss typisch für die gemeinsame Problemstellung sein. Dieses Kriterium ist regelmäßig dann erfüllt, wenn den Ansprüchen der Klasse z.B. die gleiche Anspruchsgrundlage zugrunde liegt.

4. **Adequacy:** Die Repräsentanten der Sammelklage müssen in der Lage sein, die Interessen der gesamten Klasse angemessen schützen zu können.

Liegen diese Voraussetzungen vor, muss vom Gericht in einem zweiten Schritt geprüft werden, in welche der drei Untergruppen der Rule 23 (a) die entsprechende Klasse der Kläger fällt. Bei auf Schadensersatz gerichteten Sammelklagen unter Beteiligung

Lässt das angerufene Gericht die betreffende Sammelklage zu, müssen die übrigen Geschädigten darüber informiert werden, etwa per Aufruf in Zeitungen oder anderen Medien.


Hat die Sammelklage Erfolg, wird die erstrittene Geldsumme nach Abzug der Anwaltskosten an die einzelnen Class Members verteilt. Im Ergebnis kosten Sammelklagen so die amerikanische Volkswirtschaft jährlich ca. 250 Mrd. USD, das entspricht etwa zwei Prozent des BIP der USA. Die Auswertung einschlägiger Statistiken der letzten Jahre hat zudem ergeben, dass etwa ein Drittel der von Sammelklagen betroffenen Unternehmen Insolvenz anmelden musste.

A prohibition against infringement, issued by a national court sitting as a Community trade mark court, extends, as a rule, to the entire area of the European Union

The European Community Trade Mark Regulation creates Community arrangements for trademarks whereby undertakings may obtain Community trademarks to which uniform protection is given and which produce their effects throughout the entire area of the European Union.

In order to ensure that protection, the regulation provides that Member States are to designate in their territories ‘Community trademark courts’ having jurisdiction for infringement actions relating to Community trademarks. Where a Community trademark court finds that a defendant has infringed or threatened to infringe a Community trademark, it is to issue an order prohibiting the defendant from proceeding with the acts which infringed the Community trademark. It is also to take such measures in accordance with its national law as are aimed at ensuring that this prohibition is complied with.

Chronopost SA is the owner of the French and Community trademarks ‘WEBSHIPPING’, applied for in 2000 and registered in respect of services relating to logistics and data transmission, collecting and distributing mail, and express mail management. In spite of that registration, DHL Express France SAS used the same word in order to designate an express mail management service accessible principally via the Internet.

The Tribunal de grande instance de Paris found that DHL Express France had infringed the French trade mark WEBSHIPPING. The Cour d'appel de Paris, on an appeal by Chronopost, upheld that decision on 9 November 2007, and prohibited DHL, subject to a periodic penalty payment in the event of infringement of the prohibition, from continuing to use the signs ‘WEBSHIPPING’ and ‘WEB SHIPPING’. However, it did not allow Chronopost’s claim to extend the effects of the prohibition to the entire area of the European Union. DHL brought an appeal in cassation. That appeal was dismissed, but since Chronopost had brought a cross-appeal against restricting the prohibition and the periodic penalty payment territorially, the Cour de cassation held that it was necessary to refer the matter to the Court of Justice.

The Court rules, firstly, that the regulation must be interpreted as meaning that a prohibition issued by a national court, hearing a case as a Community trademark court, extends, as a rule, to the entire area of the European Union.

The Court finds that the territorial scope of a prohibition issued by a Community trademark court is determined by two factors, one concerning the territorial jurisdiction of that court and the other the exclusive right of a Community trade mark proprietor.
A prohibition against infringement, issued by a national court sitting as a Community trademark court, extends, as a rule, to the entire area of the European Union

First, the territorial jurisdiction of the trademark court is an exclusive one to adjudicate upon all infringement actions relating to Community trademarks. Thus, that court has jurisdiction, in particular, in respect of acts of infringement within the territory of any of the Member States. Therefore, its jurisdiction extends, as a rule, to the entire area of the European Union.

Second, the exclusive right of a Community trademark proprietor extends, as a rule, to the entire area of the European Union, throughout which Community trademarks enjoy uniform protection and have effect.

A Community trademark has a unitary character whose objective is the uniform protection, throughout the entire area of the European Union, of the right conferred by the Community trademark against the risk of infringement. In order to ensure that uniform protection, a prohibition against further infringement or threatened infringement issued by a Community trademark court must therefore, as a rule, extend to the entire area of the European Union.

Secondly, the Court rules that a coercive measure ordered by a Community trademark court by application of its national law also has effect in Member States other than the Member State of that court.

Thus, in order to ensure that the prohibition is complied with, when a court of a Member State where the prohibition was infringed is seized, it must recognize and enforce the decision coupled with coercive measures, in accordance with the rules and procedures laid down by its national law. Under the principle of sincere cooperation, the Member States and their courts are required to ensure the judicial protection of an individual’s rights under European Union law.

(Court of Justice of the European Union, Press Release No 35/11, 12 April 2011)
Impact of Volcker Rule on Hedge Fund and Private Equity Activities of German Banks

The Volcker Rule, which is part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) signed into law by President Obama on July 21, 2010, will most certainly have a significant impact on the manner in which German banks invest in and sponsor hedge funds and private equity funds.

The Dodd-Frank Act established the Financial Stability Oversight Council (the “Council”) which studied the Volcker Rule and made recommendations concerning its implementation on January 18, 2011. The U.S. federal regulators have until October 18, 2011 to issue final regulations implementing the provisions of the Volcker Rule (the “Implementing Regulations”) with the rule becoming effective on July 21, 2012.

The Volcker Rule prevents any “banking entity” from sponsoring, or acquiring or retaining an interest in, a private equity or hedge fund, with certain exceptions. A “banking entity” includes any insured depository institution, any company that controls an insured depository institution, any company that is treated as a bank holding company for purposes of Section 8 of the International Banking Act of 1978, and any “affiliate” or subsidiary of any such entity. A banking entity would be sponsoring a private equity or hedge fund if it serves as a general partner, managing member, or trustee of the fund, in any manner elects or controls a majority of the directors, trustees or management or shares with the fund, for corporate, marketing, promotional or other purposes, the same name or a variation of the same name.

“Affiliates” of banking entities are considered a banking entity and therefore subject to the Volcker Rule. An “affiliate” of a U.S. banking entity is not defined in the Dodd-Frank Act and the Council’s recommendations provide no guidance as to when an entity would be considered an “affiliate” of a U.S. banking entity. As a result, it is difficult to determine which German bank affiliates will be subject to the Volcker Rule’s restrictions until the Implementing Regulations are published.

If a German fund sponsor or investor is considered an “affiliate” of a U.S. banking entity, this does not necessarily mean that this company will not be able to invest in or sponsor funds under the new law. These entities may avail themselves of several exceptions to the Volcker Rule, including the “Foreign Bank Exception.” This exception allows non-U.S. banking entities to invest in or sponsor a hedge fund or private equity fund pursuant to Bank Holding Company Act Sections 4(c)(9) or 4(c)(13) “solely outside of the United States” if interests in the fund are not offered or sold to U.S. residents and the banking entity is not directly or indirectly controlled by a banking entity organized in the U.S.

Unfortunately, ambiguity exists in the wording of the Foreign Bank Exception because “solely outside of the United States” is not defined. With no guidance on this
Impact of Volcker Rule on Hedge Fund and Private Equity Activities of German Banks

subject in the Council’s recommendations, it remains unclear which types of U.S. activities would cause a fund offering to be partially inside the United States.

The Council’s recommendations have also not provided any clarity whether a resale of a fund interest by a non-U.S resident to a U.S. resident would violate the requirement that fund interests not be offered or sold to U.S. residents, in particular if such interests are sold shortly after the initial offering. No doubt the final interpretation of this condition will be of great interest to German fund investors and sponsors.

German banking entities should review the Implementing Regulations to understand the restrictions they may impose with respect to their U.S. and overseas fund activities.
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