

The "US Flip"

What is a (US) flip?

A (US) flip is the interposition of a US holding company (usually a Delaware corporation) (the "**HoldCo**") between a German company (usually a GmbH) (the "**OpCo**") and its shareholders by means of a share swap.

In this case, the shareholders "swap" their shares in the German company for shares in the HoldCo (share-for-share transaction).

Background

A German company may decide to establish a new US holding company for various reasons:

- **Access to investors:**

The United States is one of the most important sources of venture capital and other private financing, so standards for these areas have developed over the years. Private Equity and VCs are generally most comfortable with the corporate mechanisms available in a US company.

- **Financing and liquidity:**

Some of the world's leading stock markets are in the United States, and an initial public offering (IPO) and listing on the NYSE or NASDAQ can lead to better access to capital and provide a potential route to liquidity.

- **Better exit options:**

A sale to an US acquirer is often seen as ideal potential exit, a sale of shares in a US holding company can facilitate such exit scenario.

Why Delaware:

Delaware is the preferred jurisdiction for investors seeking predictability and certainty in a transaction and offers the following **advantages**:

- Quick and easy foundation;
- Specialised and highly experienced courts;
- Most legal advisors in the USA are very familiar with Delaware's corporate law;
- Better limitation of liability; and
- Better regulation than in other federal states (which ensures a high degree of legal certainty).

Possible company forms:

- C-Corporations: Most VC-financed start-ups are C-Corporations.
- S-Corporations: Personally organised company (<100 shareholders) being transparent for tax purposes.
- LLCs: Can be treated as either a partnership or a corporation. If VC investors are to be brought on board, the company should not be founded as an LLC, as VC investors often do not want to/are unable to invest in such company forms.

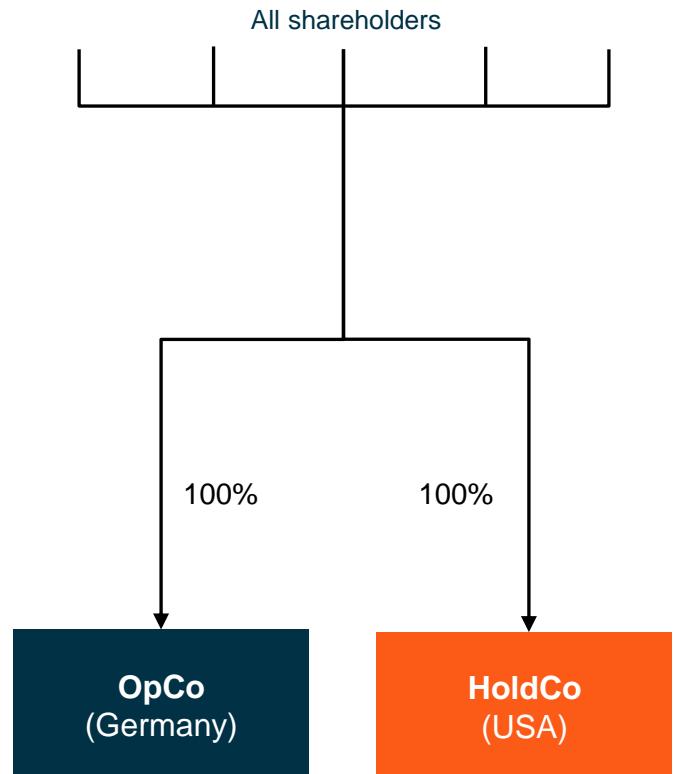


Necessary steps and implementation

Step 1

Founding of a US holding company

- The shareholders of OpCo will set-up a corporation in the US that serves as holding company.
- Constitutional documents:
 - Certificate of Incorporation
 - Bylaws
- The entire share capital of HoldCo is held by the shareholders of OpCo in accordance with their respective shareholding in OpCo.
- Whether and to what extent existing preferential rights in the German GmbH can be „transferred“ to the US HoldCo will have to be examined further with a US legal advisor.

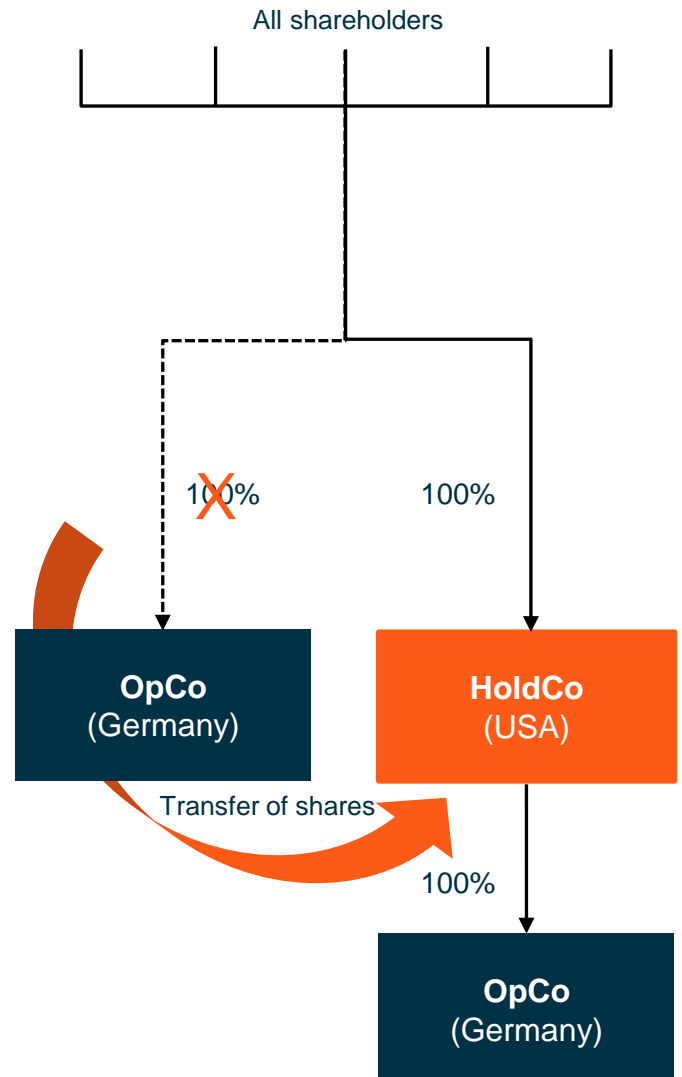


Necessary steps and implementation

Step 2

1st Option: Share exchange

- The shareholders of OpCo decide to contribute their shares in OpCo to HoldCo and enter into a corresponding contribution agreement with HoldCo.
- If the flip takes place as part of a financing round, the new investors enter into typical agreements governing their rights and obligations as future shareholders of HoldCo.
- The shareholders of OpCo transfer all shares in OpCo to HoldCo. In return, they receive shares in HoldCo (**the flip**). This share transfer is subject to German law.
 - Transfer agreement to be notarised by a German notary
- HoldCo becomes the Group's new US holding company.

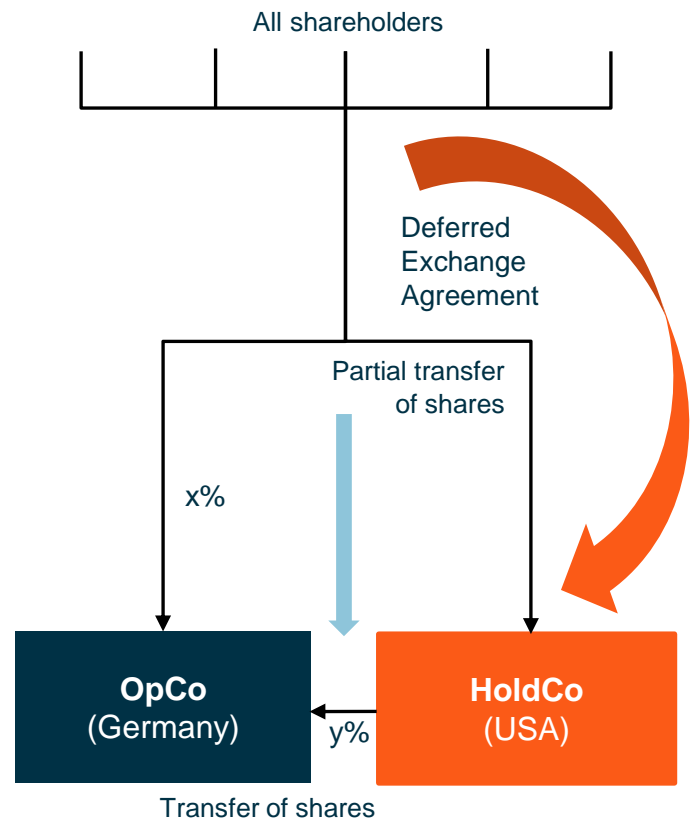


Necessary steps and implementation

Step 3

2nd Option: So-called synthetic flip

- The shareholders of OpCo initially contribute only a minority part of their OpCo shareholding to HoldCo. Otherwise, they remain shareholders of OpCo.
- Implementation by means of a Deferred Exchange Agreement, under which the parties undertake to exchange the remaining shares in OpCo for HoldCo shares. The exchange is only to be requested prior to a certain event.
 - Implementation through mutual call and put options of the OpCo shareholders and HoldCo.
- Objective: The tax burden triggered by the flip is to be postponed to a later point in time (exit/liquidity event).
 - In many cases, a synthetic flip can lead to an overall higher tax burden!
 - Capital gains generated by the transfer of the remaining shares in OpCo will be taxable in Germany.
 - Dry income is avoided.



German tax aspects:

For German tax purposes, the flip is treated as a sale of the shares in OpCo. No tax relief under the German Reorganisation Tax Act (*Umwandlungssteuergesetz*) is applicable given that HoldCo is (tax) resident outside the EU/EEA.

Any capital gain for the OpCo shareholders is calculated based on the fair market value of the OpCo shares in time of contribution into HoldCo.

With regard to the effective tax burden, a distinction must be made depending on whether the respective OpCo shareholder is a legal entity or an individual subject to German taxation:

Corporations: Usually the regular German tax relief can be claimed:

- ⇒ 95% of any capital gain would be tax-exempt, the remaining 5% are subject to regular taxation with corporate income tax and trade tax (effective tax rate: c. 1.6%).

Individuals:

With a shareholding in OpCo of at least 1 % at any time in the last five years:

- ⇒ 40% of any capital is tax-exempt, the remaining 60% are subject to regular income taxation (effective tax rate: up to c. 28.5% (increased by any church tax)).

With a shareholding in OpCo of less than 1%:

Any capital gain is subject to a reduced income tax rate of c. 26.4% (increased by any church tax)).

Partnerships are (partially) transparent for German tax purposes and the tax consequences depends on the status of the partners (corporation/individual).

Double taxation issues:

Location of the management of the HoldCo:

- ⇒ US: risk of double taxation = rather low;
- ⇒ Germany: double taxation issues may occur.

Location of the management of OpCo:

- ⇒ Germany: US Controlled Foreign Corporation rules must be checked;
- ⇒ US: double taxation issues may occur.



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