Global Private M&A Guide - Limited External Content - Germany

Quick reference guide

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# Due diligence, pricing and closing

**Typical due diligence issues**

Typical legal due diligence issues in Germany include commercial contracts (e.g., customer, supplier and distribution agreements), financing agreements (e.g., bank and shareholder loans, guarantees), real estate (owned and leased), employment and pension matters, IP, IT/software, data protection, regulatory/public law, environmental law and litigation. In a share deal (but typically not in an asset deal), corporate matters (e.g., title chain, corporate history and past re-organizations, articles, by-laws, shareholder agreements, resolutions of corporate bodies, profit and loss transfer agreements) are the main focus of the legal due diligence.

For quite some time, compliance issues, in particular relating to anti-bribery, corruption, money laundering, sanctions, export control and competition law, have also received increased attention in due diligence exercises. Compliance due diligence includes the analysis of past compliance violations and incidents, as well as the assessment of the adequacy and robustness of the target's compliance management system and internal compliance policies, procedures and responsibilities.

Legal due diligence is typically limited to a review of documents in a virtual data room, sometimes enhanced by expert interviews. For larger auction sales, it is common for a seller to provide a vendor due diligence report or a legal fact book as part of the information granted to bidders. Legal tech tools and artificial intelligence (AI) are increasingly being used to facilitate the due diligence and to create synergies between the due diligence work streams. This, for example, includes the use of cooperative due diligence platforms, AI-based software (e.g. for translations and document analysis) as well as automation tools for due diligence reports.

Issues identified in the due diligence are typically dealt with by: (i) having them rectified by the seller before signing/closing (e.g., obtaining waivers from third parties if change-of-control provisions have been identified in commercial contracts): (ii) specific indemnities regarding specific known risks identified in the course of the due diligence (e.g., environmental risks, ongoing/threatened litigation); or (iii) general representations and warranties (e.g., the existence and ownership of title to the shares that are being sold).

**Pricing and payment**

In a typical private M&A transaction (share deal or asset deal) where the purchase price is paid in cash (instead of shares), there is no statutory requirement to obtain an independent appraisal to support the valuation of the target. Nevertheless, the buyer's management will typically also conduct financial due diligence to determine the purchase price. In this context, it is common to involve third-party financial advisers to obtain a valuation of the target or a fairness opinion. For German buyers, this is mainly done to comply with management duties. The management of a German company has a general duty to make informed decisions and be able to justify its decision for an acquisition and the amount of the purchase price paid for the target.

Independent appraisals may be required where the purchase price is not paid in cash and in other types of corporate transactions, such as capital contributions in kind and/or reorganizations pursuant to the German Transformation Act.

There are generally no restrictions regarding the pricing or the payment of the purchase price from a legal perspective. Most commonly, the purchase price is paid in euros. However, a payment in other currencies or a consideration by way of shares is also possible. If the purchase price does not reflect the fair market value or if sellers receive varying purchase prices per share, this may have tax consequences.

**Signing/closing**

*Share sale*

The sale of shares in a German limited liability company (Gesellschaft mit beschränkter Haftung (GmbH)) is the most common acquisition structure in Germany. It requires the share purchase agreement (SPA), including all exhibits and annexes, to be notarized (i.e., notarially recorded) by a German notary. Notarization is formalistic and somewhat cumbersome since all parties have to be present at the notary appointment (either in person or by proxy based on a power of attorney), and the whole SPA has to be read aloud by the notary. The statutory notary fees triggered by the notarization depend on the value of the transaction and can be quite significant.

SPAs relating to shares in other types of companies (e.g., stock corporations or partnerships) generally do not require notarization and may be entered into by simply signing the SPA.

*Asset sale*

An asset sale does not typically require any notarization unless the sold assets include owned real estate, shares in a GmbH or the seller is selling all or almost all of its assets as a whole. An asset purchase agreement (APA) is typically more extensive and detailed, because it has to specify all individual assets, liabilities, contracts, employees, etc., that make up the sold business. Particularly with regard to tangible assets, German law requires an exact specification of the assets in the APA or in an exhibit. In an asset deal, the parties should allow sufficient time, and involve personnel with adequate knowledge of the target's business, for the preparation of the relevant asset lists.

Buyers that do not already have a German entity that can acquire the assets making up the sold business usually set up a special purpose vehicle to act as the buying entity and to conduct the German business operations going forward.

*Closing*

In most cases, signing and closing do not occur simultaneously because of the required merger clearance, foreign investment approval and/or approval pursuant to the new EU Foreign Subsidies Regulation (see below). Therefore, a separate closing usually has to take place. At closing, the actual share transfer takes place and the purchase price is paid. Often, the SPA or the APA also provides for other closing conditions and closing actions.

# Approvals/registrations

**Foreign investment restrictions**

Germany has a mandatory and suspensory foreign investment screening procedure, which means that transactions that meet the relevant criteria need to be notified to the relevant authority and cleared before they can be completed.

The foreign investment review (FIR) regime is limited to certain sectors. For further information, see the more detailed section on "Foreign investment restrictions".

**Antitrust/merger control**

Germany has a mandatory and suspensory merger control regime, which means that transactions that meet the relevant criteria need to be notified to the competition authority and cleared before they can be completed.

It is also necessary to consider EU merger control rules. Mergers involving companies active in several member states and reaching certain turnover thresholds are examined at European level by the European Commission. This allows companies trading in different EU member states to obtain clearance for their mergers in one go. For further information, see the more detailed section on "Antitrust/merger control".

**EU Foreign Subsidies Regulation**

As of 12 October 2023, the EU Foreign Subsidies Regulation (FSR) requires qualifying transactions, and bids in response to certain large public tenders in the EU, to be notified for upfront clearance by the European Commission where the companies involved have benefited from foreign financial contributions (a broad concept) that exceed certain (low) thresholds. Acquisitions of a target with annual revenues in the EU of at least EUR 500 million will trigger FSR deal notifications. Acquisitions of smaller targets will not, regardless of deal value. Outright mergers and large joint ventures will trigger a notification requirement if the EUR 500 million EU-wide revenue threshold is met by one of the merging parties or the joint venture.

**Other regulatory or government approvals**

Approval by the competent regulator may be required for acquisitions of companies that are subject to specific regulatory supervision, such as financial institutions, airports, telecom providers, etc.

# Employment

Share deal: In share sales, there is no change in the employer/employee relationship. Neither consent from employees nor notices to employees are required. However, an economic committee or, in the absence of such committee, the works council of the entity to be sold needs to be notified in advance of the contemplated sale. All rights, duties and liabilities owed by, or to, the employees of the entity to be sold continue to be owed by, or to, the entity. The buyer, therefore, inherits all those rights, duties and liabilities by virtue of being the new owner of the company to be sold.

Asset deal: In an asset sale that involves the transfer of a business (or part of a business) as a going concern, employees belonging to the business automatically transfer to the buyer by operation of law, and the parties to the transfer of business are not free to choose which employees will transfer with the business. Employees have a right to object to their transfer within one month from the time they are duly informed about the transfer. This information has to be provided in text format and is subject to strict requirements.

Terms and conditions of employment in principle have to remain unchanged after the transfer and the new employer by law has to recognize the employees' years of service. The buyer as the legal successor of the former employer becomes fully liable for all employment-related liabilities. Compensation for the automatic assumption of liabilities should be addressed in the transaction documents.

There is no general legal obligation to consult with works councils or the employees regarding the asset deal and the transfer of the employees. However, reorganizations and operational changes that need to be implemented in conjunction with the transaction (e.g., split of operations, carve-outs of employees, relocations) typically trigger consultation obligations. Consultations may take several months and, thus, may significantly affect the timing of the implementation of the respective reorganizations or operational changes. Terminations "due to a transfer of business" are prohibited by law. Terminations for other reasons (e.g., based on a separate restructuring decision) remain possible.

Pension schemes and the transfer of pension liabilities need to be considered carefully in the transaction context.

# Tax

**Asset deal**

The capital gains of a foreign corporate seller with a German permanent establishment are principally subject to corporate income tax (CIT) and solidarity surcharge (SolS) at a consolidated rate of 15.83% and trade tax (TT) at rates usually between 7% and 17%.

For a buyer, in an asset deal, the acquired tangible and intangible assets, including goodwill, attributable to a German permanent establishment are capitalized at acquisition costs on the basis of a purchase price allocation, often leading to a step-up of the tax basis and increased depreciation/amortization basis. Special tax valuations and accounting rules exist if liabilities are transferred to the buyer.

The transfer of assets/liabilities by way of an asset deal involving the transfer of a business (or part of a business) as a going concern will typically not be subject to value-added tax (VAT). If no going concern business is transferred, the transfer of assets/liabilities within an asset deal is principally subject to VAT. If German property is transferred, real estate transfer tax (RETT) might apply.

Due to the "transparency" of German partnerships for income tax purposes, the acquisition of an interest in a partnership is treated similarly to an acquisition of the partnership's assets.

**Share deal**

The capital gains of a corporate seller in the case of a sale of shares in a corporate entity (share deal) are principally tax-exempt under German domestic law, but 5% of the capital gain is treated as a nondeductible business expense, leading to a consolidated tax burden equal to approximately -1.5% of the capital gain. In the case of a foreign corporate seller without a taxable presence in Germany, it can be argued on the basis of case law that the capital gain is entirely exempt from German taxation. Moreover, under applicable double tax treaties, Germany usually does not have a right to tax such capital gain realized by a foreign seller, if the seller does not have a permanent establishment in Germany. Special rules may apply for the sale of real estate rich companies.

Loss carryforwards and other tax attributes available at the level of the target company before the acquisition may no longer be usable after closing due to loss forfeiture regulations.

The sale and transfer of shares is generally not subject to VAT, unless the exemption is waived. If shares in a company holding German real estate are transferred, RETT might be triggered.

**OECD's Two Pillar Solution**

The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting has put forward a so-called Two-Pillar Solution to address the tax challenges arising from the digitalization of the economy. Pillar Two is intended to introduce a global minimum effective rate of tax of 15% for large businesses in each jurisdiction where they operate and will lead to fundamental changes in the international tax system. It is currently being implemented in a large number of jurisdictions.

Groups will need to consider how the Pillar Two rules could impact on the life cycle of M&A transactions from the pre-acquisition phase (including transaction planning (such as the choice of acquisition structure and financing) and due diligence of the target group), the acquisition phase (such as contractual risk allocation around Pillar Two) to the post-acquisition phase and the impact of Pillar Two on any post-acquisition integration.

# Post-acquisition integration

For information on post-acquisition integration matters, please see our [Post-acquisition Integration Handbook](https://www.bakermckenzie.com/en/insight/publications/resources/post-acquisition-integration-2023).

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