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## NEWSLETTER – TRANSPORT

## KEY CONSIDERATIONS FOR FOREIGN INVESTORS INVESTING IN GERMAN SHIPPING COMPANIES

**Investments in German shipping companies may be attractive for a number of reasons. Foreign investors are often drawn by experienced first-class German ship managers, well established investment structures, a reliable legal framework and the benefits of the German tonnage tax regime.**

This newsletter outlines the key considerations for foreign investors seeking to invest in German shipping companies. It provides an initial overview of how German shipping companies are typically structured, the German tonnage tax regime, reflagging arrangements, forms of participation, partnership agreements, foreign investment control and merger control.

### STRUCTURE OF GERMAN SHIPPING COMPANIES

In Germany, vessels are commonly owned through a special-purpose vehicle, typically established in the legal form of a German limited partnership (*Kommanditgesellschaft*) with a German limited liability company

(*Gesellschaft mit beschränkter Haftung – GmbH*) as its general partner. Legally, such a partnership is referred to as a GmbH & Co. KG, although in practice, it is often simply referred to as the "KG".

A German limited partnership has at least one general partner and one or more limited partners.

#### **General Partner**

The general partner manages and represents the limited partnership and is, in principle, subject to unlimited liability for the obligations of the limited partnership. As a result, the general partner is typically a GmbH rather than an individual. The liability of the GmbH is generally limited to its own assets,

effectively limiting the exposure of the GmbH. The general-partner GmbH is usually a special-purpose company with few assets of its own.

The GmbH is represented by one or more managing directors, who are authorised to legally bind the GmbH and, indirectly, the limited partnership in dealings with third parties. For an investor, it is therefore important to understand who controls the GmbH, how its managing directors are appointed and removed, and which material decisions require the approval of the limited partners.

#### **Limited Partners**

The limited partners of the KG typically

provide the equity. In the internal relationship with the KG, a limited partner must pay the capital contribution specified in the partnership agreement, known as the *Pflichteinlage*.

The capital contribution of a limited partner must be distinguished from its registered liability amount, known as the *Haftsumme*. The liability amount determines the extent to which a limited partner may be subject to statutory liability towards creditors of the KG. It is registered in the commercial register and is therefore publicly available to creditors and other third parties.

The capital contribution and the liability amount are separate concepts and may differ. For example, a limited partner may agree to pay a capital contribution of EUR10 million to the KG. The registered liability amount will, however, often be significantly lower, for example EUR10,000. The limited partner remains contractually obliged to contribute the full EUR10 million to the KG. Its direct statutory liability towards creditors of the KG is, however, limited to EUR 10,000. The purpose of this distinction is to enable a limited partner to invest capital in the KG without being exposed to statutory liability for all obligations of the KG in the same amount as its investment.

Once a limited partner has fully paid its agreed capital contribution, its direct statutory liability towards creditors is generally extinguished. However, it is important for an investor to be aware that liability may revive if the KG subsequently repays all or part of the capital contribution to the limited partner. This

can occur, for example, where the KG makes distributions out of liquidity to a limited partner even though there are no corresponding profits.

## TONNAGE TAX

Tax treatment is of central importance to German shipowners. Subject to certain requirements, including registration of the vessel in a German ship register and management of the vessel by a German ship manager, profits of the KG from operating the vessel may be subject to the German tonnage tax regime.

Rather than being based on actual operating profits, taxable income under the German tonnage tax regime is calculated by reference to the net tonnage of the vessel and the number of operating days. As a result, the effective tax burden may be comparatively low, often ranging from approximately 0.5% to 2% of the vessel-owning KG's actual operating profit.

It is also noteworthy that, in usual German shipping structures, a German ship manager will frequently hold a small, limited partnership interest in the relevant shipping KG. In addition to reflecting the manager's involvement in the operation of the vessel, this may also create tax advantages. Management fees earned by a ship manager that is itself a limited partner may, under certain circumstances, fall within the tonnage tax regime rather than being taxed as ordinary service income.

## REFLAGGING

A further distinctive feature of German shipping structures is the reflagging of vessels.

One of the requirements for the application of the German tonnage tax regime is that the vessel is registered in a German ship register. If a vessel is registered in a German ship register, it will generally also fly the German flag. The flag of the vessel determines, among other things, applicable crewing, social security and regulatory requirements.

To align with international operating standards and cost structures, German shipowners frequently reflag their vessels by means of a bareboat charter arrangement. In such cases, the German KG charters the vessel under a bareboat charter to a subsidiary of the KG incorporated in a flag jurisdiction, for example Antigua and Barbuda, Liberia, the Marshall Islands, Malta or Portugal. The bareboat charterer then registers the vessel in the local bareboat register, enabling the vessel to fly the flag of that jurisdiction. The registration in the German ship register remains in place as the underlying registration and, in the case of bank financing, the vessel mortgage is also registered in the German register. Typically, a back bareboat charter is concluded between the bareboat charterer and the KG. This enables the KG to continue operating the vessel, for example by chartering it out to a time charterer.

Reflagging requires approval from the German Federal Maritime and Hydrographic Agency (Bundesamt für

Seeschiffahrt und Hydrographie – BSH). Such approval is granted for a limited period but is usually renewed on a regular basis.

## FORMS OF PARTICIPATION

### *Direct Participation in the KG as a Limited Partner*

An investor may participate as a limited partner in a KG in several ways. The investor may participate from the outset as a founding limited partner; join an existing KG; or acquire a limited partnership interest from another limited partner.

Investors joining an existing KG should carefully consider liability issues. Subject to the limitations resulting from the registered liability amount, a new limited partner may also be liable for obligations of the KG that arose before its admission.

The admission of a new limited partner must be registered in the commercial register. Until registration occurs, the incoming investor may be exposed to unlimited liability for new obligations incurred by the KG between its entry and registration. In practice, this undesirable consequence is commonly avoided by making the investor's admission to the KG subject to the condition precedent of commercial register registration.

Where an existing partnership interest is acquired, investors should verify whether the selling limited partner has fully paid its capital contribution and whether there have been any

subsequent repayments of capital contributions. If so, the limited partner's liability towards creditors of the KG may revive (see above).

### *Indirect Participation through a Trustee Structure*

Such structures were historically widely used in so-called public investment KGs involving large numbers of retail investors. Under this model, the trustee holds the partnership interest in its own name but for the economic benefit of the underlying investors. The principal advantage of this structure is administrative efficiency, as it avoids the need for each individual investor to become registered in the commercial register.

Vis-à-vis third parties, only the trustee is the limited partner of the KG and is registered in the commercial register. The investor, as trust beneficiary, derives its rights from the trust agreement with the trustee company. The investor does not itself have direct rights against the KG in its capacity as a limited partner.

A trustee structure is not limited to retail investors and may also be used by institutional and foreign investors, in particular to simplify the administration of the investment. Where an institutional or foreign investor participates through a trustee structure, it may be advisable for the investor to reserve the right to terminate the trustee arrangement and become a direct limited partner in the KG.

### *Participation through a Holding Structure*

Where an investor participates in more than one vessel, holding structures are also common. The holding company may itself be established as a GmbH & Co. KG. The investor may participate in the holding company, for example together with a German partner, while the holding company holds the interests in the individual single-vessel companies established as KGs.

A holding structure can facilitate the pooling of investments in several vessels and may provide a more centralised framework for governance, financing and portfolio management. At the same time, the economic interests and governance arrangements at holding level must be aligned with the interests and arrangements of each individual vessel-owning company.

As mentioned above, the German ship manager may also hold a nominal limited partnership interest in the individual single-vessel companies.

## PARTNERSHIP AGREEMENTS

The legal relationship between the investors is primarily governed by the partnership agreement of the KG. The partnership agreement is the central corporate governance document and typically contains provisions on ownership percentages, capital contributions, management, voting rights, consent matters, information rights, distributions and transfers of partnership interests.

Where investors wish to agree on additional arrangements regarding their cooperation, these will generally

be set out in a separate shareholders' agreement, such as a joint venture agreement. This may cover detailed funding obligations, business plan and budget procedures, deadlock mechanisms, put and call options, tag-along and drag-along rights and other commercial arrangements between the investors.

## FOREIGN INVESTMENT CONTROL AND MERGER CONTROL

Foreign investment control should be considered at an early stage, in particular where the investor is based outside the European Union or the European Free Trade Association.

An investment in a German shipping

company is not subject to foreign investment approval merely because the target owns or operates vessels. However, a filing or review may be relevant where the shipping company is active in sensitive sectors, including critical transport infrastructure, defence-related activities or other areas relevant to public order or security. The assessment will depend on the activities of the target, the identity and origin of the investor, the size of the interest acquired, and the governance or control rights granted in connection with the investment.

German merger control may also need to be considered, particularly in larger transactions or where the investor acquires control or a competitively significant influence over the target.

The analysis is not determined solely by the percentage interest acquired or the purchase price. Relevant factors include the turnover of the parties, the rights attached to the investment, and the degree of influence the investor is able to exercise over the shipping company.

## CONCLUSION

Investments in German shipping companies can offer attractive opportunities for foreign investors. The combination of an established shipping industry, experienced ship managers, flexible investment structures, a reliable legal framework and the benefits of the German tonnage tax regime can make German shipping companies particularly attractive investment platforms.

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## KEY CONTACT



### DR. CLEMENS HILLMER, LL.M.

PARTNER | RECHTSANWALT

M +49 172 6742 326

T +49 40 4011 47100-1

[clemens.hillmer@noordenjones.com](mailto:clemens.hillmer@noordenjones.com)

