

# Strategies for International Business Expansion

(Example: U.S. parent company)

	Distributor	Representative(s)	Permanent establishment	Subsidiary (legal entity)
<b>General</b>				
Marketing concept	<ul style="list-style-type: none"> <li>Foreign sales activities shifted to third party distributor</li> </ul>	<ul style="list-style-type: none"> <li>Employees of German Company will work abroad</li> <li>Limited possibility for German Company to develop foreign markets (limitations vary by country) ⚡</li> <li>Strong interrelation with German Company in Germany</li> </ul>	<ul style="list-style-type: none"> <li>Unlimited possibility to take undertake marketing activities abroad (in the name of German Company)</li> <li>Still strong organizational interrelation with German Company (since foreign activities carried out in the name of German Company)</li> </ul>	<ul style="list-style-type: none"> <li>Unlimited possibility to undertake marketing activities abroad (in the name of the foreign entity!) + → might be a very big advantage!</li> <li>Organizational interrelation with German Company is optional (service level would have to be defined)</li> </ul>
Typical business scenario	<ul style="list-style-type: none"> <li>No own staff abroad</li> <li>Instead: German Company exports to foreign distributor who then sells to the end customers abroad</li> <li>Distributor is the contractual partner for the end customers abroad</li> </ul>	<ul style="list-style-type: none"> <li>1 – 2 sales representatives abroad (without signing power!)</li> <li>1 – 2 clinical support employees abroad</li> <li>No warehouse abroad (exceptions would have to be reviewed on a by-country basis)</li> <li>No back office infrastructure abroad (e.g. no office space) ⚡</li> <li>Orders to be placed directly with German Company in Germany</li> <li>Delivery and invoicing from German Company in Germany to the foreign customers</li> <li>German Company is the contractual partner for the end customers abroad</li> </ul>	<ul style="list-style-type: none"> <li>Back office infrastructure is possible abroad (e.g. office space)</li> <li>Warehouse abroad is possible</li> <li>Foreign employees may be given signing power on behalf of German Company</li> <li>Orders to be placed with the permanent establishment (legally still German Company)</li> <li>Delivery and invoicing by the permanent establishment (legally still German Company)</li> <li>German Company is the contractual partner for the end customers abroad</li> </ul>	<ul style="list-style-type: none"> <li>Back office infrastructure is necessary abroad (e.g. office space)</li> <li>Warehouse abroad is possible (optional)</li> <li>Orders to be placed with the foreign legal entity</li> <li>Delivery either by the foreign legal entity or by German Company</li> <li>Invoicing by foreign legal entity</li> <li>Foreign legal entity is the contractual partner for the end customers abroad</li> <li>Shared services between German Company and foreign legal entity may be agreed upon (e.g. warehouse)</li> </ul>
Funding	<ul style="list-style-type: none"> <li>Funding of foreign activities is the responsibility of the distributor</li> </ul>	<ul style="list-style-type: none"> <li>Funding requirements very limited (since no formal business infrastructure abroad) +</li> <li>Salary and other costs paid by German Company</li> <li>Dividend distributions to U.S. Parent Company will have to flow through German Company (since no separate legal entity abroad)</li> </ul>	<ul style="list-style-type: none"> <li>Funding requirements depend on the scope of activities abroad</li> <li>All costs will be paid by German Company (since no separate legal entity abroad)</li> <li>Dividend distributions to U.S. Parent Company will have to flow through German Company (since no separate legal entity abroad)</li> </ul>	<ul style="list-style-type: none"> <li>Funding requirements depend on the scope of activities abroad</li> <li>Funding (including equity) is the responsibility of the shareholder (either German Company or U.S. Parent Company)</li> <li>Dividend distributions from the foreign entity directly to U.S. Parent Company possible in case U.S. Parent Company is the shareholder of the foreign entity</li> </ul>
Legal liability	<ul style="list-style-type: none"> <li>German Company generally cannot be held liable for any third party distributor</li> <li>General product liability of German Company still applies</li> </ul>	<ul style="list-style-type: none"> <li>German Company is fully liable for all its activities in Germany and abroad</li> </ul>	<ul style="list-style-type: none"> <li>German Company is fully liable for all its activities in Germany and abroad</li> </ul>	<ul style="list-style-type: none"> <li>The foreign subsidiary is fully liable for all its activities abroad (not German Company) +</li> <li>General product liability of German Company still applies</li> </ul>

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<b>Financial administration</b>				
Statutory bookkeeping	<ul style="list-style-type: none"> <li>German Company accounts for foreign sales in Germany</li> <li>Third party distributor has to take care of its own accounting</li> </ul>	<ul style="list-style-type: none"> <li>All foreign costs and export sales are accounted for in Germany by German Company +</li> </ul>	<ul style="list-style-type: none"> <li>All foreign costs and sales have to be accounted for separately by German Company abroad (under foreign bookkeeping rules!) ⚡</li> <li>Foreign activities therefore not included in the German books</li> <li>Transactions between German Company in Germany and German Company abroad will have to be documented and accounted for at fair values ('dealing at arm's length principle')</li> </ul>	<ul style="list-style-type: none"> <li>All foreign costs and sales have to be accounted for separately by the foreign entity under foreign bookkeeping rules ⚡</li> <li>Foreign activities therefore not included in the German books (since separate legal entity abroad)</li> <li>Transactions between German Company in Germany and foreign subsidiary will have to be documented and accounted for at fair values ('dealing at arm's length principle')</li> </ul>
Statutory financial statements (local GAAP)	<ul style="list-style-type: none"> <li>German Company compiles its German GAAP financial statements</li> <li>The distributor is responsible for the compilation of its own financial statements under foreign GAAP</li> </ul>	<ul style="list-style-type: none"> <li>German Company includes the foreign activities in its German GAAP financial statements (→ no problem since already included in the German bookkeeping)</li> </ul>	<ul style="list-style-type: none"> <li>German Company has to convert the foreign GAAP bookkeeping of the permanent establishment abroad to German GAAP</li> <li>Consolidation of the German activities and the activities abroad for German GAAP purposes required at German Company (→ can be rather complex and time consuming) ⚡</li> </ul>	<ul style="list-style-type: none"> <li>The foreign subsidiary compiles its foreign GAAP financial statements</li> <li>German Company compiles its German GAAP financial statements (w/out inclusion of the foreign subsidiary) → much easier compared to permanent establishment!</li> <li>No consolidation necessary in Germany at present (subject to certain thresholds) +</li> </ul>
Reporting to U.S. Parent Company	<ul style="list-style-type: none"> <li>Distributor is not subject to consolidation on the group level</li> <li>German Company includes its export sales in its standard reporting to U.S. Parent Company</li> </ul>	<ul style="list-style-type: none"> <li>German Company includes its foreign costs and export sales as part of its standard reporting to U.S. Parent Company</li> </ul>	<ul style="list-style-type: none"> <li>German Company includes all sales and costs of the foreign permanent establishment in its reporting to U.S. Parent Company</li> <li>Prerequisite: Periodic reporting from the permanent establishment abroad to Germany (→ can be rather complex and time consuming) ⚡</li> </ul>	<ul style="list-style-type: none"> <li>German Company compiles its US reporting w/out inclusion of the foreign subsidiary</li> <li>The foreign subsidiary sends its own reporting package to U.S. Parent Company for consolidation purposes in the U.S. (→ speeds up the reporting process, since no consolidation in Germany necessary) +</li> </ul>
<b>Human resources</b>				
Employment contracts	<ul style="list-style-type: none"> <li>No additional employees for German Company (since foreign activities carried out by the third party distributor)</li> </ul>	<ul style="list-style-type: none"> <li>Foreign employees of German Company (typically subject to foreign labor law)</li> </ul>	<ul style="list-style-type: none"> <li>Foreign employees of German Company (typically subject to foreign labor law)</li> <li>No separate general manager required for the permanent establishment abroad</li> </ul>	<ul style="list-style-type: none"> <li>Foreign staff employed by the foreign subsidiary under foreign labor law</li> <li>General manager legally required abroad for the day-to-day running of the business</li> </ul>
Payroll accounting	<ul style="list-style-type: none"> <li>No additional responsibilities for German Company: Distributor has to take care of all payroll related matters for his own employees</li> </ul>	Varies by country: <ul style="list-style-type: none"> <li>In some instances no foreign payroll accounting necessary +</li> <li>Otherwise: Necessity for foreign payroll (including social security filings and withholdings)</li> </ul>	<ul style="list-style-type: none"> <li>Foreign payroll accounting necessary (including social security) → must be performed by an expert abroad due to the complexity of these matters! ⚡</li> </ul>	<ul style="list-style-type: none"> <li>Foreign payroll accounting necessary (including social security) → must be performed by an expert abroad due to the complexity of these matters!</li> </ul>

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<b>Taxes</b>				
Income Taxes	<ul style="list-style-type: none"> <li>German export sales to the distributor are income taxable in Germany under German tax laws</li> </ul>	<ul style="list-style-type: none"> <li>German export sales to end customers abroad are income taxable by German Company in Germany under German tax laws</li> <li>Foreign payroll and other costs are tax deductible by German Company in Germany</li> <li>Gains from the foreign activities can be netted with losses in Germany (and any tax loss carryforwards) +</li> <li>No requirement to pay income taxes abroad → no foreign tax returns necessary +</li> </ul>	<ul style="list-style-type: none"> <li>German Company is subject to foreign income taxes with its permanent establishment abroad</li> <li>Filing of foreign income tax returns necessary for German Company (including all foreign taxable revenues and deductible costs)</li> <li>Transactions between the foreign permanent establishment and German Company in Germany are taxed at fair values ('dealing at arm's length principle')</li> <li>German net losses generally cannot be netted with foreign gains (and vice versa) ⚡</li> </ul>	<ul style="list-style-type: none"> <li>The foreign subsidiary (not German Company!) is subject to foreign income taxes with all its activities abroad</li> <li>Filing of foreign income tax returns necessary for the foreign entity</li> <li>Transactions between the foreign entity and German Company are taxed at fair values ('dealing at arm's length principle')</li> <li>German net losses generally cannot be netted with foreign gains (and vice versa) ⚡</li> </ul>
Value added taxes (VAT)	<ul style="list-style-type: none"> <li>Export sales to foreign distributor are VAT exempt in Germany for German Company</li> </ul>	<ul style="list-style-type: none"> <li>Export sales to foreign customers are VAT exempt in Germany for German Company</li> <li>Any foreign VAT paid by German Company can be recovered upon year-end</li> <li>Generally: no VAT registration of the German Company abroad → no filing of foreign VAT applications and VAT returns necessary (BUT: must be further analyzed based on the actual transactions abroad!) +</li> </ul>	<ul style="list-style-type: none"> <li>Export sales to foreign customers and/or to foreign permanent establishment are VAT exempt in Germany for German Company</li> <li>Foreign permanent establishment will have to pay foreign VAT on imported goods (and services)</li> <li>Sales of foreign permanent establishment abroad will be subject to foreign VAT</li> <li>Necessity for foreign VAT registration, including periodic filing of VAT applications and VAT returns for the German Company ⚡</li> <li>Any foreign VAT paid may be recovered in the course of filing the (monthly) VAT applications</li> </ul>	<ul style="list-style-type: none"> <li>Export sales to foreign customers and/or to foreign subsidiary are VAT exempt in Germany for German Company</li> <li>Foreign subsidiary will have to pay foreign VAT on imported goods (and services)</li> <li>Sales of the foreign subsidiary will be subject to foreign VAT</li> <li>Necessity for foreign VAT registration, including periodic filing of VAT applications and VAT returns for the foreign subsidiary ⚡</li> <li>Any foreign VAT paid may be recovered in the course of filing the (monthly) VAT applications</li> </ul>
Transfer pricing	<ul style="list-style-type: none"> <li>n/a, since distributor is third party</li> </ul>	<ul style="list-style-type: none"> <li>n/a, since no intercompany sales and purchases (all export sales performed directly to the third-party customers)</li> </ul>	<ul style="list-style-type: none"> <li>All transactions (delivery of goods and services) between German Company in Germany and the permanent establishment of German Company abroad must be priced at fair values ('dealing at arm's length principle')</li> <li>Tends to be very complex due to strong interrelation between German Company in Germany and its permanent establishment abroad ⚡</li> <li>The principles of intercompany pricing have to be documented ⚡</li> </ul>	<ul style="list-style-type: none"> <li>All transactions (delivery of goods and services) between German Company and the foreign entity must be priced at fair values ('dealing at arm's length principle')</li> <li>Tends to be less complex due to less interrelation between German Company and the foreign entity +</li> <li>The principles of intercompany pricing have to be documented</li> </ul>

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<b>Costs</b>				
Initial setup costs	<ul style="list-style-type: none"> <li>• Very low: only distribution contract</li> </ul>	<ul style="list-style-type: none"> <li>• Generally low, since no back office infrastructure abroad</li> <li>• Legal fees for drafting foreign employment contracts</li> <li>• Setup costs for foreign payroll (if required; must be further analyzed by country!)</li> <li>• Tax consulting fees to define requirements for avoiding a permanent establishment (must be further analyzed by country!)</li> </ul>	<p>Can be low or high:</p> <ul style="list-style-type: none"> <li>• Back office infrastructure abroad</li> <li>• Warehouse abroad (optional)</li> <li>• Setup costs for foreign payroll</li> <li>• Legal fees for drafting foreign employment contracts</li> <li>• Setup costs for foreign payroll</li> <li>• Setup costs of foreign statutory bookkeeping (local GAAP!)</li> <li>• Setup costs for defining the reporting format to German Company in Germany (under both, German GAAP and US-GAAP!)</li> <li>• Foreign VAT registration</li> <li>• Definition and documentation of transfer prices</li> </ul>	<p>Generally high:</p> <ul style="list-style-type: none"> <li>• Legal and tax consulting fees for founding the legal entity abroad</li> <li>• Back office infrastructure abroad</li> <li>• Warehouse abroad (optional)</li> <li>• Setup costs for foreign payroll</li> <li>• Legal fees for drafting foreign employment contracts</li> <li>• Setup costs for foreign payroll</li> <li>• Setup costs of foreign statutory bookkeeping (local GAAP!)</li> <li>• Foreign income tax and VAT registration</li> <li>• Additional registration requirements (e.g. Chamber of Commerce, ...)</li> <li>• Definition and documentation of transfer prices</li> </ul>
Recurring costs of business	<ul style="list-style-type: none"> <li>• Very low: Foreign business is carried out by third-party distributor</li> </ul>	<p>Generally low:</p> <ul style="list-style-type: none"> <li>• Salaries for employees abroad</li> <li>• Ancillary labor costs: (vary by country)</li> <li>• Only if required under local laws: payroll accounting costs (must be further analyzed by country!)</li> </ul>	<p>Generally high:</p> <ul style="list-style-type: none"> <li>• Rental costs for office (and optional warehouse)</li> <li>• Salaries for employees abroad</li> <li>• Ancillary labor costs</li> <li>• Payroll accounting costs</li> <li>• Financial accounting and reporting costs (local GAAP, German GAAP and US GAAP!)</li> <li>• Costs for consolidating the foreign accounts in Germany</li> <li>• Tax applications and tax returns</li> <li>• Depending on the materiality, the permanent establishment may be subject to a financial statement audit (as part of an audit at German Company)</li> </ul>	<p>Generally high:</p> <ul style="list-style-type: none"> <li>• Rental costs for office (and optional warehouse)</li> <li>• Salaries for employees and for general manager abroad</li> <li>• Ancillary labor costs</li> <li>• Payroll accounting costs</li> <li>• Financial accounting and reporting costs (local GAAP and US GAAP, <u>not</u> German GAAP)</li> <li>• Tax applications and tax returns</li> <li>• A statutory audit requirement for the foreign entity would be dependent on foreign laws (certain thresholds may apply → vary by country!)</li> </ul>
Costs upon exit	<ul style="list-style-type: none"> <li>• Very low: cancellation of distribution contract</li> </ul>	<ul style="list-style-type: none"> <li>• Low: Contingent costs for employee layoffs</li> </ul>	<p>Rather high:</p> <ul style="list-style-type: none"> <li>• (Re-) Transfer of assets to Germany (at fair values!)</li> <li>• Contingent costs for employee layoffs</li> <li>• Costs for closing the foreign books</li> </ul>	<p>Rather high:</p> <ul style="list-style-type: none"> <li>• Legal fees for dissolving the legal entity</li> <li>• (Re-) Transfer of assets to the shareholder (at fair values!)</li> <li>• Contingent costs for employee layoffs</li> <li>• Costs for closing the foreign books</li> <li>• Optional exit strategy: Company sale</li> </ul>