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Red Flag ALTER EGO / Piercing the Corporate Veil (Haftungsdurchgriff):

In principal, shareholder's liability in a corporation in the US is comparable to the one in Germany, this is, liability is limited to the paid in capital. But there are exceptions in the U.S. legal system as there are exceptions in German corporate law as well, commonly called Piercing the Corporate Veil. A Minnesota Court recently held that the following evidence established that the subsidiary was the parent company's alter ego:

(1) [The shareholder] is and has always been the sole shareholder; (2) [he] was the firm's sole incorporator; (3)[he], and no one else, gave loans to and borrowed money from the corporation; (4)[he] and his wife owned the building where the company was headquartered and received rental payments from the company; (5) the company purchased an automobile for [the shareholder's] business use which [he] also used for incidental personal business.

Furthermore, a West Virginia Court had stated possible prerequisites as follows:

1. commingling of funds and other assets of the corporation with those of the individual shareholders;
2. diversion of the corporation's funds or assets to non-corporate uses (to the personal uses of the corporation's shareholders);
3. failure to maintain the corporate formalities necessary for the issuance of or subscription to the corporation's stock, such as formal approval of the stock issue by the board of directors;
4. an individual shareholder representing to persons outside the corporation that he or she is personally liable for the debts or other obligations of the corporation;
5. failure to maintain corporate minutes or adequate corporate records;
6. identical equitable ownership in two entities;
7. identity of the directors and officers of two entities who are responsible for supervision and management (a partnership or sole proprietorship and a corporation owned and managed by the same parties);
8. failure to adequately capitalize a corporation for the reasonable risks of the corporate undertaking;
9. absence of separately held corporate assets;
10. use of a corporation as a mere shell or conduit to operate a single venture or some particular aspect of the business of an individual or another corporation;
11. sole ownership of all the stock by one individual or members of a single family;
12. use of the same office or business location by the corporation and its individual shareholders;
13. employment of the same employees or attorney by the corporation and its shareholder(s);

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Red Flag ALTER EGO / Piercing the Corporate Veil (Haftungsdurchgriff):

14. concealment or misrepresentation of the identity of the ownership, management or financial interest in the corporation and concealment of personal business activities of the shareholders (sole shareholders do not reveal the association with a corporation, which makes loans to them without adequate security);
15. disregard of legal formalities and failure to maintain proper arm's length relationships among related entities;
16. use of a corporate entity as a conduit to procure services or merchandise to another person or entity;
17. diversion of corporate assets from the corporation by or to a stockholder or other person or entity to the detriment of creditors, or the manipulation of assets and liabilities between entities to concentrate the assets in one and the liabilities in another;
18. contracting by the corporation with another person with the intent to avoid the risk of nonperformance by use of the corporate entity; or the use of a corporation as a subterfuge to illegal transactions;
19. for formation and use of the corporation to assume the existing liabilities of another person or entity."

Thus, it is of utmost importance to German parent companies that management has a clear understanding on how to conduct business with its U.S. subsidiary so to avoid the application of the principle of Piercing the Corporate Veil at all times.



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Wege zur Verminderung des Risikos einer Durchgriffshaftung auf die Muttergesellschaft von Gläubigern der U.S.-Tochter

Deutsche Unternehmen, welche sich in den USA wirtschaftlich betätigen wollen, errichten regelmäßig eine U.S.-Tochter in Form einer Corporation oder Limited Liability Company. Hintergrund dafür ist zumeist, Haftungsrisiken aufgrund von U.S.-Geschäftsaktivitäten von der Muttergesellschaft fernzuhalten. Hierbei kommt es jedoch nicht selten bereits bei Errichtung, häufig im weiteren Verlauf wegen Unkenntnis oder mangelnder Beratung zu diversen Versäumnissen bei der Führung der Tochter, welche das Risiko einer Durchgriffshaftung – das sogenannte „Piercing of the Corporate Veil“ – auf den Shareholder oder Member erheblich erhöhen können.

In der Praxis handelt es sich um Versäumnisse, welche dazu geeignet sind, eine Durchgriffshaftung auf Grundlage der „Alter Ego Doctrine“ zu begründen. Danach wird eine Durchgriffshaftung in Fällen anerkannt, in denen die haftende Gesellschaft und Ihr(e) Gesellschafter nicht klar getrennt sind und die Tochter lediglich ein „alter ego“ der Muttergesellschaft ist.

Eine Durchgriffshaftung nach dieser Doktrin ist insbesondere in solchen Fällen von U.S. Gerichten bejaht worden, in welchen sich das Gesellschaftsvermögen und das Vermögen der Gesellschafter nicht eindeutig voneinander abgrenzen ließen. Eine derartige Vermögensvermischung ist insbesondere anzunehmen, wenn die Muttergesellschaft Zahlungsverpflichtungen der Tochter übernimmt. Das Risiko einer Durchgriffshaftung steigt aber insbesondere auch dann, wenn Leistungen zwischen den Gesellschaften ohne dokumentierte, vertragliche Grundlage ausgetauscht werden. Hier kann man z.B. an Darlehensvereinbarungen, Serviceverträge, Lizenzverträge etc. denken.

Das Risiko einer Durchgriffshaftung besteht auch in Fällen, in welchen für einen Vertragspartner nicht eindeutig erkennbar ist, ob er Geschäfte mit der U.S.-Tochter oder etwa der Muttergesellschaft tätigt. Dieses Risiko besteht insbesondere, wenn identische Personen Ämter in beiden Gesellschaften bekleiden oder mißverständliche Firmenbezeichnungen verwendet werden.

Schließlich wird eine Durchgriffshaftung oft auch dann angenommen, wenn die Bücher der Corporation nicht ordnungsgemäß geführt werden, Directors und/oder Officers ihre Ämter nicht fachgerecht ausüben, Shareholder- und Board-of-Directors-Meetings nicht formalgerecht und regelmäßig abgehalten und dokumentiert, oder sonstige gesellschaftsrechtlichen Formerfordernisse (wie z.B. Formalien bei der Bestellung von Directors und Officers oder bei der Begebung von Anteilszertifikaten) nicht beachtet werden.

Zur Vermeidung der Haftung der deutschen Muttergesellschaft bedarf es daher mehr, als lediglich eine U.S. Rechtsperson zu erschaffen. Diese ist eigenständig zu führen!



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IP and Financial Reporting – Germany now Allowing Activation of IP in Balance Sheets

In the middle of 2009 a revised version of stipulations governing accounting standards in Germany has come into force. With respect to intellectual property the revision marks a landmark change, since – though within rather tight constraints – it is now for the first time possible to activate intangible assets that have been created in house in the balance sheets of a German entity. In practice, this means that German corporations now have the possibility to activate e.g. costs associated with the creation of IP, especially of patents. Contrary to, for example, IFRS rules, however, the corporation is not obliged to balance the costs. If balancing of costs for the creation of a patent is opted for, however, further considerations apply. Most important of all costs eligible for activation in accordance with the revised stipulations must be identified. In this context, similarly to IFRS rules, German Handelsgesetzbuch (HGB) provides that research costs may not be activated, activation thus being limited to the development in costs.

The reader will guess at this point that while there may be obvious cases many times this distinction will be difficult to make. A number of criteria were established by the law-maker during the adoption phase of the revised law which include the following indicators for the transition from “research” to “development” in the means of HGB. They include the transition from a systematic search to actual experimenting and testing, in the design of tools based on a novel technology or the termination of the search for alternatives for materials, devices, products, methods et cetera. While the revised German rules according to HGB leave it at the discretion of the corporation whether or not development costs are to be activated in the balance, IFRS rules, by contrast, in many circumstances provide for mandatory activation.

In essence the new German rules open up new degrees of freedom for innovative entities in financing and communicating to the outside world their development activities, especially in relation to the creation of patents. Patent professionals in Germany in turn should in the future be consulted not only when technical issues meet judicial issues but also when financial aspects are involved.



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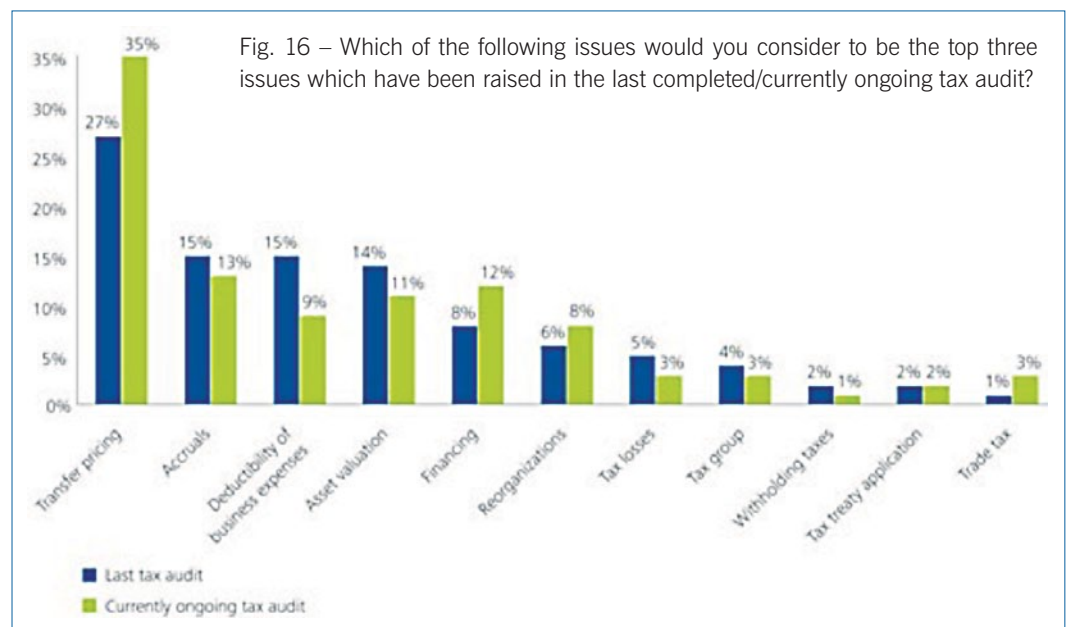
Results of Survey on German Income Tax Audits

A recent Deloitte survey provides an overview of the current status of German (income and including transfer pricing) tax audit experiences and perceived trends for multinational groups with German investments. During June and July 2010, 234 respondents from at least 18 countries answered 35 questions on their experiences with German income tax audits. Most respondents were publicly quoted groups with annual sales of more than EUR 1 billion globally and EUR 50 million to EUR 500 million in Germany; most were headquartered in the U.S., the U.K. and Japan. The German operations were mainly in the form of corporations. Most of the German operations are classified as “large” and, thus, subject to continuous and comprehensive German tax audits.

The survey reveals that inbound investors generally have many open tax years and they undergo lengthy German tax audits, which results in considerable tax uncertainty. On average, the German operations were audited through 2004. Ongoing tax audits on average covered years through 2006. Transfer pricing, by far, is the most important issue in past and current tax audits as the following chart shows, and the survey suggests that the significance of transfer pricing will continue to grow. Transfer pricing adjustments mainly seem to arise from a failure to comply with the arm’s length principle.

Top three issues in tax audits:

German tax audits tend to be costly for both inbound and outbound investors. On average, the last completed income tax audit resulted in (normalized) additional taxes of 49%



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Results of Survey on German Income Tax Audits

of the relevant group's average German income tax expense per year. However, the cash impact of tax audits can be more severe. Respondents who ranked tax group issues among their top three issues on average paid 97% of the annual average income tax (rather than 49%). The clear majority of surveyed companies (84%) responded to their last German tax audit by adopting measures to prepare for future audits.

Seventy nine percent of all German tax audits were perceived to be conducted in a professional or friendly manner. Despite the reportedly negative reputation of German tax audits, the survey demonstrates that they are perceived as equally burdensome as French or U.S. tax audits, slightly less burdensome than Italian audits and far more burdensome than Dutch or U.K. audits.

If you would like a copy of the full survey or if you have questions on German tax audits or related topics please contact the author of this article at anmaywald@deloitte.com.





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Foreign Account Tax Compliance Act of 2009 First Agency Guidance

In March of this year President Barack Obama signed into law a statute which incorporates certain provisions of the Foreign Account Tax Compliance Act of 2009 (“FATCA”). Starting in 2013, FATCA will, among other things, force non-US financial institutions to disclose their US customers or face a 30% US withholding tax on certain payments made out of the US.

Recently the Internal Revenue Service (“IRS”) issued Notice 2010-60. This is the first published guidance by the IRS and the US Treasury Department with respect to FATCA.

The Notice covers the following four principal areas:

- (a) Guidance as to non-US financial institutions and non-financial institutions potentially subject to the 30% withholding tax;
- (b) Detailed and complex procedures for non-US financial institutions to identify US and non-US individual and entity account holders;
- (c) Preliminary guidance about the reporting of information concerning US account holders to the IRS; and
- (d) Subjects for which the IRS is seeking public comments in framing its guidance to taxpayers.

The areas covered by the Notice warrant careful attention by German institutions that could potentially be affected by FATCA irrespective of whether they conduct business in the United States. German companies that are potentially affected include banks, savings banks, funds (including hedge funds and private equity funds), family investment vehicles, broker-dealers, clearing organizations and trust companies.

On the other hand Notice 2010-60 provides relief for the following German institutions:

1. Insurance companies which only issue property, casualty, and term life policies are likely not subject to withholding tax under FATCA.
2. Holding companies for a group of companies not engaged in a financial business are exempt from this withholding tax.
3. Finance or hedging subsidiaries for a group of companies not primarily engaged in financial activities are exempt from FATCA withholding tax if such subsidiaries do not provide services to non-affiliates.
4. Retirement plan administrators may be exempt from withholding tax under FATCA.
5. If shares of hedge funds or private equity funds are held in a custodial account of another foreign financial institution, only the custodial institution (and not the fund) needs to report information about US holders to the IRS.



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Foreign Account Tax Compliance Act of 2009 – First Agency Guidance

The IRS has announced that it will issue regulations incorporating the guidance in Notice 2010-60 and addressing other subjects under FATCA.

Should you have any questions about the Notice or about other issues under FATCA, please contact Charles Chromow, Senior Counsel with Wuersch & Gering LLP.

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New Foreign Reporting Requirements under the HIRE Act

In the aftermath of the UBS debacle, U.S. tax authorities have targeted enforcement of foreign information reporting. As many foreign nationals who are U.S. residents are aware, very burdensome reporting obligations exist in the form of the Report of Foreign Bank and Financial Accounts (“FBAR”), as well as Forms 5471, 926 and 8865 for certain shareholders and partners of foreign corporations or partnerships. However, recently legislation, The Hiring Incentives to Restore Employment (HIRE) Act, imposes even more reporting obligations for those with foreign accounts and assets.

Increased Reporting of Financial Accounts on Taxpayer’s Income Tax Returns

Under the new law, U.S. persons with foreign bank and financial accounts must attach a disclosure statement to their income tax returns if the aggregate value of the assets is greater than \$50,000. Such disclosure is in addition to any FBAR filing requirement and includes the name of the financial institution, the account number, and the maximum value in the account during the year. In contrast to the FBAR reporting which is required if the aggregate account value exceeds \$10,000 at any time during the year, the HIRE Act disclosures also apply to financial assets issued by foreign persons not held at a financial institution including stock or securities issued by a non-U.S. person, financial instruments and contracts issued by non-U.S. persons, and any interest in a foreign entity. In the case of any stock or security, the disclosed information must include the name and address of the issuer and such other information as is necessary to identify the class or issue of which the stock or security is a part.

Penalties under the HIRE Act range from \$10,000 to \$50,000. Furthermore, any underpayment of tax attributable to wrongfully undisclosed assets is subject to a 40% penalty and in certain situations understatement of gross income from these financial assets can trigger an increase in the statute of limitations to six years for the assessment of tax. The new disclosures must be made with any tax returns filed after March 18, 2010.

New Withholding Tax on Payment made to Foreign Financial Institutions

Foreign financial institutions will now be required to report the name, address, and tax identification number of each account holder who is a specified “U.S. person”. If the foreign institution does not comply with this reporting requirement, withholding agents will



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New Foreign Reporting Requirements under the HIRE Act

be required to withhold 30% on certain payments made to this institution. Payments include interest, gross proceeds from the sale of U.S. investments, and other payments traditionally subject to U.S. withholding tax when paid to foreign individuals. The new withholding provisions go into effect for payments made after 2012.

As discussed above, recent legislation increases the already burdensome reporting requirements imposed on certain foreign nationals.





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Managing Tax Risks when moving Supply Chain Activities Abroad

Management decisions are made on a regular basis to move supply chain activities from one country to another for operational reasons. The tax consequences are often ignored, which can create significant tax risk. It comes as no surprise that the loss of jobs and tax revenue accompanying such transfers has always been strongly scrutinized by tax authorities around the globe.

In this context, the questions that need answering are whether valuable tangible or intangible assets are part of such transfer of supply chain activities and whether potentially some form of ‘exit tax’ is triggered. German lawmakers, as early as 2008, were the first to implement rules governing the transfer of business functions into tax law. In October of this year, the German tax authorities released the final version of the administration principles reflecting their interpretation of said law.

These rules and administration principles demonstrate the importance of recognizing early on the existence of a function transfer and of taking appropriate measures to avoid potential costly repercussions. Analysis of function transfers should therefore be an important part of a company’s tax risk management strategy. There are two common areas of this type of risk observed among companies: (1) Function transfers tend to creep up on a company over time. (2) The tax implications of function transfers are often overshadowed by operational/commercial considerations. The result of these two situations is that tax implications are often not given sufficient attention or only considered after potentially harmful fact patterns have already been established.

In order to avoid such a scenario, key indicators of function transfers, e.g., number of employees, aggregate payroll expenses, revenues/profit etc., should be regularly monitored, all of which will also be monitored by the tax authorities in order to uncover “hidden” function transfers.

A more comprehensive approach for managing such risks is the adoption of company-wide guidelines for function transfers. Implementation of such guidelines eases the burden on the company’s tax department and reduces the risk resulting from imperfect communication. A further step for successfully managing a function transfer is the conclusion of a strategically effective price adjustment clause. From a risk management perspective, the final version of the administration principles provides taxpayers with further clarification of concepts and rules introduced into the law and provides guidance regarding the tax authorities’ position on the application of said law in a tax audit. However, the administrative principles still leave many questions unanswered for the taxpayer.

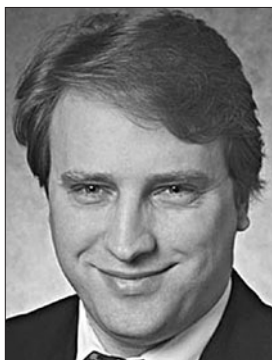
Ernst & Young’s dedicated professionals are available to address all issues and goals your company may have surrounding function transfers. Feel free to contact us at any time.





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The 2010 Elections – Consequences for Renewables in the U.S.

The November midterm elections in the United States resulted in Republican control of the House of Representatives. The Republicans also ended up with more seats in the Senate where the Democrats, even though they retained control, now lack enough seats to pass legislation without support of both parties. Eighteen months ago the mood in the U.S. renewable energy market was rather euphoric. The talk was about the ambitious agenda of the new Obama administration and how it would usher in a new “green economy”. November’s midterm elections changed everything.

The Cash Grant Program, passed by Congress last year, has been a very successful initiative for the renewables industry. To be eligible for these grants, developers must start construction by the end of 2010, leaving many to question whether Congress will extend the Cash Grant Program for projects commenced after the end of this year. Currently, an extension of the program seems unlikely and if there is no extension this year, the odds are even lower that it will be extended by the new Congress. In contrast to the Cash Grant Program, the Department of Energy Loan Guarantee Program has been a huge disappointment and is very unlikely to be extended. At this time, extending the Treasury Cash Grant Program is a bigger priority for the renewables industry.

On the carbon front, President Obama has confirmed that cap-and-trade bill is dead, leaving the issue of whether Congress will block the Environmental Protection Agency (EPA) from acting on its own to control carbon through regulatory measures. Looking at the next Congress, there are likely enough votes in the House and possibly in the Senate to impose a moratorium on any EPA action to control carbon. However, the question is whether any such action will take the form of a stand alone bill or be part of a larger appropriations bill. It would be more difficult for President Obama to veto a broad appropriations bill that cuts off funding for implementing rules on carbon than to veto a stand alone measure.

Currently there are 30 states in the U.S. that have renewable portfolio standards requiring utilities to supply a certain percentage of their electricity from renewable energy. Last year President Obama wanted to create a national standard but was not able to get it through Congress. The lobbyists, however, have not given up entirely on getting a national renewable standard passed but there is recognition now, in light of the changes in the political landscape in November, that if anything passes it would not be a renewable energy standard but rather a clean energy standard that includes nuclear, clean coal and other types of clean energy.

While the outcome of the November U.S. elections appears to be a bad result for renewable energy, as Republicans will control the agenda in the House they might



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The 2010 Elections – Consequences for Renewables in the U.S.

actually help renewable energy if they take an “all of the above approach” on energy resources. Instead of focusing on renewables, they may look to other forms of clean energy and see renewables as just one of several potential solutions to the U.S. energy problem. For now, the renewables industry will have to wait to see how these issues play out in the U.S. political arena.



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Upcoming Export Control Reforms

In both the US and Europe, the rules on export control are undergoing significant reforms. US and European authorities have recently reviewed their practical experiences with the respective export control systems. During this process, the US, for example, realised that its current export control system is overly complicated, contains too many redundancies and lacks the necessary focus on the most critical national security priorities. In Europe the licensing procedures create indirect costs of more than EUR 2.7 billion, although, at the same time, in the large majority of cases an export license is granted, especially if it is requested for a transfer within the European Union itself. Both the US and Europe are now drawing their conclusions from these reviews.

The Obama Administration is especially focusing on simplifying the Commerce Control List (CCL) and the U.S. Munitions List (USML), in order to achieve a more transparent licensing system, while also enhancing the competitiveness of key U.S. manufacturing and technology sectors. For example, the USML will be restructured to create a comprehensive list describing the controlled items precisely based on objective technical criteria instead of relying on the item's military "design intent". The longterm objective is a single list as well as a single licensing agency and a single IT system.

On the other hand a duty to obtain a permit for reexports may also result from the reform. Over the past few months, US government representatives have been discussing the US reform with European companies. Further discussions will follow in the beginning of 2011.

The European Union is also obliging its Member States to improve their national transfer rules for defenserelated products. In order to strengthen Europe's internal market, the rules on transfers within Europe will be simplified by June 30, 2011. For example, a general license will be granted for all temporary transfers within the E.U., if these transfers are made for the purposes of evaluation, exhibition or maintenance and repair. Once the competent authorities have published such a general license in their official journals, manufacturers meeting license requirements will be entitled to transfer their goods by simply notifying the authority. In Germany, the relevant authority will be the Federal Office for Economics and Export Control.

In addition to this, EU Member States will introduce a certification system and grant a general license for transfers within Europe to all certified companies. For the time being, certificates will be limited to companies with a seat or a branch office within the EU. Furthermore, they will have to meet certain exacting compliance criteria ensuring the reliability of these companies. In general it is expected that only a few defense



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Upcoming Export Control Reforms

product manufacturers will be certified. However, it will be interesting to see how the EU Member States refine their certification systems going forward. The first drafts are expected to be published in early 2011.

The large number of US and European companies do not even realize that they are affected by export control regulations, which can lead to serious consequences. Moreover, export control regulations do not reflect technical developments, such as cloud computing. Cloud computing in particular results in new and complex legal requirements because it may not be known where a server is located. It would be very helpful if the upcoming reform also provides clarification on this issue. Until such time, compliance should be ensured with the relevant national and international requirements of export control regulations.



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Customs Seizures & Penalties, Part 1: Money and Personal Property Seizures

This article will discuss the most common Customs seizures and penalties experienced by travelers. Part 2 of this article, to appear in the next issue, will review the most common seizures and penalties experienced by businesses.

Upon entering the United States, each traveler (or in the case of families traveling together, each family) must declare merchandise acquired abroad. In addition, each traveler/family, when entering or leaving the country must declare all currency in the amount of \$10,000.00 or more. It is not illegal to carry currency in any amount, nor is it taxable. But if you are either leaving or entering the country, amounts of \$10,000.00 or more must be declared. Failure to declare currency is common, especially on flights leaving the United States. Many travelers do not even know they have the obligation to report large amounts of money when leaving the country. But Customs officials patrol departure areas, and are often in the jet-ways of flights leaving the country.

If your money is seized, Customs will give you a receipt, and you will be able to file a petition for the return of your money, in exchange for a monetary penalty. That penalty is almost always at least 10% of the amount seized, even in the most innocent of circumstances. The petition should state the excuse for not declaring the funds, and must state the source of the funds. Usually, Customs asks to see income tax statements to verify that the funds came from legitimate sources and was declared as income. While ignorance of the law is no excuse for violating the law, it is a factor Customs considers when determining the penalty; not being aware of the obligation to declare the money usually results in a lower penalty. Other factors which may reduce the penalty are the traveler's difficulty in understanding English, inexperience as a traveler, and no prior violations. While most violations are treated as civil violations, it is important to remember that failure to report these funds may also be a crime. Although rarely prosecuted criminally, large amounts of undeclared cash, particularly when a legitimate source cannot be established, sometimes result in criminal prosecution. So the traveler should be careful of what he says, lest it be used against him.

Customs also seizes merchandise which is not declared by the traveler. For major purchases, the traveler should consider sending the merchandise rather than bringing it in himself. This is because at the airport, the duty a traveler pays at the airport is almost always higher than the duty paid on the same merchandise when imported commercially (the only exception is apparel which is taxed at a lower rate when imported with the traveler). When a traveler does not declare the merchan-



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dise, or when he declares a lower value than he paid for it, the law has been violated and Customs may seize the merchandise or impose a penalty equaling the value of the merchandise. As in the case of money seizures, a petition may be filed, and using similar factors, the penalty will be lowered to 10-30% of the value of the merchandise for first offenders. But, when importing prohibited merchandise such as food and agricultural products, the seized merchandise will never be returned. So in the cases of both money and merchandise, it is always the best – and usually the cheapest – course to fully declare what you are carrying. And, if the value is sufficiently high, it often is wiser to make a commercial entry and pay lower duty.

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