LÜBECK Business Development Corporation

Business Entities

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Business Entities

Setting-up a business needs careful preparation - this fact sheet delivers the necessary background information

Forms of business organisation - German law permits various forms of business organisation. The main forms, apart from businesses owned by the Government, are:

a) Companies
- Joint-stock company (*Aktiengesellschaft*-AG)
- Limited-liability company (*Gesellschaft mit beschränkter Haftung*-GmbH)
- Partnership limited by shares (*Kommanditgesellschaft auf Aktien*-KGaA)
- European public limited-liability company (*Europäische AG*-SE)

b) Partnerships and others
- General partnership (*offene Handelsgesellschaft*-OHG)
- Limited partnership (*Kommanditgesellschaft*-KG)
- Civil-law partnership (*Gesellschaft des bürgerlichen Rechts-BGB-Gesellschaft*)
- European economic interest grouping (*Europäische Wirtschaftliche Interessenvereinigung*)
- 'Partner law partnership' (*Partnerschaftsgesellschaft*)
- Branch of a foreign enterprise (*Niederlassung einer ausländischen Gesellschaft*)
- Sole proprietorship (*Einzelunternehmen*)
- Silent partnership (*stille Gesellschaft*).

The most common form of organisation for a new business starting in Germany is the limited-liability company (GmbH). The main forms of organisation that could be considered by a foreign investor wishing to acquire an existing business, or having to decide on the legal form for a new enterprise, are dealt with in more detail below.

A civil-law partnership is an association of individuals or enterprises to achieve a joint contractual purpose; a sole proprietorship is the business of one individual. In the case of a silent partnership the silent partner contributes money, assets or services to an enterprise in return for a share of the enterprise's profits and, possibly, losses. Forms under b) above provide the greatest possibilities of customising the organisation to individual needs.

Joint-stock company

The joint-stock company (*Aktiengesellschaft*-AG) is usually used when funds are to be raised from the general public, for example, on the German stock markets. It is an incorporated business entity. All details as to the rights and duties of the joint-stock company and its shareholders are governed by the Joint-Stock Companies Act (*Aktiengesetz*-AktG).

a) Capital

The minimum share capital is EUR 50,000, which must be fully subscribed and of which at least 25 percent must be paid up at the time of formation. Capital contributions in kind are possible but must be fully paid up and their value is subject to examination by the registrar. Shares must have a minimum par value of EUR 1. Shares may also be issued without par value but the value allocable to each share must reach at least EUR 1.

If shares have been issued at above par value, the premium has to be transferred to a legal reserve account. Five percent of the annual income after income taxation must also be transferred to the legal reserve account until that account equals 10 percent of the share capital.

b) Organisation

The shareholders exercise their rights in general meetings. With a few exceptions (such as the increase of share capital, mergers and liquidation) resolutions require a simple majority of votes for approval. In particular, the general shareholders' meeting appoints the supervisory board, approves the amount of dividend distributions, the increase or decrease of share capital and the amendment of the Articles of Association.

The supervisory board (*Aufsichtsrat*) is prescribed by law. It must consist of at least three members but its size varies up to a maximum of twenty-one members, depending on the amount of issued share capital. One third of the members are employees (workers) and are separately elected by the employees, if the company has at least 500 employees (workers). Special rules apply for joint-stock companies with more than 2,000 employees (workers) and for the iron and steel industry (half of the members have to be employees or workers).

The supervisory board appoints, removes, supervises and advises the management board (*Verwaltungsrat*), appoints the auditor, receives the auditor's report and the report of the management board, and reports to the general meeting on the result of its review of these reports. The members of the management board legally represent the joint-stock company and are responsible for its management. The law puts most decisions in the hands of the management board.

Limited-liability company

A limited-liability company also enjoys a legal identity of its own. Its shareholders are not personally liable for the debts incurred by the company. In contrast to the joint-stock company, the formalities required to establish and operate a limited-liability company are much less comprehensive and expensive. A limited-liability company can also be founded by a single individual or another company, which is one of the reasons why it is the most popular form of business organisation when starting a new business in Germany. The Limited-Liability Companies Act (*Gesetz betreffend die Gesellschaften mit beschränkter Haftung* - GmbHG) contains all the details.

A limited-liability company's legal existence begins when it is entered in the local commercial register. It is possible for a limited-liability company to start operations before entry in the commercial register but after the Articles of Association are signed, although the shareholders are fully personally liable until the entry in the commercial register is made. It is common to buy already existing off-the-shelf companies that have not yet started business.

a) Capital

The minimum share capital is EUR 25,000. It must be fully subscribed on the company's formation and subscriptions by individual shareholders must amount to at least EUR 100. However, only 25 percent of the capital subscribed (minimum EUR 12,500), must be paid up prior to registration. Capital contributions in kind are subject to examination by the registrar to ensure that the assets contributed are fairly valued. Share certificates are not required by law. Transfers of shares, for example by purchase agreement, must be executed before a notary public and must be brought to the attention of the company and the trade registrar.

b) Organisation

The shareholders exercise their rights at shareholders' meetings. Shareholders' resolutions require a simple majority of

votes for approval unless the articles of association or the law require a qualified majority. For instance, the law prescribes a 75 percent majority for an amendment to the articles of association.

The shareholders' meeting decides all matters outside the ordinary course of business, and all those matters ascribed to it by law or in the articles of association. A limited-liability company is legally represented and managed by one or more managing directors (*Geschäftsführer*). Managing directors are appointed and removed by the shareholders' meeting. The rights and duties of a managing director ensue from the law, the articles of association and his or her employment contract. It is possible to limit the power of the managing director(s) or to give advice in single issues.

The managing directors are personally responsible for failures of their company and can be sued for example for unpaid taxes or creditor losses in case of bankruptcy if they violate their duties.

A supervisory board is required by law only in cases where the limited-liability company employs more than 500 individuals. In that event, one third of the supervisory board members must be elected by the employees. If there are up to 500 employees (workers), it is possible, however, to provide for a voluntary supervisory board in the articles of association. Other rules apply in the case of large limited-liability companies with 2,000 employees or more and in the iron and steel industry.

European public limited-liability company (Societas Europaea - SE)

The aim of the European public limited-liability company is to ease the formation of holding companies or subsidiaries by companies in different EU Member States without legal and practical problems arising from the different legal systems of the Member States.

The SE may be formed by

- merger;
- formation of a holding SE;
- formation of a subsidiary SE;
- conversion of an existing public limited-liability company into an SE.

a) Capital

The minimum subscribed share capital is EUR 120,000. If there are laws of a Member State requiring a greater subscribed share capital for companies carrying on certain types of activity these laws apply to SEs with a registered office in that Member State. Furthermore, the share capital, its maintenance and changes thereto, together with its shares, bonds and other similar securities are governed by the provisions that would apply to a public limited-liability company with a registered office in the Member State in which the SE is registered. This means that in Germany the German law for joint-stock companies must be applied.

b) Organisation

The shareholders exercise their rights in general meetings. With a few exceptions regulated in the provisions on the statutes for an SE (Amendment of the SE's statues) or in the Member State in which the SE's registered office is situated (e.g. Germany: increase of share capital, mergers or liquidation) resolutions require a simple majority of votes for approval.

The SE has to decide on whether to establish a supervisory organ and a management organ (two-tier system, e.g. Germany) or a single administrative organ (one-tier system, e.g. UK).

c) Taxation

As of yet Germany has not implemented all the legislation necessary for the creation of an SE by way of a merger. According to German law carry-over of balance-sheet values, carry-over of reserves and carry-over of losses is not possible. Furthermore, in the event of a transfer of balance-sheet values the shareholder is taxable.

Germany is also in breach of the EC Mergers Directive due to the fact that the rollover of the value of assets and liabilities transferred is restricted, carry-over of reserves and provisions in case of a merger is not possible and carry-over of reserves and provisions in case of a transfer of a branch of activity is restricted.

In addition, the take-over of losses in cross-border mergers is disallowed,

whereas the take-over of losses is allowed in mergers between domestic companies.

In the case of a transfer of the registered office or head office of a German SE to another Member State, exit tax would be levied even where, after the transfer of the registered office or head office, a permanent establishment remains in Germany.

General and limited partnerships (OHG and KG)
The main feature of a general partnership is that each of the general partners assumes unlimited personal liability for the firm's liabilities.

A limited partnership has at least one general partner who is subject to unlimited liability and one or more limited partners. The limited partners' liability is restricted to their share of the partnership capital. The rights and duties of a partner are regulated in the German Commercial Code (*Handelsgesetzbuch*) and in the partnership agreement. A partnership does not have its own legal identity but may conclude agreements and may sue or be sued under its firm name. It comes into existence when the partnership agreement is concluded and operations start. It must be registered with the local commercial register. There are no legal requirements as to the minimum amount of capital or the maximum number of partners. Unless stipulated otherwise in the partnership agreement, each general partner is entitled to take part in the management of the enterprise whereas limited partners are excluded from the management by law. They may, however, be given the mandate of management by contract.

A combination of a limited partnership and a limited-liability company is called GmbH & Co. KG. This type of organisation is a limited partnership where the general partner is a limited-liability company. In this case only the GmbH is fully liable for the debts of the partnership, while the limited partners are responsible only to the extent of their contribution to the partnership capital.

In general, profits and losses are shared in the proportion of capital accounts. However, limited partners take part in losses only up to an amount that equals their agreed capital share. Partnerships are subject to trade tax on income (*Gewerbeertragsteuer*) but are not subject to other income taxation, whereas the partners are. Thus earnings may be subject to corporate tax or personal income tax, depending on whether the partner is an entity or an individual.

Branch of a foreign enter-prise
An alternative approach for the foreign investor is to open a branch operation, rather than to set up a separate German company.

A branch operation is simply a part of the foreign business enterprise in whatever legal form that enterprise carries on its operations. Accordingly there are no specific German legal requirements for establishing and operating a branch of a foreign enterprise in Germany (exceptions apply e.g. for bank or insurance companies). On the condition that the branch operation exercises essentially the same activities in Germany as the head office abroad, it may be entered in the German local commercial register as a registered branch (*Zweigniederlassung*) by filing the foreign incorporation documents. Representative offices not engaged in trade or business are not regarded as branches, although for taxation purposes the definition of a permanent establishment in an applicable tax treaty must be considered.

Although no formal capital is required by law, the tax authorities demand an adequate branch capital corresponding to the functions of the branch. In the case of a registered branch the head office has to appoint a branch manager as legal representative. In other cases the branch is represented by the legal representatives of the foreign company, unless some kind of proxy is given to a supervising person in order to carry out the day-to-day business of the branch.

This FactSheet has been prepared by BDO. Its aim is to provide background information for setting up and running a business in Germany in compliance with legislation in force in September 2004.

It is written in general terms and is not intended to be comprehensive. Before taking decisions advice should be sought from

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