



Corporate Law Notice (November 2008)

The Law for the Modernisation of the GmbH and to Combat its Abuse (“MoMiG”) has come into force

The Bundestag (Federal Parliament) and the Bundesrat (Federal Council of the States) have passed the bill for the Modernisation of the GmbH and to Combat its Abuse (“MoMiG”). The new law has come into force from November 1st, 2008. It brings major changes to German corporate law. Among other things, the reform will make it possible to establish a new form of the GmbH (“Unternehmergeellschaft” or “UG”) with a share capital of only 1 Euro and to establish a GmbH that has no active business in Germany but solely operates abroad.

I. Changes for founders

1. The new “UG (haftungsbeschränkt)” (Limited Liability Entrepreneurial Company)

Above all in order for the needs of existing founders to be satisfied, who by admission of the company have little capital and need it, (e.g. in the service sector), the law brings, as already seen in the bill, a means of entrance to the GmbH, the “UG (haftungsbeschränkt)”. It is not a new legal entity form, but a GmbH, which can be founded without a certain minimum capital (1 Euro per shareholder is enough). These businesses however are not allowed to fully distribute their profits. It is much more bound to provide a reserve for the amount of 25% of their annual net income and in this way gradually accrue the minimum capital of 25.000 Euros of the “normal” GmbH.

2. Raising capital

Previous existing legal uncertainties, in regards to raising capital with the formation of the GmbH, should now be reduced, as the legal institute for “hidden contributions in kind” (“Verdeckte Sacheinlage”) will be regulated in the new GmbH law. A hidden contribution in kind is, if a formal cash contribution is indeed agreed upon and supplied, but in fact a contribution in kind is made.

Practice Tip: If the company director knows about the scheduled hidden contribution in kind, he is not allowed to assure in the commercial register, the cash contribution is fulfilled. Otherwise he could be held liable.

3. Model protocols

For straight forward standard formation (with at the most three shareholders) two mandatory registration model protocols (“Musterprotokolle”) will be supplied as part of the GmbH Act.

The simplification of the formation will thereby essentially bring privileged legal costs and the registration with the court should be faster cheaper.

Practice Tip: The model protocols, in our opinion are not recommendable, as soon as more than one shareholder has a share in the newly formed GmbH or UG. The model protocols contain namely no contractual rules, which in most cases are urgently necessary. For instance, the model protocols lack rules on amortization of shares, on decision making, on the exclusion of shareholders as well as paying them off. Therefore sound legal advice on the formation of a GmbH still remains highly recommendable.

4. Speeding up the registration process

The new law should reduce the time it takes to enter a company on the commercial register. In cases where shareholders, whose companies purpose is subject to administrative authorisation/license, the timely length of the registration procedures depend on the administrative decisions. Now a GmbH like a business man and a private commercial company will no longer have to submit a licence to the registration court. An exemption to the administrative rules duty to obtain a licence is for this reason certainly not bound, the licence only must be not submitted to the registration court before.

Furthermore, it will be formally clarified, that the registration court can only demand to see the bills on capital contribution receipts or other supporting documents with the formation audit, when it has reasonable doubt as to whether the proper capital or contribution in kind has been raised.

Practice Tip: Nevertheless we recommend that shareholders and company directors should carry on keeping their documents in good order and if need be draw up valuation reports, in order to avoid having a possible lack of evidence later.

5. Minimum share capital

The minimum capital of the GmbH will remain unchanged at 25.000 Euros.

II. Changes for existing GmbHs

1. Move of the administrative centre abroad

It was previously seen as a competitive disadvantage that EU-foreign companies can choose to have their administrative centre in another EU member state – so also in Germany. These foreign companies are perceived as such in Germany. However, up until lately German companies have not had this possibility.

Through the abatement of the according statute it is now possible for German companies to chose an administrative centre, that does not necessarily correspond with the statutory centre. This administrative centre can also be situated abroad. That can be an attractive option for German companies, to run their foreign subsidiaries in the form of the familiar German GmbH.

2. List of shareholders and company shares

According to the model of the share register of the German stock corporation “Aktiengesellschaft (AG)”, it is now even more important to keep the shareholder list up to date, since only those shareholders who are registered as shareholders with the list are allowed exercise their shareholder rights within the company. Company directors and shareholders now are called to take a look into the list regularly. Creditors of a GmbH now can have a better understanding of who is standing behind the company.

3. Good faith purchase of company shares

Henceforth the shareholders list also serves as a link for a, previously legally not possible, good faith purchase of GmbH shares. Previously the purchaser of company shares took the risk, that the share might belong to another person.

Whosoever purchases a share, can now under certain conditions rely on the fact that those who are listed in the shareholders list are really shareholders.

4. Cash pooling

The customary system of cash pooling is secured, likewise the field of raising and receiving capital is governed by a statute. Cash pooling is an instrument for balancing liquidity between the business departments and subsidiaries in a corporate concern (combined cash management system). The subsidiary transfers its liquidity to the parent company. In return the subsidiary receives a right of refund from the parent company. On grounds of the former German case law, the legitimacy of the practice of cash pooling caused substantial legal uncertainty.

The new law is intended to solve these problems by bringing back the balance sheet based view of the companies assets. After this a payment from the company to a shareholder can not be judged as a forbidden payment from the company's assets, if there is an adequate exchange of assets and/or a valid counterclaim. The payment of the share capital is henceforth also acceptable, if control and profit transfer agreements between the parent company and the subsidiary are in place.

5. Deregulation of the Law on substitute equity capital

The complex area of the law on substitute equity capital is deregulated. With the law on substitute equity capital comes the question, whether the loan which the shareholders give their GmbH should be treated as a real loan or as equity capital. The equity capital stands in the insolvency behind all other creditors.

The basic idea of the new regulation is that the managers and shareholders of the healthy GmbH should find a clear legal framework. There is no longer be a difference between substitute equity capital and normal shareholder loans.

Practice Tip: This will however result in new risks for shareholders, because now any payments on shareholder loans within one year must be returned to the GmbH in case of insolvency.

III. Fight against misuses

In the practice, cases of misuse often arise in connection with the legal form of a GmbH. In particular, cases of “company burials”, in which shareholders and company directors try to tacitly “dispose of” their GmbH, should be fought through the new law.

1. Business address and service

Now a domestic business address must be entered in the commercial register. This also applies to joint stock companies, business men, private commercial companies as well as subsidiaries (also to foreign companies having a place of business in Germany). If under this inserted address a service impossible, the possibility will be improved to bring about a public service in the domestic country. This brings about simplification for the creditors of a GmbH, who previously have fought against the costs and problems of proper service.

2. "Loss of management" and insolvency

Henceforth, in cases where the company has no managing director and is insolvent, each shareholder of the company are bound to file for bankruptcy, unless he has no knowledge of the insolvency or the loss of management.

Thus it should be prevented, that the filing for bankruptcy through "descent" of the company director – like often previously observed in the practice – is avoided.

3. New rules on liability for causing insolvency

Company directors who aid and abet on the pillage of the company by making payments to the shareholders and thus cause the insolvency of the company, shall be held more liable. For that purpose the payment ban in § 64 GmbHG (and at the same time the risk of jail for company directors) will be increased.

4. Director disqualification

The previous grounds for disqualification of executive officers will be extended to convictions because of insolvency delay, false statements and incorrect portrayal as well as convictions on the grounds of existing punishable acts (§§ 263 to 264a and §§ 265b to 266a Criminal Act – StGB). Therefore, managing directors or members of the executive board now can no longer be appointed, who in a time period of five years before the appointment have been convicted for a wilful infringement of such crimes. The same applies for convictions for similar crimes abroad.

In addition, shareholders now can be held liable for letting a person, who is disqualified from being a managing director, manage the company, if such person causes damage to the company.

Our specialists in this field of law are happily available to help with any questions concerning the GmbH and Corporate Law:



Dr. Theodor Seitz, LL.M. (Harvard)

Attorney-at-law, Tax Advisor
Specialist in corporate law
Attorney-at-law (N.Y.)

TSeitz@seitz-partner.de
Tel. + 49 (0) 821 / 345 85 - 31



Dr. Christoph Knapp

Attorney-at-law

CKnapp@seitz-partner.de
Tel. +49 (0) 821 / 345 85 - 11



Dr. Rudolf Wittmann

Attorney-at-law
Specialist in tax law

RWittmann@seitz-partner.de
Tel. +49 (0) 821 / 345 85 - 36



Dr. Sven Friedl, MBA (Wales)

Attorney-at-law
Specialist in banking law

SFriedl@seitz-partner.de
Tel. +49 (0) 821 / 345 85 - 43

If you wish not to receive our „Corporate Law Notice“ in the future, please send us an e-mail at CKnapp@seitz-partner.de.

© 2008 Seitz Weckbach Fackler. Because sound legal advice must necessarily take into account all relevant facts and developments in the law, the information you will find in this Notice is not intended to constitute legal advice or a legal opinion as to any particular matter.