

## German-Israeli Chamber of Industry & Commerce

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### FAQ: Forming a GmbH

#### **Is the GmbH the right corporate form for my business venture?**

A limited liability company, such as the GmbH, is your perfect match if you want to protect your personal assets and can raise the necessary share capital of €25,000.

This corporate form also offers other advantages such as tax benefits and the public image of a fully-fledged company.

#### **What are the key characteristics of a GmbH?**

The abbreviation GmbH stands for “*Gesellschaft mit beschränkter Haftung*”, which translates to “company with limited liability”. This means that in the case of liabilities, the company is only liable with its assets rather than the shareholders’ private assets.

As a corporation, a GmbH is subject to corporate income tax (in the case of non-distribution of profits) which is considerably lower than the income tax of sole proprietorships.

The necessary share capital (*Stammkapital*) of a GmbH is €25,000, which multiple partners can contribute.

If it is not possible for you to raise the required capital, you can also form the so-called “Mini-GmbH”, a UG (haftungsbeschränkt). This is a special form of limited liability company which is specifically designed to meet the needs of startups with limited share capital.

#### **What makes the GmbH so attractive to entrepreneurs?**

**Tax savings:** The GmbH offers a much more favorable tax rate in comparison to sole proprietorships or business partnerships regulated by the German Civil Code. However, it’s important to note that the incomes of the managing directors of a GmbH, like an employee, are taxable at their personal income tax rate.

**No personal liability:** As a GmbH founder, you are not liable for damages with your private assets (e.g., your house, car, bank accounts and deposits) for company debt. This rule applies even in the event of an insolvency.

**Greater tax relief thanks to “hidden reserves”:** Another way to enjoy favorable tax conditions is via so-called ‘hidden reserves’ (*stille Reserven*) which are company-owned assets that have a lower “book value” than its market value. As long as these hidden reserves remain company assets, they are exempt from taxation.

**Freedom to nominate managing directors:** The shareholders are free to choose one or several managing directors. Whether the shareholders act as managing directors themselves or decide to employ an external managing director is a matter choice.

**Creation of a legal entity:** A GmbH is considered a legal person. It can make transactions and contracts in its own name. Its interests are represented externally by the managing director.

### **Why is the GmbH a "tax saving model"?**

Compared to the taxes that other legal forms have to pay, the taxes incurred by a GmbH are low. As a corporation, a GmbH must pay the so-called *Körperschaftsteuer* (corporation tax). A solidarity surcharge (*Solidaritätszuschlag*) is also levied on the taxable income of the company, so that the taxes incurred by a GmbH ultimately amount to 15.825 % of the income.

Additionally, a trade tax (*Gewerbesteuer*) is levied once a year on the company's profits, the amount of which is determined by the respective municipality.

If a GmbH decides to distribute profits to its shareholders, the capital gains tax of 25% must be paid.

### **What does limited liability mean?**

In contrast to partnerships, a GmbH is only liable with its corporate assets. As a rule, the private assets of the individual partners are protected.

### **What does *Unterbilanzhaftung* (short balance liability) mean?**

If GmbH company assets sink below €25,000 before its entry into the commercial register (*Handelsregister*), it is considered to be undercapitalized. In this event, the GmbH's shareholders become personally liable, allowing creditors to collect damages from the shareholders' private assets as well. This situation is called a *Unterbilanzhaftung* (short balance liability).

During the formation of your GmbH, make sure that you do not enter into any early payment obligations that endanger the prescribed minimum capital. Careful financial planning is essential to avoid this short balance liability.

### **What is *Existenzvernichtungshaftung* (liability for destruction of economic basis)?**

If a GmbH has lost its company assets due to negligence or the wrongdoing of its shareholders, there are grounds for liability, known as *Existenzvernichtungshaftung* in Germany. In this case, an insolvency administrator (*Insolvenzverwalter*) decides whether or not to remove the limited liability of the shareholders.

Liability due to *Existenzvernichtungshaftung* is based on the shareholders' obligations to protect the company's financial interests.

### **What is liability for taxation non-compliance?**

If a GmbH does not comply with tax laws and regulations, the managing directors become personally liable for any damages.

If the non-compliance occurs before the company's entry into the *Handelsregister*, all the shareholders are liable for damages with their private assets without restriction.

### **What is *Ausfallhaftung* (contingent liability)?**

If one of the shareholders defaults on his or her share capital, the remaining shareholders have to absorb the loss, and deposit the missing amount proportionate to their respective share percentage.

### **What is the function of the shareholders?**

GmbH shareholders are the owners and the decision-makers of the company. During the general shareholders' meeting, they vote on all major business decisions.

There is no shareholder minimum or cap for a GmbH. However, if you want to use the standardized articles of association template (the *Musterprotokoll*), the number of shareholders is limited to three. Any amount above this requires a customized version of the company's statutes.

### **What happens in a general shareholder's meeting (*Gesellschafterversammlung*)?**

All business-related decisions are made during the GmbH general shareholders' meeting. Alternatively, if there is a consensus, shareholders may opt to make decisions via written resolutions.

### **Who runs the GmbH?**

A GmbH's management is appointed by the shareholders. One or more managing directors implement the decisions made in the shareholders' meeting within the framework of the GmbH's statutes. The company's management represents without restrictions all interests of the company externally and can consist of one or more persons.

Shareholders can also be managing directors. If an MD has such a double function and is also majority shareholder, it can make sense tax-wise for the GmbH to employ him or her.

It is also possible to employ managing directors without them owning shares in the GmbH.

### **What are the rules for choosing a company name?**

Your GmbH needs a distinctive corporate name. You can choose a name inspired by an actual person's name, the sector, your corporate objective (or business branch) or make something up. In every case the name suffix "GmbH" is mandatory, so your chosen corporate form is transparent to the public.

The four options are explored in greater detail below:

- **Name your company after a person:** It is often natural to use the name of one or more of the shareholders as the company name, e.g., "Anna Beginner GmbH" after the hypothetical company founder of the same name.
- **Think up a fantasy name:** If you are creative and are looking for a particularly original name for your company, you can also invent a name, e.g., "Grimpotin GmbH" or "Rumpotrix GmbH". However, make sure not to infringe any trademark rights.
- **Describe what your company does:** If you want your company name to indicate the activity of the company, this can be described in the company name, e.g., "Minibus Rentals GmbH" (*Kleinbus-Verleih GmbH*).
- **Use a combination of the above options:** "Grimpotin Minibus Hire GmbH" or "Rumpotrix Gregor Founder's Fine Foods GmbH".

Before you incorporate a GmbH, you should choose your company name carefully. Something to consider is that many founders use fantasy terms that are not only unique, and thereby avoid copyright issues, but also pronounceable in as many languages as possible.

However, whatever your company name you choose, it's crucial that it only has positive connotations. Always consider your future customers before you make a final decision.

Beyond this, your company's name must characterize your business and be distinct. In addition, your name of choice must not contain any statements that are misleading - something that the district court has ultimate authority over.

### **How much share capital do founders need for a GmbH?**

GmbH shareholders need to contribute a minimum of € 25,000 share capital.

The share capital can be contributed by several shareholders and has to be provided after the formation but before registering your company with the commercial register (*Handelsregister*).

How exactly the individual shares are divided among the shareholders is regulated in the articles of incorporation. The shares must be paid in as cash deposits or contributions in kind.

### **How is it possible to form a GmbH from €12,500?**

If you cannot raise the entire €25,000, you still have the option of forming a GmbH, provided you make a deposit of at least 50%, i.e. €12,500, into your business account at the time of incorporation.

Incorporating with less than the minimum share capital is, however, associated with a much higher risk. In the event of insolvency, the missing share capital must be paid for personally by the shareholders. For example, if the share capital of a GmbH is €19,000, the remaining €6,000 must be contributed by the shareholders in the event of insolvency.

Alternatively, you also have the option to form a UG (*haftungsbeschränkt*) - colloquially known as the *Mini-GmbH* or *1-Euro GmbH*. The UG is a special variation of the corporate form GmbH and caters to the needs of startups with limited starting capital that still want to benefit from limited liability. The minimum capital requirement is a single euro per shareholder.

### **What is a Mini-GmbH?**

The 'Mini-GmbH' is the corporate legal form *Unternehmergeellschaft (haftungsbeschränkt)* — commonly known as the UG.

The UG is a limited liability structure that caters to the needs of startups that have restricted share capital (the minimum share capital is only one euro per shareholder) but still want to benefit from limited liability.

The UG is not a corporate form of its own, as frequently assumed, but was created by the German legislation as a special variation of the regular GmbH in 2008 (Modernize the Law on Limited Liability Companies and to Combat Abuse - *Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen, MoMiG*)