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Associations and Foundations in German Law

U. Drobnig

In democratic societies, the state has no monopoly in promoting the public benefit. The state has neither the power nor the resources to do that. An important supplementary rôle is played by the so-called "voluntary sector". Voluntary action by citizens takes place in two forms, either by common action of persons or by the dedication of material resources.

German law, like other Civil Law countries, does not have a general, all-purpose type of company (as England has). Rather, it distinguishes between corporations pursuing an economic purpose, espec. the making of profits, for which several statutory forms are available; - and other organisations, not pursuing econ. purposes, espec. not the making of profits.

For this latter type of organisation, distinct legal forms are provided for: associations, foundations, and cooperatives being the most important.

It must be said, however, that the original dividing line - non-econ. activity here, econ. activity there - is increasingly blurred in practice.

I. Associations

The social rôle of associations in Germany is large. In 1990 their number was estimated for Western Germany at about 250 000 with about 20 million members. There are quite different types of associations: social clubs; very many sport clubs; but also big groupings like trade unions, employers' associations, political parties, etc.

Under German law, an association is a group of persons whose common purpose it is not to exploit an (economic) enterprise (CC § 21). This negative definition serves to delimit an assoc. from a a civil or a commercial company (or corporation) because for the latter there are stricter statutory provisions, especially aiming at the protection of creditors. The dividing line has become somewhat blurred, because in fact many associations do pursue certain economic activities. This is tolerated as long as that activity is accessory and subordinated to a non-economic main purpose.

> Ex.: a radio-taxi call center was denied the status of an association (BGHZ 45, 395).

The freedom of association is a constitutional basic right (art. 9). The private law rules on associations are contained in CC §§ 21-79; their supervision by the state is regulated by a special statute, the Law on Associations of 1964.

Germany distinguishes, as do many other Civil Law countries, between incorporated and unincorporated associations.

A. Incorporated Associations (Eingetragene Vereine, e.V.)

1. Creation of an Assoc.

Four steps are necessary to bring an assoc. into being:

(1) At least 7 persons must agree upon and sign the charter, and they must elect the executive board;

(2) the charter and the protocol concerning the executive board must be filed with the Register for Associations at the local court of first instance (CC § 59);

(3) A court official examines the two documents in order to see whether they comply with the statutory requirements; he then sends a copy to the administrative authority (CC §§ 60, 61) for preventive control. The administration has to check whether the association does not contravene the constitutional order, criminal laws or the idea of understanding between the peoples (§ 3 I VereinsG). These are the constitutional limits of the freedom of association (art. 9 II GG).

(4) Unless there is an administrative objection, the association is registered by the court. By registration it obtains legal personality (CC § 21).

2. Scope of legal personality

Contrary to some other legal systems (espec. England), the legal personality and capacity of an assoc. are not limited, e.g. by its purposes. Nor are there restrictions as to the

3. Termination of membership

A member may terminate its membership according to the provisions of the charter; termination may be at once for good cause.

Also the assoc. may terminate membership by exclusion of a member. The grounds for exclusion must be fixed by the charter. If a procedure for exclusion is provided for, the member must be granted a fair hearing. He can appeal a decision of exclusion to the competent court, and this court is entitled to examine even the facts on which the exclusion was based.

4. The executive board (Vorstand)

Every association must have an executive board. This board manages the affairs of the assoc. and is its legal representative (CC §§ 27 III, 26). Its power of authority may be limited by the charter. If this limitation is registered,

it is also effective vis-à-vis third parties (CC §§ 64, 70, 68).

The executive board is elected by the general meeting of the members. They may also at any time recall the members of the executive board (CC § 27). The members of the executive board are also entered in the register. A negative consequence of the executive board's power of authority is that the association is liable for all acts of each member of the board (CC § 31). This liability exists both for contractual obligations entered into in the name of the assoc., and for torts committed in the exercise of the executive duties.

B. Unincorporated Associations

Unincorporated assoc. are not registered and are therefore not subject to state supervision as to their creation. This feature has made them attractive for major assoc., such as many political parties, the trade unions and others. However, the private law status of this informal brother of the registered assoc. is somewhat doubtful since only a single provision of the Civil Code deals with unincorporated assoc.. CC § 54 intentionally discriminates against unregistered assoc.s in order to discourage their use. CC § 54 sent. 1 declares applicable the provisions on civil companies.

In practice, however, this legislative equation has been overcome. In many respects, an unincorporated assoc. has

today a position which comes close to that of an incorporated assoc.

However, some differences do exist.

(1) The unincorp. assoc. has no legal personality. Yet, in order to facilitate the assertion of rights against an unincorporated, civil actions may be brought against an assoc., judicial decisions may be enforced against it and a bankruptcy proceeding be opened.

(ZPO §§ 50 II, 735, KO § 213).

The holding of assets by an unincorporated is, however, impossible. In practice, assosiations with major assets create a corporation which holds the assets as trustee.

(2) The identity and the power of authority of the members of the executive board are not registered. Third parties must therefore seek the necessary information. However,the assoc.'s liability may result from the general rules on apparent authority.

(3) The liability of the members is, in effect, limited by an agreement with contracting parties that is boldly implied by the courts. In case of torts, the same effect is achieved by an equally bold analogy to an incorporated assoc.

By virtue of an express provision (CC § 54 sent. 2) a person acting for the assoc. incurs unlimited personal liability. Especially members of the executive board may incur this liability.

I should mention that the short-lived Law on Associat. of the GDR of February 1990 contained some sensible rules on unregistered associat.'s.

C. Draft European Regulation

Brief mention should be made of a draft Regulation of the EEC (submitted in March 1992) on a European Association. It is inspired by the French idea of an "économie sociale" and is accompanied by corresponding draft Regulations for cooperatives and mutual benefit companies.

A European Assoc. may be created for a group of persons who wish to engage in border-crossing activities within the EC.es and who must therefore be domiciled in at least two member countries.

Of some interest is the definition of permitted purposes (art. 1): either the pursuit of public benefits, as defined by the domestic law at the seat of the Eur.Assoc.; or the direct or indirect promotion of the economic and/or professional interests of the members. The distribution of profits to the members is excluded, and the assoc. may not have a business enterprise.

The other provisions of the draft would indicate that the envisaged Eur.Assoc. comprises a large group of members. The executive board must consist of at least three members who must convene at least once every three months. The charter, the names of the members of the executive board and even the annual acounts must be deposited with the registry office of the assoc. and must be published.

Whether this draft will be accepted, is another matter.

II. Foundations

Foundations are what the Romans called an "universitas rerum": an identified fund of assets is devoted to a given purpose.

Foundations therefore, as distinct from assoc.s, have no members. On the other hand, - like assoc.s - they may or may not be legal entities.

The social and economic rôle of German foundations is small as compared to the United States. There are about 5 000 foundations of private law with assets of some 20 bill. DM (= less than 14 bill. $). Two lost wars and the inflation of the early 1920's partly explain the difference.

I shall deal only with private law foundations and not with those subject to public law. For the latter there is no general legal framework; they are usually created by special statute which regulates all details. A few aspects of public law foundations are governed by the Civil Code (§ 89).

However, even private law foundations are subject to the dichotomy of private and public law. Their private law aspects are governed by the CC §§ 80-88. By contrast, the public law aspects, especially public approval and supervision, are subject to special laws enacted by the

various federal states - with certain differences - in the last 40 years.

We have corporate and non-corporate foundations. In the latter case, assets are given to a person or a legal entity with the charge of using them for a defined purpose. Since this is merely a fund consisting of some assets earmarked for a specific purpose, no problems of organisation or public approval or supervision arise. Such a fund is held on trust by a trustee - it is the nearest equivalent to an Anglo-American trust. I shall not deal with those dependent foundations. However, some states have recently declared applicable to this type of foundat. the general rules. My concern are the corporate foundations.

1. Creation

For the creation of a foundations two acts are required.

First, an act by the founder is necessary. The founder's will may be laid down in a written declaration if it is to take effect immediately (CC § 81 I); or it must be contained in his last will if the foundation is to come into existence upon his death (CC § 83).

The founder's act must indicate

(a) the purpose of the foundat.;

(b) its seat;

(c) its organisation, especially its administration; and

(d) the assets devoted to the foundat.

Second, the founder's act must be approved by the competent administrative authority. Administrative practice in this respect varies not only from state to state but even within each state. This is so particularly as regards the required minimum capital. In general this capital must be commensurate with the foundat.'s purpose. The absolute minimum capital varies between 50 000 DM and 5 000 DM (i.e. between 33 000 and 3 300 $! (Härtl 114 f.)).

A foundation whose only purpose it is to undertake an entrepreneurial activity is today no longer allowed. Formerly, the practice was more liberal, as is demonstrated by, inter alia, the Carl-Zeiss-Stiftung. By contrast, if a foundation is merely to receive shares in a corporation - even all of the shares - that is permitted if the dividends are devoted to a public benefit.

Only upon its approval the foundation comes into being as a legal entity (CC § 80). A registration or publication is not provided for. Some of the assets devoted to the foundation are upon approval automatically transferred to it. Others, especially immovables for a foundation declared inter vivos, must be transferred to it.

2. Powers

After approval, a foundat. has all the powers which are necessary to achieve its purposes. Contrary to certain foreign countries, there are no limitations as to the acquisition of immovables or of gifts.

3. Assets

The dominant principle is that of durably preserving the foundat.'s capital in order to enable it to perform its functions as long as possible. Disbursements must strictly comply with the purposes of the foundation.

4. Administration

Every foundat. must have an executive board (Vorstand), like an assoc.. The first board is usually appointed by the founder; he may even designate himself as the sole member of the board. The founder will usually also lay down in the charter how the executive board is lateron to be appointed. There are many possibilities, inter alia cooptation by other members of the board; or appointment by a public authority - not necessarily the one which is charged with supervision of the foundat.

The powers of the executive board are governed by the same rules as those for the executive board of an assoc.

Many smaller foundations are administered on an honorary basis. But major foundations need, of course, a professional, paid management and staff.

5. Public supervision

All foundations are subject to public supervision. This is regulated separately by the legislation of each state and differs therefore in detail. The general traits, however, are uniform.

Extent and nature of supervision are controversial: in some German states only the legality of action by management is examined. Illegal aacts must be objected to, or prvented, or can even be annulled.

In practice, supervision concentrates on the financial aspects of a foundation's activities. Especially the annual accounts are examined carefully. Excessive salaries for the executive board is the most frequent object of complaint.

6. Change of purposes

A separate aspect of public supervision is the change of purposes of a foundat. or even its termination if the purpose can no longer be achieved.

CC § 87 envisages for the supervisory authorities two courses of action if the original purpose can no longer be fulfilled. The authorities may either terminate a foundation; that occurred frequently after the war if the foundat.'s assets had been completely lost.

If assets still exist, but the original purpose can no longer be fulfilled, the authority may change the purpose of the foundat.. In doing so, it must take into account as closely as possible the original intentions of the founder.

7. Foundations in other corporate forms

In Germany, there are numerous institutions which pursue public benefits and call themselves foundations but nevertheless do not use the legal form of a foundation. They use other corporate forms, espec. a registered association or a limited liability company (GmbH).

The three major reasons given for this phenomenon are indicative of possible objections to the regulation of foundations:

(1) the heavy and slow procedure of public approval for the creation of a foundat. can be avoided;

(2) the same is true for the regular public supervision of its affairs;

(3) a change of purposes can more easily be achieved.

Of course, these advantages of other corporate forms are at the same time disadvantages to preserving the founder's assets and intentions.

Finally, the tax benefits very often pursued by foundations are not lost since they are granted without regard to the legal form of the institution, as we shall see.

III. Tax Benefits

1. The Principle

As a rule, associations and foundations are subject to general taxation; it is irrelevant whether the associations or foundations are registered or unregistered. In particular, their income is subject to corporation tax and their property to property tax.

2. Tax Exemptions

More interesting than the principle are the exceptions. Indeed, many associations and foundations enjoy tax exemptions, provided they satisfy certain conditions. This is a broad field; I can merely give a brief sketch of the salient points.

The general criterion for tax exemptions is that an institution must pursue a "public benefit" (gemeinnützig). If an institution has been granted this character, this is of

general relevance for the exemption from many taxes, in particular from the corporation tax and the property tax. It does not exempt, however, from the value-added tax on the institution's turnover, such as purchases or sales.

The conditions for achieving public-benefit status are laid down by the Tax Code (AO) §§ 51-68. Various tax statutes grant exemptions to institutions (not to individuals), provided the following six conditions are met:

- First: the institution must pursue public benefits or charitable or religious purposes (§ 51);

  How are these three purposes defined?

  (a) public benefits must be pursued for the public in general (not a closed circle of persons); the benefits may be of a material, intellectual or moral character, such as science and research, education and culture, public welfare, health and sport, etc. (§ 52).

  (b) charitable purposes are, in particular, the support of sick persons who need help (§ 53).

  (c) religious purposes are self-explanatory.

- Second: These three purposes must be pursued by the tax-exempt institution exclusively and directly (§ 51);

- Third: Public benefits and charitable purposes must be pursued with unselfishness. This requirement has several implications:

  (a) the members must not receive any financial benefits from the association;

  (b) on its liquidation no assets or benefits may be distributed to the members;

  (c) rather, on liquidation the institution's net assets must be utilized only for tax-exempt purposes, for instance by transferring them to another tax-exempt institution (§ 55).

- Fourth: On the formal side, all of the preceding three conditions must be clearly laid down in the charter of an association or foundation (§§ 59-62).

- Fifth: Reality must correspond to the letters of those documents. With respect to the institution's assets, two aspects must be mentioned.

(a) An institution's expenditures must conform to the three conditions (§ 63);

(b) the tax-exempt purposes must soon be realized. The legislator forbids the accumulation of idle capital by limiting the formation of reserve funds. These are permissible only if they are necessary for effectively and permanently realizing the tax-exempt purposes; otherwise, only a maximum of 25% of the net excess of the income may be put into a free reserve fund (§ 58 no. 6, no. 7 lett. a).

- Sixth and finally: Two particular sources of an institution's income have attracted the legislator's special attention.

a) One is an internal source, i.e. an institution's entrepreneurial activity. Only in narrowly defined circumstances, an eonomic activity of an institution does not affect its tax-exempt status. Such an "innocuous enterprise"

(1) must serve to realize the tax-exempting purposes of the institution; and

(2) these purposes can only be achieved by such an enterprise; and