The Modernization of the Law on Partnerships through the MoPeG

The Act on the Modernization of Partnership Law („MoPeG") will enter into force on January 1, 2024. This will result in a comprehensive amendment of the provisions governing partnerships under German civil law („Gesellschaft bürgerlichen Rechts" or „GbR") as well as a modernization of the law governing other partnerships, including an opening up of the legal forms regulated therein to the liberal professions. The Federal Ministry of Finance has responded to the tax implications of the MoPeG with the draft bill for a law to strengthen growth opportunities, investment and innovation as well as tax simplification and tax fairness (Growth Opportunities Act) dated July 14, 2023.

The following is an overview of the legal situation under MoPeG.

I. Starting Point: Partnership under Civil Law

1. The Legal Capacity of the GbR

As a significant new innovation brought about by the MoPeG, the legal capacity of the GbR is now legally standardized and defined in § 705 (2) 1. Alt. of the German Civil Code (BGB). According to this, the partnership itself can acquire rights and enter into liabilities if it is to participate in legal transactions according to the joint will of the partners (legally capable partnership). There must therefore be a clear common will. This definition also applies in other areas of law.

Legal consequences of the legal capacity of the GbR

The formation of own assets (§ 713 BGB)

The contributions of the partners as well as the rights acquired for or by the partnership and the liabilities established against them become assets of the partnership. There are no longer any joint assets. The previous regulations in §§ 718 to 720 BGB have been deleted. The same applies to OHG, KG and PartG.

Transfer of company shares (§ 711 BGB)

Shares in a GbR can be transferred with the consent of the other partners. Except for individual proprietary claims, shareholder rights are not transferable (§ 711a BGB).

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Entry in the company register (§ 707 et seq. BGB); registered office (§ 706 BGB)

Legal capacity can be outwardly recognizable through an entry in a newly created company register. The entry is not mandatory and not constitutive, which means that there will also be legally capable GbRs without an entry. Like entries in the commercial register, however, registered GbRs enjoy protection in good faith, e.g. with regard to the existence of the partnership and representation of the partnership by its partners (§ 707a (3) BGB). The corresponding name suffix is „eGbR".

To the extent that the GbR as such wishes to dispose of rights entered in public registers (e.g. real estate, patents or company shares) or wishes to acquire such rights, however, (pre-)entry in the company register is mandatory. For example, only the GbR entered in the company register can be entered as such in the land register as the owner of a plot of land (cf. § 47 (2) of the German Land Registry Code (GBO)). A change in the shareholder structure is thus entered in the register of companies with effect for all properties.

Please note: *German civil law partnerships (GbR) that have already been entered in the land register prior to January 1, 2024 in accordance with applicable law do not have to be registered in the company register. However, an entry in the company register will be required if entries in the land register have to be changed in the future, e.g. because real property is to be sold or further real property is to be acquired.*

GbRs entered in the company register are also subject to the notification obligations under money laundering law (reports on the beneficial owner to the transparency register).

Registration also entitles a company to participate in transformations in accordance with the Transformation Act.

Registered partnerships governed by civil law (GbR) may have a domestic or - subject to recognition in the country of residence - a foreign registered office that differs from the domestic registered office (as specified by the partners in the partnership agreement). This new rule also applies to other partnerships by virtue of the reference. It is of particular importance for the GmbH & Co. KG, since the administrative seat of the general partner was previously regarded as the seat of the KG and could not be situated abroad.

Succession

The legally capable GbR as an external company is likely to be capable of succession. Assets from the deceased's estate can probably be inherited in a GbR structure.

2. Management authority (§ 715 BGB), representation of the company (§ 720 BGB)

No changes have been made regarding the management and representation of the GbR.

However, a new provision on the emergency management was created to ensure that the company is also capable of acting if not all partners can act jointly (§ 715a BGB).

3. Contributions, voting power, share in profits and losses (§ 709 BGB)

The participation ratios are based on the contributions, whereby the contribution of a shareholder can also consist of the performance of services.

The voting power and the share in profit and loss are primarily based on the agreed participation ratios. If no shareholding ratios have been mutually agreed, the ratio of the agreed amount of the contributions shall form the basis of distribution. If no amounts of the contributions have been agreed either, each shareholder shall have the same voting power and an equal share in the profit and loss irrespective of the value of his contribution.

4. Liability (§§ 721 to 721b BGB)

The liability of the shareholders is newly regulated in § 721 to § 721b BGB.

Pursuant to § 721 sentence 1 BGB, the shareholders are personally liable to the creditors directly as joint and several debtors for the liabilities of the company. Any agreement to the contrary is invalid vis-à-vis third parties pursuant to § 721 sentence 2 BGB.

In addition to the objections and defences which are based in his or her own person, the shareholder may also assert such objections and defences which may be raised by the company (§ 721b (1) BGB) or refuse to perform if the company is entitled to contest or set off (§ 721b (2) BGB).

The shareholder joining the company is liable in the same way as the other shareholders for the liabilities of the company established prior to his joining the company. Any agreement to the contrary is invalid vis-à-vis third parties (§ 721a BGB). Shareholders who have left the company are liable to the company for the deficit in proportion to their share in the profit and loss, insofar as the value of the company's assets is insufficient to cover the company's liabilities (§ 728b BGB).

5. Withdrawal (§ 723 BGB), dissolution (§ 729 BGB)

§ 723 (1) BGB specifies reasons inherent in the person of the individual shareholder which only lead to the withdrawal of this shareholder, but not to the dissolution of the company. These include, for example, death, termination, insolvency, exclusion. A so-called continuation clause in the shareholder agreement is therefore no longer required. On the other hand, the shareholder agreement must now regulate if the company is to be dissolved in these cases.

In accordance with § 712 BGB, the share of the withdrawing shareholder in the company accrues to the remaining shareholders in proportion to their shares in case of doubt. However, a deviating agreement between the shareholders is permissible.

§ 712a BGB now expressly provides that, upon the withdrawal of the penultimate shareholder, the company assets pass to the remaining shareholder by way of universal succession. Therefore, there is no longer any need for provisions in the shareholders' agreement in this respect. In this case, the company ceases to exist without liquidation.

The liquidation of the company is set out in § 729 BGB and only contains reasons that are inherent in the company itself.

Shareholder resolutions require the consent of all shareholders entitled to vote (§ 714 BGB). The shareholders' agreement may also provide for a majority decision. In this case, a majority of at least three quarters of the votes is required for resolutions on liquidation and continuation (§§ 732, 734 BGB).

6. Deficiencies in resolutions

There is no standardized right of defective resolutions for the GbR. This must be expressly agreed.

7. GbR without legal capacity

As the legal capacity of the GbR is not mandatory, there is also the „non-legal company", which serves the shareholders to structure their legal relationship with each other (§ 705 (2) BGB). It is not represented externally and has no assets (§ 740 BGB). It follows from the explanatory memorandum to the law that no assets of the partners which are bound together are taken into consideration. There remains the possibility of pursuing the corporate purpose with fractional rights. Alternatively, a shareholder can hold and manage the assets in trust for the other shareholders at the same time. The §§ 740 et seq. BGB contain special provisions on the termination of the partnership, the separation and the withdrawal of a partner. They largely correspond to the previous legal situation. Whether the partial legal capacity recognized by case law will apply to a GbR without legal capacity in the future, however, appears very questionable.

II. Commercial Partnerships

Shareholders' meeting (§ 109 HGB), resolution defects (§ 110 et seq. HGB)

As opposed to the GbR, §§ 110 et seq. of the German Commercial Code (HGB) introduce regulations on the assertion of defective resolutions. They are based on the resolution defect law for stock corporations; i.e. a resolution can primarily be challenged within three months and is only void in exceptional cases.

Furthermore, regulations on the convening and holding of partners' meetings have been included. Partner resolutions continue to require the consent of all partners. Here, too, the articles of association may provide for a majority decision. In this case, a majority of at least three quarters of the votes is also required for dissolution and continuation resolutions (§§ 140, 142 HGB).

Information rights (§ 166 HGB), liability of the limited partner (§ 171 HGB)

The information rights of the limited partner are extended in the case of the KG and cannot be excluded by deviating regulations in the partnership agreement.

Limited partners are not personally liable to a purely asset-managing limited partnership for such transactions that occur before the limited partnership is entered in the commercial register or before their accession to the limited partnership is entered in the commercial register.

Unified partnership (§ 170 HGB)

With § 170 (2) HGB, the so-called unified partnership is now also recognized by law. Under this provision, the shareholder rights to which the KG is entitled in the shareholders' meeting are no longer exercised by the management of the general partner but, subject to an agreement to the contrary, by the limited partners of the GmbH & Co. KG, subject to an agreement to the contrary.

III. Liberal Professions (§ 107 HGB)

For freelancers who continue to practice their profession or will do so in the future in the legal form of a GbR, it should be noted that due to the legal capacity of the GbR, as a rule in the case of partnerships of e.g. lawyers, tax advisors and auditors, the partnership becomes the contractual partner of the client. In addition to the partnership itself, all partners are personally, directly and unlimitedly liable as joint and several debtors for the partnership's liabilities.

Please note: *In its ruling of 10 May 2012 - IX ZR 125/10, NJW 2012, 2435, the German Federal Court of Justice (BGH) decided that all partners of an inter-professional partnership can be liable irrespective of their professional qualifications, i.e. in a partnership consisting of lawyers and a tax advisor, the tax advisor can also be personally liable for a breach of consulting duties by the lawyers of the partnership.*

One new aspect is that members of the liberal professions may now also have the general partnership (OHG), the limited partnership (KG) and the limited liability company (GmbH & Co. KG) available as a legal form. The prerequisite, however, is that the respective professional law permits registration (§ 107 (1) sentence 2 HGB). In BRAO, StBerG and WPO, however, this has been explicitly the case for many years (§ 59b (2) BRAO, § 49 (2) StBerG, § 27 WPO).

Please note: *In the case of a Freiberufler GmbH & Co. KG, a much more far-reaching limitation of liability applies than in the case of a partnership company with limited professional liability. The limitation of liability does not only apply in cases of incorrect professional practice and liabilities, but is fully effective.*

IV. Tax Implications of the Act to Modernize the Law on Partnerships (MoPeG)

According to the legislative explanatory memorandum to the MoPeG, its amendments are not linked to changes in the income tax principles for the taxation of partnerships. The transparent taxation of partnerships will be maintained. Insofar as the tax laws refer to total assets, this is to be understood in the case of partnerships with legal capacity as meaning the assets of the partnership as distinct from the assets of the individual partners (extraordinary operating assets).

On July 14, 2023, the German Federal Ministry of Finance (BMF) published a draft bill for a law to boost growth opportunities, investment and innovation as well as tax simplification and tax fairness (Growth Opportunities Act). In addition to a number of mainly editorial adjustments to the MoPeG, the planned new version of § 39 (2) no. 2 AO is of considerable significance. The provision is to be worded as follows:

> "Economic assets to which several entities are entitled jointly and severally or to which a partnership with legal capacity is entitled shall be attributed to the parties involved or to the partners on a pro rata basis to the extent that separate attribution is required for taxation purposes. For the purposes of income taxation, partnerships with legal capacity are deemed to be jointly owned and their assets are deemed to be jointly held assets.

In this respect, the explanatory memorandum merely states that the principle of joint ownership must continue to be observed in the case of income taxation. Pursuant to Sentence 1, assets belonging to a partnership with legal capacity are attributed to the participants or shareholders (as before) on a pro rata basis, irrespective of the new civil law situation, insofar as separate attribution is necessary for taxation purposes. Sentence 2 additionally stipulates that for the purposes of income taxation, partnerships with legal capacity are deemed to be joint owners and their assets are deemed to be joint assets.

Consequently, the tax regulations that are linked to the joint ownership principle of the partnership, in particular, for example, § 6 (5) sentence 3 of the German Income Tax Act (EStG), which enables the tax-neutral transfer of assets between the taxpayer's (special) business assets and the joint assets of a partnership and vice versa, are likely to continue to apply in unchanged form.

Whether the real estate transfer tax benefits of §§ 5, 6 of the Real Estate Transfer Tax Act ("GrEStG"), which provide for the non-levy of real estate transfer tax for the transfer of real estate from or to a joint ownership by persons participating in the joint ownership, will also be applicable is uncertain. However, in a discussion draft of a law to amend the Real Estate Transfer Tax Act, the Federal Ministry of Finance proposes to replace §§ 5, 6, 6a GrEStG with a tax concession provision that is neutral with regard to the legal form.

Accordingly, an acquisition transaction is to be exempt from tax if the determining control of an acquirer or a group of acquirers over a property does not change as a result of this acquisition transaction.

V. Assessment

The amendments made by the MoPeG firmly establish the legal capacity of the GbR in law and modernize the law governing partnerships. The statutory changes are also relevant for existing companies.

Partnership agreements ought to be checked for possible need of adjustment. In particular, for GbRs with legal capacity, it should be reviewed whether entry in the register of companies is necessary or desirable. Furthermore, advice should be sought as to whether voting by heads or by shareholdings is desired.

The proposed tax changes in the draft bill should not result in any far-reaching need for action, at least as things stand at present. However, the outcome of current tax legislative procedures remains to be seen. Only then will it be possible to assess the extent to which there may be a need for action.