

U.S. INTERNATIONAL GRANTMAKING

Germany

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I. Summary

A. Types of Organizations

Germany is a federal civil law country with three primary forms of not-for-profit, nongovernmental organizations (NPOs):

- associations (*Verein*);
- foundations (*Stiftung*); and
- limited liability companies (*Gesellschaft mit beschränkter Haftung*, “GmbH“)

The limited liability company, or GmbH, is increasingly used in Germany to create not-for-profit entities.

Other forms of NPOs are outside the focus of this Note due to their limited interaction with foreign grantmakers. The excluded forms include public institutions (*Anstalten des öffentlichen Rechts*), foundations established under church law and public law, and cooperatives (*Genossenschaften*, which are formed and regulated under the *Genossenschaftsgesetz*).

B. Tax Laws

Generally, only those NPOs that exclusively and directly pursue public benefit, charitable, and church-related purposes are exempted from corporation tax (*Körperschaftsteuer*), commercial tax (*Gewerbesteuer*), and gift and inheritance tax (*Erbschaft- und Schenkungsteuer*). The General Fiscal Law (*Abgabenordnung*) in Articles 52-54 describes these exempted purposes.

Germany, in line with all the members of the European Union, subjects most sales of goods and services to a Value Added Tax (VAT). Many types of public benefit activities are exempt from VAT, including health-related, educational, cultural, and scientific activities. If an activity of a tax benefited organization is subject to VAT and it falls under its statutory purposes, the applicable VAT rate is 7%. If a grant to an NPO complements VAT taxable services, the VAT included in the project’s expenditure might be recoverable. If a grant does not fall under any VAT taxable service, the VAT included in the expenditure will not be recovered by the tax office. In that case the NPO is in the position of a final consumer.

II. Applicable Laws

German Constitution (*Grundgesetz* -GG), Article 9. (German) (English)

German Federal Civil Code (*Bürgerliches Gesetzbuch* or BGB), Second Title, Legal Entities, Chapters I (associations), II (foundations), & III (public law juridical entities). (German) (English)

Laws on Foundations of the following German Bundesländer (states):

- Baden-Württemberg (German)
- Bayern (German)
- Berlin (German)
- Brandenburg (German)
- Bremen (German)
- Hamburg (German)
- Hessen (German)

- Mecklenburg-Vorpommern (German)
- Niedersachsen (German)
- Nordrhein-Westfalen (German)
- Rheinland-Pfalz (German)
- Saarland (German)
- Sachsen (German)
- Sachsen-Anhalt (German)
- Schleswig-Holstein (German)
- Thüringen (German)
- DDR-Gesetz (German)

Law on Associations (*Vereinsgesetz*) of 1964. (German)

General Fiscal Law (*Abgabenordnung*) of 1976, as amended, Part III (tax-privileged purposes). (German)

General Fiscal Law implementing rules (*Anwendungserlass zur Abgabenordnung* BStBl I S. 630).

Corporate Income Tax Law (*Körperschaftsteuergesetz*, BGBl. I. S. 817) of 1999, as amended, sections 5(9) (exempt organizations) & 9 (deductions for donors). (German)

Corporate Income Tax implementing rules (*Körperschaftsteuer-Richtlinie*).

Local commercial tax (*Gewerbesteuer*) – a tax imposed by the municipalities (German)

Income Tax Law (*Einkommensteuergesetz*, BGBl. I S. 821) of 1997, as amended, Article 10b (tax incentives for individual donors). (German)

Income Tax Law implementing rules, *Einkommensteuer-Durchführungsverordnung* (German) (BGBl. I S. 717) & *Einkommensteuer-Richtlinien*

Inheritance and Gift Tax Law of 1997 (*Erbschaftsteuer- und Schenkungsteuergesetz* BGBl. I S. 378), Articles 13 & 29 (tax exemptions). (German)

Value Added Tax Law (*Umsatzsteuergesetz*) of 1999, sec. 4. (German)

III. Relevant Legal Forms

A. General Legal Forms

Under German law, nearly all types of private legal entities, including associations, foundations, and corporations, can be used to form an NPO. The principal legal forms are associations, foundations and limited liability companies. German NPOs are governed by federal law. Foundations also are subject to the law of the *Länder* (states).

Federal law is used to determine whether an organization receives tax benefits, but it is the local tax office that makes the actual decision on eligibility.

Associations

An association is a membership organization whose members have come together to permanently pursue a common purpose. Associations can exist without being registered and without legal personality (see Article 54 German Federal Civil Code or BGB).

Non-economic associations (*nichtwirtschaftliche Vereine / Idealvereine*) must have a primary aim and activity other than the conduct of business. Non-economic associations receive legal personality upon registration at the local court. (Section 21 BGB). When such an association is registered, it assumes the designation “e.V.” (*eingetragener Verein*) (Section 55 BGB). To register, an association must have at least seven members (Section 59 BGB).

The state can, in limited cases, also grant legal personality to a different type of association that primarily conducts business (*Wirtschaftlicher Verein*) (Section 22 BGB).

Associations are regulated by Articles 21–80 of the BGB and by the Associations Law (*Vereinsgesetz*). Both public benefit and mutual benefit associations are permitted. For that reason, the designation “e.V.” does not necessarily reflect the existence of a public benefit organization.

Foundations

A foundation established under Articles 80-88 of the BGB (*Stiftungen bürgerlichen Rechts*) is a legal entity whose earnings on assets are used to pursue a specific purpose set forth by the founder. The current Federal legislation in the BGB, which was modified in 2002 (Law to Modernize the Foundation Law, July 15, 2002 - *Gesetz zur Modernisierung des Stiftungsrechts*), is not extensive. Foundations are more extensively regulated by the laws of the 16 states (*Länder*). German law permits both public benefit and private purpose foundations.

Under the BGB, a foundation has legal personality, which it receives upon recognition by the competent authority in the state (*Bundesland*) in which the foundation seeks to be headquartered (Section 80 BGB). The authority must recognize the foundation if the legal requirements are met, the purpose can be pursued permanently, and the purpose does not contravene the common good (Section 80 BGB). The law does not specify a minimum capital for the establishment of a foundation, but the authorities normally require at least €50,000.

Non-autonomous foundations without legal capacity are called “*nicht rechtsfähige*” or “*unselbständige Stiftung*.” Their establishment is subject to the general rules on contract law of the BGB which governs the contract between the founder and the trustee. This relationship is comparable to a common law trust. The non-autonomous foundation may enjoy the same tax benefits as the BGB-foundation with legal capacity, but because it is only subject to the control of the tax office that determines tax benefit status, it can act more independently.

Other legal forms of organizations, such as associations, stock companies, and limited liability companies (e.g., the GmbH, described below), are allowed to bear the name “*Stiftung*” (so-called “*Ersatzformen*”). Thus, the appendix “*Stiftung*” does not guarantee that an NPO is, in a legal sense, a foundation. The biggest German foundation – the Robert Bosch Stiftung – for example, is operating under the legal form of a limited liability company or GmbH.

German law permits corporations to establish foundations.

Companies

NPOs may also take a corporate form, specifically the limited-liability company *Gesellschaft mit beschränkter Haftung* or GmbH (registered and regulated under a special law). The GmbH is a commercial company in corporate form with legal personality. It has stock originating from its shareholders. The shareholders are not liable for the debts of the company. NPOs often choose this legal form when their purpose includes the delivery of services without remuneration.

B. Public Benefit Status

As indicated, a foundation or association can be formed for mutual benefit, private benefit, or public benefit purposes. The definition of “public benefit” is found in the “General Fiscal Law” (*Abgabenordnung* or AO). Tax benefits are defined in the tax codes concerning Income Tax, the Corporate Income Tax, Commercial Tax, VAT and the Inheritance and Gift Tax. The tax codes refer in that respect to the *Abgabenordnung*. Accordingly, one must refer to the AO in order to determine what qualifies as a public benefit purpose. In addition, the AO sets forth special requirements for organizations carrying out public benefit purposes.

The AO defines three types of purposes as being of public benefit:

- General public benefit (*Gemeinnützige*, Article 52);
- Charitable or benevolent (*Mildtätige*, Article 53); and
- Church-related (*Kirchliche*, Article 54).

According to the first section of Article 52, an organization pursues general public benefit purposes (*gemeinnützige Zwecke*) if “its activities aim to support the general public materially, intellectually, or morally.” The beneficiaries must not be limited to a closed circle of people, such as members of one family or employees of one corporation. The second section lists a series of purposes that are regarded as supporting the general public if the requirements of section one are met. The list, which is exclusive since 2007, includes the following categories: science and research, education, arts and culture, religion, international understanding, development aid, preservation of the environment and cultural heritage, support of youth or the aged, public health, amateur sports (including chess), support of democracy, care of soldiers and reservists, and the support of civic engagement. The complete listing can be found in Article 52 of the AO; additional explanations are found in the regulations of the *Anwendungserlass zur AO*, the guideline for the *Abgabenordnung*.

An organization pursues charitable or benevolent purposes (*mildtätige Zwecke*) under Article 53 of the AO if it aims to support and help people in need either because of their economic situation or because of their physical, psychological, or mental situation.

According to Article 54 of the AO, church-related purposes (*kirchliche Zwecke*) include the support of public law religious communities, construction of houses of worship, spiritual development, and religious education.

Until 2007, the Income Tax Law and the Corporate Tax Law gave special tax treatment to donations for “charitable, church, religious and scientific purposes (as defined above in the AO) and those public benefit purposes that are especially support-worthy.” A list of “especially support-worthy” public benefit purposes could be found in the Regulations on the Income Tax Act (Anlage 1 zu § 48 Abs. 2). The revision of § 52 AO in 2007 eliminated the distinction between different tax benefited purposes, as the tax laws no longer award different rates of tax deduction for the support of different purposes (see below). In addition, the General Tax Law (AO) requires that an organization receiving tax benefits must carry out its tax-privileged (public benefit, charitable, or church-related) purposes exclusively and directly (Article 51 section 1), and

unselfishly (with “disinterest”) (Article 55). The organization should pursue its activities on its own (directly) but may choose to use a so-called “*Hilfspersonen*,” assisting legal or natural persons. The income of a tax-privileged entity must be used before the end of the year following the year during which the income was received.

According to Article 59 of the AO, tax benefits are given to an organization if the governing document or charter specifies the organization's purposes and states that they will be carried out according to the dictates of Articles 52-55 of the AO. The actual governance and activities of the organization must follow the rules laid down in the governing documents and the charter.

IV. Specific Questions Regarding Local Law

A. Inurement

The prohibition on private inurement for tax-exempt organizations can be found only in the tax law, specifically in the *Abgabenordnung* (AO). The AO states the rule against inurement in several ways:

1. The assets of the organization must be used exclusively and directly to pursue its tax-exempt purposes.
2. Members of associations, shareholders, and founders of foundations and their heirs must not receive distributions from the organizations to which they belong or which they founded. Article 58 section 5, however, allows a foundation to use up to one-third of its income to support the founder and his or her close relatives, or to maintain their graves. In addition, an organization may use up to one-third of its profits to preserve the endowment.
3. No one shall receive special private benefits from the organization, including unreasonable salaries.
4. In case of dissolution, remaining assets must be used solely for tax-privileged purposes. This requirement is met if remaining assets are transferred to an organization pursuing tax-privileged purposes or to a public body for tax-privileged purposes.
5. For corporate NPOs, shareholders can receive a distribution of no more than their initial capital contribution plus the lowest value of their in-kind contributions; the remaining assets must then be distributed to pursue tax-exempt purposes.

(Article 55, AO)

The provisions of the Civil Code/BGB and the *Vereinsgesetz* do not deal with private inurement in associations, beyond stating that the assets of an association must be used to pursue its purposes.

With respect to foundations, the laws of the various *Länder* require that the endowment be preserved and returns be used to pursue the foundation's purposes.

B. Proprietary Interest

To be eligible for tax-exempt status, an NPO must carry out its tax-privileged purpose unselfishly, exclusively, and directly. Foundations may, however, spend up to one-third of their income to support the founder and his or her close relatives, or to care for their graves (Article 58 Nr. 5 AO).

For NPOs formed as corporations, the AO states that shareholders can receive their initial cash contribution plus the lowest value of their in-kind contributions upon dissolution (Article 55, AO).

C. Dissolution

If a tax-privileged organization is dissolved, either voluntarily or involuntarily, the remaining assets must be used for similar purposes. The merger of foundations is also possible.

In case of dissolution of a tax-exempt organization, the remaining assets must be used solely for tax-privileged purposes. This requirement is met if remaining assets are transferred to an organization pursuing tax-privileged purposes or to the state for pursuit of tax-privileged purposes (Article 55 AO).

In the case of an NPO formed as a corporation, shareholders can receive a distribution of no more than their initial capital contribution plus the lowest value of their in-kind contributions; the remaining assets must then be distributed for tax-exempt purposes.

D. Activities

1. General Activities

German foundations and associations are legal persons. As such, they are permitted to engage in all legal activities of legal persons except to the extent the laws discussed here provide otherwise.

2. Public Benefit Activities

As discussed above, a foundation or association can be formed for mutual benefit, private benefit, or public benefit purposes. The “General Fiscal Law” (*Abgabenordnung* or AO) provides definitions of these terms, which are then referenced in other tax laws, such as the Income Tax Law, the Corporate Income Tax Law, and the Inheritance and Gift Tax Law. In addition, the AO sets forth special requirements for organizations carrying out public benefit purposes.

3. Economic Activities

German NPOs that pursue tax-privileged purposes may engage in economic activities. If the activity is necessary to pursue the organization’s public benefit purpose and it does not compete with for-profit organizations more than necessary, profits are not taxed and VAT is reduced to 7% (so-called “*Zweckbetrieb*,” according to Article 65 AO). Commercial activities which are not necessary to pursue the statutory purposes of the NPO are taxed at ordinary rates if the annual gross income of non-statutory commercial activities exceeds €35,000 (Article 64, AO).

E. Political Activities

Organizations pursuing tax-privileged purposes must not spend any of their assets for the direct or indirect benefit of political parties (AO Article 55 section 1). General political education and the general support of democratic development both qualify as tax-privileged purposes. The commentary to Article 52 of the AO guidelines (*Anwendungserlass*, AEAO) states that political purposes do not qualify as public benefit purposes. In the discussion of the meaning of the term “political,” the regulation indicates that some activities relating to the development of public opinion are acceptable. An organization is allowed to comment on politics related to its public

benefit purpose and is also allowed to communicate with legislators about proposed legislation without losing tax-exempt status.

F. Discrimination

Various provisions of the German Constitution relate to the prohibition against racial discrimination in schools or educational organizations. Article 1 states that human dignity is inviolable and Article 3 guarantees equality and non-discrimination. The establishment of private schools is specifically permitted under Article 7. Additional details relating to the educational system are found at the state level.

Constitutional rights in Germany, though formally enforceable only against the state, also have a strong influence in the private sector.

G. Control of Organization

Associations and foundations are not stock companies, therefore there is no possibility that private persons or entities can obtain ownership. The law does not, however, prevent other organizations or persons from controlling not-for-profit organizations.

The founder (natural or legal person) of a foundation can be the only board member.

Stock companies (GmbH, AG) may qualify as tax-exempted NPOs as long as they meet the conditions for tax benefits stipulated by the AO. There are no requirements concerning the number of shareholders. Shareholders can be natural persons or commercial corporations. Therefore, it is possible for a for-profit entity or an American grantor charity to establish and control a German NPO association or foundation and (in the case of a tax-exempted company) own it as the sole shareholder.

V. Tax Laws

A. Tax Exemptions

All legal entities are in principle subject to corporate income tax, but they can be exempted when they pursue qualified philanthropic purposes enumerated in the AO (Arts. 52-54 *Abgabenordnung*).

Article 5 (1) No. 9 of the Corporate Tax Law (KStG) permits all “corporations, associations, and endowments” to be exempt from the corporate income tax as long as they are organized and operate exclusively for public benefit, charitable, or church-related purposes along the lines of articles 51-68 of the AO. The KStG also cross-references Chapter 3 of the AO, discussed above.

A foundation must carry out its tax-privileged purpose unselfishly, exclusively, and directly. As a general rule, the income of the assets of the organization must be used exclusively to pursue the tax-exempt purposes, there are however a few exceptions:

- an organization is permitted to build reserves of up to one-third of its annual income from capital investment;

- newly established foundations can build up their endowments during their first three years without making expenditures; and
- one third of an organization's income can be spent to support the founder and his or her close relatives or to care for their graves without losing tax benefits (Art. 58 Nr. 5 AO).

The funds of an NPO must be used immediately (*zeitnah*), which means before the end of the year following the year of the accrual.

NPOs do not lose their tax-exempt status if they pursue their purposes outside of Germany. Following the decision of the European Court of Justice (ECJ) in the "Stauffer Case", public benefit organizations, which (1) have their legal seat in one of the EU member states or the European Economic Area (EEA), and (2) which are tax exempted in their seat countries according to regulations similar to the German regulations, are granted tax exemption for their income from German sources.

B. Deducibility of Donations to German NPOs by Individuals and Corporations Based in Germany

The Corporate Tax Law (*Körperschaftsteuergesetz* or KStG) and the Income Tax Law (*Einkommensteuergesetz* or EStG) allow individual as well as corporate donors to deduct contributions to certain public benefit organizations (see below).

For contributions made by individuals or corporations, a tax deduction of up to 20 percent is possible on yearly taxable income (or 0.4 percent of the sum of the turnover, wages, and salaries) if the recipient organization pursues qualifying purposes (Article 10b EStG and Article 9 (1) No.2 of KStG). Donations exceeding the deductible limit may be carried forward to subsequent fiscal years.

In addition, an individual donor can deduct up to €1,000,000 for a donation to the endowment of a foundation with qualifying purposes. The deduction can be taken in the year of donation and/or divided over the following nine years.

According to Article 10b (1) of the Income Tax Law, the recipient of a tax deductible donation must have its legal seat in Germany. The European Court of Justice (ECJ), however, decided this regulation does not comply with the EU common market rules, which require the free movement of capital including donations. As a consequence of the Court's decision (Persche Case), the German government is planning to amend Article 10b of the Income Tax Law to make donations deductible for the German taxpayer whenever the recipient has its legal seat in one of the EU member states. The envisaged amendment, however, will not be presented to Parliament before 2010 due to the German elections in September 2009. Because the ECJ's decision must be respected by all EU member states, EU-Europe as a whole will see relevant changes in cross-border giving regulations.

C. Gift and Inheritance Tax

Inheritance tax or a gift duty is levied at a progressive rate on the transfer of property to a German foundation, except when the donation is to a domestic foundation pursuing qualified tax-privileged purposes. This exemption also applies to donations made to foreign organizations in cases of tax reciprocity (see below). A complete exemption from inheritance tax is also given when the inheritance is passed on to a tax-privileged purpose foundation within two years after

the succession. (See Article 13 section 1 No. 16 and Article 29 section 1 No. 4 of the Inheritance and Gift Tax Law of 1997.)

D. Value Added Tax (VAT)

Germany generally subjects the sale of goods and services to Value Added Tax (VAT). Some standard public benefit activities are exempt from the VAT, including health-related, educational, cultural, and scientific activities. A reduced VAT rate of 7% is applied to taxable remunerations for services which are necessary to pursue an NPO's statutory purposes. Grants are generally not subject to VAT.

E. Other Taxes

NPOs that pursue public benefit purposes as listed in Articles 51-68 of the AO do not pay trade or commercial tax (*Gewerbesteuer*).

Wealth tax (*Vermögensteuer*) was generally abolished in 1997.

F. Double Tax Treaties

Germany and the United States have signed a double-tax treaty. (Convention between the Federal Republic of Germany and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital and to certain other Taxes, dated August 29, 1989.) (See <http://www.irs.gov/pub/irs-trty/germany.pdf>)

In addition to preventing double taxation, the treaty provides for a form of reciprocity: a tax-exempt organization of one country will also be tax-exempt in the other country, to the extent that the organization would also be tax-exempt in the second country if it were organized and active solely in that country. (Id., Article 27.)

A second treaty creates another form of tax reciprocity: property transferred to an organization pursuing public benefit purposes, which is resident and tax exempt in one state, shall be exempted from gift and inheritance tax by the other contracting state, if that property transfer would also be tax-exempt if made to a domestic organization. (Convention between the Federal Republic of Germany and the United States of America for the Avoidance of Double Taxation with respect to taxes on estates, inheritances, and gifts, new version dated December 21, 2000, Article 10.) http://www.germany.info/Vertretung/usa/en/04_Legal/02_Directory_Services/07_Taxes/Estates/Taxes_Estates.html

VI. List of Knowledgeable Contacts

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