German and Canadian Company Law – An Overview

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Insofar as this article adverts to provincial rules, it is usually the case that these rules refer specifically to the Province of Ontario where one-third of the population of Canada lives. These rules may vary from those of other provinces.
We strongly recommend that you seek professional legal advice from a qualified lawyer to resolve your particular legal problem.

A *REFERENDAR* IS A GERMAN TRAINEE LAWYER RECEIVING PRACTICAL TRAINING IN JUDICIAL AND OTHER LEGAL WORK HAVING COMPLETED AT LEAST FIVE YEARS OF FORMAL LEGAL STUDIES AT UNIVERSITY AND HAVING PASSED THE FIRST OF TWO STATE EXAMINATIONS FOR ADMISSION TO THE LEGAL PROFESSION (AS A JUDGE, LAWYER, STATE ATTORNEY, ETC.).

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I. Introduction

Choosing the right form for a business is not always an easy task. The business plan and its goals must be kept in mind when choosing the appropriate form. Through consideration of these factors, the optimal legal basis for the business can be determined.

There are several key differences between Canadian and German Business Law. The following essay will summarize the common forms of businesses of both countries. Regarding the issue of which legal form of business would be the best for tax purposes in your situation, please confer with your tax consultant.

The German conception of Business Law

Business Law covers the law of associations under private law which are established for the purpose of reaching certain common goals through legal transactions. The law regulates the framework and the procedure for individuals to form a company. There are specific rules for the internal organization of a company as well as rules for the protection of creditors interacting with that company.

II. The German legal forms of Companies

The German law provides two legal forms for setting up a company: Partnerships and corporate bodies.

The most common forms of partnerships are (a) the non-trading partnership (*GbR*), (b) the general partnership (*OHG*), (c) the limited partnership (*KG*) and (d) the professional partnership (*PartG*).

The important corporate bodies are the limited liability company called *GmbH* and the public limited company called *AG*. These corporate bodies are recognized as legal entities, are awarded legal personality and are thus capable of holding rights and incurring obligations. Additionally, the law allows some combinations of the legal forms. The most common combination is the *GmbH & Co.KG*, which is a limited commercial partnership with a GmbH as general partner.

The following section will describe the main features and specific characteristics of the aforementioned legal forms of a business, such as its formation, organization, representation and liability.

Difference between a partnership and a corporate body

The main difference between a partnership and a corporate body is the status of its legal personality. While a corporate body is considered to be a legal entity by law, a

partnership is only granted partial legal personality and only under certain circumstances can it be subject to legal rights and duties.

Other significant differences between the two legal forms is the fact that, by definition, a partnership cannot consist of only one shareholder (i.e. partner) and that the shares of a partnership are generally not freely transferable, but both scenarios are possible in the case of a corporate body.

Numerus clausus of the legal forms of companies

The *numerus clausus* of the legal forms means that only legal forms which are recognized by the law can be established. This rule is mandatory. However, there is a possibility of combining the legal forms recognized by the law, e.g. the combination of a *GmbH* and a *KG* (see above). Also, the Court of Justice of the European Union requires the member states to recognize the legal capacity of companies established in another member state if the company enjoys legal capacity under the law of its state of incorporation.[1]

The principle of *Numerus Clausus* is applied to protect contract partners of the partnership or corporation, and to enable them to rely on the liability of the partnership or corporation and on its compliance with mandatory law.

1. Partnerships

(a) Non-trading partnership (*GbR*)

The non-trading partnership (*GbR*) is the basic legal form of all partnerships in Germany. It is an association founded for the purpose of reaching a certain common non-commercial goal. Therefore, the rules laid down in section 705 ff. of the German Civil Code (*BGB*) apply as fundamental rules to all other partnerships as long as the German Commercial Code (*HGB*) does not contain rules differing from the Civil Code.

As a non commercial company, the operating of a business is not a valid purpose of the *GbR*. It is an association for all other kinds of purposes. The purpose of operating a business is reserved for merchants and trading businesses; this distinguishes the *GbR* from the commercial partnerships.

[1] The decisions of the Court of Justice of March 09, 1999 [C-212/97 [1999] ECR I-1459], in the matter of Centros, and in the matter of Überseering of November 5, 2002 [C-208/00 [2002] ECR I-9919], changed the law in Europe in regard to Business Law. The members of the European Union violated the right of mobility and the freedom of establishment provided for by the Treaty of the European Union by denying a registration of a business that had been registered in another member state of the European Union with the reasoning that the establishment of such business purports to avoid (stricter) national protective regulations. It is now settled law that companies established in one member state of the European Union can develop branches in other member states of the European Union. Consequently, many Germans establish limited corporations in the UK to avoid Germany's stricter rules regarding the incorporation of a GmbH.

Even though the *GbR* is not a legal entity, the Federal Supreme Court of Germany recognizes the *GbR* as capable of having rights and incurring obligations on its own, in so far as they result from participation in legal relations. The following are examples in which a *GbR* is an appropriate form of business: a group of contractors working towards the realization of a joint development, individuals forming a car pool, a lottery pool, a flat-sharing community or an investment club. It is not necessary for the common goal to be of a commercial nature.

The law considers the professions of lawyers, doctors, artists and others (for a list of these professions visit http://de.wikipedia.org/wiki/Freier_Beruf) to be non-commercial. Therefore the *GbR* is a common partnership among these professionals.

Formation

The *GbR* is established by a company agreement, which can be made orally. This requires a valid agreement in regard to the essential parts of the contract. It is required that the basics of contract law are fulfilled, which means the parties must agree on an objective that they develop and support jointly. The objective can be for any purpose. Establishing a *GbR* is excluded when the common goal is to run a commercial enterprise. When a commercial enterprise is formed, the legal form will not be a *GbR*, but an *OHG* or *KG*.

Organization

With the closure of a company agreement, rights and obligations *in personam* are created. The shareholders must provide their dues and fulfill other obligations as set out in the company agreement. There exists a common fiduciary duty between the shareholders. Furthermore, every shareholder has the right to be informed about the business matters of the GbR, and at the same time has a correspondent duty to disclose any such information to the other partners.

The internal decision-making of the company is not completely regulated by statute. The internal relationships between the shareholders are generally governed by the company agreement. The default rules will only apply where the company agreement fails to address an issue.

Representation

It is assumed that the right to (external) legal representation is equivalent to the right to (internal) managing authority (*§ 714 BGB*). Since, in general, all shareholders perform corporate acts jointly there is also only a joint power of representation. However, the company agreement can contain a clause which differs from the law and regulates the power of representation and the managing authority in a different manner.

Liability

Since a decision of the German Federal Supreme Court in 2001, it is recognized that the *GbR* is partially capable of having legal rights and being liable for debts and obligations. Furthermore, each shareholder is, without limit, personally liable for obligations of the *GbR*. Additionally, they are directly and accessorily liable, which means that the creditor can make a claim against any shareholder, forcing him or her to pay the complete amount owed, and does not necessarily have to sue the company. The shareholders themselves are equally liable, jointly and severally, which means the claim can be set against them and they cannot argue against the creditor that they hold only a portion of interest within the company. In such a case, the defendant has a right of recourse against the other shareholders.

(b) General partnership (*OHG*)

The general partnership (*Offene Handelsgesellschaft*, *OGH*) is based on the idea of operating a business. As soon as a *GbR* has a commercial purpose, the *GbR* will be treated as an *OGH* even when the shareholders do not intend it to be an *OGH*. The law and the courts will assume such formation.

Formation

The *OHG* is a partnership of two or more individuals with mutual interest in running a commercial enterprise. In general, the formation of an *OHG* is similar to that of a *GbR*, as the *GbR* is the basic legal form. The *OHG* will be established through a company agreement. The content of the agreement differs from that of the *GbR* in so far as the formation is focused on engagement in a trade. It is sufficient for the *GbR* to maintain any purpose; such flexibility of purpose is not permissible for the formation of the *OHG*. A business within this classification comprises any legal and commercial activity. The establishment of an *OHG* does not require a certain minimum of capital. A service, payment or benefit in kind can constitute an investment in the partnership.

Organization

The organization of the *OHG* is similar to the organization of the *GbR*, since the *GbR* is the basic form of all partnerships.

Representation

Each of the shareholders is in general entitled to manage the internal relations as well as to represent the company in their legal relationships. Unlike the shareholders of the *GbR*, the shareholders of the *OHG* are entitled to have single managing authority or single power of representation on behalf of the *OHG*. Like the *GbR*, a clause can be used to revise an article within the company agreement relating to representation.

Liability

The *OGH* is capable of being a subject of rights and obligations so that a creditor can claim against the *OHG* directly in regard to obligations or debts (*§ 124 HGB*). Additionally, the shareholders are directly and personally liable, without limits, for all obligations of the company.

(c) Limited partnership (*KG*)

Formation

A *Kommanditgesellschaft* (*KG*) is established like an *OHG*, by a company agreement between at least two partners. Furthermore, one individual shareholder of the *KG* must be a general partner and at least one must be a limited partner.

A general partner is a fully liable shareholder of a *KG*. He or she is jointly and severally liable to creditors for debts and obligations of the company. The general partner of a *KG* has the same position as the shareholder of an *OHG*.

As the name suggests, the limited partner only has limited liability. His liability is restricted to the amount which he has agreed to be liable for in the company agreement. The amount up to which the limited partner is liable has to be disclosed in the commercial register. As soon as that amount has been paid to the company as an investment, the limited partner has no further liability. His liability will revive only if the investment has been returned to him.

Organization

The limited partner's duty towards the company is to pay the investment. Within the internal relationship, the limited partner is engaged in the profit and loss of the company in accordance with the percentage of his investment. The limited partner is excluded from managing the company, as long as the contractual agreement does not state otherwise.

Representation

Because of the lack of managing authority of the limited partner, the external representation is in general incumbent on the general partners. The limited partner is excluded from representing the company (*§ 170 HGB*). Nevertheless, it is possible to give him a full power of attorney ("*Prokura"*) so that he is able to represent the *KG*.

Liability

The system of liability of the *KG* is similar to the one of the *OHG*. The *KG* itself as well as its general partners is liable in the same way as in the case of an *OHG*. The limited partner is only liable up to the amount he has invested into the company and registered in the commercial registry.

(d) Professional Partnership

The professional partnership is a formation of professionals such as lawyers or doctors. By law, their work is not considered a commercial business. Members of a professional partnership can only be individuals; mere capital participation is not sufficient to become a partner.

Formation

To establish a professional partnership, a written contract is required. This agreement must state the head office, the reason for the formation, and the full names of the partners, their occupation, and place of residency.

Organization

Most of the regulations concerning the organization of a professional partnership refer to the rules relevant for an *OHG*. Therefore, the organization is similar to that of an *OHG*.

Representation

In general, all partners are equally entitled to act on behalf of their business unless the partnership agreement specifically states otherwise.

Liability

Each member of the professional partnership is liable jointly and severally for all obligations and debt. A restriction in liability is not recognized by the law. Nevertheless, only the partners who are involved in the specific work in question and the partnership itself are liable. Accordingly, general liability of a partner for all obligations or debts does not exist.

2. Corporate Bodies

a) Aktiengesellschaft

One legal form of limited company in Germany is the *Aktiengesellschaft* (*AG*). The number of new *AG*s in Germany increased from 3,600 in the year 1996 up to 16,000 in the year 2006.[2] The owners of such companies are the shareholders, while their executive bodies are a board of directors, a supervisory board, and regular shareholder meetings.

Most of the companies that choose the *AG* as their legal form do not apply for an admission to the stock exchange; therefore the shares of such companies are not freely transferable.

Formation

[2] http://www.zeit.de/2006/15/G-Aktiengesellschaften

The formation of an *AG* is similar to the already described legal forms of a company. The formation of the *AG* is regulated in the *Aktiengesetzt* (*AktG*). A notarized company agreement is required. The incorporators have to take over the shares. The supervisory board, the managing board and the auditor have to be commissioned, the contributions have to be rendered and the corporation has to be registered with the commercial register.

Organization

As with other legal entities, the *AG* proceeds through its executive body. In the *AG*, there are three different categories of executive bodies acting: the managing board, the supervisory board and shareholder meeting.

The managing board is in charge of business management and representation of the corporation. Theboard members are solely responsible for their decisions; and they are not bound by any direction of the two other executive bodies. This is a key difference of the *AG* in comparison to the *GmbH*, within which the managing directors comply with directions generated at meetings of the shareholders.

The supervisory board controls the board of directors and is elected by the shareholder meeting. The supervisory board monitors the board of directors and represents the company before the members of the managing board, whose corporate officers the supervisory board appoints and recalls.

All shareholders have an annual shareholder meeting, at which the shareholders make decisions regarding the usage of capital gains, and approve the decisions of the managing and the supervisory boards. The decision-making of the shareholder meeting is carried out by passing resolutions. In this context, the impact of the voting right of a single shareholder is proportional to the nominal amount of the shares owned by that shareholder.

Representation

The managing board provides sole directions for the company. Provided the company charter does not mention a regulation regarding the representation of the company, the members of the managing board are only authorized to manage and represent jointly.

Liability

As a legal entity the *AG* is liable with all its assets. The shareholders themselves are not liable for obligations of the *AG*. In order to balance this disadvantage, each *AG* must have a share capital of at least €50,000. This share capital must be paid before the company is registered in the commercial register. Furthermore, the capital gain of the company can only be distributed to the shareholders only if the company does not revert to drawing on the €50,000 minimum share capital.

b) GmbH

A common company form in Germany is the *Gesellschaft mit beschränkter Haftung* (*GmbH*). Similar to an *AG*, a *GmbH* is an independent legal entity. The formation, organization, representation and liability are regulated in the *GmbH-Gesetz* (*GmbHG*).

Formation

In order to found a *GmbH*, a notarized company agreement is required. Thereafter, the executive bodies of the company must be appointed and the share capital must be paid. With registration in the commercial registry, the new company comes into existence. However, the company already has certain rights and obligations even when it is in its establishment stage. The so called *Vor-GmbH* (pre-*GmbH*) is a legal entity *sui generis*, but is recognized by the law in *§ 11 GmbHG*. All obligations of the *Vor-GmbH* will transfer to the *GmbH* when the company is registered as such.

Organization

The important executive body of the *GmbH* is the meeting of shareholders. At such a meeting, the shareholders of the *GmbH* decide about fundamental business matters of the company. They decide, for example, about the distribution of gains, or about the acceptance of new shareholders or they approve the director's actions. Apart from these basic decisions, the managing director directs and guides the business of the *GmbH*.

Representation

The *GmbH* must have at least one managing director in order to be capable of acting in legal relations. The managing director does not need to be a shareholder. The managing director has the authority to represent the *GmbH*. Even if the authority is restricted by the shareholders internally, the managing director can act effectively in external terms irrespective of the restrictions. If the shareholders cease to trust the managing director, he or she can be recalled by unilateral declaration of intent at a shareholder meeting. The decision becomes effective once received by the managing director.

Liability

The system of liability of the *GmbH* is similar to that of the *AG*. The law requires the *GmbH* to maintain assets of at least € 25,000. The shareholders are not personally liable. Instead, only the assets of the company may be subject to liability in relation to the obligations of the *GmbH*.

III. The Canadian legal forms

The most important Canadian legal forms of business are corporations, partnerships, limited partnerships, and sole proprietorships.

Basic differences from the German legal forms

A fundamental difference between the German and the Canadian legal forms is the fact that not all Canadian businesses are registered on a federal level.

Whether to form a Canadian company on a provincial or a federal level has to be decided in every individual case. If the company wants to run the business in more than one province or territory, or even outside of Canada, it has to be registered under federal law. However, a company established pursuant to the Canadian *Business Corporation Act* must also register in the province where it commences business. Therefore, for example, a federal company commencing business within Ontario must register pursuant to the *Ontario Business Corporation Act*.

The following analysis focuses on the establishment of a provincial business. For more details about the establishment of a federal business, please obtain further legal advice.

1. Corporation

Unlike German business law, Canadian business law only provides one legal form of corporation. A corporation, also known as a limited company, is an association of several individuals on the basis of a company agreement. The corporation is a legal entity which is separate and distinct from its members. Each shareholder has limited liability. A creditor with a claim against the corporation normally has no right to make a claim against its shareholders; instead he or she can claim against the company's assets.

Ownership interests in a corporation are usually easy to transfer.

There are different categories of corporations – a business (for-profit) and a not-for-profit corporation. In Ontario, the latter is a corporation governed under the *Ontario Corporations Act*. Not-for-profit corporations are often social or cultural organizations and they usually do not offer transferable shares. The business corporation, instead, is a legal entity governed by the *Ontario Business Corporations Act*, and exists to generate profit.

Formation

To found a corporation in Canada, certain documents have to be filed with the appropriate authority and in compliance with the rules of the *Canada Business Corporations Act* or, if it is to be registered on the provincial level, in compliance with the *Ontario Business Corporations Act*. The document known as the "articles of incorporation" sets out the corporate constitution. This document must contain the name, the capital, the head office, the numbers of managing directors and associated rights or restrictions.

Filing all documents and paying all registration fees will start the registration process, which must be completed before the corporation comes into existence as a legal entity.

Organization

The managing directors and the managing employees are in charge of the corporation's management. They are bound to act in accordance with good faith. If this duty is violated, the protection of the corporation does not apply, i.e. the managing directors may be personally liable for damages occurring because of the violation.

Representation

The corporation acts independently and is subject to rights and responsibilities as a separate legal personality. The managing directors are appointed by the shareholders, normally for the period of one year, and are assigned specific responsibilities. Normally, there has to be an annual general meeting. At this annual meeting, the shareholders discuss the financial results of the previous year, and necessary votes are taken, e.g. the (re-)election of the managing directors. There are different types of shares: preferred shares and non-voting shares. The shareholders can vote in person or through a representative.

The advantages of a corporation are its limited liability, transferable ownership, continuous existence, legal status as a separate legal entity, and the ease of raising capital. Its disadvantages include close regulation, the organizational and extensive administrative costs, and the double taxation of shareholder dividends.

2. Partnerships

The law of the different provinces and territories generally defines a partnership as an agreement between two or more individuals, who manage a company together in order to make a profit. The law does not set a limit on how many partners may be involved. A partnership can sign contracts and borrow money in its own right. The law distinguishes between three categories of partnership: General, limited, and limited liability partnership. The most common type is the general partnership. In a general partnership, each partner is jointly and severally liable for the debts of the partnership. One partner can be held liable for all debts and obligations incurred in the name of the business by another partner. In addition to the general partnership, the law provides for establishment of a limited partnership, i.e. an arrangement where a person can contribute capital to a business without being involved in the affairs of the partnership. The liability is limited to the amount that person has invested in the firm. To retain this status, that person must not participate in the management of the firm, or act on its behalf, or become a general partner. Finally, in the case of a limited liability partnership, partners are not liable for the

negligence of other partners, though they may still be liable for the intentional wrongs of other partners.

Formation

A partnership can be established in two ways. On the one hand, the partners can have a partnership agreement, which can be oral or written. In order to have proof of such an agreement – e.g. in the case of liquidation of the partnership or a conflict between the parties – it is advisable that the agreement be put in writing. The partnership agreement should set out the main duties and responsibilities of its members as well as the purpose of the partnership.

On the other hand, there is the possibility of a judicial declaration of the establishment of a partnership in the case of a conflict between the parties. In such a case, it is not necessary to prove the closing of an agreement. It is sufficient that the legal requirements for the establishment of a partnership have been fulfilled. The declaration of the establishment of a partnership by the court results in the liability of the parties.

Organization

In general, all members of a partnership have equal rights. The partnership is jointly and severally liable. Thus, the members of a partnership have to be appointed carefully and there should be a solid mutually trusting relationship between the members. An exception applies to a limited partnership because the liability is restricted to the amount of the capital investment. In a limited partnership there has to be at least one general partner. The general partner is fully liable for the debts and the obligations of the business, but to balance this disadvantage, he or she may be entitled to a greater share of the profits.

The advantage of a partnership lies in its easy and inexpensive formation. There might also be a possible advantage regarding taxation because a partnership does not have to file separate income tax returns or pay separate income tax. The partnership is combined with the personal income of the partners. Another advantage is that management is constrained by fewer regulations. The main disadvantage lies in the partners' unlimited liability and in the difficulty of raising additional capital. Furthermore, there is the risk of having a conflict between partners. Unlike corporations, partnerships are dissolved when their members change.

3. Sole proprietorship

When opening a business in Canada, sole proprietorship is the simplest legal form. It consists of a person operating a business in his or her own personal capacity.

Formation

A sole proprietorship can be formed only on a provincial level and only by a Canadian citizen or legal permanent resident. In a sole proprietorship, one person performs all the functions required for the successful operation of the business. The proprietor secures the capital, establishes and operates the business, assumes all risk, accepts all profits and losses, and pays all taxes. If the individual wishes to act under a certain name, he or she has to register that name under the *Business Names Act*.

Organization

The owner is personally and without limitation liable for all debts and obligations of the proprietorship, and is also entitled to the gains of the company. Furthermore, the start-up costs are low, and the bookkeeping and income tax reports are much easier to handle than those of a corporation. Sole proprietorship is suited to smaller businesses. Because of the relatively minor business transactions involved, the sole proprietor does not need to have limited liability, or to raise significant amounts of capital.

Most small companies and businesses take the form of sole proprietorships. The small flower shop on the corner, for example, is usually a sole proprietorship. The owner is personally responsible and liable for damages which occur in connection with his or her business.

An advantage of sole proprietorship lies in low start-up costs and fewer regulatory constraints. Another advantage is that the owner is in direct control of decision making. In addition, he or she enjoys tax advantages and is entitled to all profits. Disadvantages include unlimited liability, difficulties in raising capital, and discontinuity (i.e. the inability to transfer the business to another person without dissolving the sole proprietorship).