

Germany: an emerging market for philanthropy social investment advice – how legal and tax advisers may contribute to raising the quality of giving

Dr. Julia Runte, LL.M. and Iring Christopeit, LL.M. (www.esche.de)

Charities and donors benefit from a variety of tax exemptions in German tax law. That is why German lawyers and tax advisers play an important role for charities as well as for donors when it comes to setting up a social project. But by doing this, legal and tax advisers also get the opportunity to contribute to raising the quality and quantity of giving. This is especially true when they manage to combine different aspects and interests – such as corporate successions or social entrepreneurship – with the thought of philanthropy. Understanding the client's needs is crucial, but only precise knowledge of the ever-changing legal and tax framework can increase the quality of giving.

Most social investments or social projects in Germany start with legal and tax advice in order to ensure that the legal requirements for being accepted as a charity – which are controlled by German fiscal authorities – are met. Lawyers and tax advisers that are specialised in the law of tax-exempt organisations thus get the opportunity to increase the quality and quantity of giving by expanding their legal and tax advice. Consequently, the outcome for donors, for the charity and for any other economic interest may be improved.

Choosing the most appropriate legal framework

A good example for this is the choice of the charity's legal framework. According to German law, a variety of legal frameworks are open to non-profit organisations. The right choice depends on the different interests of those setting-up the social project and, especially, the way the non-profit organisation intends to earn money. The *gemeinnützige GmbH* (gGmbH) is increasingly getting more popular because it combines the advantages of a limited liability company with granted tax exemptions. As the German version of Ltd. (*Unternehmersgesellschaft haftungsbeschränkt*), which may be founded by a small amount of money, is just a variation of a regular limited liability company, even a 'non-profit limited' (*gemeinnützige Unternehmersgesellschaft haftungsbeschränkt*) may be taken into account if the financial resources for the set-up are limited.

If, on the other hand, the intention to raise money by donations is more important, social investors may prefer the legal framework of a charitable foundation (*Stiftung*). Already the expression *Stiftung* is almost automatically combined with the impression of a long-lasting, merely non-profit-orientated institution. The *Stiftung* is, despite this reputation, not apt for every project because it is not as flexible as the gGmbH. Amendments to its statutes are difficult and the *Stiftung* is subject to a specific form of control executed



Julia Runte



Iring Christopeit

by an administrative body (Stiftungsaufsicht). Perhaps the most difficult aspect of a Stiftung in relation to a possible improvement of the quality of giving is that it has actually the legal obligation to preserve its assets and is only allowed to spend its earnings for the charitable purposes pursued. While it is, as an exception, also possible under specific circumstances to use all or parts of these assets directly for the charitable purposes, on occasions the adviser may advise against the Stiftung for a specific project. Also, it should be kept in mind that a separate new legal entity is not always needed, but it may be worth considering a simple donation to a pre-existing Stiftung which pursues the charitable purposes that the 'founder' would like to promote. It may even be possible to attribute the name of the founder to this donation if the donor so wishes. In this case, it is possible to join forces for good and avoid additional administrative expenses related to a separate legal entity by choosing a donation. If it is possible for the tax and legal adviser to show that this solution for a charitable project may be in the best interests of all, he or she may make a substantial contribution to the quality of giving.

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Another aspect that specialised lawyers and tax advisers may consider is the combination of charitable interests with other, not primarily commercial, interests. An example of such a combination is the use of a non-profit organisation as a means of structuring a corporate succession. For various reasons, the owner of a well-running business may not find an appropriate successor if, for example, he or she does not have any children, the children are not interested in running the business or are not qualified to do so. Also, he or she may not want to sell the business to third parties. In cases like these, implementing a non-profit organisation as a legal framework to perpetuate the corporate business is advisable.

Many options are available. Family members that are not interested in running the business may be interested in taking part of a non-profit organisation; profits from the well-running commercial business may be at least partially turned into profits for a

charitable purpose. Also, a family tradition or at least a family influence in the firm may be granted by certain positions that are reserved for family members of the last company holder.

In these fields the owner of the business will need legal and tax advice because there are different ways to implement such a perpetuation of a business by using a non-profit organisation. One way could be the donation of the business to a non-profit organisation that already exists or that is to be set up by the company owner. Another way could be the integration of a charitable organisation into the existing commercial business, leading to a Stiftung & Co. KG, which is a combination of a foundation as the partner with unlimited liability and a partnership.

Fundraising

Unlike what many people believe, it is not always necessary to set up a social project alone. Legal and tax advisers can assist social investors or project initiatives

to define the fundraising tools that fit best and through these structures improve the quality of giving.

One way could be to explain the way external donations work. They provide an opportunity for social investors to participate in an already existing charitable organisation. External donations are legally different from ordinary donations: while ordinary donations have to be re-invested quickly by the charitable organisation, external donations can be used to raise the capital stock of the foundation. By this means a social investment is more directly bound to the aims of its social project. Sometimes even special rights or special merits are combined with an external donation.

In our experience it is a common misunderstanding that non-profit organisations in German tax law are not allowed to make profits. Thus, it can be important to clarify that while it is indeed not possible to distribute profits for non-charitable purposes, it is permitted to use commercial activities to raise more funds for the charitable purposes pursued. This leads to more flexibility and in the long run awakens a higher interest in social projects in general.

Finally, even if the status as a charitable organisation seems very attractive at first sight, it is not mandatory for social entrepreneurship activities. While relief from corporate tax is granted for the actual charitable activities, unrelated commercial business activities are allowed but proceedings are not tax-exempt. Even for social business activities it may be therefore advisable not to apply for tax-exempt status, particularly because restrictions applicable for charitable organisations may in the long run have a negative impact on business development.

In order to contribute to improve the quality of giving, tax as well as legal advisers will therefore need a good understanding of the client's business case, of the legal and tax framework to be considered but also of the current trends and tendencies in the non-profit sector. If an adviser meets these criteria, he or she may, while advising the client, also contribute to raising the quality of giving in general.

Dr Julia Runte is a lawyer and tax adviser as well as partner at *Esche Schümann Commichau* in Hamburg. She has studied in Cologne, Paris and Munich and is a specialist in legal and tax advice to foundations, non-profit organisations and private clients. Dr Runte has been scientific assistant at the Institute for Foundation Law and the Law of Non-Profit-Organizations at Bucerius Law School, Hamburg. She is author of numerous articles and a speaker on foundation and non-profit-organisation

topics. Among her clients are museums, large fundraising organisations and private collectors in northern Germany and beyond.

Iring Christopeit is a lawyer and tax adviser at *Esche Schümann Commichau* in Hamburg. Iring Christopeit has studied at the University of Mannheim and at the John Marshall Law School in Chicago/USA. He specialises in legal and tax advice to private clients, family businesses and foundations.