SCHULTZE & BRAUN **INSOLVENCY LAW**

The liability of the GmbH director (limited liability company) in insolvency scenarios – Part 2[1]

Background

The law imposes extensive duties on the director of a German GmbH. These become even more stringent when the company is in crisis. These diligence requirements in a corporate crisis can turn into a tightrope walk for director, because he is torn between safeguarding the interests of the company and being exposed to a wealth of liability risks which affect him personally. Many directors are insufficiently aware of these liability risks. Yet they may have far-reaching effects on the director, even jeopardising his existence, because it is not only the director's property which is under threat, the law also provides for severe sanctions under criminal law.

Property liability of the director under § 823 Section 2 BGB (Civil Code)

§ 823 Section 2 BGB imposes liability under civil upon anyone infringing a protective law. A protective is one in which the regulation under criminal law serves to protect individual property interests. This means that sanctions under criminal law are not the final actions. The persons protected by the rules under criminal law must also be compensated for the damage and loss they experienced.

§ 823 Section 2 BGB in conjunction with § 64 Section 1 GmbHG (Law on Limited Liability Companies).

§ 64 Section 1 GmbHG, discussed in the previous issue, is a third-party-protecting regulation. The persons protected include the creditors of the company. Calculating the damage and loss suffered by the creditors has long been a hotly disputed issue. The BGH (Federal Court of Justice) initially assumed that the creditor had suffered damage merely as so-called quota damage, i.e. only in the additional amount which the creditors would have received from the estate had he filed his application in good time.[2]

Legislation changed in the year 1994, resulting in a pronounced intensification of the director's liability.[3] It now says that creditors, who have acquired their claim against a GmbH after the duty of filing for insolvency has been complied with, can now draw on § 823 Section 2 BGB in conjunction with § 64 Section 1 GmbHG to demand, in addition, full compensation for the damage and loss they suffered by entering into an agreement with the company. This view has meanwhile been endorsed by the BGH.[4] Liability for quota damage continues to exist and is also asserted by the insolvency administrator under § 92 InsO. The director is therefore under threat of liability for the full contractual claim by the opposing party if this party has rendered services in advance and then goes empty-handed in the proceedings.

[1] The first part of this article appeared in *Der Syndikus*, 19th issue May/June 2001, 40ff.
[2] BGH ruling dated 16 Dec 1958 BGHZ 29, 100
[3] BGH ruling dated 6 June 1994, BGHZ 126, 181
[4] BGH ruling dated 7 Nov 1994, ZIP 1995, 31

§ 823 Section 2 BGB in conjunction with § 266 a StGB
The third-party-protecting nature of the regulation is particularly relevant in the context of § 266 a StGB, i.e. unlawfully retaining social security contributions. What is protected here is the property of the social insurance funds. As discussed above, companies in crisis often pay out wages and salaries without also paying the social contributions. This infringement of § 266 a Section 1 StGB also results in the direct personal liability of the director for unlawfully retained social security contributions, to the extent the employees' share of the contributions is affected. Especially in major companies, this often involves huge sums for which the director is personally liable. These claims are also rigorously pursued by the health insurance funds.

Special regulations
There are also a number of special regulations which define the director's property liability in the event of insolvency or over-indebtedness.

§ 64 Section2 GmbHG
Pursuant to § 64 Section 2 GmbHG, the director of the company are under the obligation to compensate for payments made after the company's inability to pay has become evident or after the over-indebtedness has been established. This does not apply to payments which are made thereafter and which are consistent with the due diligence and prudence of a businessman.

This demonstrates, once again, how important it is for the director to be fully and totally aware of the time the insolvency and/or the over-indebtedness sets in, since from that point in time forward he is not only threatened under criminal law, but also exposed to the property risks. This does not necessarily mean that this is a partner/shareholder who is also a director. Rather, the director's liability also arises if he is not a shareholder of the company limited by shares (Kapitalgesell-schaft). Practical examples for actions triggering liability include: payment of liabilities not due or granting security interests for which there is no valid claim.

Also, the director should under no circumstances rely on such claims not being enforced or asserted if insolvency occurs. The insolvency administrator is held to pursue all of the company's property claims in order to satisfy the company's creditors in the best possible manner. The insolvency administrator must therefore also examine the director's conduct after insolvency or over-indebtedness has occurred in order to determine whether any liability claims exist against the director which, if enforced successfully, would put the creditors into a better position.

§ 34 AO (Fiscal Code)
§ 34 AO lays down that the statutory representatives of natural persons or legal entities are obliged to fulfil the latter's tax obligations. This applies, in particular, to the delivery of tax returns and the payment of taxes. Again, this is where all directors are liable,[5] with their liability being limited, but not abolished, by the allocation of managerial duties.[6]

Pursuant to § 69 of the AO, these persons are liable to the extent that claims from tax debts are not assessed or not assessed within the proper time due to gross negligence of their duties. This liability also covers the surcharges levied as a consequence of this dereliction of duty.

[5] BFH (Federal Court of Finance) ruling dated 23 May 1990 BStBl 90, 1008
[6] BFH ruling dated 26 April 1984, BStBl 84, 776

Liability attaches for damage caused by gross negligence. Again, the joint and several liability of all directors must be assumed. Clearly worded provisions laid down in writing in the partnership agreement or in resolutions can help to exculpate individual directors.[7]

As far as this regulation is concerned, it is again worth bringing to mind the concretisation which this rule has experienced through legislation. On the one hand, the inability to pay taxes has a relieving effect.[8] But, on the other hand, the BFH believes that the taxpayer must ensure payments not just at the time the tax debt is due.[9] In particular for taxes held "in trust" by the company (e.g. wage tax), the directors are exposed to enhanced liability.

For general tax debts, the principle of the so-called prorated redemption applies, which means that tax debts are not allowed to be treated any differently from other liabilities.[10] This has practical significance, particularly for value added tax or turnover tax. The director must prove that the VAT liability has been satisfied at roughly the same ratio as the liabilities in relation to other creditors.[11]

However, the director is liable for the entire value added tax if, although input tax has been claimed, the appropriate VAT return has not been submitted in contravention of § 16 Section 2 Sentence 1 UStG (VAT Law) with the effect that the full payment of the input tax has been achieved.[12]

As mentioned above, liability is stricter when it comes to wages tax. Irrespective of the quota which the other creditors receive, the finance authority must not be treated any worse than the employees with regard to the wages paid out to them.[13] The reference figures for the issue of equal treatment of the finance authority is therefore not the collective of creditors, but only the employees because, the BFH argues, wage tax is part of the labour wage which the employer only holds in trust.[14] In the event the entire wages including wage tax cannot be paid, the director is under the obligation to curtail the wages pro rata in order to ensure the appropriate payments to the tax office. This shows once again how risky it is to pay out net wages and salaries to employees, a practice often found in real life. Again, the director is under threat of personal liability for the entire wage tax, if he has caused net payments of the salaries and wages.

Summary

The above outline shows that the corporate crisis entails an immense risk potential for the director as natural person. The director is under threat of sanctions under criminal law, and he is also under the threat that the demise of the company jeopardises his private property. This also applies if the director is not a partner/shareholder and has not assumed personal liability for the company's liabilities. These risks should definitely be kept in mind when the director commits himself to the rescue of the company.

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7 BFH ruling dated 26 April 1984, BStBl 84, 776
8 BFH ruling dated 20 April 1982, BStBl 82, 521
9 BFH ruling dated 21 June 1994, BStBl 95, 230
10 BFH ruling dated 8 July 1982, BStBl 83, 249
11 BFH ruling dated 12 July 1988, BStBl 88, 980
12 Unpublished rulings by the BFH, BFH/NV 96, 97
13 Unpublished rulings by the BFH, BFH/NV 88, 685
14 BFH ruling dated 20 April 1982, BStBl 82, 521, 522