LIKAR Rechtsanwälte

**Start-up employee participation**

According to the previous legal situation, the free or discounted transfer of (GmbH) shares was taxed as a non-cash benefit from the employment relationship, i.e. at a marginal tax rate of up to 50% or 55%. As a result, the shareholding and thus the non-cash benefit was valued at the time the shareholding was received, which led to the so-called "dry income" problem, i.e. an employee had to pay income tax on the shareholding without having received any cash. It is now possible for all corporations to fall under the start-up employee participation regime and thus the newly introduced Section 67a EStG if the following conditions are met:

**1. requirements that must be met by the employer:**

- free of charge for objective, business-related reasons (a "purchase price" up to a maximum of the nominal value is deemed to be free of charge in this context); special skills and experience of the individual employee can be regarded as an objective, business-related criterion;
- no more than 100 employees on an annual average;
- no more than € 40 million turnover;
- the company is not to be fully included in consolidated financial statements and does not hold a stake of more than 25% in other companies that are themselves to be included in consolidated financial statements.

**2. conditions that the employee must fulfil:**

- the employee must not hold a (direct or indirect) shareholding of 10% or more in the employer's capital at the time the shares are transferred or before.

**3. general requirements in connection with the actual granting of shares:**

- The shares must be granted within 10 years of the end of the calendar year in which the company was founded (creation of a non-existent operational structure in accordance with NeuFÖG);
- a written agreement between the employer and employee stating that a sale or transfer by the employee inter vivos is only possible with the consent of the employer (transfer restriction);

- a written declaration by the employee making use of the scheme upon receipt of the shares (option for start-up employee participation); this declaration and the amount of the participation are recorded in the payroll account;
- the employment relationship has lasted at least two years and the inflow has not taken place before the expiry of three years from the date of the first transfer of the start-up employee shareholding to the employee (does not apply to termination of the employment relationship);
- taxation must take place as part of the tax assessment if the benefit accrues after termination of the employment relationship.

The consequence of the application of Section 67a EStG is a deferral of taxation; taxation only occurs at the time of the sale by the employee (transfer back to the employer is deemed to be a sale) or upon the occurrence of other circumstances or upon termination of the employment relationship (exception: company value shares in a FlexCo, if the employer is liable).

The proceeds of the sale (sale price less acquisition costs) are taxed; a special tax rate is applied: 25% of the non-cash benefit (sale proceeds) is taxed at a rate of 27.5%, the remaining 75% of the non-cash benefit is subject to the progressive income tax rate.
Non-wage labour costs and social security contributions are also only incurred for the 25% share of income.

It is important to note that in the case of very high increases in value, the tax burden may be higher at the end of the day under the new regime than under the previous legal situation; in any case, however, the "dry income" problem is avoided or solved when the shares are transferred for the first time.

The newly created Enterprise Value Shares (UWA) are of particular importance in connection with employee participation models. UWA is a completely new share class that exists alongside the previously known shares and represents a novelty and specific feature of FlexCo. UWA may not reach 25% of the share capital, but represent a portion of the total share capital. Enterprise value shareholders (UWB), i.e. holders of UWA, participate in the balance sheet and liquidation profits, but have no voting rights at the general meeting. Typically, start-ups do not have sufficient funds at the beginning to adequately remunerate highly qualified employees.

Issuing UWA is one way to counteract this problem and prevent employees from looking for better-paying employers.

To summarise, it can therefore be said that the combination of the newly created share class of the UWA through the newly created FlexCo and the start-up employee participation in accordance with §67a EStG offers optimal opportunities to involve employees, i.e. to implement a de facto bonus system in a legally and, above all, tax-safe manner.

We have optimised tried-and-tested employee share ownership programmes under the new regime in cooperation with renowned tax consultants, already, and are happy to answer any questions you may have regarding the establishment of start-up employee share ownership programmes.