



PRACTICAL LAW

MULTI-JURISDICTIONAL GUIDE 2011/12

EMPLOYEE SHARE PLANS

LABOUR AND EMPLOYEE BENEFITS VOL 2

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Essential legal questions answered
in 21 key jurisdictions

Comparative table

Analysis of critical
legal issues



Germany

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EMPLOYEE PARTICIPATION

1. Is it common for employees to be offered participation in an employee share plan?

Employee share plans, and share option plans in particular, are important in German companies as a means of providing incentives for managerial employees and intensifying their degree of identification with the company. They are considered to be an integral part in the competition for internationally experienced managers. A considerable body of provisions exists to encourage employee shareholdings, although specific incentives are not yet set out in legislation. As there are no substantial tax advantages, share plans are still not as popular in Germany as in the US or UK, particularly among medium-sized companies.

2. Is it lawful to offer participation in an employee share plan where the shares to be acquired are shares in a foreign parent company?

Employees in Germany can generally participate in the share plan of a parent company that is located in a different jurisdiction. However, certain employment law principles, such as that of equal treatment (see *Question 5*), only apply to the German company and not to the corporate group as a whole.

Share option plans with foreign entities are not considered to be part of the employment contract, which is why the principles of Article 8 of Regulation (EC) 593/2008 on the law applicable to contractual obligations (Rome I) do not apply. Therefore, such share option plans can be governed by foreign law without depriving the employee of the protection afforded to him by German Labour Law.

SHARE OPTION PLANS

3. What types of share option plan are operated in your jurisdiction?

As share option plans are not substantially tax-incentivised there are no specific types of plans in Germany.

4. In relation to the share option plan:

- What are the plan's main characteristics?
- Which types of company can offer the plan?
- Is this type of plan popular? If so, among which types of company is this plan particularly popular?

Share option plan

Main characteristics. A company grants a specific number of shares at a defined exercise price within a defined time period to its employees or managers, or those of its affiliated companies. Employees exercise options to profit if the shares' market value (that is, the price at which they are traded on the market) is above the exercise price. Share option plans have a minimum vesting period of four years for plans implemented after 5 August 2009 (and two years for those implemented before that date) (*section 193, paragraph 2, no. 4, German Stock Corporation Act*).

If an employee exercises an option, the employer has two ways of obtaining/providing the shares. The employer can either:

- Purchase its own shares on the market (*section 71, paragraph 1(8), Stock Corporation Act (Aktiengesetz)*).
- Increase its share capital (*section 192, paragraph 1, 2(3), Stock Corporation Act*).

The share option plan's terms and conditions must be adopted by a resolution of the company's shareholders' meeting (*section 193, paragraph 2, Stock Corporation Act*). The resolution must specify the:

- Distribution of options.
- Individual vesting conditions.
- Fixed date at which the option can first be exercised.
- Period of time in which the employee can exercise the option.

Types of company. Types of company offering share option plans include:

- Public limited companies (*Aktiengesellschaften*) (AG).
- Companies with elements of a limited partnership, especially those limited by shares (*Kommanditgesellschaft auf Aktien*) (KGaA).
- European Companies (*Societas Europaea*) (SE).

Popularity. The popularity of share option plans has faded significantly since the general collapse of prices at the German Stock Exchange in 2000 and more recently due to the global economic crisis. A share option programme allows a company to strengthen its solvency and its own capital contribution, while it may be risky for employees to invest in company shares in times of insecure market conditions.

Grant

5. In relation to the grant of share options under the plan:

- Can options be granted on a discretionary basis or must they be offered to all employees on the same terms?
- Can options be granted to non-employee directors and consultants as well as employees?
- Is there a maximum value of shares over which options can be granted, either on a per-company or per-employee basis?
- Must the options have an exercise price equivalent to market value at the date of grant?
- What are the tax and social security implications of the grant of the option?

Share option plan

Discretionary/all-employees. In principle, the granting of share option awards to employees and managers is at the sole discretion of the employer. However, in doing so the employer must comply with the principle of equal treatment, meaning there must be a reasonable justification for offering different terms to individual groups of employees. Therefore, the employer must offer the same terms to employees that have comparable skills and positions. In addition, the employer's discretion can be narrowed by the implementation of binding rules in the company's articles or by-laws.

Non-employee participation. Share option plans (and employee share plans in general) are a common instrument of the variable remuneration of non-employee directors. The purpose of such plans is to create a special incentive to increase performance, while in relation to the rest of the staff the main purpose is employee retention.

Under a Decision of the German Federal Court (BGH), exclusively non-executive directors (supervisory board members) cannot participate in a share option plan, because this would contradict with their control function within the stock company.

As consultants are in a third-party relationship with the company, they are not usually participants of stock option plans.

Maximum value of shares. The value of shares that a German company can offer under share option plans cannot exceed 10% of its share capital.

Share options granted to management board members must be in reasonable proportion to their overall remuneration. (Further requirements on the remuneration of members of the management board are set out in section 87 of the Stock Corporation Act.)

Market value. The exercise price must not be below market level but may exceed it.

Tax/social security. No tax or social security is payable on grant.

Vesting

6. In relation to the vesting of share options:

- Can the company specify that the options are only exercisable if certain performance or time-based vesting conditions are met?
- Are any tax/social security contributions payable when these performance or time-based vesting conditions are met? Who is obliged to account for the liability and by when? How (if appropriate) is the liability recovered from employees?

Share option plan

Exercisable only on conditions being met. An option cannot be exercised any earlier than two years after grant, or after four years if grant was after 5 August 2009. The plan may also specify performance conditions. Shareholders must agree to the terms (see Question 4, *Share option plan: Main characteristics*).

Tax/social security. Tax and social security contributions are not payable on vesting.

Exercise and sale

7. Do any tax or social security implications arise when the:

- Option is exercised?
- Shares acquired on exercise are sold?
- Who is obliged to account for the liability and by when?
- How (if appropriate) is the liability recovered from employees?

Share option plan

Tax/social security on exercise. Income tax is charged on exercise at progressive rates, ranging from 14% to 45% in 2011. The taxable benefit is the difference between the shares' fair market value on exercise and the exercise price.

EUR360 of the taxable amount is tax free for each employee per calendar year, subject to the further conditions of section 3 no. 39 of the German Income Tax Act, which applies to certain savings plans (as at 1 August 2011, US\$1 was about EURO.7).

Social security contributions are also payable.

Tax/social security on sale. On sale of shares acquired on or after 1 January 2009, employees must report and pay a flat tax of 25% on their capital gains (assuming they own shares of less than 1% of the total share capital of the company). The taxable capital gain is the difference between the shares' fair market value on exercise and the sales price (*section 32d, paragraph 1, German Income Tax Act*). The sale of shares acquired on exercise of a share option does not trigger social security contributions.

Accounting for tax/social security. Income tax on the benefit realised by the exercise of the option must be declared and paid by the employer to the tax authorities before the tenth day of the month following the month in which the option was exercised. The employer recovers the tax by withholding it from the employees' salary payable in the month of exercise. Employees and employers share social security contributions equally between them. The employer is liable for the payment to the social insurance agencies, which must be before the last two banking days of the month of exercise.

Income tax on a capital gain (if any) realised on sale of the shares is withheld and paid to the tax authorities by the broker if the broker is a German financial services institution. Otherwise, the employee must declare the capital gain in his personal annual income tax return and (typically) pay the tax within four weeks of the receipt of his personal income tax assessment.

How liability is recovered from employee. See above.

SHARE ACQUISITION OR PURCHASE PLANS

8. What types of share acquisition or purchase plan are operated in your jurisdiction?

As share acquisition or purchase plans are not substantially tax-incentivised there are no specific types of plans in Germany.

9. In relation to the share acquisition or purchase plan:

- What are the plan's main characteristics?
- Which types of company can offer the plan?
- Is this type of plan popular?

Share acquisition or purchase plan

Main characteristics. The company offers employees the right to buy a certain number of shares, usually at a discounted price. Another possibility is the purchase of certain shares at market value, in order to receive additional shares free of charge or to participate on the future increase of the company's value.

Types of company. Only public limited companies can offer a share purchase plan, irrespective of whether it is listed or under another company's control.

Popularity. Share purchase plans are a popular and commonly used incentive for employees, especially for key personnel.

Acquisition or purchase

10. In relation to the initial acquisition or purchase of shares:

- Can entitlement to acquire shares be awarded on a discretionary basis or must it be offered to all employees on the same terms?
- Can shares be offered under the plan to non-employee directors and consultants as well as employees?
- Is there a maximum value of shares that can be awarded under the plan, either on a per-company or per-employee basis?
- Must employees pay for the shares and, if so, are there any rules governing the price?
- What are the tax/social security implications of the acquisition or purchase of shares?

Share acquisition or purchase plan

Discretionary/non-discretionary. The employer must comply with the equal treatment principle when awarding an entitlement to acquire shares (see *Question 5, Share option plan: Discretionary/non-discretionary*).

Non-employee participation. See *Question 5*.

Maximum value of shares. The shareholders' meeting can only authorise up to 10% of the company's share capital as shares offered under a share purchase plan (*section 71, paragraph 1, no. 8, Stock Corporation Act*).

Payment of shares and price. The company can sell shares to the employee for a price that is below their market value. However, the price cannot be inappropriately low (*section 255, paragraph 2, Stock Corporation Act*).

Tax/social security. If employees purchase shares for less than their fair market value, income tax and social security contributions become due on the difference between the purchase price and the fair market value (see *Question 7*). Again, the tax must be declared and is payable by the employer, who withholds the tax from the employees' salary. Employees and employers share social security contributions equally between them, and the employer is liable for the payment to the social insurance agencies.

Vesting

11. In relation to the vesting of share acquisition or purchase awards:

- Can the company award the shares subject to restrictions that are only removed when performance or time-based vesting conditions are met?
- Are any tax/social security contributions payable when these performance or time-based vesting conditions are met? Who is obliged to account for the liability and by when? How (if appropriate) is the liability recovered from employees?

Share acquisition or purchase plan

Restrictions removed only on conditions being met. The company can place performance or time-based vesting conditions on the award. It is particularly common to impose time-based conditions, to commit the employee to the company. However, vesting periods cannot exceed five years, because such a long term of commitment is considered to be an unreasonable disadvantage for the employee.

Tax/social security. No tax and/or social security contributions are payable when vesting conditions are met.

Sale

12. What are the tax and social security implications when the shares are sold? Who is obliged to account for the liability and by when? How (if appropriate) is the liability recovered from employees?

On a sale of shares, employees must report and pay a flat tax of 25% on their capital gains (see Question 7). The taxable capital gain is the difference between the shares' fair market value on purchase and the sales price. The sale of shares does not trigger social security contributions. Income tax on a capital gain will be withheld and paid to the tax authorities by the broker if the broker is a German financial services institution. Otherwise, the employee has to declare the capital gain in his personal annual income tax return and (typically) pay the tax within four weeks of the receipt of his personal income tax assessment.

PHANTOM OR CASH-SETTLED SHARE PLANS

13. What types of phantom or cash-settled share plan are operated in your jurisdiction?

There are two types of phantom share plans:

- Phantom share plan.
- Share appreciation rights.

The main difference between the two types is that phantom share plans contain a dividend. Both types are classified as a stock market price oriented bonus, which always affects the company's liquidity. Therefore, the company must make provision for any potential liability (section 249, paragraph 1, German Commercial Code).

14. In relation to the phantom or cash-settled share plan:

- What are the plan's main characteristics?
- Which types of company can offer the plan?
- Is this type of plan popular? If so, among which types of company is this plan particularly popular?

Phantom share plan

Main characteristics. A phantom share plan is a contractual analogue of a share acquisition plan. The employee owns equity units that mirror the company's shares and receives a cash award that amounts to the difference between the employer's shares' market value and a specified price that the employer and employee agree on. The employee may also receive cash dividends that relate to the performance of the company's shares, for a certain period of time. This is often paid as part of the employee's regular salary.

Types of company. Only public limited companies can offer a phantom share plan.

Popularity. Phantom share plans are not very common.

Share appreciation right

Main characteristics. The employee receives the same economic reward as he would have received if a share option had been granted. The employee can exercise the award and he benefits from any increase in the share value without actually receiving any shares.

Types of company. Only public limited companies can offer share appreciation rights.

Popularity. Share appreciation rights are not very common, but they are useful for employers that wish to reward members of their supervisory board, who cannot receive share options (see Question 5, *Share option plan: Discretionary/non-discretionary*).

Grant

15. In relation to the grant of phantom or cash-settled awards:

- Can the awards be granted on a discretionary basis or must they be offered to all employees on the same terms?
- Can participation in the plan be offered to non-employee directors and consultants as well as employees?
- Is there a maximum award value that can be granted under the plan, either on a per-company or per-employee basis?
- What are the tax/social security implications when the award is made?

Phantom share plan/share appreciation right

Discretionary/non-discretionary. See Question 5.

Non-employee participation. See Question 5.

Maximum value of awards. There is no specific limit on the maximum value of awards that can be granted. The general restrictions on the remuneration of managers under section 86 of the Stock Corporation Act must be complied with.

Tax/social security. No income tax or social security contributions are charged on grant.

Vesting

16. In relation to the vesting of phantom or cash-settled awards:

- **Can the awards be made to vest only where performance or time-based vesting conditions are met?**
- **Are any tax/social security contributions payable when these performance or time-based vesting conditions are met? Who is obliged to account for the liability and by when? How (if appropriate) is the liability recovered from employees?**

Phantom share plan/share appreciation right

Awards vested only on conditions being met. The award can be structured to vest only if certain performance or time-based conditions are met.

Tax/social security. No tax and social security contributions are payable when the vesting conditions are met.

Payment

17. What are the tax and social security implications when the phantom or cash-settled award is paid out? Who is obliged to account for the liability and by when? How (if appropriate) is the liability recovered from employees?

Phantom share plan/share appreciation right

The award is regarded as part of the employee's (monthly) salary and charged with income tax, which is withheld from the employee's salary and paid to the tax authorities by the employer before the tenth day of the month following the month of payment of the award. Both the employer and the employee pay social security contributions on the award. The employer must declare and pay the social security contributions to the social insurance agencies.

INSTITUTIONAL, SHAREHOLDER, MARKET OR OTHER GUIDELINES

18. Are there any institutional, shareholder, market or other guidelines that apply to any of the above plans, and which types of company are subject to them? What are their principal terms?

The Corporate Governance Code (*Deutscher Corporate Governance Kodex*) applies to public limited companies listed on the German Stock Exchange. It is updated every year by a

government commission (*Regierungskommission Deutscher Corporate Governance Kodex*) and contains several basic mandatory principles. Managers and the supervisory board must report each year as to whether they fully comply with the code. If not, they have to disclose their reasons for non-compliance. The report must always be accessible to the public (*section 161, Stock Corporation Act*).

There are no other applicable guidelines.

EMPLOYMENT LAW

19. Is consultation or agreement with, or notification to, employee representative bodies required before an employee share plan can be launched? If so, what information must be provided and how long does the process take?

If there is a works council in the company, it has information, consultation and co-determination rights concerning the implementation of share option plans, share plans, cash-settled share plans and other forms of variable remuneration (*section 87, paragraph 1, no. 10 to 11, Works Council Constitution Act (Betriebsverfassungsgesetz)*).

Although the employer can launch a plan without the works council's consent, the works council must agree to how the options are to be distributed and to the plan's conditions and technical terms.

However, the works council has no co-determination right over plans offered towards managerial employees.

If a foreign parent company implements an employee share plan or a share option plan, consultation with the works council is not required because the co-determination right refers only to employment remuneration.

The works council must be provided with all the necessary information to fulfil its tasks. The information must be all-embracing and provided in due time. As there is no specific statutory period, the time the process takes depends on the circumstances of the particular case.

20. Do participants in share plans have rights to compensation for loss of options or awards on termination of employment?

According to the German Federal Labour Court (*Bundesarbeitsgericht*) (BAG), share option rights can legally be combined with an acceleration clause, especially if the expiry is linked up with the continuance of the employment relationship. Therefore, participants have no rights to compensation for loss of options or awards, if the loss is caused by the termination of the employment relationship. The reason given for not protecting participants is the speculative character of share options and that these always include uncertainty.

EXCHANGE CONTROL

21. How do exchange control regulations affect employees sending money from your jurisdiction to another to purchase shares under an employee share plan? If consents or filings are needed, how much will they cost and how long will they take?

There are no exchange control regulations in Germany. However, an employee who transfers abroad more than EUR12,500 must inform the German Central Bank (*Bundesbank*).

22. Do exchange control regulations permit or require employees to repatriate proceeds derived from selling shares in another jurisdiction? Are there any conditions for repatriating funds (such as monetary limits, timing, filings or consents)?

See *Question 21*.

INTERNATIONALLY MOBILE EMPLOYEES

23. What is the tax position when:

- **An employee who is resident in your jurisdiction at the time of grant of a share option or award leaves your jurisdiction before any taxable event (such as the amendment, vesting, exercise or release of the option or award or the grant of a replacement) affecting the option or award takes place?**
- **An employee is sent to your jurisdiction holding share options or awards granted to him before he is resident in your jurisdiction and a taxable event occurs after he arrives in your jurisdiction?**

Resident employee

If an employee exercises an option granted in Germany when no longer a German resident, German tax is charged on that part of the taxable benefit that is attributable to the former employment in Germany. All contractual arrangements must be taken into account (such as vesting conditions) to determine what part of the benefit is attributable to such former employment. A subsequent capital gain (difference between exercise and sales price) is typically not taxable in Germany.

Non-resident employee

If an employee exercises an option in Germany that was granted while he was resident in another jurisdiction, German tax is charged on that part of the taxable benefit that is attributable to the employment in Germany. All contractual arrangements must be taken into account (such as vesting conditions) to determine what part of the benefit is attributable to the present (German) employment. A subsequent capital gain (difference between exercise and sales price) realised during residency in Germany is also taxable in Germany.

PROSPECTUS REQUIREMENTS

24. For the offer of and participation in an employee share plan:

- **What are the prospectus requirements?**
- **Are there any exemptions from prospectus requirements?**
- **If so, what are the conditions for the exemption(s) to apply?**
- **Are any prospectus/securities laws consents or filings required?**

Prospectus needed for employee share plan offer. The German Securities Prospectus Act (*Wertpapierprospektgesetz*) implements Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading (Prospectus Directive).

The Prospectus Directive requires companies to publish a prospectus for offers of securities to the public. An offer of securities to the public is defined as a communication that sets out sufficient details to enable investors to decide whether to purchase or subscribe for the securities. A prospectus is also required if the shares are listed on an EU stock exchange.

Exemption(s) for employee share plan offers. An employer can present a document instead of a prospectus for securities offered to employees that are listed on a regulated market. This document must contain information on both the:

- Amount and form of the securities.
- Reason for making the offer.

Most share options do not fall under the Prospectus Directive, because they are generally non-transferable and non-negotiable on the capital market. In addition, there are exemptions that significantly limit the number of share plans that require a prospectus (*section 2, Securities Prospectus Act*).

Conditions for exemptions. The most important exemption applies if the shares are already listed on the regulated market and the issue price for all shares offered within a 12-month-period amounts to EUR2.5 million. This threshold refers to the amount payable by employees and not to the value of shares offered.

Another important exemption applies if an offer is made to less than 100 employees.

Consents or filings. Governmental approval is generally not required when launching an employee share plan. However, the Securities Trading Act (*Wertpapierhandelsgesetz*) gives certain rules, in particular the prohibition of insider trading. In addition, any capital share increase must be registered in a commercial register (*Handelsregister*).

OTHER REGULATORY CONSENTS OR FILINGS

25. Are there any other regulatory consents and filing requirements and/or other administrative obligations for an offer of and participation in an employee share plan?

There are no other regulatory consents or filing requirements.

FORMALITIES

26. What are the applicable legal formalities?

Translation requirements. There are no translation requirements. Even if a contract is in German, relevant declarations do not necessarily have to be also delivered in German.

E-mail or online agreements. The purchase of stocks and the granting of stock options are classified as sales contracts, which do not have to meet any formal requirements. Therefore binding agreements can be concluded electronically.

Witnesses/notarisation requirements. See above.

Employee consent. Whether actions in relation to the employee's options or awards need the employee's consent depends on the specific frame agreement. There are no statutory regulations.

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Recent transactions. Under Ms Glaser's authority Heuking Kühn Lüer Wojtek has become one of the leading German law firms in labour issues, not only for German but also for foreign clients, including foreign governments.

DEVELOPMENTS AND REFORM

27. Please briefly summarise:

- The main trends and developments (including market practice) relating to employee share plans over the last year.
- Any official proposals for reform of any laws which will affect the operation of employee share plans.

Trends and developments

Since the implementation of the Act on Adequate Remuneration for Members of a Management Board and the associated focusing on long-term incentives in 2009, there have been no recent developments relating to employee share plans.

Reform proposals

There are no proposals for reform of the law relating to employee share plans.