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Stakeholder or Shareholder? Employee participation in LLCs across Germany, Austria and the United States

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Stakeholder or Shareholder? Employee participation in LLCs across Germany, Austria and the United States

Abstract (Deutsch)

Weltweit werden Mitarbeiterbeteiligungsprogramme als geeignetes Mittel zur Gewinnung und Bindung von Mitarbeitern und Mitarbeiterinnen sowie zur kontinuierlichen Motivation zu Bestleistungen angesehen. So soll sich der Unternehmenserfolg insgesamt positiv beeinflussen lassen. Dieser Aspekt ist insbesondere für Start-ups relevant, die oft über begrenzte finanzielle Mittel verfügen und aus diesem Grund – zumindest auf den ersten Blick – für Mitarbeiter und Mitarbeiterinnen oftmals weniger attraktiv erscheinen. Aber auch für bereits etablierte Unternehmen ist das von Relevanz.

Die Forschung in Deutschland und Österreich hat sich bisher keine abschließende Meinung zur tatsächlichen Auswirkung von Mitarbeiterbeteiligungsprogrammen gebildet. Zudem ist festzustellen, dass die Analyse der Mitarbeiterbeteiligung in der Lehre dort zumeist auf die Gesellschaftsform der Aktiengesellschaft (und vergleichbare Gesellschaftsformen) beschränkt ist. Die Gesellschaftsform der Gesellschaft mit beschränkter Haftung (GmbH) wird in diesem Zusammenhang bislang nur unzureichend berücksichtigt, obwohl es sich bei der GmbH um die am weitesten verbreitete Rechtsform in Deutschland handelt. Ebenso erfreut sich diese Gesellschaftsform in Österreich und den Vereinigten Staaten enormer Beliebtheit. Die GmbH verbindet typischerweise das Bedürfnis nach einer Beschränkung des Haftungsrisikos mit den Anforderungen der Marktteilnehmer an die wirtschaftliche Transparenz. Dies resultiert in gesellschaftsrechtlichen Spezifika, die sich auf die Stellung eines Mitarbeiters im Rahmen des Beteiligungsprogramms auswirken und ihn in Richtung Stakeholder oder Shareholder rücken.

Politische Maßnahmen und Reformen zur Verbesserung der Rahmenbedingungen für Mitarbeiterbeteiligung zielen in den Mitgliedstaaten der Europäischen Union meist auf die Optimierung steuerrechtlicher Aspekte ab und blenden den vom Gesellschaftsrecht gesetzten Rahmen für Mitarbeiterbeteiligungen in GmbHs ein Stück weit aus. Das ist bemerkenswert, da sich Regierungen weltweit zum Ziel gesetzt haben, die Bedingungen für Mitarbeiterbeteiligungen zu optimieren. Um im internationalen Wettbewerb attraktiv zu bleiben, ist ein gezielter Vergleich der Rahmenbedingungen im internationalen Umfeld erforderlich.

Dies bildet den Ausgangspunkt für die vorliegende Masterthesis. Nach einer Einführung in die Grundlagen und Definitionen werden die gängigsten Formen der Mitarbeiterbeteiligung in GmbHs dargestellt. Darauf aufbauend werden die gesellschaftsrechtlichen Rahmenbedingungen unter Bezugnahme auf steuerrechtliche Aspekte, für Mitarbeiterbeteiligungsprogramme in GmbHs in Deutschland, Österreich und den USA näher beleuchtet. Auf dieser Grundlage skizziert die Masterthesis die Gemeinsamkeiten und Unterschiede sowie die Erfolgsfaktoren in Bezug auf die

Richtung, die der Gesetzgeber einschlagen müsste, um attraktivere Mitarbeiterbeteiligungsmodelle zu ermöglichen.

Abstract (English)

Employee participation programs are regarded worldwide as an effective means of attracting and retaining employees and motivating them to perform at their best on an ongoing basis. The objective is to generate a positive impact on the company's overall success. This aspect is of particular relevance to start-ups, which often have limited financial resources and therefore – at least at first glance – appear less appealing to employees. Nevertheless, it is equally relevant for established enterprises.

Research in Germany and Austria has not yet reached a conclusive opinion on the actual impact of employee participation programs. Furthermore, it can be observed that the analysis of employee participation in national academic research has been largely focused on the legal form of the stock corporation (and comparable legal forms). The limited liability company (LLC) has not been adequately considered in this context, despite the fact that it is the most common legal form in Germany. Similarly, the LLC enjoys enormous popularity in Austria and the United States. Typically, the LLC combines the need to limit liability risk with the market participants' demands for economic transparency. Consequently, specific features of company law come into effect, impacting the role of employees within the participation program and causing a shift in their status towards that of stakeholders or shareholders.

The implementation of political measures and reforms intended to enhance the framework conditions for employee participation in member states of the European Union has predominantly centered on optimizing tax law aspects. These measures have, to a certain extent, overlooked the framework established by company law for employee participation in LLCs. This is noteworthy, given that governments worldwide have set themselves the objective of optimizing the conditions for employee participation. However, to maintain competitiveness on the global stage, a deliberate comparison of the prevailing framework conditions in the international context is essential.

This forms the starting point for this master's thesis. Following an introduction to the principles and definitions, the most common forms of employee participation in LLCs are presented. Building on this, the corporate law framework for employee participation programs in LLCs in Germany, Austria, and the US is examined in more detail, with reference to tax law aspects. On this basis, the master's thesis outlines the similarities and differences as well as the success factors in terms of the direction that legislators should take to enable attractive employee participation models.

Table of Contents

List of Abbreviations

BAG	German Federal Labor Court
BMWi	German Federal Ministry for Economic Affairs and Energy
EPP	employee participation plans/programs
ESOP	employee stock ownership plans
EU	European Union
FlexCo	Flexible Capital Company
FMV	fair market value
GmbH	German term for limited liability company
LLC	Limited liability company
NCEO	National Center for Employee Ownership
SME	small and medium-sized enterprises
UAR	unit appreciation rights
VSOP	Virtual Share Option Plan

A. Introduction - Theoretical principles and objectives

Participation of employees in the company (and its success) in the form of employee participation plans/programs (EPPs) is regarded by business, academia, and politics worldwide as an effective means of attracting and retaining employees and motivating them to perform at their best. The rationale underpinning this support for financial employee participation is the assumption that it positively impacts both productivity and employment.[1] However, the existence of clear empirical evidence for this effect in Germany and Austria remains to be demonstrated. International comparisons that include the full spectrum of employee participation are challenging to undertake due to the heterogeneity of available data and the absence of comprehensive statistical information.[2] The present thesis thus primarily analyses the factors that can explain the occurrence, design and practical implementation of financial employee participation.

All corporate entities inherently possess the possibility of employee participation. Nevertheless, concerns regarding specific forms of participation are expressed by both employers and employees. The ease with which shares can be sold, in conjunction with the clear division of responsibilities between management and shareholders, gives rise to a positive correlation between listed companies and the existence of financial employee participation.[3] However, a (stock) corporation is not typically an option for small and medium-sized enterprises (SMEs) or start-ups[4] in Germany and Austria due to the significantly higher minimum share capital (*Stammkapital*) required compared to a limited liability company, the strict capital commitment, and the legal complexity of this type of company. In the United States, too, the limited liability company is the vehicle of choice for smaller, personally driven investments.[5] Given the significance of the motives behind employee participation for SMEs and start-ups, and the enormous popularity of this corporate entity, the present paper will focus on limited liability companies (LLCs).

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[1] Johannes Ahlswede and Jana Landhäußer, ‚Quo Vadis Mitarbeiterbeteiligung in der GmbH?‘ [Quo Vadis employee participation in LLC?] [2023] ZGR 2023, 709, 713.

[2] Herbert Hofmann and Christian Holzner, ‚Mitarbeiterkapitalbeteiligung - Ein internationaler Vergleich‘ [Employee participation – an international comparison], ifo Schnelldienst 12/2002 7 with further references.

[3] Hofmann and Holzner (n 2) 9.

[4] There is no universally valid definition of the terms small business, medium-sized enterprise, and start-up. However, start-ups are generally understood to be young, innovative companies with growth ambitions. SMEs are often family businesses with stronger regional ties and lower turnover and employee numbers compared to larger market players. It is in this sense that these terms are used in this paper. For more details on SMEs from a German perspective, see Gerd Waschbusch and Markus Sendel-Müller, ‚Mitarbeiterbeteiligung im Mittelstand – ein unauflösbarer Konflikt?!‘ [Employee participation in small and medium-sized enterprises – an irresolvable conflict?!] [2025] StB 2025, 161, 173.

[5] Delaware Division of Corporations 2008 Annual Report <http://www.corp.delaware.gov/2008AR.pdf> accessed 25 July 2025.

The objective of this master thesis is threefold. Firstly, it provides a comprehensive overview of theoretical principles and of the different forms of employee participation in LLCs (part A. and part B.). Secondly, it presents their legal framework in Germany, Austria and the United States, each of which is covered by a separate chapter (part C.). Thirdly, it analyses success factors based on identified differences and similarities (part D.). The following key issues will be examined: the timing and type of taxation and tax allowances, the valuation procedures, share transfers and classes and the participation of employees in decision-making. Developments in employee participation resulting from the introduction of the so called "Flexible Capital Company" in Austria and the implementation of the Future Financing Act in Germany will be addressed.

1. Definition and Scope

In both research and practice, the term "employee participation"' is generally understood to mean the material, monetary participation (financial employee participation) of persons working in a company in the capital and/or success of the company.[6] Non-financial employee participation, which aims to achieve a special identification of the employee with the company by means of the company's organization, is beyond the scope of this thesis – This is more of an organizational theory concept than a legal issue.[7]

This thesis examines forms of employee participation that include both "genuine" participation and purely contractual forms of participation, profit sharing and equity participation. Special forms, such as profit participation rights, are addressed less extensively. Other forms of special remuneration, including pension fund models, are not addressed comprehensively due to their absence of profit-sharing characteristics and for the purpose of maintaining clarity. Moreover, pure profit-sharing schemes, which are distributed to employees immediately and are not subject to a fixed participation system, are not examined in detail.

The forms of employee participation discussed in this paper are aimed at managers, i.e., members of executive bodies and senior executives (first- and second-level managers) or other employees. Notably, the forms described herein are to be distinguished from so-called "management participation" in buyout scenarios, including, but not limited to, succession, spin-off, or public-to-private situations.[8]

The examination of EPP is predominantly concentrated on corporate law, while areas such as labour law, social security law, accounting law and in-depth tax law remain largely unexamined.

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[6] Adalbert Rödding, Jan Brinkmann and Alexander Fischer in: Jochen Lüdicke and Christian Sistermann (eds) Unternehmenssteuerrecht [corporate tax law] (2 edn C.H.Beck 2018), sec 14 para 139.

[7] Unless expressly stated otherwise in this thesis, the term 'employee participation' refers to financial employee participation.

[8] For details regarding the case scenarios, please refer to Wolfgang Weitnauer, Management Buy-Out (2 edn C.H.Beck 2013) 141 ff.

The essential legal framework is outlined. However, it is not feasible to address every potential special problem within the scope of this thesis.

A distinctive aspect of this thesis is its focus on limited liability companies. Historically, EPPs were particularly common in listed stock corporations, manifesting in the form of stock option programs. Consequently, research has predominantly centered on this legal instrument. Due to the steadily increasing relevance of employee participation for SMEs and start-ups, the topic has gained relevance for legislators and practitioners. Start-ups, for whom the motives behind employee participation are of great importance, regularly operate as LLCs. These company forms enable founders to limit their personal liability and to reduce the complexity of business operations associated with the legal form. Consequently, while this thesis examines LLCs in a general context, it places particular emphasis on SMEs and start-ups.

Intracompany/Intracommunity effects as issues that arise, for example, for international corporations that want to provide similar EPPs to their employees in different countries are beyond the scope of this thesis. Today, programs adapted to individual country locations are usually set up, e.g., as sub-participation programs or through local subsidiaries.[9] In recent years, however, there has been a trend toward standardizing programs.[10] Further research is required in this area.

2. Prevalence of Employee Participation

Since the early 1990s, the European Commission has promoted employee participation in European Union (EU) member states.[11] Member states have responded differently to these recommendations, implementing them with varying intensity. As a result, the legal framework, support programs, and attitudes towards EPP vary considerably across different countries. These differences can be attributed to institutional variations among the member states, as well as to their distinct political approaches and historical and economic developments.[12] The capital market structure, company size, attitude and influence of social partners, and generosity of government support are all decisive factors.[13] Since 1967, France has had legislation in place stipulating that

[9] Prégardien, Winterhalder and Toliou (n 9) 246.

[10] ibid.

[11] Commission of the European Communities, ‘The PEPPER V Report - Benchmarking Employee Participation in Profits and Enterprise Results in the European Union, the United Kingdom and the United States’ (2024) <https://www.eurofound.europa.eu/sites/default/files/2024-09/pepper-v-report-web-revised-sept2024_en.pdf> accessed 22 May 2025 5.

[12] Study commissioned by the German Federal Ministry for Economic Affairs and Energy [*Bundesministerium für Wirtschaft und Energie* - BMWi], ‚Verbreitung der Mitarbeiterkapitalbeteiligung in Deutschland und Europa – Entwicklungsperspektiven‘ [The spread of employee share ownership in Germany and Europe – development prospects] (2020) <www.bmwk.de/Redaktion/DE/Publikationen/Studien/verbreitung-der-mitarbeiterkapitalbeteiligung-in-deutschland-und-europa.html> accessed 4 July 2025 7 and 90f.

[13] Hofmann and Holzner (n 2) 8.

certain companies must implement profit-sharing arrangements for their employees.[14] The majority of other EU nations employ tax incentive systems.[15]

Since 2009, the PEPPER IV report[16] has provided the first comprehensive overview of the development of employee participation in all EU member states and candidate countries, along with their national legal frameworks and obstacles to its development. The report also reveals a positive trend in employee participation in the EU since 1999. The most recent editions of various large-scale country studies (Cranet 2021-2022[17] and Eurofound 2019[18]) confirm this trend. However, it should be noted that the available data sets are difficult to compare, and there is no reliable information on the actual prevalence of EPP in the EU or Germany. Data sets pertaining to LLCs (SMEs and start-ups), are particularly challenging to interpret.[19] Nevertheless, the EU has decided to actively promote EPPs across the EU and to identify and investigate potential barriers to cross-border EPP programs. In this regard, the European Commission advanced a significant initiative with its 2015 "Five-point plan to remove obstacles to employee participation". This initiative was subsequently reflected in the 2018 European Parliament report on "The role of employee financial participation in job creation and the reactivation of the unemployed."[20]

In the United States, a high degree of risk-taking willingness, the presence of attractive exit opportunities, and labor laws that are flexible in nature have contributed to the positive development of EPP. The concepts of employee participation has been promoted on a broader scale in the United States since the 1950s. However, it was not until the government of the time declared balanced wealth distribution to be an important economic policy goal in the mid-1970s that participation

[14] Commission of the European communities, ‘The PEPPER Report - Promotion of employee participation in profits and enterprise results - Social Europe’ Supplement 3/91 (1991) <https://www.eurofound.europa.eu/system/files/2023-05/pepper1.pdf> accessed on 5 May 2025 67.

[15] Hofmann and Holzner (n 2) 9.

[16] PEPPER stands for "Promotion of employee participation in profits and enterprise results".; Commission of the European communities, ‘The PEPPER IV Report: Benchmarking of Employee Participation in Profits and Enterprise Results in the Member and Candidate Countries of the European Union’ (2009) <https://www.eurofound.europa.eu/system/files/2023-05/pepper4.pdf> accessed 22 May 2025.

[17] CRANET, Research Network, ‘Cranet Executive Report on International Human Resource Management: Summary and Analysis of 2021-2022 Survey Data’ (2023) <https://ssrn.com/abstract=4647015> accessed 8 May 2025.

[18] Eurofound and Cedefop, ‘European Company Survey 2019: Workplace practices unlocking employee potential’, European Company Survey 2019 series (2020 Publications Office of the European Union) <https://www.eurofound.europa.eu/de/publications/2020/europaeische-unternehmenserhebung-2019-erschliessung-des-potenzials-der> accessed 10 July 2025.

[19] With some explanatory comments, please refer to Waschbusch and Sendel-Müller (n 4) 173; Peter Volz, ‘Employee participation in Europe, Japan, and the USA’ (2007) Friedrich Ebert Foundation 7.

[20] European Parliament, ‘REPORT on the role of employee financial participation in creating jobs and reactivating the unemployed’ <https://www.europarl.europa.eu/doceo/document/A-8-2018-0293_EN.html accessed 27 July 2025.

programs received increased government support.[21] In the context of start-ups, robust support for employee participation in the United States has resulted in a scenario where, at the conclusion of their Series D financing round in 2020, employee participation averaged around 25% of total company value in US start-ups, significantly higher than the European average of 10%.[22] Many European countries are currently implementing government support measures with the objective of enhancing the appeal of employee participation. For example, Germany introduced tax deferral under Section 19a of the Income Tax Act (EStG). In Austria, the objective of the Employee Participation Foundation Act (*Mitarbeiterbeteiligungsstiftungsgesetz* 2017 – MitarbeiterBetStG[23]) is to enhance employee participation.[24] Furthermore, employees are to be granted a maximum of EUR 3,000 in tax-free profit sharing, provided that specific criteria are met.[25]

3. Motives and Objectives of Employee Participation

In 1991, the European Commission published a report on promoting employee participation within the individual member states.[26] In this first PEPPER report[27], the Commission outlined the following motivations for its support of EPP.[28]

- Incentive effects: increasing employee motivation and productivity;
- Wage flexibility: increasing competitiveness through flexible wages;
- Macroeconomic effects: including a more even distribution of the value created by the company and its employees, greater involvement of employees in decision-making processes, and stabilization of employment.

Against this backdrop, little has changed to date – and these motives apply equally to companies in the United States. From the companies' perspective, however, the primary objective of employee participation is to is to enhance the company's attractiveness in the competition for talent and skilled workers, thereby strengthening employee loyalty to the company.[29] The resulting increase in

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[21] Stefan Stracke and others, ‘Mitarbeiterbeteiligung und Investivlohn’ [Employee participation and investment wages] (2007) Economy and Finance edition of the Hans Böckler Foundation Vol. 205 107.

[22] Index Ventures handbook, ‚Rewarding Talent‘ (2020) <https://www.indexventures.com/rewardingtalent/keyfindings> accessed 9 April 2025.

[23] German Federal Law Gazette I no. 105/2017.

[24] Prégardien, Winterhalder and Toliou (n 9) 245.

[25] ibid.

[26] PEPPER Report (n 14) accessed 17 July 2025.

[27] The first PEPPER Report (n 14) was published in 1991; follow-up studies appeared in 1997, 2006, and 2009.

[28] PEPPER Report (n 14) accessed 17 July 2025 12-15 and 185-189.

[29] Study commissioned by the BMWi (n 12) accessed 5 July 2025 85; Waschbusch and Sendel-Müller (n 4) 173; National Center for Employee Ownership (NCEO), ‘A guide to employee ownership for very small businesses’ <https://www.nceo.org/what-is-employee-ownership/employee-ownership-small-businesses-under-20-employees> accessed 28 July 2025.

competitiveness, motivation, and productivity should provide sufficient incentive for management to introduce profit- or capital-sharing schemes, independent of government support. Nevertheless, from an entrepreneurial perspective, there are further reasons for introducing EPP:

- Liquidity-preserving remuneration for employees through the granting of a fundamental right that only has to be exercised at a later date (e.g., silent partnership);[30] and
- Capital raising: SMEs are not always able to obtain financing on the capital market on the same terms as larger enterprises. In this case, employee participation can improve liquidity and help LLCs achieve their financial goals.[31]

4. Significance of Employee Participation – Impact on Productivity

The impact of EPP is subject to controversial discussion in the academic literature in Germany and Austria, particularly because the correlation between individual performance and company success is ambiguous.[32] Some argue that EPPs would weaken shareholders' ownership rights and burden employees with disproportionate risk.[33] Given that it is oftentimes impracticable or unprofitable to evaluate individual performance in a meaningful way, the returns from participation in the company's profits and/or capital are not generally based directly on individual performance. Rather, said returns are based on the performance of the entire workforce. This dynamic can give rise to a problem of free riding, as ultimately, all employees benefit from the efforts of their colleagues.[34] Employees with limited influence on the operating result may be more inclined to reduce their own efforts, potentially at the expense of their colleagues.[35] Consequently, companies frequently provide profit sharing exclusively to management, as this criticism is less applicable to managers.[36]

In the absence of compelling evidence demonstrating a causal relationship between employee participation and productivity or employment outcomes, the government's ongoing promotion of EPPs is called into question. This issue is further complicated by the need to determine whether the government should intensify its support for EPPs, and if so, the most effective approach to do so. A notable argument in support of this position is the potential of EPPs to serve as a mechanism for job preservation.[37] In the context of increasing globalization, characterized by greater international mobility of goods and production factors, employee compensation in high-wage

[30] Hofmann and Holzner (n 2) 11.

[31] ibid; Waschbusch and Sendel-Müller (n 4) 173.

[32] Bernd Luxbacher and Angelika Schury, 'Mitarbeiterbeteiligung: an Unternehmen und Start-Ups' [Employee participation: in companies and start-ups] (dbv-Verlag 2024) cp 1, 12.

[33] PEPPER Report (n 14) accessed 4 July 2025 16 f.

[34] Hofmann and Holzner (n 2) 12.

[35] ibid.

[36] Luxbacher and Schury (n 32) cp 1, 12.

[37] Hofmann and Holzner (n 2) 12.

countries, particularly for workers with relatively low qualifications, is experiencing significant pressure. The distribution effects triggered by this dynamic can be mitigated through the implementation of EPP.[38]

In addition, according to motivation theory, profit and capital sharing positively affects employees' identification with their company, thereby potentially increasing productivity.[39] This finding has been supported for profit sharing[40] by a large number of empirical studies from the United States[41] and Japan[42]. A survey indicates that companies with EPPs generate 20% more value added.[43] Consequently, EPPs are of significant importance for start-ups, which depend on the successful recruitment and retention of skilled employees from both the national and international workforce.[44] SMEs and start-ups often face limitations in capital, which hinders their ability to compete with the salary levels of established companies in the initial stage of operation ("early stage").[45] At the same

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[38] Hofmann and Holzner (n 2) 12.

[39] Aaron A. Buchko, 'The effects of employee ownership on employee attitudes: An integrated causal model and path analysis' (2007) Journal of Management Studies 30(4):633, 657; #ESOPasap, ‚Faire Mitarbeiterbeteiligung in Startups – mit Unternehmergeist Innovation und Wachstum beschleunigen' [Fair employee participation in start-ups – accelerating innovation and growth with entrepreneurial spirit] (2020) <https://startupverband.de/fileadmin/startupverband/mediaarchiv/Politik/200701_IEF_BGC_ESOPasap.pdf> accessed 20 July 2025 21; Michael Wolff and Ulrike Zschoche, Studie zur Wirkung der Mitarbeiterbeteiligung am Beispiel der Siemens AG [Study on the impact of employee participation using the example of Siemens AG] <https://agpev.de/wp-content/uploads/wirkung_mitarbeiterbeteiligung_siemens_ag.pdf> accessed July 2025 19 ff.

[40] For Germany, please refer to the study commissioned by the BMWi (n 12) 7 and 91; #ESOPasap (n 39) 26; In the case of equity participation, the experience is less clear: Michael Poole and Glenville Jenkins find positive effects (1991), 'The Impact of profit-sharing and employee shareholding schemes' (1991) Journal of General management 16 (3) 52, 54, while Elke Wolf and Thomas Zwick, 'Produktivitätswirkung von Mitarbeiterbeteiligung: Der Einfluss von unbeobachteter Heterogenität' [Productivity effects of employee participation: The influence of unobserved heterogeneity] (2002) MittAB 1/2002, 123, 130 find no correlation.

[41] Subal C. Kumbhakar and Amy E. Dunbar, 'The elusive ESOP—productivity link: evidence from U.S. firm-level data' (1993) Journal of Public Economics 52 (2) 276 ff; Joseph Blasi, Michael Conte and Douglas Kruse, 'Employee Stock Ownership and Corporate Performance among Public Companies' (1996) ILR Review 50 (1) 62 ff.; Joseph Blasi, Douglas Kruse and D Weltmann, 'Firm survival and performance in privately held ESOP companies' in: Douglas Kruse (ed), 'Sharing ownership, profits, and decision-making in the 21st century (edn 14) 109–124.

[42] Instead of all Derek C. Jones and Takao Kato, 'The Productivity Effects of Employee Stock Ownership Plans and Bonuses: Evidence from Japanese Panel Data' (1995) The American Economic Review 85(3) 391-414, with further references.

[43] Heribert Heckschen and Peggy Glombik, 'Erscheinungsformen der Mitarbeiterbeteiligung an der GmbH' [Forms of employee participation in limited liability companies] [2013] GmbHR 2013, 841, 842.

[44] Study commissioned by the BMWi (n 12) 7 and 90; #ESOPasap (n 39) 14 and 27; Index Ventures handbook, ‚Rewarding Talent' (2020) <https://www.indexventures.com/rewardingtalent/employee-ownership-why-it-matters> accessed 8 April 2025.

[45] #ESOPasap (n 39) 12f.; Study commissioned by the BMWi (n 12) accessed 5 July 2025 90; Christoph Tamcke and others ‚Zwischen Löwen und Gorillas – Wie funktioniert Venture Capital?' [Between lions and gorillas - How does venture capital work?] [2022] JA 1019, 1024; Jens Wenzel and Clemens Höhn in: Wolfgang Meyer-Sparenberg and Christof Jäckle (eds), Beck'sches M&A-Handbuch (2 edn C.H. Beck 2022) sec 61 para 39.

time, the business risk is high during this phase.[46] The opportunity to participate directly in the company's success and in the increase in value of the start-up creates a balance here.[47] In a 2020 representative survey, 81% of start-up employees, 88% of start-up founders, and 94% of start-up investors indicated that EPP was a decisive factor in the success of a start-up.[48] According to the survey results, 59% of employees perceive EPP as a substantial financial incentive or form of financial compensation.[49]

Furthermore, EPPs have been demonstrated to play a significant role in the retention of skilled workers. Employee turnover poses a significant risk for some companies, a risk that is intensified by the growing mobility of employees in the job market.[50] EPPs can mitigate this risk by motivating employees to remain with the company.[51] This tendency is attributable to the nature of EPPs, which are typically characterized as long-term commitments. Specifically, employees typically acquire access to their shares/participation over time in accordance with the terms of so-called vesting agreements.[52] Moreover, it is generally agreed upon that the realization of shares in the company can only occur at the so-called exit.[53]

In summary, it can be concluded that further support from legislators for EPPs serves a very useful purpose, as employee participation is predominantly characterized by positive aspects for the economic system.

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[46] #ESOPasap (n 39) 12f.; Index Ventures handbook, ‘Rewarding Talent‘ (2020) <https://www.indexventures.com/rewardingtalent/keyfindings> accessed 9 April 2025.

[47] Stephan Bank, Venture Capital Agreements in Germany (1 edn C.H. Beck 2017) pt 3 para 418; Wenzel and Höhn (n 45) sec 61 para 39; Study commissioned by the BMWi (n 12) accessed 5 July 2025 90f; #ESOPasap (n 39) 13.

[48] #ESOPasap (n 39) 18.

[49] ibid.

[50] ibid 28; Index Ventures handbook, ‘Rewarding Talent’ (2020) <https://www.indexventures.com/rewardingtalent/keyfindings> accessed 9 April 2025; Ahlswede and Landhäußer (n 1) 712.

[51] John Guzek and Ashley Whillans, ‘Overcoming Barriers to Employee Ownership: Insights From Small and Medium-Sized Businesses’ (2024 Sage Publications) Compensation & Benefits Review 0(0) 1,1; Heinrich Beyer and Hans-Jörg Naumer, CSR und Mitarbeiterbeteiligung [CSR and employee participation] (2018 Springer Berlin Heidelberg) 199, 202ff; Study commissioned by the BMWi (n 12) 91; #ESOPasap (n 39) 27; Index Ventures handbook, ‚Rewarding Talent‘ (2020) <https://www.indexventures.com/rewardingtalent/keyfindings> accessed 9 April 2025.

[52] Please refer to part B.3.of this thesis below for further details; #ESOPasap (n 39) 28.

[53] #ESOPasap (n 39) 28 and 71; Christoph Tamcke and others, ‘Zwischen Löwen und Gorillas – Wie funktioniert Venture Capital?‘ [Between lions and gorillas - How does venture capital work?] [2022] JA 1019, 1024.

B. Forms of Employee Participation in LLCs

A variety of approaches have been taken in the academic literature and in research to differentiate EPP.[54] A fundamental distinction can be made between two forms of participation: "genuine" participation, such as owning shares or membership interest in a company, and purely contractual forms of participation, such as VSOPs.[55]

Furthermore, participation can be categorized as either direct or indirect, with indirect participation involving an intermediary such as a company, foundation, or fund.[56] In indirect EPPs, the management of employees' shares is typically entrusted to a trustee or consolidated within a holding company. In practice, the indirect participation of employees via a holding company is structured in many different ways[57] - all forms of employee participation mentioned in this thesis can be structured as indirect participation. Indirect participation may be limited to the employer company (company participation) or it may involve other companies (intercompany participation). Initially, this refers to other companies within the same group; however, it ultimately extends to companies that are not affiliated with one another.[58] To that end, indirect forms remain outside the scope of this paper, which focuses exclusively on direct forms of employee participation.

There are a several special forms of employee participation that share similarities with one of the aforementioned forms – “genuine” participation or purely contractual forms – yet emphasize a different aspect.

The subsequent forms have been established for the purpose of implementing employee participation in LLCs in Germany or Austria.

- Direct participation through the issuance of company shares;
- The granting of options to company shares;

[54] cf. Volz (n 19) 7 and, for example, Waschbusch and Sendel-Müller (n 4) 162, outlining the various aspects of the possible distinctions.

[55] The same as here: Sebastian Schwarz and Jannik Zerbst, ‘Mitarbeiterbeteiligungsmodelle bei GmbHs in der anwaltlichen Beratung’ [Employee participation models for limited liability companies in legal consulting] [2025] NZG 2025, 781, 781.

[56] Ahlswede and Landhäußer (n 1) 724.

[57] cf. Gerd Waschbusch and Markus Sendel-Müller, ‘Erscheinungsformen und Einsatzmöglichkeiten von Mitarbeiterbeteiligungsgesellschaften‘ [Forms and applications of employee participation companies] StB 2020, 246, 252 ff.; In Austria, the Employee Participation Foundation Act [MitarbeiterbeteiligungsstiftungsG] 2017 allows for the creation of a core shareholder with uniform voting rights.

[58] Ahlswede and Landhäußer (n 1) 724.

- Various forms of virtual participation (so called phantom shares or virtual shares), which economically replicate the participation forms of genuine capital participation on a purely contractual basis.

In German and Austrian contexts, the following forms of employee participation are observed with less frequency.

- Contractual claims to a share in profits in the form of profit participation rights or profit participation certificates[59];

- The granting of silent participations, which establish a relationship under company law and can be structured in various ways[60];

- The granting of loans or credits by employees to the company via salary deductions. For example, this could be a loan with performance-related interest.[61]

In contrast to the more established use of LLCs in Germany and Austria, the adoption of this legal entity in the United States is a comparatively recent development. The LLC was first introduced into law in the United States in 1977 in Wyoming, and it is now regulated in all states by special limited liability company acts.[62] It was developed to address the necessity among business entities to integrate the liability protection offered by corporations with the tax transparency characteristic of partnerships which has been achieved in Germany, Austria, and some other countries through the legal recognition of the GmbH & Co. KG.[63] LLCs bear a strong parallel to S corporations; however, the basis of ownership is membership interests rather than "stock".[64] Consequently, LLCs usually do not have employee "stock" ownership plans ("ESOPs"[65]),[66] which represent one of the most prominent form of employee participation in the United States.[67] For this reason, this paper

[59] Jörg Schrade and Christian Linseisen, ‚Beteiligungsähnliche Genussrechte – Die Zukunft der Mitarbeiterbeteiligung?‘ [Participation-like profit participation rights – the future of employee participation?] Ubg 2025, 89, 89.

[60] Waschbusch and Sendel-Müller (n 4) 162.

[61] ibid.

[62] Rembert Süß in: Stefan Leible and Jochen Reichert (eds), ‚Münchener Handbuch des Gesellschaftsrechts VI‘ [Munich Handbook of Corporate Law VI] (5 edn C.H. Beck 2022) 597.

[63] ibid.

[64] ibid.

[65] When used outside the United States, the term "ESOP" means different things, such as stock options in India.

[66] NCEO, ‘Equity Incentives in Limited Liability Companies (LLCs)’ <https://www.nceo.org/what-is-employee-ownership/equity-compensation/equity-incentives-limited-liability-company-llc> accessed 22 May 2025.

[67] NCEO, ‘Employee Ownership by the Numbers` <https://www.nceo.org/research/employee-ownership-by-the-numbers> accessed 20 July 2025.

briefly addresses this form of an EPP as well. Given the limited scope of state pension provisions in the United States, the distinction between EPPs and occupational pension schemes is somewhat indistinct. In the context of employee participation, the now widespread 401(k) plans[68] are frequently mentioned. Notably, however, that these plans are primarily focused on retirement savings and therefore fall outside the scope of this discussion.[69] The following are the most common forms of compensation awards for partnerships and LLCs[70]

- Profit Interest;
- Phantom Equity;
- Unit Appreciation Rights (UAR).

Although less common, the following award types are also possible in the United States for partnerships and LLCs[71]

- Capital Interest;
- an option to purchase units.

In addition to their individual objectives and irrespective of their country of establishment, the design of EPPs starts with tax criteria, such as, the timing (keyword: dry income) and the type of taxation (as salary or capital gains), as well as other regulatory, labor law, corporate law, social security law, data protection law, and accounting criteria. The structure of the statutory support is the primary determining factor. The scope of application of laws often determines which company sizes are eligible for support and who can be a beneficiary.[72]

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[68] This term refers to the section of the same name in the US Internal Revenue Code (IRC).

[69] There are various types of plans, including traditional 401(k) plans, safe harbor 401(k) plans and automatic enrollment 401(k) plans. These plans can also be used by owners of an LLC, provided certain conditions are met. The responsibility for the design of a 401k plan lies with the employer, meaning that considerable variations in plans may be observed. Employees can contribute a portion of their gross salary to a 401(k) plan tax-free: Unlike ESOPs, the funds are subsequently invested in shares of the employer's enterprise as well as in shares of other enterprises or other financial assets (funds, fixed-term deposits, etc.). Enterprises offer further incentives, for example by increasing the amount retained through an additional benefit, such as a combination with an ESOP. Income tax is only payable upon the distribution of assets. For a more comprehensive overview please refer to Stracke (n 21) 109 f.

[70] Lauren Schuster and Scott Hunt, 'Equity-Based Compensation for Corporations, Partnerships and LLCs' (2020) 66 St Louis Bar Journal 29.

[71] ibid.

[72] Prégardien, Winterhalder and Toliou (n 9) 246.

1. Granting of Shares / Interests

In the context of an EPP with a genuine participation in the capital in Germany and Austria, existing or newly created shares can be (partially) transferred to the beneficiaries.

Additionally, the transfer of shares can be executed on a conditional basis. In this scenario, the shares are transferred in their entirety to the employees, yet they remain subject to a contractual right of acquisition ("call option") in favor of the company.[73] The company reserves the right to exercise this option in the event of specified events, particularly the departure of the employee from the company ("leaver event").[74]

In the case of an LLC based in the United States, the company has the option to transfer capital interest or – and in practice this is the more relevant option – profit interest.[75] The determination of whether an interest in an LLC constitutes a capital interest or a profits interest is a factual analysis, depending upon the economic rights assigned. Two economic rights are possible: the right to current-year profits and losses, and the right to a share of the proceeds upon the sale of the LLC's assets at fair market value and the subsequent distribution of the proceeds in the complete liquidation of the LLC.[76] When a partnership grants both economic rights, it grants a capital interest. Conversely, in the event that an LLC grants only the right to the profits and losses from the current year, a profits interest is all that is granted.[77]

Capital interests can be considered analogous to restricted stock grants in S or C corporations. In the context of a partnership or LLC, the grant of a restricted capital interest or restricted unit entitles the recipient to receive a portion of the proceeds in the event of the LLC's complete liquidation.[78] It is not possible to be a partner or LLC member and an employee at the same time, so the holder of capital interests is subject to the corresponding complexity.[79]

Nevertheless, the transfer of profit interests is generally more relevant in practice.[80] In the context of a partnership or LLC, the grant of a profits interest constitutes an award to the recipient of the right to share in expected profits and appreciation in value of the enterprise. Consequently, a profit interest is not equivalent to a profit share, but rather signifies a proportionate share of the growth

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[73] Ahlswede and Landhäußer (n 1) 715.

[74] ibid.

[75] Matthew E. Foreman and Michelle S. Kabel, 'Profits interests: The most tax-efficient equity grant to employees' [2025] The Tax Adviser 2025 (1), 30, 33.

[76] ibid 33.

[77] ibid 34.

[78] ibid 29.

[79] ibid.

[80] A profit interest is known by different names, such as profit-only interest.

of the LLC's value throughout a specific duration.[81] Stipulations regarding vesting can be linked to this interest.[82] In the United States, there are no codified regulations dictating the structure of profit interests. The distribution of earnings is typically based on vested units; however, it can also be based on allocated units.[83]

2. Granting of options or subscription rights to shares/membership interests

As an alternative to the direct transfer of shares, option rights can be granted to employees. Employees initially receive a contractual right to the issuance of a certain number of shares at a future date.[84] The terms and conditions of the grant as well as the conditions for exercise, are usually set out in an option agreement.[85] In contrast to the direct transfer of shares, the employee is not entitled to any membership rights upon the grant of the option, as the shares are only transferred when the employee exercises the option at the agreed-upon exercise date. It is only in this manner and as a consequence of this process that the employee becomes a shareholder in the company.[86]

The terms of each option program specify the number of options to be issued and the criteria for eligibility to participate. An exercise price is often agreed upon. In essence, this is the purchase price that employees must pay for the shares when they exercise their options (also known as the strike price).[87] In addition, options are regularly subject to longer vesting periods or may only be exercised annually up to a certain percentage.[88] Furthermore, especially in the context of start-ups, the objective is usually to either go public or sell the shares to a financial or strategic investor (exit).[89] For this reason, a co-sale obligation is often incorporated into the option agreement, as a

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[81] NCEO (n 66); Schuster and Hunt (n 70) 29.

[82] NCEO (n 66). Please refer to the following part B.3. of this thesis for more information on vesting clauses.

[83] ibid.

[84] Walter Bayer in: Markus Lutter and Peter Hommelhoff (eds), GmbHG (21 edn otto schmidt 2023) Sec 15 GmbHG para 54; Wolfgang Weitnauer, Handbuch Venture Capital [Venture Capital Handbook] (7 edn C.H.Beck 2022) pt F, para 142f.; Heribert Heckschen and Peggy Glombik, 'Unmittelbare oder mittelbare Beteiligung des Mitarbeiters an einer GmbH – Gestaltungsfragen' [Direct or indirect participation of employees in a limited liability company (GmbH) – structural issues] [2013] GmbHR 2013, 1009, 1019.

[85] Stephan Bauer, Manja Georgi and Melanie Weist in: Erwin Salamon, Entgeltgestaltung [remuneration structure] (1 edn C.H.Beck 2019) cp I, 166; Barbara Koch-Schulte and Lorena J. Echarri in: Klaus Wagner and others, Lohnsteuer [Income Tax] (1 edn C.H. Beck 2023), p P, 826.

[86] Ahlswede and Landhäußer (n 1) 716.

[87] #ESOPasap (n 39) 38.

[88] Stracke (n 21) 111. Please refer to the following part B.3. of this thesis for more information on vesting clauses.

[89] Regarding the term "exit", please refer to, for example, Jörg Risse and Florian Kästle, 'M&A und Corporate Finance von A-Z' (3 edn C.H.Beck 2018).

buyer will generally want to acquire all shares and will not accept minority shareholders.[90] This arrangement is advantageous for the employees in that the financing of the share acquisition upon exercise of the option is secured by the proceeds from the sale of the shares and they also benefit from the increase in the value of the company.[91]

As mentioned above in the section on direct granting of shares above (B.1.), options are typically exercised either through the (partial) transfer of existing shares or through a capital increase to create new shares.[92]

Overall, options for employees differ from freely tradable (stock) options in only a few respects. However, it is important to note that these options are non-transferable and cannot be sold.[93]

3. Virtual Employee Participation – Virtual Share Option Plan (VSOP) and phantom equity

In the context of VSOPs, the term virtual shares or virtual share options refers to simulated shares or simulated share options, respectively. The employee does not hold a direct stake in the company; rather, they possess a contractual claim to payment of a sum of money upon exit.[94] The amount of the payment is usually calculated using an agreed formula and is therefore variable. Consequently, employees are placed in the same position as if they had acquired a certain number of shares and sold them as part of the exit event.[95] VSOPs are predominantly used in German start-ups; in a study, 73% of founders with EPPs stated that they currently use VSOPs.[96] Such programs have also been implemented in a number of LLCs in the United States.[97]

In the context of establishing VSOPs, as well as EPPs with genuine participation, it is customary to incorporate vesting clauses, which stipulate that the complete acquisition of shares or options is subject to the duration of an individual's employment with the company.[98] Employees do not receive the (virtual) shares immediately or cannot exercise the options immediately, but instead accumulate them gradually over a certain period of time until they are fully vested. Typically, a duration of three

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[90] Ahlswede and Landhäußer (n 1) 716. The term „vesting“ is explained in more detail under part B.3. of this thesis.

[91] ibid 717.

[92] Ahlswede and Landhäußer (n 1) 717.

[93] Stracke (n 21) 111.

[94] Ahlswede and Landhäußer (n 1) 723.

[95] #ESOPasap (n 39) 71; Ahlswede and Landhäußer (n 1) 723.

[96] #ESOPasap (n 39) 40.

[97] Schuster and Hunt (n 70) 29.

[98] Ahlswede and Landhäußer (n 1) 723; #ESOPasap (n 39) 71.

to five years is selected for this purpose.[99] The international approach is analogous: at the beginning of the vesting period, no shares (genuine or virtual) or options are transferred to the participating employees for a period of one year (known as a "cliff"). At the end of the cliff, 25% of the shares/share options to be vested are allocated to the employees. Subsequent to the initial allocation, a linear allocation of shares or share options is executed on a monthly, quarterly, or annual basis until the conclusion of the vesting period, which normally lasts four years including the cliff.[100] Employees whose (virtual) shares or options have already vested and have not expired are entitled to exercise (virtual) shares or options. Moreover, the occurrence of a defined exercise event is necessary. For exit-oriented start-ups, this is typically defined as the completion (i.e., closing) of the exit transaction, which may take the form of a share deal, asset deal, or stock market listing of the company.[101]

In the event that an employee leaves the company prior to a stipulated exercise event, the respective (option) agreement typically governs the disposition of both vested and unvested options or (virtual) shares.[102] Depending on the reason for leaving, departing employees are classified as good leavers or bad leavers. Good leaver cases typically involve circumstances beyond the employee's control, such as death, occupational disability, or retirement upon reaching retirement age.[103] The definition of a bad leaver is quite broad in Europe and includes, for example, termination due to serious disciplinary violations or voluntary resignation. In the United States, the term is more narrowly defined, as options/shares are considered an essential part of compensation there and can only be withdrawn from the employees in exceptional cases.[104] In general, good leavers are permitted to retain their vested options or (virtual), while bad leavers lose all (or only some) of the vested options/(virtual) shares.[105]

4. Various Rights to Participate in Profits

Another form of participation based on a contractual obligation in Germany and Austria is participation-like profit participation rights. Profit participation rights are not unknown in the

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[99] Verena Prégardien, Alixx Winterhalder and Philipp Moosbauer, ‚Mitarbeiterbeteiligung im internationalen Vergleich (Teil II)' [Employee participation in international comparison (Part II)] GWR 2022, 263, 264.

[100] Index Ventures handbook 'Rewarding Talent' (2020) <https://www.indexventures.com/rewardingtalent/vesting-schedules> accessed 20 April 2025.

[101] Ahlswede and Landhäußer (n 1) 723.

[102] Prégardien, Winterhalder and Moosbauer (n 99) 264.

[103] ibid.

[104] For details, please refer to Prégardien, Winterhalder and Moosbauer (n 99) 264.

[105] Please refer to, for example, section 3 of the Model option terms and conditions of the German Standards Setting Institute (GESSI) <https://standardsinstitute.de/standardvertraege/mitarbeiterbeteiligung> 75. Especially when it comes to vesting clauses, German courts are currently changing their approach. For further details, see part C.1. of this thesis below.

international financing context and for strengthening the liable equity capital of credit and insurance companies. Profit participation capital is also recognized as economic equity capital for rating purposes if structured accordingly. Nevertheless, they remain infrequent in practice for the specific purpose of employee participation.[106] These instruments of employee participation are, however, currently undergoing a renaissance with increasing popularity, especially in the start-up environment in the DACH region (Germany, Austria, and Switzerland).[107]

These forms of employee participation are classified as hybrid forms of financing[108] and exist in a variety of forms, due to the fact that profit participation agreements can be freely structured within certain limits.[109] In essence, these claims are of contractual nature, and as such, they generally grant the holder property rights, including the right to profits and/or liquidation proceeds, as well as the right to interest. However, these claims do not entail membership or management rights under company law, as evidenced by the absence of voting rights at shareholders' meetings and the severe restriction of control and information rights against the issuer of the participation right.[110] In exchange for the allocation of property rights, the holder of the profit participation right grants the issuer with capital or receives the profit participation capital in return for the performance of work or for the granting of other financial benefits (e.g., rights of use). In the case of obligation-like participation rights, the holder of the participation right has a contractual claim against the issuer of the participation right for repayment of the capital provided, whereas in the case of equity-like participation rights, a repayment claim is often not guaranteed – any claim in the event of retransfer, termination, or cancellation of the participation right is then generally based on the market value of the company participation.[111] In practice, profit participation rights are often linked to conversion or option rights.[112]

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[106] Schrade and Linseisen (n 59) 89.

[107] ibid.

[108] Whether the respective form of participation is more similar to equity or debt capital must always be examined on a case-by-case basis using various criteria.

[109] For example, terms or termination rights can be agreed or excluded, loss participation can be provided for or excluded, payment terms can be linked to various parameters (profit, net income, turnover, cash flow, etc.), subordination agreements and subordination clauses can be implemented, or powers of disposal over assets and sources of income can be regulated. When using standardized profit participation rights terms and conditions in the context of employee participation models, provisions on the review of general terms and conditions pursuant to Sections 307 ff. BGB must be observed, please refer to German Federal Court of Justice dated 5.10.1992 - II ZR 172/91, BGHZ 119, 305.

[110] Schrade and Linseisen (n 59) 90.

[111] Participation-like profit participation rights are characterized by a cumulative participation in profits and liquidation proceeds. If one of these two conditions is not met, the profit participation rights are considered debt-like or obligation-like. For reasons of focus, this distinction will not be discussed in further detail here.

[112] Schrade and Linseisen (n 59) 90.

In the context of United States LLCs, the transfer of so-called unit appreciation rights is permissible. The award granted to the recipient is equivalent to the appreciation of a predetermined number of units of the LLC, contingent upon specific vesting criteria.[113]

5. Silent Partnerships

The (typical) silent partnership is a well-established form of employee participation in Germany and Austria, characterized by a high degree of legal certainty in its structure, which is used predominantly by established LLCs and less by start-ups.[114] In this context, the employees and the LLC form a so-called internal partnership, which does not appear externally. The employees provide capital to the company in exchange for a return in the form of a fixed or profit-related share. The mandatory loss participation reduces the nominal value of the participation through negative interest, and as a rule, there is no insolvency protection for employee contributions.[115] In LLCs, the typical silent partnership is a relatively common form of financing by traditional investors or banking institutions.

This hybrid financing instrument is a mechanism that enables employee participation and offers a wide range of options. The primary benefit of silent partnerships is their straightforward nature, which can be implemented with a relatively modest capital investment from employees.[116] Moreover, employees are not granted any influence in the silent partnership. However, silent partnerships are characterized by a common purpose, namely the promotion of a collective goal that goes beyond the mere transfer of capital.[117] Within the framework of EPP, such a common purpose is usually not present. [118] The reason for this is, in particular, that the nature and amount of this income are intended solely as an additional incentive for the beneficiary employee to perform their work and do not constitute an unusually large portion of their total remuneration compared to other components of their remuneration.[119] It should be noted, however, that an exception to this general rule may apply in cases where the employee in question also holds a position of shareholder, thereby ensuring their ability to exert significant influence over the company's operations and decisions, as stipulated by the provisions of company law.[120] The establishment of

[113] Schuster and Hunt (n 70) 29.

[114] Study commissioned by the BMWi (n 12) accessed 5 July 2025 84.

[115] ibid 86.

[116] Waschbusch and Sendel-Müller (n 4) 171.

[117] Schrade and Linseisen (n 59) 91; An indication of the existence of a common purpose is given if the consent of the silent partner is required for a change in the object of the company, i.e., through a membership-like right of co-determination granted in the investment agreement.

[118] Schrade and Linseisen (n 59) 91.

[119] For details, please refer to Schrade and Linseisen (n 59) 91 ff.. This should apply not only to "ordinary" employees, but also to managing directors, authorized signatories, or other senior executives.

[120] Schrade and Linseisen (n 59) 91.

a co-entrepreneurial partnership would typically be questionable due to the absence of adequate co-entrepreneurial risk and initiative.[121]

This complex situation creates a degree of legal uncertainty for EPPs, which in case of doubt, also has a negative impact on employees and thus negates the advantages of an EPP. Accordingly, silent partnerships are frequently regarded as an unsuitable instrument for employee participation and are therefore seldom utilized in business practice.[122]

6. Employee Loans

An employee loan is a financial instrument of a contractual nature; the employee, as the lender, receives a claim to repayment and interest. A special category of the employee loan is the profit-participating loan.[123] This is the case when the loan features a variable interest rate that depends on profits (performance-related interest) in addition to or as an alternative to a fixed interest rate. In such an arrangement, the employee receives a share of the profits (based on profits or sales) in return for providing the capital.[124] Employer loans are not subject to any special legal provisions, which means that the loan terms can be structured with a high degree of flexibility.

7. Digression: Employee Stock Ownership Plan (ESOP) in the United States

The most common structure for broad-based employee participation in the United States is the employee stock ownership plan (ESOP). As indicated by recent data, there are 6,358 ESOP companies, which collectively employ 14.9 million individuals.[125] In the United States, an ESOP is defined as an employee benefit plan that employs an intermediary corporate vehicle and facilitates the involvement of individual investors through a trusteeship, i.e., company stock is bought and held in accounts for the benefit of participants (Section 407(d) ERISA).[126] This enables companies to take advantage of tax benefits, such as the exemption from taxation on dividends and capital gains derived from intermediary trust assets. The main advantage for employees is that they are only obligated to pay income tax or capital gains tax on capital gains when they receive payments from the ESOP.[127]

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[121] For more details, please refer to Schrade and Linseisen (n 59) 91 ff.

[122] Waschbusch and Sendel-Müller (n 4) 171.

[123] Schrade and Linseisen (n 59) 93.

[124] ibid.

[125] NCEO, 'What Is Employee Ownership?' <https://www.nceo.org/what-is-employee-ownership#esops> accessed 25 July 2025. It should be noted, however, that the proportion of ESOPs in SMEs is lower and has been declining in recent years.

[126] ibid.; PEPPER V Report (n 11).

[127] NCEO, 'Forms of Employee Ownership' <https://www.nceo.org/what-is-employee-ownership/comparison-of-forms-of-employee-ownership> accessed 25 July 2025.

A state law LLC has the option to be taxed as either an S or C corporation, depending on various factors. In these cases, the implementation of an ESOP is also a possibility for LLCs, albeit contingent upon the fulfillment of specific criteria.[128] The initial issue to be addressed is whether LLC units may be regarded as common stock in accordance with the provisions of relevant ESOP regulations. According to IRC section 7701 and the Internal Revenue Service (IRS) private letter ruling in 2015[129], this is a plausible scenario. Consequently, it can be argued that LLCs may possess the operational flexibility to implement an ESOP. Nevertheless, in each individual case, the details of any LLC structure would need to be confirmed to verify the presence of the attributes of common stock attendant to the applicable units. This is of significant importance, as private letter rulings are only binding for the specific taxpayer to whom they are addressed.[130]

C. Legal Framework Conditions influencing the Implementation and Design of Employee Participation in LLCs

At present, there are no harmonized regulations for the introduction of EPP at EU level or beyond. Therefore, country studies are required on a regular basis - especially insofar as EPP are to be implemented in international companies, but also for the development of new policy ideas in order to remain competitive on the global stage.[131] The subsequent part of this thesis is, thus, intended to outline the fundamental characteristics of the legal framework for EPP in LLCs in Germany, Austria and the United States with the objective of identifying the factors that contribute to success.

Following a brief overview of the currently relevant legislation, the present thesis will examine the following legal criteria in greater detail: Timing and type of taxation, Tax allowance, Valuation method, Transfer of shares, Special Category of Shares, Participation in Decision-Making.

Timing and type of taxation play a particularly important role in the structuring and practical implementation of EPP. For all forms of employee participation, the tax assessment depends on whether and at what point in time the beneficiary can be assumed to have made a capital investment and whether the granting of employee participation leads to an inflow of wages. Three

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[128] Schuster and Hunt (n 70) 29.

[129] In Private Letter Ruling 201538021 (18 September 2015), the Internal Revenue Service (the IRS) conducted an analysis of a parent-subsidiary structure, with the parent entity being a limited liability company (LLC) that had elected to be taxed as a corporation. The parent operating agreement was analyzed with a focus on provisions that stipulated the conferral of uniform rights to distributions, dividends, and liquidation proceeds to all LLC units. Furthermore, the parent stipulated that its operating agreement would undergo amendments to ensure that all LLC units would possess uniform voting rights and otherwise comply with the stipulations outlined in IRC section 409(l)(2). The IRS determined that the LLC units met the definition of employer securities as outlined in IRC section 409(l)(2) for the purposes of IRC section 4975(e)(7), a tax provision related to ESOPs.

[130] Claire Y. Nash and James Parker, 'Establishing Substantial Authority for Undisclosed Tax Positions' (2009) The Tax Adviser 2009 (4), 33.

[131] Prégardien, Winterhalder and Toliou (n 9) 246.

points in time are relevant here: (1) granting or establishing the participation, (2) ongoing "awards" (e.g. dividends) and (3) realization of changes in value through transfer or retransfer or settlement of a terminated participation.[132] A related issue is the question of whether there is a reliable valuation method for determining the value of the participation. Finally, it is of great practical relevance to what extent and with what effort different categories of shares can be created and transferred, and whether there are categories of shares tailored to the specific case of EPPs in LLCs. To conclude, the question of the impact of the respective EPP on the company's ability to act and make decisions is addressed - Can employees act from a position of strength as shareholders within the framework of the participation programs, or do they only represent their own interests through less powerful mechanisms?

1. Germany

The significance of EPPs for Germany as a business location has been recognized by politicians; however, consistent implementation remains pending. In a manner similar to that of its predecessors, the current federal government has established the objective of enhancing the appeal of employee participation.[133]

Virtual participation programs are particularly widespread in Germany. A recent study conducted in Germany revealed that 14% of surveyed founders of start-ups offering EPP reported utilizing genuine company shares for this purpose.[134] Meanwhile, 22% indicated their use of share options[135], and an overwhelming majority of 73% revealed their employment of VSOPs.[136] Germany's comparatively weak position may be attributed to an inadequate government support system for EPPs.[137]

1.1 Relevant Legislation and Jurisdiction[138]

The enactment of the Employee Capital Participation Act (*Mitarbeiterkapitalbeteiligungsgesetz*[139]) in April 2009 signified a first step towards improving the conditions for EPP in Germany, albeit only to a minor extent. Specifically, the extension of the 5th Capital Accumulation Act (*Fünftes*

[132] Schrade and Linseisen (n 59) 93.

[133] 2025 coalition agreement between the CDU, CSU, and SPD, available at: <https://www.koalitionsvertrag2025.de/sites/www.koalitionsvertrag2025.de/files/koav_2025.pdf> accessed 12 July 2025 4.

[134] #ESOPasap (n 39) 36.

[135] ibid 38.

[136] ibid 40.

[137] Study commissioned by the BMWi (n 12) accessed 5 July 2025 31.

[138] Unless expressly stated otherwise, all legislation referred to in this part C.1. is legislation enacted by the German legislature.

[139] German Federal Law Gazette I 2009, 451.

Vermögensbildungsgesetz, 5. VermBG[140]) and the augmentation of the tax allowance from EUR 135 to EUR 360 were key factors in this achievement.[141] In 2021, the Fund Location Act (*Fondsstandortgesetz*[142]*)* was passed. Notably, this legislation increased the tax-free maximum amount for employee participation grants to EUR 1,440 per year and introduced tax deferral for the granting of genuine shares (Section 19a Income Tax Act (*Einkommenssteuergesetz* – EstG).[143] This was done with the intention of addressing the dry income problem, which is addressed in more detail below in part C.1.2(c) of this thesis.

Given the restricted scope of the new legislation, which pertained exclusively to SMEs that had been established no more than twelve years previously, the debate continued and led to the enactment of the Future Financing Act (*Zukunftsfinanzierungsgesetz*[144]) on 1 January 2024 – a development that opened up new opportunities for EPP in Germany.[145] With amendments to more than 30 laws, in addition to adjustments to financial market law and the further development of company law, the (tax) law framework has been improved. The Future Financing Act is designed specifically to cater to the needs of SMEs. A central objective of the legislation is to ease the process of raising capital and to streamline the route to the stock market for both mature start-ups and young growth companies.[146] Specifically, the Future Financing Act includes tax relief for EPP (Section 3 no. 39 EStG, Section 19a EStG).[147]

In the contemporary German legal landscape, case law has also witnessed an escalating focus on EPP-related issues. On 19 March 2025, the German Federal Labor Court (BAG) modified its case law concerning the expiration of rights to options following voluntary termination of employment. The court ruled that a clause in general terms and conditions that stipulates the immediate expiration of vested virtual option rights upon termination of the employment relationship due to voluntary termination by the employee is invalid.[148] The BAG's position on the matter, to date, has been that vested options that remain unexercised during the period of employment may expire without replacement upon termination of the employment relationship.[149] It is yet to be determined

[140] German Federal Law Gazette I 1994, 406.

[141] Koch-Schulte and Echarri (n 85) p P, 448.

[142] German Federal Law Gazette I 2021, 1498 ff.

[143] Koch-Schulte and Echarri (n 85) p P, 449.

[144] German Federal Law Gazette I 2021, 1498.

[145] Koch-Schulte and Echarri (n 85) p P, 449.

[146] Government draft The Future Financing Act BT-Drs. 20/8292, 1, 58.

[147] Please refer to part C.1.2(c) of this thesis.

[148] German Federal Labor Court, judgment of 19 March 2025 – 10 AZR 67/24.

[149] German Federal Labor Court, judgment of 28 May 2008 – 10 AZR 351/07. The decisive factor in this decision was the classification of stock options as pure acquisition opportunities of a speculative nature that did not constitute a guaranteed component of remuneration.

what further consequences the BAG will draw from this categorization of (vested) options as a form of compensation for work performed. Nevertheless, the ruling is of considerable practical significance.

1.2 Timing and Type of Taxation

German tax law stipulates that taxation on the employees' site in the framework of EPPs is executed as wage taxation[150] at the time of receipt[151], i.e., when the employee acquires economic power of disposal.

(a) Virtual Employee Participation

In the context of virtual EPP, taxation is subject to significant variation depending on the particular design of the program. The initial involvement in a virtual EPP is typically characterized by a state of tax neutrality for the employee, due to the absence of economic ownership.[152] Taxation is only triggered upon realization, defined as the moment of payment (or exit). The payment is regarded as a form of wages, as stipulated in Section 19 (1) sentence 1 no. 1 of the Income Tax Act (EStG).[153]

(b) General Principle

The acquisition of genuine shares and participation-like profit participation rights in return for payment is generally tax-neutral.[154] Nonetheless, in the event of a gratuitous or discounted issuance to employees, the amount of the monetary benefit (i.e., the difference between the market value and the payments made by the employee)[155] is to be treated as income in the form of a benefit in kind. This generally triggers an obligation to deduct income tax within the meaning of Section 38 EStG at the time the legal right is granted.[156] This principle finds similar application in cases involving the grant of share options to employees. The obligation to pay income tax arises only when an employee exercises their option right.[157] However,

[150] According to the personal progressive income tax rate of up to 45% plus social security contributions.

[151] Prégardien, Winterhalder and Toliou (n 9) 247.

[152] Katharina Weißenbacher, 'Mehr Rechtssicherheit für Mitarbeiterbeteiligungsprogramme' [Greater legal certainty for employee participation programs] [2024] BB 2024, 1435,1437.

[153] Wolfgang Weitnauer, ‚Mitarbeiterbeteiligung: „Echt" oder virtuell? [Employee participation: "real" or virtual?], GWR 2022, 39, 42 f.

[154] According to Section 20 of the German Income Tax Act (EStG), only income from the use of capital (i.e., at the time of exit) is taxed; Schrade and Linseisen (n 59) 94.

[155] At least the nominal amount (based on the share capital figure) is paid by the employee on a regular basis.

[156] Progressive standard taxation of up to 47,475% (including solidarity surcharge plus any church tax) applies.

[157] Weitnauer (n 8) cp 4, 47.

given that the market value of the shares has typically increased significantly since the exercise price was agreed upon – otherwise, exercising the option would not be economically advantageous – the difference between the exercise price and the market value constitutes a monetary benefit that employees are required to pay tax on immediately.[158]

A potential challenge arises from the possibility of "dry income taxation" for employees due to a deficiency in cash flow. The discrepancy between the exercise price and market value constitutes a monetary benefit that results in immediate tax liability for employees.[159] This issue is particularly significant in the context of start-ups, as employees in such companies often face restrictions on the resale of their shares prior to an exit event in contrast to employees of well-established companies.[160] Consequently, the implementation of the EPP is not a realistic option in such circumstances, as the majority of employees lack the financial resources to settle the tax obligations on the "dry income" derived from the share grant.

It is possible to avoid this issue, i.e. the essentially taxable monetary benefit, by contractually stipulating a negative liquidation preference (so called “hurdle”[161]). Under this approach, the employee would only participate in future increases in value, and the monetary advantage would be mitigated accordingly at the time of the grant.[162]

Income earned by employees from distributions on genuine shares (dividends) and participation-like profit participation rights is subject to the capital gains tax of 26.375%. This tax is classified as income from capital assets within the meaning of Section 20(1) no.1 sentence 1 EStG (including solidarity surcharge plus any church tax) and levied by way of capital gains tax withholding in accordance with Section 43 (1) sentence 1 no. 1 EStG.[163]

Gains from the sale of genuine shares and participation rights are generally subject to a flat rate of 25%, plus a solidarity surcharge of 5.5% of the capital gains tax, and where applicable, church tax in accordance with Sections 20(2) sentence 1 no. 1, Section 32d (1) EStG (income from capital assets) if the employee's share in the employer's company is less than 1% or in the case of a minimum participation of 1% pursuant to Section 17 (1) sentence 1 in conjunction with Section 3 No. 40 sentence 1 lit. c EStG (so-called partial income

[158] #ESOPasap (n 39) 44.

[159] Schrade and Linseisen (n 59) 94.

[160] Prégardien, Winterhalder and Moosbauer (n 99) 263 ff.

[161] Essential information on this topic is provided below in part C. 1.6 of this thesis; for further information on hurdle, growth, or zero shares, please refer to Tobias Schönhaar, ‘Incentivierung von Gründern durch Einräumung von Zero-Shares’ [Incentivizing founders by granting zero shares] [2020] GWR 2020, 313 and/or Daniel Grisar and Mirco Zantopp, ‘Liquidationspräferenzen in Mitarbeiterbeteiligungsprogrammen’ [Liquidation preferences in employee participation programs] DStR 2020, 1768.

[162] Weitnauer (n 153) 40; Schrade and Linseisen (n 59) 94.

[163] Schrade and Linseisen (n 59) 94.

procedure).[164] This legal consequence is independent of any original gratuitous or discounted issue. [165]

(c) Tax Deferral under Section 19a EStG

Dry income taxation can be avoided under the conditions of Section 19a EStG by postponing the date of taxation for wage tax purposes in certain cases. Subsequent to the enactment of the Fund Location Act (FoStoG[166]) in July 2021, the grant of a qualified shareholding is no longer subject to immediate taxation, as stipulated in Section 19a EStG. Instead, a deferral of taxation is granted, thereby offering a fiscal incentive for investors. The recent increase in thresholds by the ZuFinG has led to an expansion in the number of qualified companies falling within the scope of the tax relief.

This includes companies that have been in existence for no more than 20 years, employ fewer than 1,000 people, have an annual turnover of no more than €100 million, or have a balance sheet total of no more than €86 million (Section 19a (3) sentence 1 EStG).[167] Consequently, the scope of application encompasses not only start-ups but also SMEs.

In addition to LLC shares pursuant to Section 2 (1) No. 1 lit. l in conjunction with paragraph 4 5. VermBG, the shares eligible for tax deferral also include participation-like profit participation rights, provided that repayment at par value is not promised.[168] The granting of qualified company shares pursuant to Section 19a (1) sentence 1 EStG must be executed directly by the employer (or a shareholder of the employer) to the intended beneficiary employee and in addition to the employee's existing salary, either without charge or at a reduced price. The acquisition of shares by a fractional ownership community (e.g., a joint deposit account of the employees), a grant to consultants, freelancers, advisory board members, or other service providers is not eligible for tax deferral under Section 19a EStG.[169]

[164] For more details please refer to Weißenbacher (n 152).

[165] Weißenbacher (n 152) 1437. However, reclassification as wages at the time of exit may be considered if the employees receive an above-market price as part of the exit, see Federal Finance Court, 14.12.2023 - VI R 1/21 and 14.12.2023 - VI R 2/21.

[166] German Federal Law Gazette I 2021, No. 30

[167] For details please refer to Katharina Weißenbacher, 'Zukunftsfinanzierungsgesetz - ein Meilenstein für Mitarbeiterbeteiligungsprogramme [Future Financing Act – a milestone for employee participation programmes] [2024] BB 2024, 603, 603.

[168] For details on the application of the 5th VermBG, cf. German Federal Ministry of Finance of 31 May 2024 - IV C 5 – S 2439/19/10003 :005, Federal Law Gazette I 2024, 929 para 26 in conjunction with para 21.

[169] Schrade and Linseisen (n 59) 95.

Section 19a (1) sentence 2 EStG permits the acquisition to be made indirectly through a partnership in which the employer holds an interest.[170]

As outlined in Section 19a (4) EStG, the monetary benefit is subject to taxation under specific conditions:

- in the event that the share/right is transferred in its entirety or in part, either free of charge or against payment;
- in the event that a period of 15 years has expired; or
- in the event of an employee's termination of their employment with the company (referred to as a "leaver event").

Notably, the deferral of taxation under Section 19a EStG is exclusively applicable for income tax purposes, excluding its application to the collection and payment of social security contributions. This can have significant consequences if income falls below the contribution assessment thresholds (*Beitragsbemessungsgrenzen*).[171]

1.3 Tax Allowance

The more flexible allowance rules are, the more employers can provide higher levels of support for the purchase of employee shares.[172] In Germany, the enhanced tax allowance of EUR 2,000 can be utilized once per calendar year, provided that the monetary benefit is received within the context of a current employment relationship (Section 19a (1) EStG in conjunction with Section 3 no. 39 sentence 1 EStG). However, this provision is applicable only in the context of EPPs that are extended to all employees who have been continuously employed by the company for a minimum period of one year at the time the offer is formally announced (Section 3 no. 39, Sentence 2, EStG). Pursuant to Section 3 no. 39 EStG, an allowance must be deducted during the calculation of the benefit subject to tax deferral as outlined in Section 19a EStG.

1.4 Valuation

A practical challenge exists in correctly determining the value of the share or the monetary benefit (if any) granted under the EPP (i.e., the amount of taxable remuneration), which is the difference between the fair market value (FMV) at the time of grant and the employee's additional payments. In Germany, a reliable and universally applicable valuation method is lacking – This issue is particularly problematic for start-ups, as the conventional valuation methods are not applicable to them due to their insufficient market maturity.[173]

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[170] Schrade and Linseisen (n 59) 94.

[171] ibid 97.

[172] Prégardien, Winterhalder and Toliou (n 9) 248.

[173] ibid. Therefore, they usually refer to the last financing round.

The FMV is generally determined on the basis of the valuation principles set out in Section 9 of the Valuation Act (*Bewertungsgesetz*, BewG[174]). According to these provisions, the price that would be achievable in the ordinary course of business for the asset in question at the time of sale is decisive (Section 9 (2) sentence 1 BewG).[175] It is essential to consider all circumstances that may influence the price, as outlined in Section 9 (2) sentence 2 BewG. However, unusual or personal circumstances are generally not taken into account under this provision, as specified in Section 9 (2) sentence 3 BewG. Transactions between third parties that are not associated with one another and that occurred less than one year prior typically serve a useful function, such as sales or exit transactions, or the involvement of new investors in the context of a capital increase.[176]

It is possible to have the amount of the benefit not taxed by the employer confirmed by the tax office responsible for the permanent establishment by means of a free request for information pursuant to Section 42e EStG. Given the absence of an established practice, it is also advisable to obtain advance information regarding the general application of Section 19a EStG in the case of the preferential granting of participation-like profit participation rights to employees.[177]

1.5 Share Transfer

(a) Capital Measures (Formal Capital Increase)

Both the issuance of genuine shares and share options is generally executed through either a (partial) transfer of existing shares by the existing shareholders (Section 15 (1) Act on Limited Liability Companies (*Gesetz betreffend die Gesellschaften mit beschränkter Haftung* - GmbHG[178]) or through the granting of shares created by way of a capital increase to the employees.[179] The capital increase to create new shares can be effected in two ways: either by a resolution of the shareholders' meeting to increase the share capital (Section 55

[174] German Federal Law Gazette I 1991, 230.

[175] The relevant value is not determined by the usual final price at the place of delivery, reduced by customary discounts, as is otherwise generally applicable to non-monetary income pursuant to Section 8 (2) sentence 1 EStG (German Federal ministry of Finance ruling dated 1.6.2024 - IV C 5 - S 2347/24, German Federal Tax Gazette I 2024, 946 para 40 in conjunction with para 18). Section 8 (2) sentence 11 EStG and R 8.1 (2) sentence 3 LStR are therefore not applicable.

[176] Schrade and Linseisen (n 59) 97. Alternatively, a valuation may be carried out taking into account the earnings prospects or using another recognized method that is customary in ordinary business transactions for non-tax purposes, or using the simplified income approach, cf. Section 11 in conjunction with Sections 199 ff of the BewG.

[177] Schrade and Linseisen (n 59) 97.

[178] German Federal Law Gazette 2024 I no. 323.

[179] Randolf Mohr, ‚Ausgestaltung von Mitarbeiterbeteiligungen bei GmbH unter Berücksichtigung gesellschafts-, arbeits- und steuerrechtlicher Aspekte‘ [Structuring employee participation schemes for limited liability companies (GmbH) taking into account corporate, labor, and tax law aspects] [2005] GmbH-StB 305, 306; Roman Stenzel R, Grundlagen von Managementbeteiligungen an AG und GmbH (Teil II) [Basics of management participation in corporations and limited liability companies (Part II)], [2018] DStR 2018, 139, 140.

GmbHG) or by the management exercising authorized capital (Section 55a GmbHG).[180] A conditional capital increase pursuant to Section 15 (1) GmbHG is not an option for LLCs in Germany. The specific EPP and the number of shareholders have a decisive influence on the preferred type of capital increase, whereby the creation of new shares by exercising existing authorized capital is the more common method.[181] In this context it should be noted that the authorization of the management to increase the capital pursuant to Section 55a (1) sentence 2 GmbHG is limited to half of the LLC's share capital and is only permissible within five years of the LLC's formation (Section 55a (1) sentence 1, (2) GmbHG). In practice, this time limit exerts a particularly restrictive effect.[182]

In the context of EPP with share options, an important aspect to consider is that new shares to be created during the exercise period through a capital increase to serve the options can only be promised for acquisition if the employees' entitlement to the shares is guaranteed.[183] To this end, the company may opt to generate either authorized capital or conclude a contractual voting agreement among its existing shareholders. In the latter scenario, the shareholders undertake an irrevocable obligation to contribute to an increase in share capital, thereby ensuring the fulfillment of claims arising from the exercise of share options.[184] However, practical considerations significantly constrain this EPP form because frequent linking of options to exits means capital increases and employee share acquisitions must be precisely timed. Given that the effectiveness of the capital increase in the event of the exercise of authorized capital depends on its entry in the commercial register (see Section 57 (1) GmbHG), the relevant point in time, though, cannot be determined precisely.[185] Should there be no authorization to exercise authorized capital at the time of the exit (cf. Section 55a (1) sentence 1, (2) GmbHG), the process is further complicated by the fact that a capital increase resolution must first be passed. Typically, a period of more than five years elapses between the formation of a company and the issuance of share options, which are often made available to employees at this stage.[186]

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[180] In German stock corporations, conditional (*bedingtes*) capital is utilized for options for employees and members of the management (Section 192 ff AktG). This has the practical advantage (compared to LLC shares from an ordinary and authorized capital increase) that the shares are automatically created upon issue, so-called subscription shares (*Bezugsaktien*). The conditional capital increase thus enables capital to be raised as needed (for an unlimited period).

[181] Ahlswede and Landhäußer (n 1) 714.

[182] ibid.

[183] ibid 715.

[184] Wolfgang Weitnauer and Carsten Dunkmann, Strukturierung von Mitarbeiterbeteiligungsmodellen – Teil 1 [Structuring employee participation models – Part 1] [2013] GWR 349, 350.

[185] Ahlswede and Landhäußer (n 1) 717.

[186] ibid 722.

In both scenarios – that is, the increase in the share capital and capital increase from authorized capital – shareholders are typically entitled to a subscription right (*Bezugsrecht*) in accordance with the current prevailing opinion analogous to Section 186 (1) sentence 1 Stock Corporation Act (*Aktiengesetz* – AktG[187]).[188] This is intended to provide them with the opportunity to maintain their share in the company's share capital. However, in practice, this subscription right can be excluded in various ways. For example, the exclusion of subscription rights is possible under certain conditions analogous to Section 186 (3) and (4) AktG.[189] In some cases, the participation of employees who have a significant role within the company, may serve as a legitimate reason for exclusion. Moreover, a subscription right may be excluded with the consent of the shareholders affected by the transfer of shares or by a provision in the articles of association.[190]

Additionally, shares can be transferred to employees under a condition, whereby they are transferred in full yet subject to a contractually agreed-upon right of acquisition (a "call option") in favor of the company. This right may be exercised upon the occurrence of specified events, in particular the termination of the employee's relationship with the company (referred to as a "leaver case").[191]

(b) Formal Requirements

In addition to the formal requirement of notarization pursuant to Section 15 (3) GmbHG for the transfer of shares, an updated list of shareholders must be submitted to the company's commercial register by the management after each transfer of shares in an LLC has become effective (Section 40 (1) sentence 1 GmbHG). This applies not only to the direct transfer of shares, but also to the granting of share options.[192] Given that the option agreement required constitutes a condition precedent on the part of the company to transfer shares, it must also be notarized in accordance with Section 15 (4) GmbHG.[193] Thus, the process of transferring shares requires a significant investment of effort, both in terms of financial and temporal investment.[194]

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[187] German Federal Law Gazette 1965 I, 1089.

[188] Holger Altmeppen, 'GmbHG' (23 edn C.H.Beck 2023) sec 55 para 27 with further references; the Federal Court of Justice left the question open, cf. Federal Court of Justice, NZG 2005, 551, 552.

[189] German Federal Court of Justice, NJW 1982, 2444 – Philipp Holzmann; German Federal Court of Justice, AG 1994, 276 – Deutsche Bank.

[190] Ahlswede and Landhäußer (n 1) 715.

[191] Michael Denga, ‚Handelsbräuche bei Wagniskapitalfinanzierungen' [Commercial practices in venture capital financing] [2021] ZGR 725, 733 ff.

[192] Ahlswede and Landhäußer (n 1) 721.

[193] Higher Regional Court Munich, BB 1995, 427, 428.

[194] #ESOPasap (n 39) 47; Prégardien, Winterhalder and Toliou (n 9) 248.

In contrast, in the context of virtual employee participation, notarization is typically not required due to the contractual nature of the claim.[195]

1.6 Special Category of Shares

The transfer of shares or the issuance of share options via EPPs has the potential to result in a challenging situation, characterized by the presence of a substantial number of minor shareholders, in addition to the drawbacks associated with employee shareholders, which are discussed in more detail in part C.1.7 below. The introduction of distinct categories of shares has been demonstrated to address this concern, for instance, by limiting the shareholders' rights to property rights or by reducing the number of beneficiaries.[196] In Germany, the mandatory forms/principles of company law must be observed in such arrangements, which limits the scope for creative structuring – The legislature is called upon to create greater flexibility in this area.

Hurdle shares, which are increasingly being used by companies with growth potential and in the framework of EPP, are important in this context. These shares are granted immediately, but their associated rights are largely stripped away: Employees receive shares with a so-called negative liquidation, profit, and proceeds preference at nominal value.[197] This means that the shares are initially excluded from participation in the existing company value at the time of granting. Participation in the profits will only take place after a certain hurdle, to be defined, has been reached within the framework of the agreed exit (e.g., sale of the employer's company, good leaver events, IPO, etc.).[198] However, the tax classification of hurdle shares remains unsettled; case law in Germany has not yet established a clear jurisprudence on this matter.[199] It is important to note that in Germany, the right to participate in shareholders' meetings and to receive information cannot be withdrawn, which contributes to the complexity of the shareholder situation.[200]

1.7 Participation in Decision Making

(a) In the event of "genuine" Participation

One of the primary factors contributing to the limited utilization of EPP, in the form of genuine shares or options, is the presence of disadvantages under company law, particularly in the

[195] Schwarz and Zerbst (n 55) 786.

[196] For example, in France, BSPCEs can – but do not have to – be issued to all employees; they can be restricted to management personnel. In this case, it is recommended that a simplified shareholders' agreement be concluded with the beneficiaries prior to exercise in order to determine the shareholders' rights after the options have been exercised.

[197] Weitnauer (n 84) pt F, para 133.

[198] ibid; Grisar and Zantopp (n 161) 1768, 1773.

[199] German Federal Finance Court, 4.5.2012 - VIII B 174/11; Prégardien, Winterhalder and Toliou (n 9) 249.

[200] Overall critical on this point: Weitnauer (n 153) 39 ff.

context of LLCs; Employees who hold shares and, consequently, the status of shareholders, can exercise substantial control, engagement, and information rights (see Sections 47 ff GmbHG). Employee-shareholders must be involved in all matters that require a decision by the shareholders. The standard notice periods and information requirements must be observed, which many companies find challenging from an administrative perspective.[201]

Moreover, the participation of employees results in an increase in the number of shareholders with voting rights, which has been shown to reduce the efficiency of decision-making processes within the company.[202] This also increases the risk that business decisions will be delayed by shareholder lawsuits. Efficient decision-making is, however, essential for start-ups and SMEs in particular during growth phases with high business risk.[203] The expansion of the shareholder base has the potential to dilute the influence of existing shareholders.

In addition, as shareholders, employees are entitled to extensive rights of information and inspection vis-à-vis the management pursuant to Section 51a GmbHG. The right to information extends all matters relating to the company and thus includes everything that is relevant to the shareholder's membership.[204] The right of inspection/information applies to all books and documents of the LLC, which ultimately means all business documents.[205] Such comprehensive insight into the affairs of the company by employees is not normally aligned with the interests of the management.[206]

(b) Without "genuine" Participation

Due to the disadvantages described above in the context of EPP in the form of genuine shares or share options, most start-up LLCs in Germany opt for virtual employee participation. According to a representative study on the current state of employee participation in German start-ups, only 36% of the founders surveyed offer their employees genuine, direct participation in their company, of which 14% issue company shares directly and 22% issue share options.[207]

However, from an international perspective, virtual EPP at German companies are subject to criticism precisely for not granting employees any ownership rights. A study conducted by

[201] Mohr (n 179) 306; Ahlswede and Landhäußer (n 1) 720.

[202] Ahlswede and Landhäußer (n 1) 721.

[203] #ESOPasap (n 39) 47.

[204] German Federal Court of Justice, BGHZ 220, 354 44.

[205] Higher Regional Court Munich, GmbHR 2008, 104, 105.

[206] Ahlswede and Landhäußer (n 1) 721.

[207] #ESOPasap (n 39) 37.

Index Ventures[208] examined and compared the conditions for employee participation and its implementation in 24 countries. The study's findings indicated that the conditions for employee participation in company capital in Germany and Belgium were among the least favorable in the international context.[209] The main reason for this, apart from the tax framework, is the adoption of virtual EPPs.[210] Employees perceive virtual forms of participation as non-transparent, and virtual participation is also a "German special case" that does not correspond to international market standards.[211]

2. Austria

Employee participation has been a subject of considerable debate in Austria. The Austrian government's program for 2020-2024 finally established a new corporate form that is competitive on an international scale, particularly for innovative start-ups, and that strengthens Austria as a business location.

A parallel can be drawn between Austria and Germany, as both countries have been observed to utilize virtual forms of participation, particularly among newly established enterprises.[212]

2.1 Relevant Legislation and Jurisdiction[213]

The Employee Participation Foundation Act (*Mitarbeiterbeteiligungsstiftungsgesetz 2017* – MitarbeiterBetStG 2017)[214], which came into force on 1 January 2018, introduced a new framework for private foundations in Austria, characterized by enhanced flexibility. This legislative development also led to the establishment of a novel category of private foundation: the employee participation foundation. This was primarily designed to make hostile takeovers more challenging and to ensure job security.

Moreover, Austria is pioneering further developments: since 1 January 2024, a novel corporate form has been in effect – the Flexible Capital Company (so-called "FlexCo"[215]). The objective of

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[208] Index Ventures handbook, 'Rewarding Talent' (2020) <https://www.indexventures.com/rewarding-talent/> accessed 2 July 2025.

[209] Index Ventures handbook, 'Rewarding Talent' (2020) <https://www.indexventures.com/rewarding-talent/country-by-country-review> accessed 15 May 2025.

[210] Index Ventures handbook, 'Rewarding Talent' (2020) <https://www.indexventures.com/rewarding-talent/ripe-for-change> accessed 17 May 2025.

[211] #ESOPasap (n 39) 48.

[212] Index Ventures handbook, 'Rewarding Talent' (2020) <https://www.indexventures.com/rewarding-talent/country-detail-tables-austria> accessed 17 May 2025.

[213] Unless expressly stated otherwise, all legislation referred to in this section C.2. is legislation enacted by the Austrian legislature.

[214] Austrian Federal Law Gazette I No. 105/2017.

[215] Alternatively permissible English designation in accordance with Section 2 FlexKapGG.

the newly introduced corporate form is to generate a positive reputation among international venture capital investors, thereby facilitating the operational environment for start-up enterprises.[216]

The Flexible Capital Company Act (*Flexible-Kapitalgesellschafts-Gesetz* - FlexKapGG[217]), which is part of the 2023 amendment to company law[218], provides for the subsidiary application of the Limited Liability Companies Act (*Gesetz vom 6. März 1906, über Gesellschaften mit beschränkter Haftung* - GmbHG[219]) to FlexCo throughout, thereby enabling recourse to existing doctrine and case law relating to LLCs.[220]

At first glance, the FlexCo appears to be a subtype of the LLC; however, upon closer inspection, it is revealed to be a hybrid form between the LLC and the stock corporation.[221] FlexCo is characterized by different categories of shares: In addition to conventional LLC shares, so called company value shares (*Unternehmenswert-Anteile*) can be issued. These company value shares are characterized by full property rights but significantly reduced control rights and, in principle, no voting rights.[222] In the following section of this paper, the legal framework around LLC and FlexCo is thus examined in a comparative manner.

2.2 Timing and Type of Taxation

(a) Virtual Employee Participation

In contrast to EPPs involving genuine participation, virtual EPPs do not result in an increase in property or assets at the time of the transfer/granting and therefore do not trigger a taxable event at this point in time. Taxation is only executed at the time of the inflow of liquidity. In the event that the grant in question is already considered to be a financial benefit, it is subject to taxation as regular income.[223]

Upon the occurrence of the payout, a comparable treatment is applied as for bonus payments; the payout is considered income subject to income tax.[224]

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[216] EBRV 2320 BlgNR 27. GP 1. However, social entrepreneurs and SMEs are also mentioned as potential users of FlexCo.

[217] Austrian Federal Law Gazette I 2023/179, Article I of the GesRÄG 2023.

[218] Section 25 FlexKapGG.

[219] Austrian Federal Law Gazette I No. 58/1906.

[220] EBRV 2320 BlgNR 27. GP 1.

[221] EBRV 2320 BlgNR 27. GP 1, GP 15.

[222] Eveline Artmann, ‚Flexible Kapitalgesellschaft ("FlexCo") in Österreich: Vorbild für Deutschland‘ [Flexible Kapitalgesellschaft (‘FlexCo’) in Austria: Model for Germany] [2024] ZGR 482, 494.

[223] Luxbacher and Schury (n 32) cp 3, para 48.

[224] ibid.

(b) General Principle

The grant of shares, participatory loans, profit participation rights or silent partnerships free of charge or at a reduced price may result in a monetary benefit (market value of the shares granted less any purchase price) for the employee arising from the employment relationship (taxable benefit in kind) and thus, in principle, constitutes taxable income from employment in accordance with Section 25 of the Income Tax Act (*Einkommensteuergesetz 1988* - EStG[225]).[226] Monetary benefits are typically subject to progressive income tax rates for the employee. This principle similarly applies to the grant of options, which the employee must generally finance from their taxable income, with the tax liability only arising when the option is exercised. Even if the employer retains salary components and utilizes them to pay the exercise price of the options, an inflow in the sense of wage tax and, consequently, taxation cannot be avoided.[227] In addition, the timing of the tax inflow is controversial in this context.[228] In Austria, as in Germany, this gives rise to the dry income problem.

Current profits (e.g. dividends) and capital gains realized through the sale are generally subject to capital gains tax (KESt) at a rate of 27.5% or 25%, irrespective of the holding period and the extent of the participation.[229]

(c) Tax Deferral under Section 67a EStG

The central provision governing the income tax measures accompanying the introduction of FlexCo is the newly created Section 67a EStG. The objective of this provision is to avoid the dry income problem. Therefore, in contrast to other tax exemptions for employee participation,[230] it merely postpones the date of taxation to a later date. This means that at the time the shares are granted, no taxation occurs (Section 67a (3) EStG).

The scope of the provision covers companies that have not been active for more than 10 years after the end of the calendar year in which they were formed (Section 67a (2) (3) EStG), which do not employ more than 100 employees on average over the year, generate annual sales revenue within the meaning of Section 189a (5) Company Code (*Unternehmensgesetzbuch* – UGB[231]) of no more than EUR 40 million and are not included in consolidated financial statements.

[225] Austrian Federal Law Gazette I No. 400/1988.

[226] Luxbacher and Schury (n 32) cp 3, para 25.

[227] ibid cp 3, para 58.

[228] For more details, please refer to Luxbacher and Schury (n 32) cp 3, para 59-61.

[229] ibid cp 3, para 40.

[230] Please refer to the following part C.2.3 of this thesis.

[231] Austrian Federal Law Gazette I No. 114/1997.

In accordance with the administrative practice, the shares that are eligible for tax deferral include, in particular, stock, interim certificates (*Zwischenscheine*), and LLC shares, as well as substance profit participation rights (*Substanzgenussrechte*).[232] Newly introduced company value shares pursuant to Section 9 FlexKapGG also fall within the scope of application.[233] The transfer of eligible shares must be executed free of charge, though compensation up to the nominal value of the respective share is permitted.[234]

In order to benefit from this tax deferral, the following conditions must also be met:

- The employee would be deemed ineligible for participation in the transfer of shares if they have held a direct or indirect stake of at least 10% in the capital of the employer's company at the time of the transfer or at any point in time prior to that (Z 4).
- An agreement must be in place with the employee and employer that stipulates the necessity of the employer's consent for the sale or transfer of shares (Z 5).
- Employees are required to provide written confirmation that they intend to claim taxation in accordance with the provisions of Section 67a EStG (Z 6).

In the event of a sale of the shares, if the employment relationship has lasted for a minimum of three years and a minimum of five years have passed since the initial transfer/granting to the respective employee within the framework of employee participation (Section 67a (4) (2) EStG), three quarters of the proceeds of the sale are taxed at a fixed rate of 27.5%, while the remaining quarter is taxed as other income according to the progressive income tax rate pursuant to Section 67(10) EStG. In the event that the stipulated deadlines are not met (for example, where the three-year period has not yet expired at the time of exit), taxation is deferred but applied at the full progressive income tax rate.[235]

2.3 Tax Allowance

Under certain conditions, Austria grants a tax allowance of EUR 3,000 per year for employee participation foundations[236] and EUR 4,500 per year for employee participation trusts (*Mitarbeiterbeteiligungsstiftungen*).[237] The exemption covers stock, shares in purchasing and economic cooperatives (*Erwerbs- und Wirtschaftsgenossenschaften*), LLC shares, genuine silent

[232] cf. para 1206 KStR.

[233] Alexandra Wild, 'Start-Up-Mitarbeiterbeteiligung und Mindestkörperschaftsteuer: Die steuerlichen Maßnahmen des Start-Up-Förderungsgesetzes' [Start-up employee participation and minimum corporation tax: The tax measures of the Start-up Promotion Act] RWZ 2023, 175 ff.

[234] Christoph Puchner and David Gloser, 'Die neue Start-up-Mitarbeiterbeteiligung' [The new start-up employee participation] [2024] CFO aktuell 20, 21.

[235] Puchner and Gloser (n 234) 24.

[236] cf. Section 3 (1) (15) (b) to (d) of the Austrian Income Tax Act (EstG). Otherwise, income from employment is deemed to have been earned.

[237] Legal situation since 1 January 2022, details in Luxbacher and Schury (n 32) cp 3, para 28-29.

partnerships, participation certificates (*Partizipationsscheine*), and profit participation rights (*Substanzgenussrechte*) in the employer's company or in a group company affiliated with that company. Transferable options to acquire such shares are also covered if the option is exercised in the calendar year in which it is granted.[238] The exemption for employee participation is limited exclusively to wage tax.

Virtual forms of employee participation, under which only the difference between the market value at the time of exercise and the exercise price is paid without the employee actually acquiring shares, are not subject to the tax relief provided for.[239]

2.4 Valuation

In relation to the procedures for determining the value of the participation or the monetary advantage (if any) granted by way of EPP, the situation in Austria is similar to that in Germany - there is no simple, reliable valuation method.[240]

The FMV is generally determined based on the valuation principles set out in Section 10 Valuation Act (*Bewertungsgesetz* - BewG[241]), according to which the price that would be achievable in the ordinary course of business for the asset in question at the time of sale is decisive (Section 10 (2) sentence 1 BewG). As outlined in Section 10 (2) sentence 2 BewG, all circumstances influencing the price must be given full consideration, with those deemed unusual or personal in nature generally not factored into this assessment (Section 10 (2) sentence 3 BewG).

As a rule, the FMV must be determined at the time of receipt and is derived from several transactions/sales in accordance with Section 13 (2) BewG. The decisive factor is whether the purchase prices, considering supply and demand and the balancing of conflicting interests of several parties involved in the sales transactions, are close to a market price.[242]

2.5 Share Transfer

(a) Capital Measures (Formal Capital Increase)

In the case of an LLC, shares may be granted to employees by way of a capital increase, through a process that excludes subscription rights (for which a shareholder resolution with a three-quarters majority is required, as outlined in Section 52 (1) to (5) GmbHG).

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[238] Luxbacher and Schury (n 32) cp 3 para 40.

[239] Performance-related remuneration is generally taxed as other income in accordance with Section 67 of the Income Tax Act (EStG).

[240] Index Ventures handbook, ‘Rewarding Talent‘ (2020) <https://www.indexventures.com/rewarding-talent/country-detail-tables-austria> accessed 20 July 2025;; Prégardien, Winterhalder and Toliou (n 9) 248.

[241] Austrian Federal Law Gazette I No. 148/1955.

[242] See Austrian Federal Finance Court, 26.9. 2019, RV/1100510/2016, with further references.

Alternatively, shares may be transferred from existing shareholders.[243] The legal framework governing capital increases in LLCs is notable for its flexibility, with the option to execute increases either up to a maximum amount or in instalments.[244]

The implementation of the provisions on conditional capital increases (Sections 19 and 20 FlexKapGG), authorized capital (Section 21 FlexKapGG) and other forms of financing (Section 22 FlexKapGG) from the Stock Corporation Act (*Aktiengesetz* - AktG[245]) in the context of the FlexCo now ensures even greater flexibility in financing. Additionally, shares can be acquired through a step-by-step plan.[246] This results in a significant simplification for typical EPPs with a time-based staggering of the participation amount (vesting), as the acquisition of additional shares within the framework of a step-by-step plan can be carried out informally – in other words no additional notarial deed is required, nor does the new "form requirement sui generis" regulated in Section 12 FlexKapGG[247] need to be fulfilled.[248] The process of acquiring its own shares becomes more flexible for FlexCo. Section 15 (1) Z 5 FlexKapGG is particularly noteworthy here, as it creates an open-purpose acquisition provision based solely on a (qualified) resolution of the general meeting or a corresponding authorization.[249] The acquisition of up to one-third of the share capital is permitted, creating potential opportunities for EPP in particular; On the one hand, share options or the rights of creditors from other financing instruments (Section 22 FlexKapGG) can be serviced in this way, but it also opens up opportunities for the creation of acquisition currency to prepare company acquisitions, for reorganizations, debt-equity swaps, or to ward off unwanted potential acquirers, as well as for the acquisition of shares based on withdrawal or exclusion rights and similar rights.[250]

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[243] Luxbacher and Schury (n 32) cp 3 para 18.

[244] Artmann (n 222) 488.

[245] Austrian Federal Law Gazette I No. 24/1985.

[246] Artmann (n 222) 490.

[247] EBRV 2320 BlgNR 27. GP 10.

[248] On this highly controversial issue in the legislative process, see in particular the comments by Friedrich Rüffler (9/SN-276/ME) <https://www.parlament.gv.at/PtWeb/api/s3serv/file/6ffe6af0-190e-4f52-be13-1e0fffcd6d58> accessed 19 July 2025 and Christian Zib (20/SN-276/ME) <https://www.parlament.gv.at/PtWeb/api/s3serv/file/5fc5eb4c-d067-42f3-bf1d-c0f251cb2043 accessed 19 July 2025 on the one hand and Martin Karollus (30/SN-276/ME) <https://www.parlament.gv.at/PtWeb/api/s3serv/file/2cf589b1-0b21-45df-b30f-92f945e071b3> accessed 19 July 2025 on the other.

[249] cf. Section 65 (2) AktG.

[250] Artmann (n 222) 491.

As in Germany, financing may only be provided from distributable assets and contributions must be paid in full, although these requirements do not apply to all clauses.[251]

(b) Formal Requirements

Within the legal framework governing Austrian LLCs, the transfer of shares and the formalization of acquisitions in the context of capital increases – including both conditional and authorized capital increases – are subject to the requirement of a notarial deed (*Notariatsakt*).[252] Option agreements on shares also require a notarial deed (Section 76 (2) GmbHG). [253]

For FlexCo, a (private) deed prepared by a notary or lawyer is sufficient for the transfer of "normal" LLC shares and declarations of acceptance in connection with capital increases of FlexCo - with the exception of the formation stage[254] - pursuant to Section 12 FlexKapGG. That said, capital increases still require the services of a notary, especially since the capital increase resolution must be notarized in accordance with Section 49 GmbHG in conjunction with Section 2 FlexKapGG. The FlexKapGG does not modify the aforementioned requirement, nor does it affect the necessity for certified registration in the commercial register. The relevance of the exclusion clause in Section 12 (4) FlexKapGG cannot be determined at this time; this clause stipulates that no deed may be drawn up in the event of self-participation. It is apparent that Section 12 (4) FlexKapGG is intended to prevent conflicts of interest. However, the question of when a notary or lawyer is considered to be "involved in the matter itself" remains unresolved.[255] With regard to the transfer of company value shares, though, compliance with the requirement to use written form (Section 9 (6) FlexKapGG) is sufficient, which is to be understood as requiring a signature within the meaning of the Austrian Civil Code (*Unterschriftlichkeit*, Section 886 Austrian Civil Code).[256] In contrast to the provisions pertaining "normal" LLC shares, these regulations are applicable to both the original and derivative transfer.[257] In this respect, neither a notarial deed within

[251] For more details, please refer to Susanne Kalss, ‚Die FlexCo, die kleine Schwester der GmbH, die schnell wachsen wird' [FlexCo, the little sister of the GmbH, which will grow rapidly] GesRZ 2023, 345 ff.

[252] Artmann (n 222) 490.

[253] Luxbacher and Schury (n 32) cp 3 para 18.

[254] Although a simplified formation could be carried out in accordance with Section 9a of the Limited Liability Companies Act (GmbHG), which is also expressly permitted in the case of FlexCo, as specified in Section 4 of the Flexible Capital Act (FlexKapGG), this is not suitable for start-ups because Section 9a GmbHG only applies to formations by one person, which is generally not the case for start-ups.

[255] Details can be found in Artmann (n 222) 495.

[256] This is also evident from the different wording in Section 7 (2) FlexKapGG, which opens up the possibility of voting on circular resolutions in plain text form.

[257] Artmann (n 222) 495.

the meaning of Section 76 (2) GmbHG nor a document pursuant to Section 12 (1) FlexKapGG needs to be drawn up. The written form requirement is also fulfilled if a qualified electronic signature is used.[258]

2.6 Special Category of Shares: Company Value Shares

The FlexKapGG establishes a wholly novel category of shares, in addition to the "normal" shares, as outlined in Sections 9-11 FlexKapGG – a "sui generis form of participation."[259] The Austrian legislature does not appear to have based this directly on an international model.[260] The so-called company value shares (*Unternehmenswert-Anteile*) form part of the share capital and can be structured as unit shares like "normal" LLC shares. The grant is limited to a maximum of 24.9999% of the share capital[261] and must be provided for in the articles of association, together with a provision on the right of co-sale (Section 10 (1) FlexKapGG).[262] In the context of the grant of company value shares, special disclosure and information obligations must be observed vis-à-vis employees, in particular with regard to the legal nature of the company value shares and their sale in the event of termination of employment (Section 11 FlexKapGG).

Although company value shares are intended for use in EPP, their use is not limited to this purpose.[263] Founders, shareholders, and investors may be holders of company value shares. FlexCo itself (or a subsidiary) may also hold company value shares, provided that the provisions on the acquisition of own shares (Sections 15-18 FlexKapGG) are complied with. The concept provides that employees can acquire company value shares with a minimum value of one cent (Section 9 (2) FlexKapGG), participate in FlexCo's current profits in proportion to their ownership, and, in the event that the founding shareholders sell the majority of their shares, have a right of co-sale. Moreover, there is a theoretical entitlement to a share of the liquidation proceeds, given that successful companies are typically sold, rather than liquidated, in practice.[264]

2.7 Participation in Decision Making

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[258] EBRV 2320 BlgNR 27. GP 7.

[259] EBRV 2320 BlgNR 27. GP 7.

[260] Artmann (n 222) 492.

[261] EBRV 2320 BlgNR 27. GP 5. The aim of this measure is to prevent excessive capital participation by participants via company value shares who are structurally excluded from the decision-making process.

[262] This may be the case from the outset or a corresponding clause may be inserted by amending the articles of association, for which a qualified majority is required. If company value shares are created by means of a capital increase, the existing shareholders are entitled to a subscription right, which may only be excluded if there is objective justification, but the priority issue of shares to employees constitutes sufficient grounds for this (cf. Section 153 (5) AktG).

[263] This is also expressly stated in EBRV 2320 BlgNR 27. GP 4.

[264] Christian Fritz 'Eine neue Rechtsform in Österreich: Die Flexible Kapitalgesellschaft - ein praxisnaher Überblick aus österreichischer Sicht' [A new legal form in Austria: The flexible corporation – a practical overview from an Austrian perspective] [2024] GmbHR 169, 171.

(a) In the event of "genuine" Participation

In Austria, EPPs based on genuine participation are not considered favorable by most LLCs due to the extensive shareholder rights that this would confer upon employees. This is due to the fact that, as a result of being granted equity interests, employees as shareholders receive property rights, control rights (e.g. Sections 45 (1) and 46 GmbHG), voting rights (Sections 35 (1) and 39 (2) GmbHG), and rights to information and disclosure (Section 22 (2) GmbHG).[265] Consequently, they are able to significantly influence or delay the company's business decisions.[266]

The introduction of FlexCo's innovative company value shares marks a shift in this regard. Employees have the potential to become genuine shareholders, thereby acquiring a range of rights and obligations that differ from those typically associated with typical shares. Similar to preferred stock in the context of stock corporations, company value shares entitle holders to a share of profits and a share in the company's assets[267], but only allow for very limited influence on decision-making.[268] Holders of company value shares are entitled to participate in a general meeting, but are (almost entirely) excluded from voting rights and the right to challenge resolutions (Section 9 (4) FlexKapGG). Due to the maximum participation limit (Section 9 (1) sentence 1 FlexKapGG), holders of company value shares are always minority shareholders. As such, they are entitled to the minority rights under the GmbHG, apart from Section 30b (1) GmbHG.[269] While holders of "normal" shares are entitled to the right of appeal under Section 41 GmbHG, this right is (largely) excluded for company value shares.[270] Nevertheless, shareholder resolutions resulting in an amendment of the shareholders' rights can only be passed with the individual consent of all company value participants affected within the meaning of Section 50 (4) GmbHG.[271] Additionally, they do not hold the comprehensive right to information that has been established through judicial development of the law in context with shareholders of LLCs.[272] The management is, though, required to submit the annual financial statements, including the management report, and any consolidated financial statements, promptly following their preparation (Section 9 (4)

[265] Fritz (n 264) 171 with further references.

[266] Luxbacher and Schury (n 32) cp 3 para 40.

[267] Holders of company value shares are entitled to a share of the net profit in accordance with their contractually agreed shareholding ratio (Section 9 (3) sentence 1 FlexKapGG).

[268] Fritz (n 264) 170.

[269] ibid 171.

[270] Artmann (n 222) 508.

[271] Fritz (n 264) 172.

[272] Austrian Supreme Court 18.02.2025 - 6 Ob 65/24p; Austrian Supreme Court 02.09.2020 - 6 Ob 11/20s.

sentence 1 FlexKapGG). Furthermore, the holders of company value shares must be granted a right of co-sale if the founding shareholders sell the majority of their shares (Section 10 FlexKapGG).

(b) Without "genuine" Participation

The issue outlined above (part C.2.7(a)) can be effectively mitigated through the implementation of virtual EPP, which are widely prevalent in Austrian startups.[273] In the context of virtual participation, employees typically do not possess any control rights and are not subject to any specific obligations. In the same way as Germany, Austria is also being criticized for the spread of virtual EPP.[274]

3. United States

In contrast to the majority of EU member states, the United States has been promoting the concept of employee participation on a large scale since the 1950s; today, the legal framework in the United States allows for a wide range of individually tailored participation systems, each of which is directly tailored to the needs of the company.[275] In the United States, the predominant objective of employee participation is to facilitate retirement savings.[276] The underlying factors contributing to this development are rooted in the restricted nature of state pension provisions. Consequently, company pension schemes are of greater importance than in Germany or Austria, for example, and are widespread.[277]

3.1 Relevant Legislation and Jurisdiction

Employee participation and compensation in the United States is characterized by a wide range of retirement plans, including qualified retirement plans (defined benefit pension plans, profit sharing plans, 401(k) plans[278], stock bonus plans and ESOPs) and numerous types of non-qualified incentive plans (direct cash bonuses, direct stock purchases/bonuses, incentive stock option plans, employee stock purchase plans, restricted stock bonus plans and phantom stock plans). The majority of retirement plans and a significant proportion of incentive plans are to some extent incentivized by provisions aimed at reducing taxes obligations.[279] Consequently, the US Income

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[273] Index Ventures handbook, ‘Rewarding Talent’ (2020) <https://www.indexventures.com/rewarding-talent/ripe-for-change> accessed 21 July 2025.

[274] Index Ventures handbook, ‘Rewarding Talent’ (2020) <https://www.indexventures.com/rewarding-talent/country-detail-tables-austria> accessed 21 July 2025.

[275] Stracke (n 21) 105.

[276] ibid 107.

[277] ibid 106.

[278] The plan gets its name from the section of the US Internal Revenue Code (IRC) that covers it.

[279] PEPPER V Report (n 11) 241.

Tax Act (US Internal Revenue Code - IRC) and the Employee Retirement Income Security Act of 1974 (ERISA) are decisive at the federal level.

The legal regulations concerning LLCs in most US states are based primarily on the Uniform Limited Liability Company Act of 1996 (ULLCA) of the National Conference of Commissioners on Uniform State Laws or on the Revised Uniform Limited Liability Company Act (RULLCA) published in December 2006.[280] Nonetheless, there are some significant differences in the regulations, necessitating a case-by-case evaluation.

3.2 Timing and Type of Taxation

With regard to the type and timing of taxation on employee participation, the implications of Sections 409A and 83 of the IRC, as amended, must be given particular consideration.

Section 409A IRC applies to equity-based compensation that is either deemed or otherwise results in deferred compensation that is earned in one year but paid in another year. When considering Section 409A IRC, the type of award will dictate whether the award should be designed to: (1) fall within the scope of an exemption, or (2) be designed to comply with the requirements.[281] In the event that an award subject to Section 409A IRC does not qualify for an exemption and fails to comply with the requirements of Section 409A IRC, the employee will be subject to acceleration of income and an additional 20% income tax.[282] The thoughtful structuring of awards, however, can generally circumvent these harsh adverse tax consequences without hindering an organization's compensation objectives.[283]

By contrast, equity-based compensation awards of property are subject to Section 83 IRC and are generally not considered deferred compensation subject to Section 409A IRC. If a taxpayer receives noncash property as compensation for their services, the FMV of the property received must be included in their gross income, with any amount paid for the property deducted (Section 83(a) IRC). The type of the property received, whether tangible, intangible or personal, is irrelevant to the analysis.[284] It is well established that the receipt of equity or any other form of value in exchange for services constitutes income to the recipient under Sections 61 and 83 IRC. Specifically, when a partnership or LLC grants a profits interest or a capital interest, the award is considered property subject to Section 83 IRC.[285]

[280] Süß (n 62) 598.

[281] Schuster and Hunt (n 70) 28.

[282] ibid.

[283] ibid.

[284] Schuster and Hunt (n 70) 26.

[285] ibid.

Furthermore, any form of deferred compensation that provides benefits in a manner similar to retirement plans may be subject to Employee Retirement Income Security Act (ERISA) rules, the same set of regulations that govern pension and other retirement plans. The absence of explicit regulations in this area is notable, with the existing guidance primarily derived from a limited number of relevant court cases, predominantly initiated by employees.[286]

(a) Profit Interests

Profit interests can be exempt from taxation at the time of grant, provided that the recipients are employees or other service providers. In such cases, the transfer is generally not considered a taxable event for the issuer or the recipient, though there are some exceptions.[287] Consequently, the employee would be subject to taxation on the value of any difference between the grant price and any consideration paid at ordinary income tax rates.[288] If there is no value at the time of grant, then the tax is zero – Typically, profit interests should be designed to have no value on grant. Moreover, in the event that an 83(b) election is filed in a timely manner by the profit interest holder, these assets are not subject to taxation upon vesting. In the absence of an 83(b) election, or if it is deemed not to have been made, the employee is obligated to pay taxes on gains at vesting as ordinary income. Consequently, the vast majority of employees opt for the 83(b) treatment.[289]

In the event of the sale of interest, capital gains tax rates are applicable. The specific rate is determined by the holding period; that is, whether the profits are held for a long or short term.[290]

A potentially significant disadvantage of allocating a profits interest is that the recipient is no longer regarded as an employee for tax purposes.[291] Instead, the profits interest holder is subject to the complexities inherent in being a partner or LLC member.[292] Consequently, they are treated as self-employed individuals and are required to pay self-employment taxes on their share of the income generated by the LLC's activities.[293] The tax partner status of the

[286] NCEO (n 66).

[287] ibid.

[288] ibid.

[289] As recommended by Foreman and Kabel (n 75) 36.

[290] Schuster and Hunt (n 70) 30.

[291] It is unclear whether a profits-interest holder would be treated as an employee if there are no vested interests, and enterprises have tried various workarounds, such as layering entities so that one LLC holds the membership interest and another is the employer – most of them without success. For more details, please refer to NCEO (n 66).

[292] NCEO (n 66).

[293] ibid.

recipient also imposes limitations on the recipient's tax advantages with respect to employee benefits, health insurance, and other fringe benefits.

In contrast to the taxation of profit interest, capital interest is subject to taxation upon receipt by the interest holder (Sections 61 and 83 IRC).

(b) Virtual Employee participation

In the process of granting phantom equity, it is recommended that the employer in question shall ensure that the terms of the award comply with Section 409A IRC.[294] In terms of income tax purposes, the deferred compensation attributable to phantom equity is subject to taxation only upon its actual payment to the employee. Consequently, no tax liability arises at the time of grant or vesting. While the increase in value of “genuine” membership interests upon sale may be subject to favorable capital gains tax rates, payments from phantom equity are subject to the normal income tax rate for the employee.[295]

(c) Options and UAR

Specifically, when the LLC awards options or unit appreciation rights (UAR), the organization can generally design the award to be exempt from Section 409A IRC.[296] Neither UAR nor options are subject to taxation at grant in this case, thereby enabling the recipient to defer compensation into a subsequent year. This deferral occurs because the recipient does not receive the value as compensation until settlement, which typically happens in a year following the year of the grant. Once the options or UAR vest and the employee exercises or the designated payment event occurs, the company typically makes a cash payment (depending on the rules of the plan). At the time the transfer is initiated, the excess of FMV over the exercise price or threshold value is subject to taxation as ordinary income.[297]

UAR do not constitute actual equity in the LLC; consequently, such a plan does not give rise to any partner-employee issues.

3.3 Tax Allowance

In the context of federal income tax, a standard deduction is typically applicable, amounting to USD 14,600 for single filers or married couples filing separately, and USD 29,200 for married couples filing jointly or eligible surviving spouses.[298]

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[294] Schuster and Hunt (n 70) 28.

[295] ibid 30.

[296] ibid 28.

[297] ibid 30; Stracke (n 21) 108.

[298] Internal Revenue Services (IRS), ‘Credits and deductions for individuals’ <https://www.irs.gov/credits-and-deductions-for-

3.4 Valuation

In the United States, the so called “409A procedure” is an established and cost-effective method of valuing non-publicly traded membership interests in a neutral, reliable, and transparent manner.[299] Section 409A IRC establishes three "safe harbor" methods: (i) Qualified independent appraiser method, (ii) the illiquid start-up method, and (iii) non-lapse restriction valuation method. The most common approach is qualified independent appraiser method, in which the valuation is determined by a qualified independent appraiser as of a date no more than 12 months before the date of grant.[300]

The value of profit interest depends on the performance of the company. Therefore, the first step in profit interest valuation is to determine the value of the underlying security. The subsequent valuation process is significantly influenced by the underlying EPP.[301]

In the context of phantom equity, the valuation methods can be stipulated directly within the LLC's operating agreement and in the respective phantom equity agreement with the employee.[302] The valuation of the phantom equity can be derived from two sources: the value of the partnership/LLC equity or the increase in value over a specific period of time. The value can be a fixed value, determined by an explicit formula or by an expert opinion. The relevant key points must be specified in the relevant phantom equity EPP.[303]

The value of UAR is based on value of partnership/LLC equity and is determined at the time of exercise by the employee.[304] Upon settlement of a UAR, the value awarded to the employee is determined on the excess of FMV over the exercise price or threshold value (which is typically equal to the FMV at the time of grant). Private companies that issue UARs do not have a readily ascertainable market value. Instead, they must follow the general equity compensation valuation rules for private companies and utilize a reasonable valuation method, such as an express written formula, or have a third-party appraisal performed to determine the FMV per membership interest.[305]

individuals#:~:text=Standard%20deduction%20amounts,%2421%2C900%20for%20head%20of%20household> accessed 3 July 2025.

[299] Prégardien, Winterhalder and Toliou (n 9) 248.

[300] DLA Piper, ‚Section 409A valuations’ <https://www.dlapiperaccelerate.com/knowledge/2020/section-409a-valuations.html> accessed 5 July 2025.

[301] ibid.

[302] ibid; Ubertaccio v. Ubertaccio, 161 N.C. App. 352

[303] ibid.

[304] DLA Piper, ‚Section 409A valuations’ <https://www.dlapiperaccelerate.com/knowledge/2020/section-409a-valuations.html> accessed 5 July 2025.

[305] ibid.

3.5 Membership Interest Transfer

(a) Capital Measures

The legal framework governing the requirement for capital contributions to LLCs post-formation is determined by the laws of the respective state, as there is no uniform company law in the United States.[306] In addition, regulations on capital measures are hardly comparable with those in Germany and Austria. This discrepancy arises, at least in part, from the fact that the legal form of the US LLC cannot be directly equated with the LLC in Germany and Austria.[307] For example, there is no minimum capital requirement for an LLC in the United States.

The respective operating agreement of the company is also decisive in determining the specific parameters of the transaction, including the timing, amount, and form.[308]

(b) Formal Requirements

The documentation legally required to record an LLC membership transfer with the relevant state authorities varies depending on the jurisdiction and the specific circumstances of the transfer.[309] The provisions in the LLC's operating agreement are also essential in this context. Under the legal framework of the United States, the transfer of membership interests and options is typically not subject to any formal requirements.[310] In most cases, the transfer of membership interest requires a resolution by the shareholders' meeting (or general meeting) - but notarization is not required.[311] Nevertheless, the transfer must be registered in the commercial register.[312]

3.6 Participation in Decision Making

The risk of losing control of the company due to an EPP is virtually non-existent in the United States. In the context of the widespread ESOP, voting rights are exercised by the plan trustees, not by the

306 Holger Fleischer in: Holger Fleischer and Wulf Goette, Münchner Kommentar zum GmbHG [Munich Commentary to the GmbHG] (5 edn C.H.Beck 2025) 262.

307 The reason for creating this new type of legal entity in the US was the need of the economy to combine the liability protection of a corporation with the tax transparency of a partnership (hybrid) – which has been achieved in Germany, Austria, and some other countries through the legal recognition of the GmbH & Co. KG.

308 Prégardien, Winterhalder and Toliou (n 9) 249.

309 Fleischer (n 306) 262.

310 Frederike Volkmann, 'Das ZuFinG - Chancen für den Unternehmens- und Finanzstandort Deutschland' [The ZuFinG - Opportunities for Germany as a business and financial centre], BB 2024, 1224, 1225; Prégardien, Winterhalder and Toliou (n 9) 248.

311 Prégardien, Winterhalder and Toliou (n 9) 249.

312 ibid.

participants. In addition, studies conducted by the National Center for Employee Ownership (NCEO) have revealed that participants have little to no interest in voting rights.[313] What participants do want is greater say in day-to-day decision-making on the shop floor or in the workplace.[314] As more and more ESOPs acquire 100% ownership of their companies, more and more companies have begun to explore various ways to further engage their employees in day-to-day decision-making.[315]

In the case of LLCs, the operating agreement is the primary governing document for control rights.[316] The organizational structure is characterized by its high degree of flexibility, thereby allowing for significant flexibility in the structuring of rights and duties of members, managers, and employees. Operating agreements may include provisions related to management, voting rights, profit-sharing, and decision-making processes, allowing LLCs to tailor their internal governance to suit their specific needs.[317] The applicable state law is decisive in this regard. In all states, LLC legislation is consistent in its reflection of the fundamental principle of freedom of contract.[318] State legislators have closely followed model laws developed by academics in commercial and corporate law, such as those of the American Bar Association. Furthermore, the presence of prominent commercial law firms and corporations operating on a national scale facilitates the consistent implementation of effective corporate structures throughout the country.[319]

This flexibility enables the implementation of EPPs without the need to grant employees substantial voting and participation rights. The majority of profit interests do not include any non-economic rights, e.g., voting rights, and the majority come with so-called drag-along rights that require the holder to sell if owners of other classes agree to sell a business.[320] Employees can receive membership interest that provide either voting rights, equity rights, or both.[321]

Similarly, phantom equity programs are typically governed by the terms of the operating agreement and the specific phantom equity agreements with employees and can therefore be structured just as flexibly. Employees do not gain voting or dividend rights, which limits their influence over company decisions.

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313 PEPPER V Report (n 11) 247.

314 ibid.

315 ibid.

316 Süß (n 62) 600.

317 ibid.

318 Fleischer (n 306) 262.

319 ibid.

320 Foreman and Kabel (n 75) 31.

321 NCEO (n 29).

D. Analysis and Conclusion

1. Summary Comparison of the Framework Conditions

The presentation of the legal framework in part C of this thesis demonstrates that, at the outset, there is a higher density of legal regulations for employee participation in LLCs in Germany and Austria than in the United States. However, regulatory frameworks concerning valuation procedures are deficient in Germany and Austria – although this can be identified as an area that requires regulation. The legal situation, the application of the law, and its requirements for EPP vary, as do the fiscal treatments of EPP. A comparison between Germany and Austria reveals not only striking parallels in their economic and social landscapes, but also a tendency towards liberalization in Austria, exemplified by the emergence of a novel corporate entity: FlexCo.

In summary, the differences between the legal frameworks in the three nations can be attributed to the specific social, economic, and political conditions, as well as to the capital market structures typical of each nation, the different sizes and cultures of companies, and the influence of social partners.[322] The design and practical implementation of the individual EPPs are influenced by these varying factors. It is important to note, however, that all three nations share a number of similarities.

1.1 No Special Programs for LLCs

None of the three nations Germany, Austria and the United States has developed specific forms of EPP that are tailored to the legal structure of LLCs. In contrast, the majority of the concepts have been adopted, at least in part, from stock corporations and have been adapted to LLCs to a certain extent. This results in a certain degree of complexity and adoption barriers, which, by itself, is one of the most significant obstacles for the implementation of EPP.[323]

The introduction of the new FlexCo and company value shares in Austria may have laid the foundation for an EPP tailored to LLCs (or FlexCos). It is yet to be determined how this dynamic will manifest in practical applications.

1.2 Taxation

A further point of similarity is evident in the tax incentives for EPPs in LLCs in Germany, Austria and the United States, which are predominantly based on tax allowances and tax deferrals. Moreover, employee participation is largely subject to income taxation in all three nations under consideration, and the regulations on capital gains taxation do not apply in general.

In Germany and Austria, the issue of dry income is of particular concern and will continue to influence the implementation of EPP in both countries. The relief measures provided by Germany

[322] Stracke (n 21) 107.

[323] Guzek and Whillans (n 51) 12.

and Austria for "young" companies in this regard – in particular Section 19a of the German Income Tax Act (EStG) and Section 67a of the Austrian Income Tax Act (EStG) – can cushion the problem to a certain extent. As both regulations have only recently been created or amended, there is no standing case law as regards cases of doubt.[324] The resulting uncertainties have a negative impact on the perception of the regulations among employees and companies.[325]

All EPPs practiced in the United States share a common characteristic: they are strongly promoted by the state. In each instance, a unique set of legal provisions and tax incentives is applicable. However, this applies to a lesser extent to the EPP practiced by LLCs than, for example, to ESOPs or 401(k) plans.[326] Rather, also in the United States, the granting of equity is subject to taxation as ordinary income to the recipient (Sec. 83 IRC). Nevertheless, the considerable flexibility in company law regulations renders it somewhat more feasible to circumvent tax disadvantages.

The most significant distinction to Germany and Austria is that, under the prevailing United States regulations, there is an absence of what is referred to as "dry income taxation" at the level of the beneficiary employees. For tax purposes, the only relevant transaction is the inflow of value upon sale of the shares received through the exercise of the option, not the original transfer from the company to the employee.[327]

1.3 Valuation

Germany and Austria differ notably from the United States with regard to the methods employed in valuating employee participation and/or the financial benefit granted to the employee in this manner. In instances where shares in Germany or Austria have not been valued as part of a financing round, a current reference point for the market value is not available, and there is an absence of uniform valuation standards.[328] This can result in divergent interpretations by individual authorities, which is a subject of ongoing discussion. Such uncertainty can be particularly challenging for start-ups and their employees.[329]

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[324] Schrade and Linseisen (n 59) 97; Puchner and Gloser (n 234) 24.

[325] Schrade and Linseisen (n 59) 95 ff.

[326] Schuster and Hunt (n 70) 28.

[327] Foreman and Kabel (n 75) 36.

[328] Index Ventures handbook, ‘Rewarding Talent’ (2020) <https://www.indexventures.com/rewarding-talent/ripe-for-change> accessed 21 July 2025; Prégardien, Winterhalder and Toliou (n 9) 248.

[329] #ESOPasap (n 39) 50.

In contrast, the United States has implemented standardized valuation procedures.[330] Furthermore, the valuation can be regulated in a conclusive manner within the framework of most common EPPs as part of the contractual agreements between companies and employees.[331]

1.4 Formal Requirements

The divergent formal requirements in the three nations under consideration are of particular relevance in the context of employee participation.

In the German legal system, the notarization requirement for the transfer of LLC shares or share options represents a significant obstacle for companies and employees.[332] This requirement, coupled with the subsequent obligation to update the list of shareholders in the commercial register, poses a considerable burden on business entities.[333] In the context of share option grants, a dual notarization requirement emerges: The notarization of both the option agreement between the company and the employee, as governed by the law of obligations, and the transfer of shares in rem upon the exercise of the option, are necessitated by law (see Sections 15 (3) and (4) of the German GmbHG).[334]

A parallel can be drawn to the situation in Austria.[335] In the context of the recent developments concerning company value shares, there has been a notable relaxation in the formal requirements stipulated. However, it remains to be observed whether this relaxation will ultimately result in any tangible practical consequences. [336]

In the United States, by contrast, the transfer of membership interest and options is typically not subject to any formal requirements, i.e., it can be executed without the involvement of a notary.[337] This approach has been demonstrated to result in a substantial reduction in bureaucratic effort and transaction costs.

1.5 Structure and Form under Corporate Law

In summary, significant disparities exist among Germany, Austria and the United States with regard to the freedom of corporate structuring.

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[330] Prégardien, Winterhalder and Toliou (n 9) 248.

[331] DLA Piper, ‚Section 409A valuations' <https://www.dlapiperaccelerate.com/knowledge/2020/section-409a-valuations.html> accessed 5 July 2025.

[332] #ESOPasap (n 39) 47; Prégardien, Winterhalder and Toliou (n 9) 248.

[333] Ahlswede and Landhäußer (n 1) 727.

[334] ibid.

[335] Artmann (n 222) 490.

[336] ibid.

[337] Volkmann (n 310) 1225; Prégardien, Winterhalder and Toliou (n 9) 248.

The first aspect to consider thereby is the framework condition for capital measures and the transfer of shares. The regulations governing capital measures in Germany are quite rigid and complex.[338] The existing mechanisms for creating new shares or providing for share options by increasing the share capital or utilizing existing authorized capital are overly complex for exit-oriented start-ups with a significant number of employees. The formal increase in the share capital of an LLC (Section 55 GmbHG) and the capital increase from authorized capital (Section 55a GmbHG) do not offer any practical mechanisms for servicing share options.[339] A parallel can be drawn to the situation in Austria.[340] However, the legal framework governing capital increases in LLCs is characterized by greater flexibility there, with the option to execute increases either up to a maximum amount or in instalments.[341] The recent enactment of the FlexCo regulations also contributed to the simplification of this area in Austria.[342] Notably, capital requirements for LLCs in the United States are less formally regulated compared to those observed in Germany and Austria. Rather, essential terms can be negotiated in a flexible manner within the operating agreements.[343]

The second aspect is the company's operational autonomy and the extent to which employees' rights influence decision-making processes within the organization. The issue of employee ownership and its potential implications for tax and compliance considerations are of relevance in the United States, as they are in Germany and Austria. The transition from employee to shareholder status can introduce complexities and financial obligations, necessitating a comprehensive understanding of the relevant regulations and their potential impact.[344] A considerable number of employees are unwilling to shoulder the added complexities that come with being a member of an LLC. Simultaneously, many companies are keen to circumvent these complexities. A variety of programs have been developed in Germany, Austria, and the United States, with the objective of addressing this issue.[345] The primary objective is to ascertain that the shareholder base does not become excessively extensive or convoluted.

In the German and Austrian corporate legal landscapes, regulations tend to prioritize formality and structure, leaving limited flexibility for alternative approaches. This formalistic approach, in turn, necessitates the use of complex programs to circumvent potential negative consequences. German law, for example, recognizes the concept of non-voting preference shares[346] and also

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[338] Ahlswede and Landhäußer (n 1) 750.

[339] ibid.

[340] Artmann (n 222) 490; Luxbacher and Schury (n 32) cp 3 para 18.

[341] Artmann (n 222) 488.

[342] Please refer to part C.2.5. of this thesis in that regard.

[343] Volkmann (n 310) 1225; Prégardien, Winterhalder and Toliou (n 9) 248.

[344] NCEO (n 66).

[345] Weitnauer (n 84) pt F, 133.

[346] ibid.

hurdle shares.[347] Nevertheless, in the case of LLCs, the obligation to call a shareholders' meeting and the ambiguous legal situation regarding the potential for adequately restricting shareholder rights mean that the creation of non-voting shares is not a sufficient alternative.[348] The rights that employees acquire with the transfer of shares are too extensive. This applies in particular to the right to participate and vote at shareholders' meetings, the right to issue instructions to the management, and the right to information and inspection vis-à-vis the company. Under Austrian LLC law, voting rights cannot be completely excluded for shares (see Section 39 (2) sentence 2 GmbHG in conjunction with Section 1 (2) FlexKapGG). As a result, virtual participation has emerged as best practice in both the German and Austrian markets.[349] This is despite the fact that there has been considerable criticism from employees and stakeholders for years.[350] Furthermore, the establishment of a virtual EPP involves a considerable amount of administrative work and significant costs.[351] The recent introduction of company value shares in Austria deserves particular emphasis in this context. These provisions enable the near-total exclusion of voting rights along with the transfer of shares.[352]

In contrast, the design of EPP is somewhat simpler, and there is less risk of a loss of control in the United States in the context of EPP. This is due to the flexibility of company law regulations; for example, minority shareholders do not have to be invited to a shareholders' meeting if the required majority of shareholders has already approved a decision outside of a shareholders' meeting.[353] The legal framework for EPPs in LLCs is characterized by its considerable flexibility, which enables the customization of these programs through operating agreements.[354] While there have been no significant recent reforms or rulings directly targeting employee participation in LLCs, existing statutes and case law emphasize the adaptability of LLC structures to accommodate such programs. This flexibility enables LLCs to align their governance and participation mechanisms with their operational goals and employee engagement strategies.

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[347] Weitnauer (n 84) p F, 133.

[348] Ahlswede and Landhäußer (n 1) 726.

[349] #ESOPasap (n 39) 37; Index Ventures handbook, ‘Rewarding Talent’ (2020) <https://www.indexventures.com/rewarding-talent/ripe-for-change> accessed 21 July 2025.

[350] Schrade and Linseisen (n 59) 89.

[351] Ahlswede and Landhäußer (n 1) 726.

[352] Fritz (n 264) 170.

[353] #ESOPasap (n 39) 57.

[354] Süß (n 62) 600.

2. Success Factors

Based on the framework conditions in the individual nations and the comparison of these, conclusions can be drawn as to which factors have a positive influence on the individual EPPs and their practical implementation in LLCs.

In summary, fiscal incentives have been demonstrated to be useful, especially when preventing the "dry income" problem. In order to facilitate the implementation of EPP, it is advantageous to remove bureaucratic obstacles - the implementation of standardized processes and programs is ideal. Moreover, the establishment of suitable valuation methods represents a significant beneficial factor in this particular context. International harmonization of participation programs would also be desirable.[355]

The efficacy of these factors has been further substantiated through additional research.[356] For instance, the Baltic states (Estonia, Lithuania, and Latvia), Israel, and Canada are the frontrunners in the aforementioned study from Index Ventures (part B.1.7.(b)).[357] A notable aspect of these countries' economic policies is the provision of advantageous tax conditions for employees. Additionally, these employees are often granted share options within their respective companies. Furthermore, it is either possible to issue non-voting shares[358] or to exclude minority shareholders from participating in business decisions that are already supported by the majority.[359]

In detail.

2.1 Taxation - Dry income must be excluded

The analysis of EU member states indicates that tax incentives are not a prerequisite for the success of EPPs. Analyzing the situations in Germany and Austria, it is evident that EPPs without tax incentives, such as profit-sharing plans, in some cases prove to be more incentivizing than those with tax relief provisions. In Austria, the proportion of companies participating in EPP in 2005 was only 8%, despite the introduction of tax incentives in 2001, while 25% of companies operated profit-sharing plans without such incentives. [360] In Germany, 2.4% of companies had EPPs in 2001,

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[355] For a more detailed analysis of this subject, please refer to the proposal for a European ESOP in Pepper V Report (n 11) 251 ff..

[356] Guzek and Whillans (n 51) 1.

[357] Index Ventures handbook, 'Rewarding Talent' (2020) <https://www.indexventures.com/rewarding-talent/winners> accessed 18 July 2025.

[358] For example, in Latvia and Canada cf. Index Ventures handbook, 'Rewarding Talent' (2020) <https://www.indexventures.com/rewarding-talent/winners> accessed 19 July 2025.

[359] For example, in France and the USA cf. Index Ventures handbook, 'Rewarding Talent' (2020) <https://www.indexventures.com/rewarding-talent/high-ranking> accessed 19 July 2025.

[360] PEPPER V Report (n 11) 251.

supported by (marginal) tax incentives, whereas at the same time 8.7% of companies operated profit-sharing plans without tax incentives.[361]

Nevertheless, tax incentives have been demonstrated to be an effective instrument for promoting the spread of EPP.[362] These findings are consistent with the observations made in countries that have historically implemented tax incentives for EPP, such as France and the United Kingdom.[363] This phenomenon is also evident in countries where such incentives are more recent, including Austria.[364]

In any event, the issue of dry income needs to be ruled out. In the worst case, a monetary advantage is assumed at the time the shares are granted, and if the start-up does not ultimately achieve a breakthrough, the hoped-for inflow of liquidity does not materialize. Consequently, the employee is confronted with dual risk: firstly, the prospect of advance taxation without adequate cash flow, and secondly, the possibility of insufficient cash flow relative to the original monetary advantage subject to taxation.[365]

In light of the fact that the financial benefits derived from EPP do not constitute regular wages, but rather arise from long-term company participation, it is recommended that the financial benefits from employee participation programs be taxed uniformly as capital gains and not as income from employment.[366] This would constitute a reasonable solution.

2.2 Transparency, standardized procedures and less administration

In the countries surveyed by Index Ventures that offer better conditions for employee participation (e.g., the United States[367] and France[368]), recurring regulatory best practices have emerged. It is therefore not surprising that founders in Germany view the lack of standardization of documents and contracts relating to employee participation as particularly negative.[369] Since there are no tried-and-tested standard models as yet, the implementation of EPP is associated with uncertainty and increased costs. In the event that an EPP is then implemented incorrectly from a legal perspective,

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[361] PEPPER V Report (n 11) 251.

[362] Hofmann and Holzner (n 2) 9.

[363] PEPPER Report (n 14) 67.

[364] ibid.

[365] Ahlswede and Landhäußer (n 1) 727.

[366] Please refer also to the study commissioned by the BMWi (n 12) accessed 22 July 2025.

[367] Index Ventures handbook, 'Rewarding Talent' (2020) <https://www.indexventures.com/rewarding-talent/country-detail-tables-united-states> accessed 15 July 2025.

[368] Index Ventures handbook, 'Rewarding Talent' (2020) <https://www.indexventures.com/rewarding-talent/country-detail-tables-france> accessed 15 July 2025.

[369] #ESOpasap (n 39) 50.

further costs arise.[370] Standard option conditions for setting up virtual EPP do exist in Germany, such as the GESSI standard conditions.[371] However, the process remains complex, requires the drafting of complex contractual regulations and, in most cases, extensive advice from specialized lawyers.

In addition, highly skilled professionals from around the world expect EPP that are transparent and simple, and which ensure legal security in regard to their involvement in the company's success. Virtual EPPs have been the subject of considerable criticism due to their failure to provide “genuine” shares.[372] In contrast, widely accepted option-based EPP typically provide the right to a predetermined number of "genuine" shares. This approach ensures transparency for employees regarding the quality of the participation granted to them. In the event of an exit, these employee shareholders are typically able to sell their shares on the same terms as all other holders of the same share class.[373]

Finally, there is a compelling need for a standardized valuation procedure. In Germany and Austria, the valuation process is challenging for tax authorities, particularly as regards start-ups, and is typically determined on a case-by-case basis. For employees, this results in potential risks that are difficult to calculate due to the possibility of excessive tax claims based on unpredictable valuations.[374] In order to effectively reduce these legal uncertainties in, simple and cost-effective valuation procedures should be introduced, from which the tax authorities should only deviate in exceptional cases. The US-American 409A procedure[375] is a potential role model for valuation in this context.[376]

2.3 Flexibility in the Framework of Corporate Law

In Germany and Austria, the prevalence of virtual EPPs and the legal form-specific disadvantages outlined above with regard to employee participation in decision-making demonstrate that the corporate law framework does not align with the needs of companies.[377] Consequently, the consideration of further reforms – e.g., a reform of the GmbHG (Limited Liability Companies Act) – should be considered in order to further increase the attractiveness of EPP in Germany and Austria.

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[370] Study commissioned by the BMWi (n 12) accessed 5 July 2025 99.

[371] Model option terms and conditions of the German Standards Setting Institute (GESSI) <https://standardsinstitute.de/standardvertraege/mitarbeiterbeteiligung> accessed 12 July 2025.

[372] Index Ventures handbook, ‘Rewarding Talent‘ (2020) <https://www.indexventures.com/rewarding-talent/ripe-for-change> accessed 17 May 2025.

[373] #ESOPasap (n 39) 48.

[374] Schrade and Linseisen (n 59) 97; Luxbacher and Schury (n 32) cp 3 para 40.

[375] Prégardien, Winterhalder and Toliou (n 9) 248.

[376] #ESOPasap (n 39) 62.

[377] ibid 48.

This approach enables the adaptation of the (corporate) legal framework to favor an efficient, cost-effective, and legally secure option for employee participation, thereby enhancing the international competitiveness of EPP.[378] One potential approach to simplifying the implementation of EPP and reducing transaction costs would be to relax the formal requirements in the context of the transfer of shares and options.[379]

In the medium term, a new class of shares for employee participation could be introduced in Germany following Austria's example: The objective of establishing a form of "genuine" employee participation in LLCs that offers the necessary flexibility and legal certainty to meet the needs of different types of shareholders and stakeholders can best be achieved by introducing a new class of shares.[380] In Germany, a separate provision could be added to the GmbHG, to address all associated rights and obligations, as well as the terms and conditions of transfer. Key aspects that necessitate regulation include the grant and transfer of shares, the sale and retransfer of shares by employees, documentation of share ownership, and formal requirements. The holders of the new class of shares may be granted limited voting and participation rights in the shareholders' meeting, and information rights and rights to challenge shareholder resolutions could be restricted.[381]

3. Conclusion

As illustrated in this thesis, there are compelling arguments to support the assertion that EPPs are particularly important for start-ups, but also for established SMEs. Consequently, the efforts of the European Union and its Member States to enhance the framework conditions for employee participation appear to be a rational course of action. Meanwhile, research and feedback from practitioners indicate that the costs, administrative burden, and other complexities currently hamper the introduction of financial participation schemes across the EU, particularly in startups and SMEs.[382]

The analysis of EPP in the context of LLCs in Germany, Austria, and the US, as presented in this thesis, demonstrates that it is hardly possible to draw a clear and universal distinction between shareholder and stakeholder approaches. Instead, the schemes operate in a field of tension that combines elements of the shareholder principle - particularly with regard to financial participation in the company's success - with stakeholder perspectives, primarily through the goal of long-term employee retention and motivation.

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[378] Ahlswede and Landhäußer (n 1) 750.

[379] ibid 751.

[380] For a detailed proposal, please refer to Ahlswede and Landhäußer (n 1) 731 ff.

[381] Ahlswede and Landhäußer (n 1) 731 ff.

[382] PEPPER V Report (n 11) 249.

A commonality among the three jurisdictions is the absence of a specific, customized framework for employee participation in LLCs. This allows flexibility but also creates uncertainty and potential need for adaptation. The comparison with the United States in particular shows that greater flexibility in company law promotes innovative forms of employee participation there, while in Germany and Austria, stricter regulatory requirements and the absence of proper valuation mechanisms limit the scope for design.

Tax and company law in Germany and Austria form a regulatory framework for employee participation that is unattractive in some respects. However, shortcomings in the transparency (lack of legal certainty), common virtual EPP and the bureaucratic and formalistic complexity associated with employee participation in Germany also represent significant obstacles, making the business location Germany unattractive in international comparison.[383]

The analysis of the various EPP in different countries can provide both legislators and legal practitioners with ideas and suggestions for the design of EPP. In order to remain competitive in the international race for talent, the (primarily tax) framework conditions in Germany and Austria must not be more disadvantageous than those in other countries and should be as compliant as possible with international standards. The German legislator should therefore consider adopting the tried-and-tested strategies from other countries.

Finally, the question of “shareholder or stakeholder?” can only be answered within the respective legal and tax context, with framework conditions determining which approach appears to be dominant. What is clear, however, is that integrating employee participation in LLCs in each of the three nations requires careful legal and tax considerations in order to promote both the interests of employees and the economic and strategic objectives of companies in the long term.

[383] #ESOPasap (n 39) 41.

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