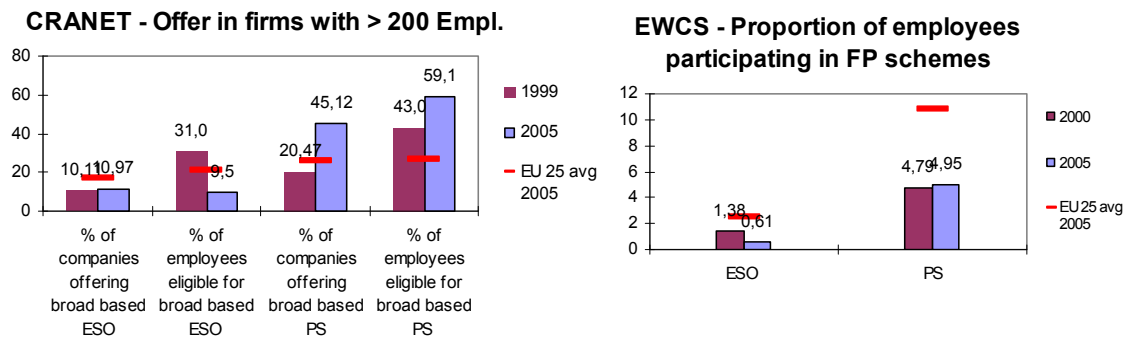


VII. Germany

Despite a long standing tradition and the general acknowledgement of the positive effects on both productivity and job creation, employee financial participation is not widespread. Traditionally German schemes focus on defined contribution savings plans with a total capital allocated much higher than that of all employee share plans; with regards to financial participation the combination of share ownership plans with these savings plans may be considered typical. Germany's lower standing in comparison to other countries and a recent decrease in employee share ownership may be attributed to insufficient government support. Another reason is the traditional skepticism of both trade unions and employers' associations towards employee financial participation.

Since 2007, a number of government officials as well as representatives of major political parties declared that employee financial participation should be better promoted in the future. Nevertheless, resulting from the substantial differences that divide the two member parties of the Grand Coalition the new 'Law on Capital Participation of Employees' which came into force in April 2009 merely increased existing insignificant fiscal incentives. Under the new Law and the Third Law on Asset Participation including previous provisions¹⁰⁵ these are only offered for employee share ownership, while profit-sharing is not supported by any tax incentives.



Although profit-sharing enjoys no tax incentives, it is more widespread than share ownership. In 2001, 8.7 per cent of enterprises were reported to have profit-sharing schemes, and 2.4 per cent share ownership schemes (Würz, ed., 2003, p. 59). In 2005, profit-sharing plans were operated by 9 per cent of enterprises according to the IAB company survey (Bellmann and Möller, 2006, p. 13)¹⁰⁶ and by 11 per cent according to the BISS project (Hauser-Ditz et al., 2006)¹⁰⁷; share ownership plans were implemented by 2 per cent of enterprises according to the IAB survey and by 3 per cent of enterprises according to the BISS survey. In 2006, 620 joint-stock companies maintained share ownership plans for

¹⁰⁵ The provisions of the Fifth Law on Asset Accumulation and § 19a Income Tax Law.

¹⁰⁶ Data based on questionnaires of 16,000 German companies.

¹⁰⁷ Data based on a representative survey of 3,254 German companies.

1,423,000 employees, and 250 limited liability companies for 8,000 employees; 17,000 employees of co-operatives had membership status (AGP/GIZ of 1 January 2007). According to the IAB company survey, profit-sharing plans are prevalingly implemented in companies with more than 500 employees (one third of all such companies) and in the mining, utilities, banking and insurance sectors (one quarter of all companies in the above sectors), whereas no relevant difference between the sectors exists as far as employee share ownership is concerned. Additionally, financial participation is much more widespread in Western German than in Eastern German companies, and in foreign companies located in Germany rather than in German-owned companies.

1. General Attitude

Regardless periodical discussions of the topic during the last 50 years, until recently, the attitude of the government and social partners towards employee financial participation has been - with some exceptions - generally indifferent or negative. After Federal President Horst Köhler endorsed employee financial participation in 2007, in response to his speech, the Federal Chancellor Angela Merkel and a number of politicians of the Grand Coalition announced to improve the legal framework. Nevertheless, the concepts of the members of the Grand Coalition remained contradicting¹⁰⁸ and – with new Law on Capital Participation of Employees that passed parliament on 23 January 2009 – resulted in a modest compromise leaving far behind previous ambitious plans for reform.

Trade unions continue to exercise strong political power through workers' codetermination, despite declining union membership. With some exceptions, until recently the majority of the Unions feared decentralisation and de-solidarisation of the wage policy along with a general loss of power. As an argument against profit-sharing, they cite the risk that employers could calculate a decrease in the amount of profit to the detriment of employees. Employee share ownership, they argue further, imposes on employees the risk of losing both jobs and share income. Profit-dependent wage components are usually accepted only as auxiliary earnings in good times, while participation in loss is refused. In the context of the financial crisis employee share ownership as a partial substitute for wages or in combination with wage reductions is now under consideration. Recently the employers' associations have paid more attention to employee financial participation. They generally favour voluntary company-level plans and share plans over profit-sharing.

¹⁰⁸ The Christian Democrats proposed to support voluntary schemes at the company level by introducing additional tax incentives for share schemes up to Euro 1,000 per employee annually with the possibility to defer taxation if connected to a retirement savings plan. The Social Democrats favoured a 'Germany Fund' under state guarantee with employees investing in the fund, that in turn would invest in German enterprises, especially SMEs.

2. Legal and Fiscal Framework

German legislation permits both, share ownership and profit-sharing, while no fiscal or other incentives are available for the latter. Asset formation or savings plans offer a vehicle to allocate and invest sums received as salary or as remuneration in financial participation schemes. In this context share schemes can be combined with such savings plans and, to promote asset formation of employees, the employee contributions may be matched by the state. The 2009 Law on Capital Participation of Employees did not change the incentive system under § 19a of the Income Tax Law and the Fifth Law on Asset Formation, but merely increased the amounts, percentages and income ceilings: With regard to an employer allowance the ceiling of the value of the tax free benefit from free or reduced shares from Euro 135 to Euro 360 annually; the absolute limit of the savings bonus matching employee investments of up to 400 Euro from 18 per cent to 20 per cent (that is, a maximum bonus of Euro 80 annually as compared with a maximum of Euro 72 previously); and the income ceiling for eligibility of the bonus from Euro 17,900 to Euro 20,000 annually, which is still exceptionally low. As previously a blocking period of six years applies.

a) Share Ownership

Share ownership is mostly practiced in joint-stock companies (Aktiengesellschaft) due to special features of German company law. In commercial partnerships (OHG, KG), the concept of co-ownership and thus co-entrepreneurship on the one hand and the inflexible transferability of the legal position of a partner on the other preclude the development of employee share ownership. In limited liability companies (GmbH), employee share ownership is rare because of specific legal obstacles, for example, the relatively strong position of a shareholder vis-à-vis management, the transfer of share ownership only by notarial deed. However, a partnership that serves to facilitate employee financial participation in a limited liability company and holds a share of this limited liability company as its sole asset (holding-GbR), is not required to make a notarial deed to transfer its shares.¹⁰⁹

Employee Shares – In joint-stock companies, stock can be distributed to employees in connection with the acquisition of the firm's own shares or with a capital increase. With regard to the acquisition of the firm's own shares with a view to the transfer to its (former) employees or employees of affiliated firms (§ 71 para. 1 no. 8 Law on Joint-Stock Companies (JSCL)) a decision of the General Assembly is not necessary provided that the shares are transferred within 12 months; prerequisite is a reserve fund for own shares to be established without reducing equity capital or reserve funds (§ 71 para. 2 sentence 2 JSCL, § 272 para. 4 Commercial Code (CC)). The company may advance funds, make loans, provide security in order to facilitate the acquisition of the shares by the employees (*financial assistance*, § 71a para. 1 sentence 2 JSCL). With regard to capital increase the law provides for a conditional capital increase (§§ 192 et seq. JSCL) and a capital increase by authorised capital (§§ 202 et seq. JSCL). In both cases a General Assembly's decision is necessary and the nominal amount restricted to 50 per cent, the amount of shares or stock

¹⁰⁹ See decision of the Federal High Court (Bundesgerichtshof) of 10 March 2008 regarding § 15 Abs. 4 Law on Limited Liability Companies and § 125 Civil Code; II ZR 312/06.

options to 10 per cent of equity capital (§192 para. 3 sentence 1). In the latter case, the board of directors is authorised by the general meeting to increase capital up to a certain nominal value. Such an authorisation, however, must be intended in the company statute. The general meeting's decision to authorise the board requires a majority of three quarters of the decision-making stock capital (§ 202 para. 2 JSCL). If an employee receives stock from the employer company under his employment contract free of charge or at a reduced price, the difference between the market value and the subscription price is regarded as a part of salary. If an employee receives stock from the employer company under his employment contract free of charge or at a reduced price, the difference between the market value and the subscription price is regarded as a part of his salary. However, the benefit is exempt from taxes and social security contributions with a maximum of 360 Euro in a calendar year (§ 19a para. 1 Income Tax Law).¹¹⁰ Proceeds from the share sale are not taxed if the period between the date of acquisition and sale is more than one year (§ 23 para. 1, no. 2 Income Tax Law).

Stock options – are more common as executive schemes, but broad-based schemes exist. The decision to adopt a stock option plan as part of a capital increase (see above §§ 192 et seq. and §§ 202 et seq. JSCL) the plan must contain a description of the allocation scheme (§ 193 para. 2 no. 2 JSCL). The plan itself must determine the strike price per share (§ 193 para. 2, no. 3 JSCL). In lieu of the strike price, the decision can state the basis for the calculation of the price. Details on the blocking period and vesting period shall be included in the decision on capital increase (§ 193 para. 2 no. 4 JSCL). The law stipulates a blocking period of at least two years.

Special Fund for Employee Participation – Introduced by the 2009 Law on Capital Participation of Employees primarily for SMEs these funds are governed by the Investment Law. They pool voluntary employee savings including savings bonuses as well as capital participation shares offered by participating companies to their employees and re-invest them in these companies and in the capital markets.

Table 6. Composition of the Special Fund for Employee Participation

(Limitations for certain types of assets/issuers in per cent of total value of the Special Fund)

minimum 60 per cent qualified assets of enterprises that grant their employees contributions in order to acquire shares in the Special Fund maximum 20 per cent of a single enterprise/group		maximum 40 per cent qualified assets of other enterprises / other investments
up to 100 per cent – listed securities – selected financial instruments – non-bonded loan-claims	maximum 25 per cent – non-bonded holdings – non-listed securities	maximum 5 per cent of each issuer / investment fund: – Listed securities – Blocked current account – Money market: cash equivalents – Investment shares – Derivatives

¹¹⁰ The previous requirement that the benefit was not to exceed 50 per cent of the share value was removed in 2009.

The funds may be set up at branch level in co-operation with employers association and/or trade unions and have to invest 60 per cent of their assets in the employer companies. While a company may apply for re-investment, it has no claim to actually receive financing from the fund. The model has yet to be accepted by the market and it is uncertain whether there will be a sufficiently large number of interested companies and fund management firms.

b) Profit-Sharing

Profit-sharing, while not legally regulated or linked to tax incentives, is believed to be more widespread than employee share ownership. The statistical evidence on this issue might reflect the fact that indirect financial participation (for example, employee loans, participation certificates and debenture bonds) sometimes is considered as profit-sharing. The only genuine form of profit-sharing practiced more commonly is cash-based profit-sharing within a bonus plan, which partly connects the share amount to the annual profit of the enterprise and partly to the individual performance of the employee.

c) Participation in Decision-Making

Co-determination and participation rights of employees through their representatives are traditionally well developed under German labour law. Employees (and to a certain extent trade unions) are represented in the supervisory board as well as in companies with more than 1,000 workers in the management board, and the workers' council protects the rights of employees at the level of the individual undertaking. There is no direct connection between participation in decision-making and financial participation of employees in the sense that financial participation plans would automatically extend existing rights pertaining to decision-making.

An employee shareholder enjoys mandatory rights (right to control, right of participation, right to demand information). Examples of these rights are the right of a shareholder in a limited liability company (GmbH) to inspect and demand information pursuant to § 51a of the Law on Limited Liability Companies, and the right of the stockholder in a joint-stock company (AG) to demand information at the general meeting pursuant to § 131 of the Law on Joint-Stock Companies.