

ESOPs in start-ups: Deferred taxation now available for German employees of non-German start-ups

Authors: Elena Lessing, Sebastian Schwarz

New legislation extends application of Section 19a German Income Tax Act to corporate groups

The German Parliament (*Bundestag*) has passed the Annual Tax Act 2024 (*Jahressteuergesetz 2024*) which significantly improves the taxation of employee stock ownership plans (ESOPs) in start-ups and the German Federal Council (*Bundesrat*) has now approved the bill on 22nd November.

The new affiliated entities clause in Section 19a German Income Tax Act (GITA, *Einkommensteuergesetz*) now enables employees of subsidiaries and other affiliated entities within the meaning of Section 18 of the German Stock Corporation Act (*Aktiengesetz*) to benefit from the tax deferral under Section 19a GITA when they are granted participations in start-ups. Until now, only participations in the employer entity itself are covered (at least according to the tax authorities' interpretation).

In taking this step, the legislator is addressing an urgent practical need and eliminating the unfounded disadvantage faced by employees of affiliated entities of startups. In particular, it created a disadvantage for employees of non-German startups who are employed by German subsidiaries, but also for employees of startups that (have to) use a multi-tiered corporate structure for other reasons. The affiliated entities clause was already included in last year's draft bill of the Future Financing Act (*Zukunftsfinanzierungsgesetz*), but was removed shortly before final deliberations in the German Parliament at the recommendation of the finance committee.

Section 19a GITA enables start-ups to offer their employees equity participations either free of charge or at a discount, and the taxable salary in the amount of the discount is not taxed until the participations are sold at a later date (exit). The tax deferral can only be claimed if the company is younger than 20 years and certain thresholds are not exceeded in the year the participation is granted or in the previous six years (annual turnover up to 100 million euros, balance sheet total up to 86 million euros and number of employees up to 1,000). For more details on Section 19a GITA, read our briefing: [**New opportunities, familiar challenges: How the Future Financing Act is changing ESOPs.**](#)

The new clause extends the scope of application to affiliated entities within the meaning of Section 18 German Stock Corporation Act (subsidiaries, parent companies and sister companies). Accordingly, the tax deferral can also be claimed for participations in affiliated entities, provided that the group as a whole meets the thresholds set out in Section 19a (3) GITA and none of the affiliated entities is older than 20 years.

Extended application for international start-up structures

The extended scope is of particular importance for non-German start-ups with subsidiaries in Germany. Participations in a multi-tiered company are typically granted at the level of the parent company because only this enables a participation in the overall success of the company. Therefore, employees of German subsidiaries of non-German start-ups have not been able to claim the advantages of Section 19a GITA so far. Direct employment by the foreign company would enable the employees to take advantage of the benefits of Section 19a GITA, but would have unwanted tax consequences for the startup (establishment of a permanent establishment) and may trigger labor law, social security law and other legal obligations for the startup that are better fulfilled through a local subsidiary (it is for these purposes that the establishment of local subsidiaries is advisable).



However, there are also other (solely national) multi-tiered corporate structures that are chosen for organizational, regulatory or liability reasons. Such structures are not uncommon in the start-up sector and can be economically advantageous or (in certain, specially regulated areas) even legally mandatory. The new regulation now makes it possible to offer tax-privileged employee participation schemes in accordance with Section 19a GITA in such multi-tiered structures, thereby strengthening employee loyalty and motivation.

Impact on open questions regarding the calculation of the threshold values

The addition of the affiliated entities clause in Section 19a (1) Sentence 2 GITA (new version) could, in addition to extending the scope of application to employees of affiliated entities, also have consequences for the calculation of the threshold values pursuant to Section 19a (3) GITA.

Until now, it was unclear and disputed whether affiliated entities should be included when calculating the threshold values. This is particularly relevant for start-ups that are part of larger corporate structures (so-called corporate venturing). The fact that the term 'employer company' has now been extended to include affiliated entities in Section 19a (1) Sentence 2 GITA (new version) suggests that the term 'employer company' used in Section 19a (3) GITA should be understood in the same way, and that a group consideration should therefore also be applied in this respect. This would definitively exclude corporate ventures from the scope of Section 19a of the GITA.

It is unclear whether and to what extent this would also apply to financial investors who acquire a majority stake in the start-up. In this respect, it is also unclear how a retrospective assessment of the past six years is to be carried out if the financial investor has only acquired the majority stake within this period.