AUSTRIA

Philip Rosenauer
Counsel
PHH Rechtsanwälte
Julius-Raab-Platz 4, 1010 Wien+43 1 714 24 40 - 0
rosenauer@phh.at

Matthias Fucik
Rechtsanwalt
PHH Rechtsanwälte
Julius-Raab-Platz 4, 1010 Wien+43 1 714 24 40 - 0
fucik@phh.at

Q&A

Please provide a brief overview on how an ESOP in a start-up is usually structured in your jurisdiction (of particular interest: virtual or real participation programs, market practice with regard to vesting, participation (exits, proceeds and dividends) and voting rights).

PHH Rechtsanwälte (Austria):

In the majority of cases and based on the assumption that the ESOP is issued by an Austrian company with limited liability (which is the typical case of a start-up), option programs for key employees are structured as virtual (phantom) stock option programs (PSOP) and not in the form of an employee stock option program granting an option on direct shareholdings, whereas between 5% to 10% of the nominal share capital will be issued to/reserved for those beneficiaries. A PSOP is usually preferred, as, in particular, the cap table of the company remains unaffected by any triggering event and thus future shareholders (e.g., investors under a "Series A Round") will not be confronted with a group of minority shareholders (potentially) attributable to the founders. In addition, it is not required to establish a PSOP in the form of an Austrian notarial deed (which would be the case for an option on direct shareholdings).

The definite agreement governing a PSOP (and also an ESOP) is typically structured as follows:

A beneficiary under a PSOP is usually entitled, after lapse of a vesting period, based on a

linear monthly or quarterly vesting, of three to five years (in some cases also combined with a vesting cliff), to pro rata participate in proceeds deriving from the following trigger events: (i) share transfer (more than 50%), (ii) sale of core assets, (iii) listing/IPO, and/or (iv) dividend payments (e.g., each of the aforementioned only in case of an excess of a defined threshold). Voting rights and other shareholder rights (e.g., general information and inspection rights) are usually not attached to a PSOP-share. However, a beneficiary will be granted certain contractual information rights under a PSOP in order to be able to verify his/her claim in case of a trigger event. Therefore, the company will be obliged to inform beneficiaries about the occurrence and the economic terms of a trigger event and a share capital increase as the PSOP-beneficiaries are typically diluted.

Please provide an overview of the respective tax situation an employee finds him-/herself in when he/she participates in a real/virtual equity investment program (applicable taxes and approximate tax burden (a) at the time of the investment and (b) at the time when revenues therefrom are received).

PHH Rechtsanwälte (Austria):

Austrian tax law requires to assess if ESOPs are structured as direct shareholdings (*direkte Beteiligungen*), options on direct shareholdings (*Optionen auf direkte Beteiligungen*) or virtual shareholdings (*virtuelle Beteiligungen*), as each structure has different tax consequences.

I. Direct shareholdings

At the time of the investment in an ESOP, structured as a direct shareholding, the beneficiary receives a monetary benefit (*geldwerten Vorteil*) in form of a payment in kind (*Sachbezug*), if the ESOP shares are not granted at arm's lengths (on the basis of the fair market value of the ESOP shares), but at a lower price or even without consideration. In such cases the monetary benefit is qualified as taxable income from non-independent work (*Einkommen aus nicht selbstständiger Arbeit*) and therefore is subject to income taxation at the time of the investment in the ESOP. The difference between the (incentivized) costs of the investment in the ESOP (i.e., the costs at which the beneficiary acquired the ESOP shares) and the fair market value of the acquired ESOP shares is the tax assessment base (*Steuerbemessungsgrundlage*), which depending on the annual individual income of the beneficiary, is subject to the progressive income tax rate (*progressive Einkommensteuertarif*) of up to 55%.

This means that at the time of the investment, (possibly high) tax amounts become due. In most cases neither the start-up nor the beneficiary will have the necessary liquidity to pay the due tax amounts upon the time of the investment, which is why ESOPs structured as direct shareholding are not really attractive from a tax perspective.

Beneficiaries of ESOPs, structured as direct shareholdings, can receive revenues either in form of regular dividend distributions (*Dividendenausschüttungen*) or upon the sale of their direct shareholdings (*Veräußerung ihrer direkten Beteiligung*). The receipt

of dividends and of the proceeds from a sale of direct shareholdings are both qualified as income from capital assets (*Einkünfte aus Kapitalvermögen*) and are both subject to income taxation at a tax rate of 27.5%, which is levied either in form of a withholding tax (*Kapitalertragsteuer*) or by way of assessment (*im Wege der Veranlagung*). If dividends are received by the beneficiary, the total received dividend amount is regarded as the tax assessment base, while in the case of the sale of a direct shareholdings only the income from the realized increase in value of such direct shareholding (i.e., proceeds of sale less the acquisition costs of the (sold) direct shareholding) is subject to income taxation.

In cases in which direct shareholdings are granted under an ESOP, beneficiaries might benefit from a tax exemption on income of up to EUR 3,000 per year received upon the free or reduced-price transfer of direct shareholdings in the employer's company. To qualify for such tax exemption, the employer must grant the direct shareholdings to all employees or certain groups of employees and the direct shareholdings must be held by the beneficiaries for a period of at least five years calculated as of the end of the calendar year in which the beneficiary has invested into the ESOP.

II. Options on direct shareholdings

For tax purposes, it is necessary to distinguish between unrestricted stock options (USOP) and restricted stock options (RSOP). USOPs can be exercised and transferred at any time, as the beneficiary is not subject to any restrictions. At the time of their granting, USOPs are qualified as a monetary benefit received by the beneficiary and therefore are subject to income taxation at the progressive income tax rate of up to 55%. The tax assessment base is the fair market value of the underlying shares at the granting date. In practice, USOPs are not very attractive as ESOP instruments, as the beneficiary is subject to taxation on the granting date (similar to ESOPs in form of direct shareholdings).

RSOP are characterized by their limited legal and economical transferability and by personal limitations (e.g., the binding to an effective employment relationship). Under Austrian tax law, the granting of RSOP is not qualified as a monetary benefit at the granting date and therefore does not constitute a taxable event at the time of the investment. Only at the time when RSOPs are exercised, the monetary benefit of RSOPs is deemed to be granted to the beneficiary and therefore is subject to income taxation at the exercise date. The tax assessment base equals the difference between the exercise price of the option and the fair market value of the option at the exercise date and is subject to income taxation at the progressive income tax rate of up to 55%.

Stock options that are subject to a vesting period (i.e., they cannot be exercised in full by the beneficiary for a certain period of time, while after lapse of the entire vesting period they can be exercised by the beneficiary) are qualified as a taxable the monetary benefit at the vesting date. The tax assessment base is the fair market value of the underlying shares at the vesting date.

III. Virtual shareholdings / PSOP

If virtual shareholdings are structured similar to RSOPs (i.e., the beneficiaries cannot freely execute or transfer their entire virtual shareholdings), they are not subject to income taxation at the time of their granting.

Payments made to beneficiaries of virtual shareholding programs (which are not subject to taxation at the time of their granting), are subject to income taxation at the time of the payment at the progressive income tax rate of up to 55%. The income tax is either levied in form of wage tax (*Lohnsteuer*), which is withheld by the employer, or by way of assessment (e.g., in cases in which freelancers are incentivized with a virtual shareholding program).

Are there any tax advantages for an employee if the revenues based on the equity investment are reinvested in start-ups or other companies?

PHH Rechtsanwälte (Austria):

No tax advantages for employees under Austrian tax law on the reinvestment of revenues received under ESOPs.

Are there any tax advantages for the company if an ESOP is established in the company?

PHH Rechtsanwälte (Austria):

In general, there is no particular tax advantage/incentive for a company if an ESOP is established.

However, in a recent decision, the Austrian Supreme Administrative Court (*Verwaltungsgerichtshof*) held (i) that the granting of stock options, which entitle a beneficiary to participate in a share capital increase and thus to receive new shares following his/her exercise of the granted option rights, does not lead to taxable operating expenses, but (ii) that the granting of stock options in an Austrian stock company (this is not the common corporate form of a start-up prior to its scale-up/growth/expansion phase), which upon their exercise shall be granted by means of purchased treasury shares (*Rückkauf eigener Aktien*), causes tax deductible operating expenses in that point in time, when the option is exercised. Subsequently, it is necessary to assess on a case-by-case basis if and to what extend companies can profit from potential tax deductibility of expenses made in connection to the granting of ESOPs.

Please highlight one pro and one con of the legal set up with regard to ESOPs in your jurisdiction.

PHH Rechtsanwälte (Austria):

From a tax perspective direct shareholdings and unrestricted stock options are only suitable

as ESOP-instruments for start-ups in times, when the enterprise value of the startup is low. In case the enterprise value of the startup is already high, the granting of such ESOP-instruments are not favorable for beneficiaries, as (possibly high) tax amounts would become due at the time of the granting of such ESOP-instrument and a beneficiary will most likely not have the necessary liquidity to pay the accrued taxes at that point in time. If a beneficiary under a virtual stock option program receives a return as a consequence of the occurrence of a trigger event, such return will be taxed and thus the beneficiary will not face a liquidity problem (which makes a PSOP favorable).