



Overview of ESOP regimes in Central Europe

Comparative analysis in 15 jurisdictions

August 2024



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ESOPs: Let your employees share in your success!

Are you looking for new ways to increase employee motivation?

Are you considering implementing an employee stock plan, but wondering whether it is the right fit for you?

In recent years, it has become increasingly common for employers to link employee remuneration to business goals through Employee Stock Ownership Plans (ESOPs). So what are the benefits of ESOPs and why are a growing number of companies finding them attractive?

WHAT IS AN ESOP?

There are two main categories of incentive plans deployed by employers:

- Incentive plans that give employees **actual shares** in the company or another company in the same group (e.g. ESOPs or Restricted Stock Units).
- Cash bonuses linked to **virtual shares** if certain conditions are met (Phantom Plans or Stock Appreciation Rights).

The term ESOP covers various types of employee stock ownership plans, which already enjoy some popularity in Central European markets. They have proven to be an effective incentive mechanism both **for start-ups** (which are often unable to offer employees competitive salaries) and **for established companies** (to reward employees for their loyalty and contribution to the company).

However, each category of ESOP has a distinct legal structure, with varying repercussions on how employee income is taxed and differing levels of suitability for employers.

WHY CHOOSE AN ESOP?

- ✓ Retain key employees, whose shares will be profitably capitalised in the event of success (e.g. in the event of capital shortages in the product development phase).
- ✓ Motivate employees to personally contribute to the growth of the company.
- ✓ Incentivise employee retention in a highly competitive environment.
- ✓ Boost employee interest in how the company is run.

ESOP Implementation

KEY CONSIDERATIONS

If you are thinking about implementing an ESOP, you're probably asking yourself some of the following questions:

How favourable is the legislation in each CE country?

Which employees should we offer this benefit to? Do we want employees to have decision-making rights?

What kind of ownership interest should we offer employees? Should we give it to them for free?

How do we draw up the documentation and integrate this benefit into our internal policies?

What will be the tax implications for employees and the company?

HOW CAN WE HELP YOU?

We will talk you through the opportunities provided by ESOPs: our dedicated workshops will introduce you to the ESOP system, its pros and cons, and discuss your own ideas and your company's specifics.

If you choose to go ahead with the ESOP, we will guide you through the entire implementation process: together, we will find the right answers and the solution that best suits your needs.



INTEGRATED SUPPORT

Our full-service approach lets you set up an effective ESOP backed by extensive tax and legal perspectives. With our **client-tailored solutions**, our experts will design an entire ESOP just for you so that you can **get started the right away**.

In this publication, we look at ESOP regimes across 15 Central European jurisdictions, including Albania, Austria, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Hungary, Kosovo, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia, and Ukraine.

We hope you will find this overview interesting and helpful to your work.

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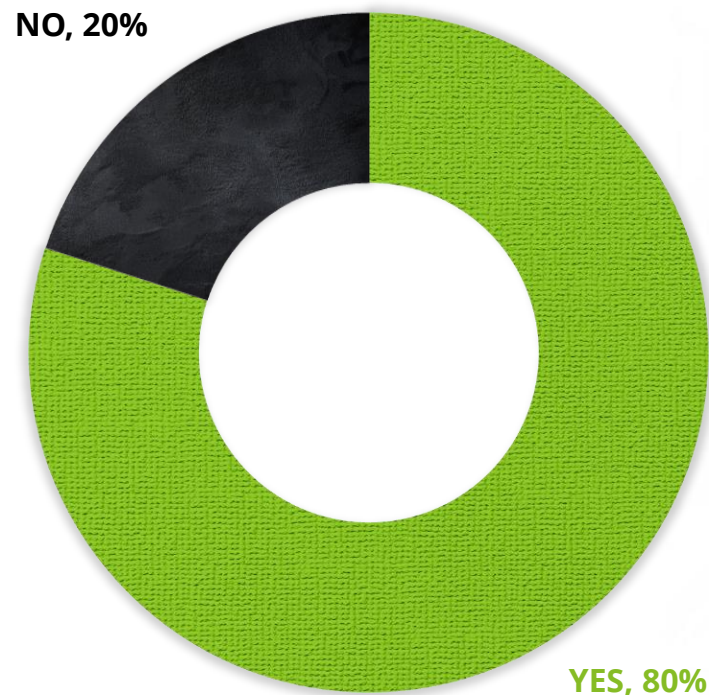
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Central Europe market experience

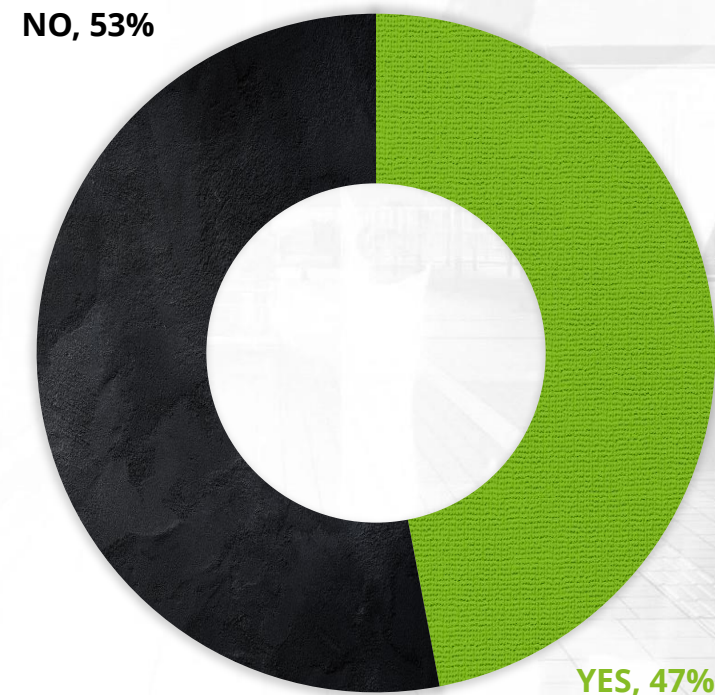
Our analysis shows that, in most CE countries, the viability of employee stock ownership plans depends on the legal and tax treatment of this benefit.

While some countries such as Austria are already streets ahead in this department, most others are still working to create a favourable tax regime or, in many cases, a bespoke corporate law regime.

Our analysis also makes clear that this incentive – which gives employees a direct stake in their employer's success and which has been more widely adopted in other global regions – is considered a key legislative priority in several countries. For more details, read our country-by-country report below!



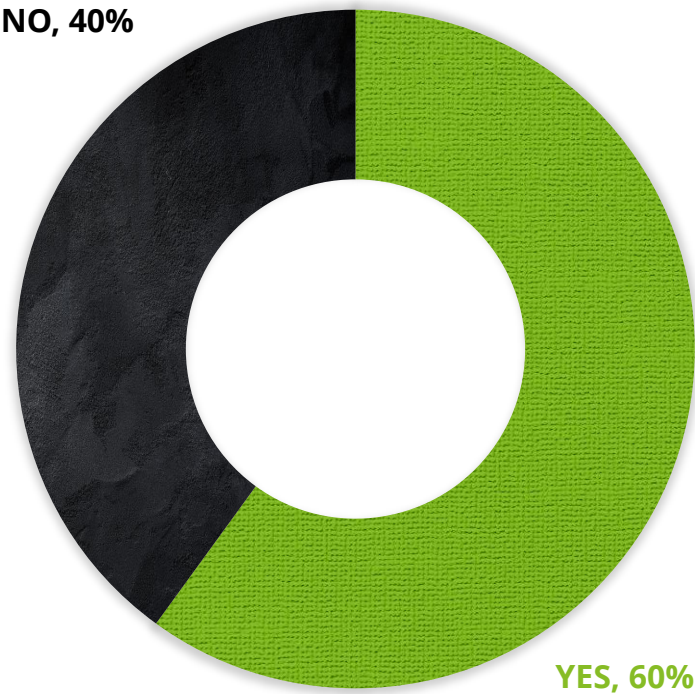
Is there any legal framework regulating ESOP?



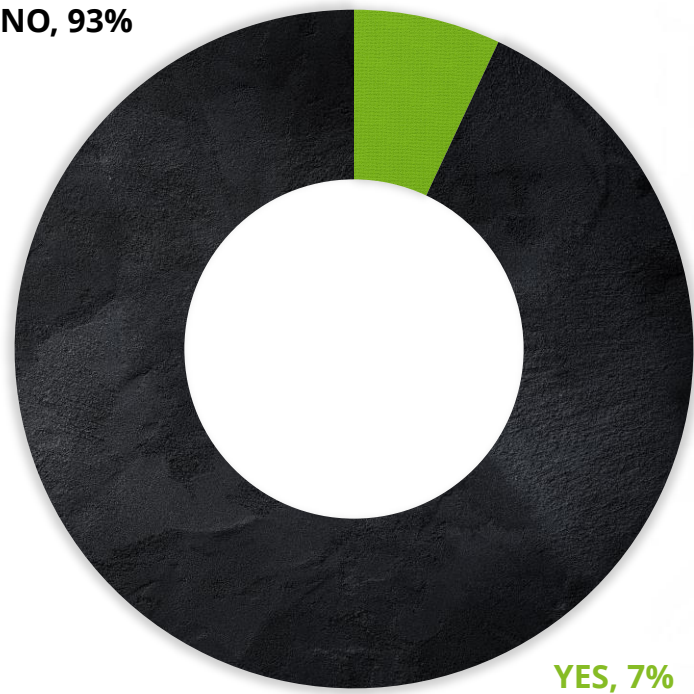
Do ESOP shares have a specific corporate law regime (e.g., specific rights associated with these shares)?



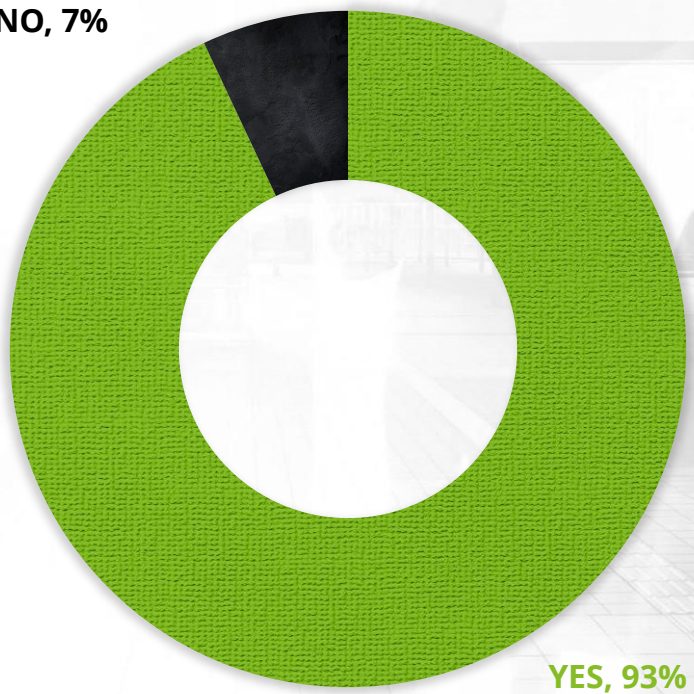
Central Europe market experience



Do ESOP shares have a favourable tax regime?



Is there any specific regime applicable for phantom share plans?



Does the implementation of ESOP of a foreign HQ trigger any legal and tax consequences?



Comparative analysis of ESOP regimes

Albania



Is there any legal framework regulating ESOPs?



Do ESOP shares have a specific corporate law regime (e.g., specific rights associated with these shares)?



Do ESOP shares have a favourable tax regime?



Is there any specific regime applicable for phantom share plans?



Does the implementation of ESOPs of a foreign HQ trigger any legal and tax consequences?



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MARKET EXPERIENCE

The Albanian legal system does not currently provide for specific legal framework for ESOPs. Based on the applicable legislation, namely the Labor Code, employee's salary is calculated based on time, according to the work performed or in function of the company's results (with profit participation or revenue turnover), however this calculation method is far from considered as ESOP.

Nonetheless, a similar scheme has been applied in the early 90-ties during the privatization process of the state-owned enterprises, where one method of payment implemented is the participation as shareholders in the company of the employees.

Austria



Is there any legal framework regulating ESOPs?



Do ESOP shares have a specific corporate law regime (e.g., specific rights associated with these shares)?



Do ESOP shares have a favourable tax regime?



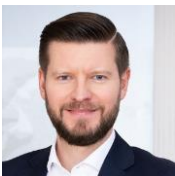
Is there any specific regime applicable for phantom share plans?



Does the implementation of ESOPs of a foreign HQ trigger any legal and tax consequences?



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MARKET EXPERIENCE

By introducing a new additional form of limited liability company in Austria in 2024 (the Flexible Company – FlexCo), Austria now has a legal framework in place for ESOPs. An Austrian FlexCo may issue “company value shares” (Unternehmenswertanteile) for up to 25% of the share capital of the company. These company value shares entitle the holder to participate financially in the profits and liquidation surplus of the company.

However, holders of company value shares have no voting rights at the company's shareholders' meeting. Additionally, holders benefit from a statutory tag-along right in case the majority of shares in the company are sold.

Company value shares are open to everyone and are not only issuable to employees. If company value shares are issued to employees, further legal provisions must be observed (e.g. regarding the sale of shares if the employee leaves the company).

Bosnia and Herzegovina



Is there any legal framework regulating ESOPs?



Do ESOP shares have a specific corporate law regime (e.g., specific rights associated with these shares)?



Do ESOP shares have a favourable tax regime?



Is there any specific regime applicable for phantom share plans?



Does the implementation of ESOPs of a foreign HQ trigger any legal and tax consequences?

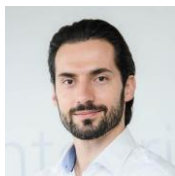


MARKET EXPERIENCE

The BiH legal system does not provide a clear and simple legal framework for ESOPs. ESOPs are treated as employee benefits/income from employment, which has tax implications insofar as it can trigger two tax events (when the shares are granted free of charge and when income is realised after the sale of shares).

Shares granted free of charge are considered a benefit-in-kind from employment and are subject to the same treatment as salary (subject to PIT and SSC), thus triggering an obligation for the employer to calculate, withhold and pay PIT and SSC. Income realised from sale of shares is added to each employee's personal income tax liability.

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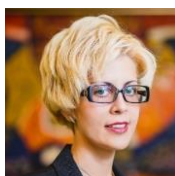
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Bulgaria



Is there any legal framework regulating ESOPs?	✓
Do ESOP shares have a specific corporate law regime (e.g., specific rights associated with these shares)?	✓
Do ESOP shares have a favourable tax regime?	✗
Is there any specific regime applicable for phantom share plans?	✗
Does the implementation of ESOPs of a foreign HQ trigger any legal and tax consequences?	✓

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MARKET EXPERIENCE

On 1 August 2023, new amendments to the Bulgarian Commercial Act were passed into law, introducing a new type of commercial entity known as the variable capital company ("VCC"). The VCC gives an opportunity for flexible solutions and aims to support the long-term growth of start-ups.

The amendments enable VCCs to offer share options to employees and other third parties, as well as to attract capital in the form of convertible loans. In addition, there is an option to transfer VCC shares to third parties by simple written agreement (notarial certification of signatures is not required).

However, the Bulgarian legal framework does not provide a clear mechanism for implementing ESOPs and these are only partly regulated in view of the new variable capital company: there is no prohibition on implementing ESOPs in other forms of legal entities. Currently the most preferable type of legal form for implementing ESOPs in Bulgaria is the joint stock company.

Croatia



Is there any legal framework regulating ESOPs?	✓
Do ESOP shares have a specific corporate law regime (e.g., specific rights associated with these shares)?	✗
Do ESOP shares have a favourable tax regime?	✓
Is there any specific regime applicable for phantom share plans?	✗
Does the implementation of ESOPs of a foreign HQ trigger any legal and tax consequences?	✓

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MARKET EXPERIENCE

The Croatian legal system does not provide an explicit legal framework for ESOPs. Nevertheless, the provisions of the Croatian Companies Act regulating share transfers do also apply to ESOPs.

In this regard, the most common practice in limited liability companies is for the majority shareholder to designate the employees it wishes to reward and to transfer shares to them right away, for which certain legal protections are in place.

On 1 January 2024, amendments to the Income Tax Act came into effect: these extended the reduction of the ESOP tax burden – previously applicable to joint stock companies – to limited liability companies.

Share awards are taxed at a flat rate of 24%; no social security contributions apply.

The tax point arises at the moment the share option is exercised or on the vesting date of the share award.

The difference between the FMV and the option price (if lower) is considered taxable income: this amount is considered net and is made subject to gross-up for tax purposes (the effective rate being 31.58%).

Czech Republic

Is there any legal framework regulating ESOPs?	✓
Do ESOP shares have a specific corporate law regime (e.g., specific rights associated with these shares)?	✗
Do ESOP shares have a favourable tax regime?	✓
Is there any specific regime applicable for phantom share plans?	✗
Does the implementation of ESOPs of a foreign HQ trigger any legal and tax consequences?	✓

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MARKET EXPERIENCE

The Czech legal system does not provide a clear and simple legal framework for ESOPs.

At the beginning of 2024, an amendment to tax regulations came into effect with the intention of creation a more tax-friendly regime for ESOPs. The changes include recognising ESOPs as non-monetary employee income, which will no longer have to be taxed immediately upon granting the ESOP, but rather it will be possible to defer the tax date until the future (e.g. until the shares are transferred).

Other favourable amendments concerning ESOPs are currently being debated in relation to social security and health insurance contributions.

Hungary



Is there any legal framework regulating ESOPs?	✓
Do ESOP shares have a specific corporate law regime (e.g., specific rights associated with these shares)?	✓
Do ESOP shares have a favourable tax regime?	✓
Is there any specific regime applicable for phantom share plans?	✗
Does the implementation of ESOPs of a foreign HQ trigger any legal and tax consequences?	✓

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MARKET EXPERIENCE

Hungarian regulations provide different ways in which employers or other members of the employer's group can provide security (e.g. share) incentives to employees, which are subject to legal frameworks, formal and administrative requirements and tax and social security (including social tax) implications.

We are also seeing a trend of foreign parent companies with subsidiaries in Hungary providing their shares to the employees of their local subsidiaries.

Whilst this is also a great way of engaging the local workforce, it requires careful planning both from tax and legal perspective.

Kosovo



Is there any legal framework regulating ESOPs?



Do ESOP shares have a specific corporate law regime (e.g., specific rights associated with these shares)?



Do ESOP shares have a favourable tax regime?



Is there any specific regime applicable for phantom share plans?



Does the implementation of ESOPs of a foreign HQ trigger any legal and tax consequences?



MARKET EXPERIENCE

The legal system of Kosovo allows shareholders to implement ESOPs in joint stock companies.

However, this is not common in practice. The tax regulations do not explicitly legislate for income from ESOPs, although the current laws do exempt dividends from taxation.

In this sense, insofar as income from ESOPs is considered income from shares, it will not be subject to any tax.

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Is there any legal framework regulating ESOPs?



Do ESOP shares have a specific corporate law regime (e.g., specific rights associated with these shares)?



Do ESOP shares have a favourable tax regime?



Is there any specific regime applicable for phantom share plans?



Does the implementation of ESOPs of a foreign HQ trigger any legal and tax consequences?



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MARKET EXPERIENCE

Joint stock companies: the primary legal framework governing ESOPs in Latvia is stipulated in the Commercial Law, which saw its initial amendments regarding ESOPs come into effect on 13 July 2017. This law introduced two new categories of stock: personnel options and personnel shares.

Limited liability companies have the option of issuing ESOPs on terms of their preference. The Commercial Law does not provide specific regulations regarding ESOPs. However, the general legal framework is favourable to them.

Latvian tax regulations provide a favourable tax regime for ESOPs as long as the minimum vesting period is at least 12 months from the granting date and certain other criteria defined in the law are met. The favourable tax regime provides that both the

granting and vesting of ESOP shares are exempt from payroll taxation. In all other cases, ESOP shares are taxable at vesting and payroll tax is applied on the difference (if any) between the fair market value of ESOP shares and their acquisition value.

Moreover, employees in Latvia are also subject to payroll tax on ESOP shares issued by foreign entities. Typically, tax is withheld and remitted to the State exchequer by the employer in Latvia, but this approach could differ on a case-by-case basis and should be assessed individually. Any further proceeds arising from the sale of ESOP shares are subject to capital gains tax at a flat rate of 20%; it is the employee's responsibility to remit this tax to the State exchequer.

Lithuania



Is there any legal framework regulating ESOPs?	✓
Do ESOP shares have a specific corporate law regime (e.g., specific rights associated with these shares)?	✓
Do ESOP shares have a favourable tax regime?	✓
Is there any specific regime applicable for phantom share plans?	✗
Does the implementation of ESOPs of a foreign HQ trigger any legal and tax consequences?	✓

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MARKET EXPERIENCE

Lithuania’s current legal framework for ESOPs was updated in the year 2022.

A favourable tax regime now applies to ESOPs established after 1 February 2023, albeit only if the shares are acquired at least 3 years after entering into the option agreement.

Poland



Is there any legal framework regulating ESOPs?



Do ESOP shares have a specific corporate law regime (e.g., specific rights associated with these shares)?



Do ESOP shares have a favourable tax regime?



Is there any specific regime applicable for phantom share plans?



Does the implementation of ESOPs of a foreign HQ trigger any legal and tax consequences?



MARKET EXPERIENCE

As a rule, income derived under ESOPs is classed as income from employment or other sources.

However, if the plan meets the specific conditions stipulated in Polish tax provisions, taxation of that income can be deferred until the shares are sold and taxed under a more favourable tax regime with no social security contributions payable.

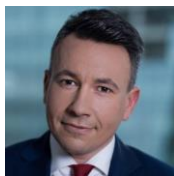
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Is there any legal framework regulating ESOPs?



Do ESOP shares have a specific corporate law regime (e.g., specific rights associated with these shares)?



Do ESOP shares have a favourable tax regime?



Is there any specific regime applicable for phantom share plans?



Does the implementation of ESOPs of a foreign HQ trigger any legal and tax consequences?



MARKET EXPERIENCE

Romania applies a preferential tax treatment for equity plans that meet certain conditions stipulated in Romanian tax legislation (i.e., the plan must qualify as a Stock Option Plan under Romanian tax legislation, regardless of the name of the plan).

Where these statutory conditions are met, no income tax or social charges are due upon the granting, vesting or exercise of shares under the salary tax regime.

Rather, taxation is deferred until the shares are sold (i.e., taxation under the capital gains regime). We recommend reviewing each plan to determine whether it qualifies as a Stock Option Plan under Romanian tax legislation.

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Is there any legal framework regulating ESOPs?



Do ESOP shares have a specific corporate law regime (e.g., specific rights associated with these shares)?



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Does the implementation of ESOPs of a foreign HQ trigger any legal and tax consequences?



MARKET EXPERIENCE

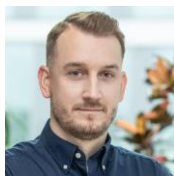
Slovak regulation of employee equity plans is very general and dated, and does not reflect current market standards and international ESOPs.

Despite very minor amendments to the Income Tax Act last year – which only apply to equity plans for start-ups (i.e. companies which have not yet distributed dividends) – a broader slate of amendments ushering in a more favourable tax regime in place would be welcomed and appreciated by the market.

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Slovenia

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Do ESOP shares have a specific corporate law regime (e.g., specific rights associated with these shares)?	✗
Do ESOP shares have a favourable tax regime?	✓
Is there any specific regime applicable for phantom share plans?	✗
Does the implementation of ESOPs of a foreign HQ trigger any legal and tax consequences?	✓

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MARKET EXPERIENCE

The Slovene legal system does not currently provide any specific legal framework for ESOPs.

Stock options are permitted but are not widespread due to the high tax burdens. The employee’s right to purchase or acquire (parent) company shares is presently deemed as a benefit in kind valued at 65% of the comparable market value of the shares. This applies if the employee has been with the company for over a year until the day of the exercise/transfer of the right and the benefit is not provided as a business performance bonus with more favorable tax treatment.

However, the Slovene government recently

prepared a proposal to amend the Personal Income Tax Act with a more favorable tax treatment for employment income (benefits) received as shares or interests in the company if the employer is an innovative start-up under a special law (currently 134 companies).

The proposed amendment provides for the deferral of the fiscal burden from such income (taxation would generally occur (i) upon the sale of shares, (ii) termination of the employment relationship or termination or restructuring of the employer, or (iii) after 10 years from the acquisition of the shares).

This initial proposal may be amended during the legislative process.

Ukraine



Is there any legal framework regulating ESOPs?



Do ESOP shares have a specific corporate law regime (e.g., specific rights associated with these shares)?



Do ESOP shares have a favourable tax regime?



Is there any specific regime applicable for phantom share plans?



Does the implementation of ESOPs of a foreign HQ trigger any legal and tax consequences?



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MARKET EXPERIENCE

The Ukrainian legal system does not provide a specific legal framework for ESOPs.

Tax legislation does not contain clear and specific provisions on the taxation of ESOPs. Therefore, ESOPs are subject to the general provisions of the Tax Code of Ukraine on “foreign income”.

It is common practice in Ukraine for ESOPs to be administered abroad, and Ukrainian employers are not usually involved in providing shares to Ukrainian employees under those schemes. If the shares are administered abroad, the employees themselves are personally responsible for reporting their income from the scheme in their annual PIT returns and paying tax on the income in Ukraine.

The existing gap in Ukrainian legislation often means that income received by individuals under ESOPs is subject to double taxation, as two separate tax events arise.

The first event is when an individual resident in Ukraine receives a foreign company's shares either free of charge or at a discount (compared to the FMV). The value of those shares is regarded as foreign income of that individual and is subject to taxation in Ukraine. The subsequent sale of the shares usually triggers a second tax event: the receipt of foreign investment income under the rules on taxation of “transactions with investment assets”.

Tax authorities may consider these two events to be “unrelated”. As a result, they may not allow the taxpayer to deduct the costs incurred (e.g. PIT paid by the individual at the first taxable event) when it comes to taxing the capital gain.

It is worth noting that phantom share plans should not result in double taxation, as individuals do not acquire legal rights to the shares.



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