




**Right to Acquire Share Financial instrument  
Incentives for startups and other businesses**

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***RIGHT TO ACQUIRE SHARE FINANCIAL INSTRUMENT  
INCENTIVES FOR STARTUPS AND OTHER BUSINESSES***

**The very idea of introducing a new financial instrument issued by a limited liability company (“LLC” or “Company”) is to improve the economic environment as well as financial growth by providing a way for companies to incentivize employees, especially the ones in IT industry, thus enabling companies to operate in accordance with high standards adopted worldwide.**

**Considering that the companies within the IT industry and start-ups, in general, have the capacity to multiply their own value in the short term (developing a ‘viable product’) such undertakings usually lack the initial funds to pay adequate compensation and salaries so the additional incentives for employees are enabled creating the opportunity for them to become the shareholders of the company, and to participate in dividend distribution or to capitalize by selling the acquired shares with a premium.**

## RESERVED OWN SHARE | RIGHT TO ACQUIRE THE SHARE

Law on Companies ('Law'), as the organic law regulating rights and obligations regarding this matter, defines reserved own share as a share the company acquires from its member without consideration (free of charge), for the very purpose of granting a financial instrument – right to acquire a share ('financial instrument or 'RaS').

The Law envisages that a reserved own share is acquired upon General Meeting's decision unless otherwise provided by the company's Incorporation Act, whereas the deciding authority can also be transferred to the company's director or a supervisory board in case of the two-tier management system.

The decision by General Meeting must be adopted with 2/3 majority of the total voting shares of all company members, whereas the company may acquire reserved own share only from the fully paid (or with fully entered non-pecuniary contribution) shares. The reserved own share can only be acquired from the shares of members who have voted in favor of such a decision whilst the share percentage of total reserved own shares cannot exceed the 40% threshold of the company's total share capital.



## REGISTRATION OF THE RESERVED OWN SHARE WITH SBRA

After the above decision has been adopted by the company's General Meeting (or other deciding authority), the Serbian Business Registers Agency ("SBRA") conducts the registration of the reserved own share based on the mentioned decision and written consent of members whose shares are proportionally reduced thereof, while the company acquires the reserved own share only after the registration is made with SBRA.

When registration is being finalized, the members who gave their consent ('agreeable members') are left with reduced shares and the company's reserved own shares are formed for the purpose of awarding financial instruments.

## TAX PERSPECTIVE

Albeit this financial instrument is still considered to be a novelty, the Tax Authority already took an official position that, for a single shareholder company, the transfer without compensation for the purpose of forming a reserved own share with the aim to grant a financial instrument – RaS, is not subjected to capital gain tax when a single shareholder is a natural person (Law on Personal Income Tax).

Stretching the same legal logic to the capital gain tax definition under the Law on Corporate Profit Tax (for example, when a company is a shareholder), it follows there is no capital gain tax obligation in either situation, given the Law explicitly prescribes that a reserved own share with aim of issuing financial instrument - RaS can only be acquired 'free of charge' whereas both tax laws regulating capital gain taxes prescribes that a transfer eligible for capital gain tax is the one realized by the taxpayer through sale or other transfer for a fee, whereby a 'capital gain' represents the difference between the price for which the right/share was acquired and selling price thereof.

As reserved own share is formed 'free of charge' by the company's member(s), it cannot be deemed as transfer eligible to capital gain tax for either a natural person or a legal entity as a member of the respective company

## **LIMITATIONS ON RESERVED OWN SHARE AND FINANCIAL INSTRUMENT**

Once the reserved own share is registered, the company loses the voting rights thereon, and it cannot be used and counted in the quorum of the company's General Meeting. A reserved own share represents a non-transferable instrument issued by LLC allowing the agreeable holder (an employee, for example) the right to acquire a share on a particular day and for a pre-agreed price.

Rights arising from the financial instrument – RaS cannot be disposed of nor subjected to any pledge. If the holder passes away before the maturity day, prior to the acquisition of shares, the subject financial instrument cannot be inherited.

Also, pre-emption rights cannot be exercised by other company members for the share which is acquired on the grounds of financial instrument.

## **REGISTRATION OF FINANCIAL INSTRUMENTS WITH CRS**

The decision by which financial instrument is adopted by the General Meeting of the company, or other competent body therein, needs to be submitted to Central Securities Registry ("CSR") within five working days from the day of adoption, for the purpose of registration in favor of the holder of that instrument.

The decision (either when adopted by General Meeting or other corporate body authorized under Incorporation Act) must contain the required elements provided under the Article 159 of the Law such as the number of financial instruments, data on persons acquiring the instrument, percentage of shares to be acquired, price to be paid, maturity day of the instrument and other mandatory elements.

The procedure and documentation required for the registration of RaS with CRS are exercised in accordance with the CRS' Rules of Operation and the request for registration can be submitted by the issuer itself (authorized person in the company) or a CRS' member on behalf of the issuer which is an exception to the general rule, given that requests with CRS are usually submitted only through a respective official member therein. Also, issuing financial instruments, is not considered a public offer in terms of the law governing the capital market, and therefore is 'released' from the strict rules and control by the Securities Commission of Serbia ("SEC").



## SHARE PRICE AND OTHER CONDITIONS

The price is determined by the General Meeting of the company issuing the financial instrument whereby the Law does not prescribe criteria or methodology for price determination as it is expected to be a price lower than the “market price” given the idea of the instrument to enable certain persons (employees) to acquire shares under more favorable conditions.

The determined price can even be lower than the nominal value of the share corresponding to the contribution registered with SBRA. This manner of price determination is not detrimental to the company since it has acquired its own reserved shares without compensation (free of charge) so it can dispose of the shares at a lower price, with a goal of providing incentives for employees.

All financial instruments (RaS) from a single issue shall confer the equal rights provided in the respective decision and all financial instruments arising out of one reserved own share have an equal maturity date and the same deadline for payment of the price. RaS cannot be conditioned with any additional requirements, except for the payment of the agreed price given the other conditions would not be in accordance with the Law nor the very nature of this instrument.

## EARLY MATURITY FOR FINANCIAL INSTRUMENT

The Law prescribes situations when obligations are due prior to the usual maturity date in case of:

- i. liquidation
- ii. status changes, and
- iii. change of legal form whereby the deadline for payment of the price by RaS' holder to the company in such cases is 40 days as of the day when each situation arose.

The company is obliged to send a letter to RaS' holders in these cases followed by an invitation to pay the price and the company cannot finalize liquidation, status change, or change of legal form until it completes the registration of the holder shares acquired upon financial instrument or reduction of share capital due to cancellation of unused reserved own share.

## SHARE ACQUISITION | CANCELLATION | UNUSED SHARES

Each issued financial instrument may be realized by the acquisition of shares by the legitimate holder or canceled either in accordance with the terms of the emission decision or if the holder does not fulfill the obligations above. In both cases, financial instruments shall be cleared from CSR.

Anyhow, if financial Instrument - RaS has been canceled, the General Meeting of the company or other competent body, shall render a decision to cancel that financial instrument. The company must submit an application for the clearing of RaS with CSR no later than 30 days after the expiration of the deadline for payment of the price from the emission decision for all emissions based on the same reserved own share. Thereafter, CSR makes the clearance and issues the company a certificate of clearing of the financial instrument.

After the registration of a share acquired by exercising RaS, the remaining unused portion of the reserved own share may either be canceled or used for new issuance of the financial instrument. If the decision is made to cancel the remaining unused portion of the reserved own share, the company shall reduce its share capital in the corresponding amount or use the remaining reserved own share for new emissions.

## **COURT PROTECTION FOR RAS' HOLDER**

If the company does not carry out registration of the holder's share within 60 days, the holder, if made the payment thereof, may initiate proceedings before a competent court to establish the shareholder's status and the ownership percentage in share capital or to determine the compensation that the company must pay if fails to comply with the procedure.

In case of cancellation without legal ground prior to the maturity date of RaS, the legal holder shall be entitled to compensation in the amount of the share's market value on the maturity date of the financial instrument but reduced by the designated price that holder should have paid but did not (since due day did not occur).

In case of the death of the legal holder, the heirs can demand from the company compensation in the amount of the share's market value on the maturity date and if deletion of the company occurs (liquidation), the holder of the financial instrument shall become a creditor of the company claiming the amount of share's market value as of the day of the deletion of the company reduced by the price amount, if not paid by the holder.



## CONCLUSION

This relatively new financial instrument, serving as an employee's incentive mechanism as well as a start-up's financial stimulator when lacking initial capital, seems like a promising addition to Serbian legislation and potentially a handful instrument of growth acting as a great incentive for employees who can acquire shares in this manner with the possibility to reach high profits either by participating in dividends distribution or by selling their shares for the vastly higher price than the one for which they acquired it.

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