

White Paper

**German Labor and Employment Issues
in regard of the Set-up of a Company in Germany**

Author: Lorenz Mayr, MAYR Employment Lawyers
Berlin, 20.05.2011

German Labor and Employment Issues in regard of the Set-up of a Company in Germany

I. Applicable German Labor and Employment Statutes

I.1 Free Choice of Law - Applicable Employment Law

I.2 Basic rules for Employment in Germany

I.2.1 Principles of German Labor and Employment Law

I.2.2 Principles of German Social Security Law

I.2.3 Principles of the Income Tax System

II. The most relevant Issues for Employment in Germany

II.1 Conclusion of Employment Agreements

II.2 Special Employment Contracts

II.2.1 Part-Time Employment Contracts

II.2.2 Apprenticeship Contracts

II.3 Working conditions

II.3.1 Working Time

II.3.2 Paid Leave

II.3.3 Other Leave Entitlements

II.3.4 Equality

II.4 Termination of Employment

II.4.1 Statutes

II.4.2 Statutory Requirements for Notices of Termination

II.4.3 Ordinary and Extraordinary Dismissals

II.4.4 Notice Periods

II.4.5 Termination by Mutual Agreement

II.5 Law on Collective Bargaining Agreements

II.6 Law on Workers' Councils

II.7 The posting of employees in Germany

German Labor and Employment Issues in regard of the Set-up of a Company in Germany

Especially for foreign companies, which are not experienced in German labor and employment law, it must be assured for the staff employed in Germany that their employment terms comply with all legal requirements and that these terms serve the objectives of the new company. Thus, it is important to know the applicable labor and employment statutes.

I. Applicable German Labor and Employment Statutes

The following articles summarize the principles of German labor and employment law and the essential content of the statutes, which are of major interest for a new company.

I.1

Free Choice of Law - Applicable Employment Law

Under European law the parties to the employment contract are allowed to stipulate the applicable national law. However, in order to protect the employees' interests, German national law supersedes, in relevant issues, the chosen law. It is assumed that German law usually applies to the employment relationship if it is from the national point of view mandatory law and more favorable for the employee than the chosen law. Thus, in practice the free choice of law is quite limited and usually – even if the employer is from abroad – the parties apply German labor and employment law.

ADVICE

German labor and employment law should be agreed upon in the employment contracts for the local staff.

I.2

Basic rules for Employment in Germany

Employment in Germany is based upon a variety of labor and employment laws but is also strongly influenced by the social security system and the income tax system.

I.2.1 Principles of German Labor and Employment Law

There is no unified code of German labor and employment law. The major sources are federal statutes, collective bargaining agreements, works agreements and case law of the labor courts. Minimum labor and employment standards are laid down in separate acts on various labor and employment related issues. There are special labor courts with an independent jurisdiction in labor matters. They construe the labor and employment laws and they are responsible for the case law, which is of high importance in German labor and employment law. Some matters, especially strike regulation, are partly or even totally left to case law. The labor courts have also created lots of decisions dealing with the supervision of general terms and conditions of employment contracts. Since employees are considered to be consumers, the labor courts very often declare certain provisions null and void in the light of consumer protection.

The following acts may be considered to be the most important statutes:

- The **Civil Code** (Bürgerliches Gesetzbuch: BGB) defines the employment relationship. It also includes a few regulations on terminations and the transfer of businesses or business units. However, other employment law matters like the protection against unjust dismissals are treated in specific acts listed below.
- The **Works Constitution Act** (Betriebsverfassungsgesetz: BetrVG) regulates the cooperation between employers and workers' councils. It defines the rights of co-determination of workers' councils and it includes regulations on proceedings before the conciliation committees and other labor law issues related to that.
- The **Act on Collective Bargaining Agreements** (Tarifvertragsgesetz: TVG) deals with the vast and important labor law matter of collective bargaining agreements between unions and employers' associations or single companies.

Further codes dealing with...

Employment law issues:

- Protection Against Unjust Dismissals Act
(Kündigungsschutzgesetz: KSchG)
- General Equal Treatment Act
(Allgemeines Gleichbehandlungsgesetz: AGG)
- Part-Time and Limited Term Employment Act
(Teilzeit- und Befristungsgesetz: TzBfG)
- Continuation of Remuneration Act
(Entgeltfortzahlungsgesetz: EFZG)
- Federal Paid Leave Act
(Bundesurlaubsgesetz: BUrlG)
- Documentation of Essential Employment Conditions Act
(Nachweisgesetz)
- Posted Workers Act
(Arbeitnehmerentendegesetz)

Occupational health and safety regulations:

- Maternity Protection Act
(Mutterschutzgesetz: MuSchG)
- Working Time Act
(Arbeitszeitgesetz: ArbZG)
- Federal Act on Payment of Child Raising Benefit and Child Raising Leave
(Bundeselterngeld- und Elternzeitgesetz)

Litigation and Court Procedures:

- Labor Court Act
(Arbeitsgerichtsgesetz: ArbGG)

The above mentioned labor and employment statutes can be found and downloaded on www.mayr-arbeitsrecht.de.

Because of the German membership in the European Union (EU), German labor and employment law is strongly influenced by EU legislation and case law. EU directives must be implemented into national law and EU court decisions have legally binding power.

Whether or not a statute is applicable depends very often on the number of employees. At present there are 160 different thresholds, which have to be taken into account in order to find out if the statute in question is applicable.

more than	1	Medical attendance and safety related supervision, whereas thresholds vary from the Employers' Liability Insurance Association (Berufsgenossenschaft)
at least	5	Possibility of a workers' council with one member
more than	10	Protection Against Unjust Dismissals Act applies
more than	15	Statutory right to claim a part time job
more than	20	Duty to employ at least one severely disabled person or to pay a monthly compensation charge

ADVICE

The thresholds of certain acts should always be considered as an influential factor of the staff policy. Especially the Protection against Unjust Dismissals Act might cause avoidable costs otherwise.

I.2.2 Principles of German Social Security Law

Germany's statutory social security system forces employees to pay social security contributions. However, this does not apply to independent contractors or freelancers, as they are self-employed and not bound by instructions of their principals and thus not considered to be employees. Because of that, it is very important to distinguish between these types of workers and to determine the status of each worker individually.

The five branches of the social security system are the unemployment insurance, the health insurance, the long-term care insurance, the retirement pension insurance and the accident insurance. Except for the accident insurance, which is contribution-free for the insured employees as it is just financed by the employers, the employees and the employers share the costs of the contributions. The total amount of the contributions to the social security system depends on the gross income. The employer deducts the employee's part from his or her salary. The social security system is regulated by the Social Security Code.

ADVICE

Please be aware that the employer is responsible for the orderly payment of the social security contributions. The business owner may be held personally liable if he or she does not transfer the payroll taxes and contributions.

I.2.3 Principles of the Income Tax System

Employees pay income tax on their income. The tax progressively graduates depending on the gross income. The current rates vary between 15% and 42% plus solidarity tax contribution and church tax if the employee is member of a church. The employer is responsible for forwarding the income tax to the tax authority.

The German income tax system is quite complicated since certain benefits or expenses can be deducted by the employee in his or her yearly tax declarations. Furthermore, some benefits are free from tax and social security contributions and others e.g. presents over 35 Euros have to be added to the gross salary

ADVICE

External advisors offer payroll accounting (including the accounting of income tax and social security contributions) between 5 and 40 Euros per employee per month depending on the quality and scope of advice. At least in the beginning it might be helpful to get external advice. For further information please feel free to contact us.

II. The most relevant Issues for Employment in Germany

II.1

Conclusion of Employment Agreements

Usually, the parties agree upon employment for an unlimited period of time. Under the Part-Time and Limited-Term Employment Act (TzBfG), it is also possible for the employer and the employee to conclude a contract for a limited period of time.

In order to do so, several statutory requirements have to be fulfilled. As a general rule, time limitations of employment contracts must be justified by objective conditions. However, there is no statutory definition of the term *objective condition*. Instead, the statutory provision of § 14 sec. 1 TzBfG provides a non-exhaustive enumeration of typical reasons for time limitations of employment contracts, which serve as clarification of what constitutes an objective condition. According to that, motives such as the temporary demand of a certain type of work, the intention to facilitate the start of the professional career of graduates, or the replacement of an absent employee, to name only a few, are objective conditions.

However, there are three exceptions to the general rule that fixed-term contracts must be justified by objective conditions:

- Time limitations of up to two years, unless the previous employment contract was with the same employer (prohibition of chain employment contracts, § 14 sec. 2 TzBfG).
- Time limitations of up to four years, if the contract is concluded within the first four years after the foundation of the corporation (privilege for start ups, § 14 sec. 2a TzBfG).
- Time limitations of up to five years, if the employee is at least 52 years of age and unemployed for at least four months (privilege of elder unemployed persons, § 14 sec. 3 TzBfG).

Be aware, that limited-term employment contracts must be in writing to be valid (§ 14 sec. 4 TzBfG).

When concluding an employment contract the parties often stipulate a probationary period of up to 6 months. During this period, both the employer and the employee are allowed to terminate the employment contract with a notice period of only 2 weeks (§ 622 sec.3 BGB).

II.2

Special Employment Contracts

II.2.1 Part-Time Employment Contracts

Part-time work is also governed by the Part-Time and Limited-Term Employment Act

(TzBfG). Every full-time employee, who has been employed for at least 6 months in the same establishment, can request to work part-time, unless there are generally no more than 15 employees (§ 8 sec. 1 and 7 TzBfG).

II.2.2 Apprenticeship Contracts

Contracts of apprenticeships that primarily intend to train young people for a profession are not considered contracts of employment. They are subject to the Vocational Training Act (BBiG), which, however, stipulates that the statutes and principles governing employment contracts must be applied, unless they are not consistent with the nature and aim of the apprenticeship or unless the Act provides an express statutory exception (§ 3 sect. 2 BBiG).

II.3

Working Conditions

II.3.1 Working Time

Statutes that govern the working time are the Working Time Act (ArbZG), the Maternity Protection Act (MuSchuG) and the Young Workers Protection Act (JarbschG). These statutes are applicable to white-collar workers, blue-collar workers and apprentices. As a general rule, the term *working time* is defined as the time from the beginning until the end of work without breaks (§ 2 sec. 1 ArbZG). The legal working time is 8 hours per day, except for Sunday and statutory holidays, which usually serve as idle times. The maximum working time permitted by law per week (including Saturday) is therefore 48 hours. However, in many cases it is reduced to 35 till 38,5 hours by collective bargaining agreements, which usually stipulate that the working week is only from Monday till Friday. The regular daily working time may be extended up to 10 hours, but only if the average daily working time in the following 6 months is 8 hours per day (§ 3 ArbZG). This enables a bit of flexibility of working time. However, it must always be taken into account that 11 hours of uninterrupted rest after daily work must be guaranteed. In addition to that, night work is also legally permitted, but only under certain preconditions.

II.3.2 Paid Leave

This issue is regulated by the Federal Paid Leave Act (BurlG). The statute provides that employees have to be granted minimum holidays of 24 days per calendar year, not counting Sundays and public holidays. Saturdays are thus included in the calculation. In fact, a period of 4 up to 6 weeks per calendar year is usually granted by collective bargaining agreements.

II.3.3 Other Leave Entitlements

Sick-leave is governed by the Continuation of Remuneration Act (EFZG). If the employee has been employed for at least 4 weeks and he or she was not to blame for his or her inability to work, continued payment of wages can be claimed for a period of up to 6 weeks. Therefore, during this period of time the employee is entitled to 100% of the average income.

Another entitlement for continued payment during absence is stipulated in § 616 BGB. According to that provision, wages can be claimed if the employee is unable to work for an insignificant period of time due to personal reasons such as the death or funeral of a close family member or the birth of the own child. However, this statute is not mandatory and therefore in practice often limited or barred by contractual agreements.

The Social Security Code also includes a provision dealing with absence due to a sick child.

ADVICE

The health insurance reimburses up to 80 % of the salary, which the employer has to pay in case the employee is sick. However, this is only the case if the employer applies for reimbursement and if he or she does not employ more than 20 employees.

II.3.4 Equality

Under the General Equal Treatment Act (AGG), any discrimination on grounds of race or ethnic origin, gender, religion or secular belief, disability, age or sexual identity is inadmissible. Unjustified, unequal treatment of employees is thus unlawful.

In practice, the Act affects mostly the hiring of employees, their employment and working conditions, their professional advancement, remuneration and dismissal. Under the Act the employer must take the necessary measures to protect employees against adverse treatment. The employer can fulfill this duty by training his or her employees. In case of discrimination the employee may be entitled to claim for damages or compensation for non-pecuniary damages.

II.4

Termination of Employment

II.4.1 Statutes

The termination of employment is mainly governed by the Civil Code (BGB) and the Protection against Unjust Dismissal Act (KSchG). The German Labor and Employment Law sets high standards for the employer to unilaterally terminate an employment relationship. Especially the application of the Protection Against Unjust Dismissal Act (KschG) has a strong impact on the dismissal of employees. However, as described above in the chart of thresholds, the Protection Against Unjust Dismissal Acts (KschG) only applies if the employer regularly employs more than 10 employees. Also, an employee must have worked in the company for at least six months without interruption in order to come under the Act's scope of protection (§§ 1, 23 KschG).

II.4.2 Statutory Requirements for Notices of Termination

The notice of termination must be given in writing to be valid (§ 623 BGB). It must be declared in a written document and signed by the issuer. This statutory written form requirement cannot be waived, as it is mandatory. Notices by fax or e-mail are not sufficient since they do not fulfill the written form requirements due to lack of the original signature. If notice is given by an authorized person, the original power of attorney has to be presented to the employee.

II.4.3 Ordinary and Extraordinary Dismissals

German Employment Law distinguishes between ordinary dismissals, whereby the employment relationships end with the expiration of a notice period (§ 622 Civil Code), and extraordinary dismissals, which effect the immediate cancellation of the employment contracts (§ 626 Civil Code).

Where the Protection against Unjust Dismissal Act (KschG) applies, ordinary dismissals are only allowed for operational reasons, misconduct or personal reasons (§ 1 sec. 2 KschG). Each type of dismissal requires the fulfillment of specific prerequisites. To name only a few,

Dismissals for misconduct usually require at least one written warning beforehand because the employee shall be granted the chance to change his or her misbehavior; dismissals for personal reasons are only possible if the employee is unable to perform the work e.g. due to long-term illness; dismissals for operational reasons require a structural entrepreneurial decision to eliminate the specific job, the employer's prove that there is no way the employee can be reassigned to another free position and the correct application of social criteria for the determination of who can be released ("social selection"). In any case, the individual circumstances of each case are decisive. Where the Protection Against Unjust Dismissal Act does not apply, the employer is free to dismiss any employees at any time, as long as the dismissal is not arbitrary.

Extraordinary dismissals always require a serious cause, which makes it, in good faith, unacceptable to continue the employment relationship until the end of the notice period, or, in the case of a limited-term employment contract, until the contractual date for its expiration. Typically it applies to serious misconduct and is only possible within two weeks after the notifying party has obtained knowledge of the facts that are decisive to terminate the employment relationship.

If there is a workers' council, employers must be aware that it must be heard before each dismissal. Even though the workers' council cannot prevent a dismissal, the dismissal is invalid if the employer fails to properly inform and consult the workers' council beforehand (§ 102 BetrVG).

Some groups of employees e.g. disabled persons and pregnant women benefit from particular protection against ordinary and extraordinary dismissal due to their certain individual circumstances.

II.4.4 Notice Periods

Ordinary dismissals are subject to certain periods of notice. Notice periods are stipulated by law. The minimum statutory notice period for both, the employer and the employee, is four weeks counting back from the 15th or the last day of a calendar month (§ 622 Civil Code). However, the notice period for the employer gradually increases with the company seniority of the employee: 2 months for 5 years, 3 months for 8 years, 4 months for 10 years, 5 months for 12 years, 6 months for 15 years and 7 months for 20 years of company seniority (the end of these notice periods is always at the end of the calendar month). Individual contracts of employment may only specify longer notice periods. Collective bargaining agreements, on the other hand, may depart from the statutory notice periods in the employees' favor as well as to their disadvantage.

II.4.5 Termination by Mutual Agreement

Of course, the termination by mutual agreement is possible and quite usual. The termination agreement must be in writing. Usually the agreement contains provisions about the date of the end of the employment, pay leave, severance payments, return of company property, reference etc. In order to avoid costly errors for both sides even if the termination is mutual an attorney should draft the agreement.

German Employment Law does not provide for a termination against severance pay. However, more than 85% of the lawsuits against dismissals are settled against payment of a severance. Usually it can be calculated half of a gross monthly salary per year of employment as compensation for the dismissal.

ADVICE

The Termination of Employment under German Employment Law requires in general specific legal advice with regard to the statutory requirements, especially the justification and the form.

II.5

Law on Collective Bargaining Agreements

Collective Bargaining Agreements play a central role in German Labor Law. They are concluded between the employers' association and the trade unions or between a single employer and the trade unions. Both typically have provisions dealing with working conditions, holidays, termination of employment relationships and salaries. Members of the parties to a collective bargaining agreement are bound by the conditions agreed upon. Thus, they are mandatory and the employee has a direct claim against the employer to comply with the provision of the collective bargaining agreement. Statutory provisions can be found in the Act on Collective Bargaining Agreements (TVG).

II.6

Law on Workers' Councils

The second very important issue of German Labor Law is the law on workers' councils. It is regulated by the Works Constitution Act (BetrVG). The workers' council is the representative body of the employees and it is statutorily granted specific rights of participation and codetermination. The formation of a works council is not mandatory for the employees. However, if they want to have a workers' council they have the right to initiate elections. The only requirement is that there are at least five regularly employed employees in the establishment (which is defined as the organizational labor unit of a company). The size of the workers council depends on the number of employees in the establishment (§ 9 BetrVG). Members of the workers' councils, the election committee and nominated candidates can only be dismissed for serious cause. Thus, they are granted statutorily protection against ordinary dismissals (§ 15 KschG). The workers' councils have different information and consultation rights. However, the most important rights granted by the Works Constitution Act are the codetermination rights in personal matters, such as hiring, transfers and dismissals of employees. The workers' council and the employer may also conclude works agreements in order to create general rules on working conditions. Such agreements have immediate and binding effect on the individual employment contract (§ 77 sec. 4 BetrVG).

II.7

The posting of employees in Germany

In order to limit or even prevent low-wage competition and to secure jobs of German employees, the Posted Workers Act (AEntG) stipulates that certain German statutes and provisions of collective bargaining agreements, which have been declared to be generally applicable, are also legally binding for foreign employers who post (some of) their employees for work to Germany. The Act especially applies to the construction and service industry.