Client Memorandum

December 2012

Swiss taxation of employee equity incentive plans
New provisions entering into force on January 1st, 2013

The Federal Act on the Taxation of Employee Equity Incentive Plans of December 17, 2010 and the Federal Ordinance on the Employee Equity Instruments of June 27, 2012 will enter into force on January 1st, 2013. While these rules do not fundamentally change the taxation rules previously developed by the practice of the cantonal tax authorities, they clarify specific issues that had given rise to varying cantonal practices and provide for new reporting duties for Swiss employers who have employees participating in employees equity incentive plans. In view of this recent development, it is important to review the existing tax rulings and to ensure that appropriate reporting procedures are set up.

1. Taxation Rules under the New Act

a) Taxation of the various type of employee equity instruments

Under the new rules, the taxation of the different types of employee equity instruments is the following:

> **Employee stocks**: taxation at grant.

Any difference between the fair market value of the stocks at the time of grant and the purchase price paid by the employee represents taxable income from employment. If employee stocks are subject to a restriction period, the fair market value is reduced by approx. 6% for each year of the restriction period like under the current tax regime.

For listed stocks, the fair market value will correspond to the price at which the stocks trade on closing at the time of grant. For non-listed stocks, the fair market value will be the intrinsic value which has to be determined on the basis of an appropriate valuation formula, except if there is a recent market price paid by third parties. The valuation formula chosen will then have to be maintained until sale.

In case of early lapse of the initial restriction period, an additional taxable employment income is realised. The income corresponds to the fair market value of the stocks at the time the restriction lapses multiplied by 6% for each remaining and not completed year of the initial restriction period.

In case of return of the stocks to the employer at a price lower than the fair market value, the employee realises a loss which is deductible as a professional expense from his employment income. Here again, any remaining years of the initial restriction period will be taken into account in the computation of the value of the stocks.

In principle, the subsequent sale of employee stocks qualifies as a tax exempt capital gain. However, if the shares have been assessed at their intrinsic value based on a valuation formula, only the difference between this value at the time of grant and at the time of sale (using the same formula) will qualify as tax exempt capital gain and the rest of the gain will be taxable as

employment income if the shares are sold less than five years after grant or if they are sold to the employer.

- **Employee stock options**: taxation at exercise unless the options are listed on a stock exchange and not subject to any restrictions.

  Exception: employee stock options listed on a stock exchange, and not subject to any restriction periods, will be taxable at grant.

  All other employee stock options will be taxable at exercise. The taxable income from employment will correspond to the sale price (if the options are tradable) or to the difference between the fair market value of the underlying share and the strike price paid.

- **Restricted stock units**: taxation at the time of the conversion into stocks (i. e. at vesting).

  Restricted stock units will be taxable at vesting. The taxable income from employment will correspond to the difference between the fair market value of the stocks at the time of vesting and the conversion price payable by the employee, if any.

- **Phantom stocks (or stock appreciation rights)**: taxation at the time of payment (i. e. at vesting).

  Phantom stocks are cash bonuses under which the amount of the bonus is determined by reference to the increase in value of the underlying stocks. They are taxable as income from employment at the time of payment.

b) Taxation in cross-border situations

In cross-border situations, i. e. in case of departure or arrival in Switzerland between the time of grant of the employee stock options and the effective realisation of the taxable income, the new rules provide for an income apportionment on the basis of the number of days spent in Switzerland and abroad over the vesting period.

Although the Federal Act only mentions employee stock options, the Federal Ordinance makes it clear that this principle applies also to restricted stock units and phantom stocks.

If the employee is resident in Switzerland at the time of realization of the taxable income, he will be ordinarily taxed only on the part of the income attributable to his/her activity in Switzerland. However, the total amount of the income will be taken into consideration to determine the tax rate.

If the employee is not anymore resident in Switzerland at the time of realisation of the taxable income, the former Swiss employer will have a duty to withhold and pay taxes on the part of the income attributable to the past activity of the employee in Switzerland.

c) Reporting duties of employers

Another element of the new provisions is the duty of the employers to issue, in addition to the salary certificate, a specific statement for the tax authorities with all the information relevant for taxation of the employee stocks (date of grant, date of vesting, types of stocks, value of the stocks etc.). In case of attribution of part of the income to a foreign country, the computation of the apportionment will also have to be provided with details on the number of days spent in Switzerland and abroad.

Issuing detailed statements was previously standard practice in the canton of Vaud, but this is a new development in the other cantons. It is hence important to ensure that appropriate reporting procedures are in place within the employer company.

d) Transitional rules

The new taxation rules and reporting duties apply to all employee equity instruments granted after January 1st, 2013. They also apply to employee equity instruments granted before December 31st, 2012 unless they have already been taxed before the entry into force of the new provisions or are taxable, according to a tax ruling, in a fiscal year preceding 2013. This exception will mainly concern employers based in the French-speaking part of Switzerland where tax rulings providing for taxation at grant of employee stock options have been granted until the end of 2010.

e) Circular of the Federal Tax Administration

The Federal Tax Administration will issue a circular in order to clarify certain details like valuation of employee stocks granted by non listed companies, methods to count the working days etc. This circular is expected in March 2013, but a draft version is already available.

The Federal Tax Administration will also issue another circular covering the corporate income tax consequences of equity incentive plans for employers. This second circular is expected in summer 2013.

2. Social security rules

The social security legislation has not been modified and the Federal Social Insurance Office has not updated its guidelines to date.

While it is to be expected that the social security institutions will follow the same principles in relation to the determination of income subject to contributions and to the timing of the payment of contributions, it is not clear whether the principles of income apportionment in case of cross-border situations will be applied as well.

Employers should thus seek advice from the social security institutions with which they are registered in order to be sure that social security contributions are appropriately withheld.

Please do not hesitate to contact us in case of any questions.

Your Contacts

Geneva / Lausanne
Jean-Blaise Eckert
jean-blaise.eckert@lenzstaehelin.com

Daniel Schafer
daniel.schafer@lenzstaehelin.com

Telephone + 41 58 450 70 00

Zurich
Heini Rüdisühli
heini.ruedisuehli@lenzstaehelin.com

Franziska Stadtherr-Glättli
franziska.stadtherr@lenzstaehelin.com

Telephone +41 58 450 80 00

Our Offices

Geneva
Route de Chêne 30
CH-1211 Genève 17
Telephone +41 58 450 70 00
Fax +41 58 450 70 01
geneva@lenzstaehelin.com

Zurich
Bleicherweg 58
CH-8027 Zürich
Telephone +41 58 450 80 00
Fax +41 58 450 80 01
zurich@lenzstaehelin.com

Lausanne
Avenue du Tribunal-Fédéral 34
CH-1005 Lausanne
Telephone +41 58 450 70 00
Fax +41 58 450 70 01
lausanne@lenzstaehelin.com

www.lenzstaehelin.com