

New Circular Letter on Stock Option and Warrants

30 November 2017

In brief

Further to recent announcements made by the Government on the tax treatment of stock options and warrants, the Luxembourg tax authorities released a new Circular Letter (Circular Letter L.I.R. n°104/2) on 29 November 2017 (“the Circular Letter”).

The Circular Letter replaces Circular Letter n°104/2 dated 20 December 2012 and Circular Letter n°104/2bis dated 28 December 2015. It amends the tax treatment of stock options and warrants for any grant to employees as from 1 January 2018. It also amends and increases reporting obligations for employers.

In detail

Background

The tax treatment of stock options and warrants is ruled by Luxembourg Income Tax Law and is the subject of several Circular Letters issued by the Tax Authorities. The tax treatment was initially amended in 2012 (amendment to the lump sum valuation method for certain types of options and warrants; introduction of specific conditions for warrants) and subsequently in 2015 (introduction of an upfront notification requirement at the level of the employer).

The new Circular Letter consolidates the applicable legislation, provides additional guidance, imposes reporting requirements and increases the taxable value of certain types of options and warrants where the lump-sum valuation method is applied by the employer.

What's new

Tax treatment

Grant of freely transferable options/warrants up to 31 December 2017

For options/warrants granted to employees prior to 1 January 2018, the taxable basis may be calculated via a lump-sum valuation method - 17.5% of the underlying basis to the options/warrants.

Grant of freely transferable options/warrants as from 1 January 2018

Where the granting of the options is made on or after 1 January 2018, the taxable basis may be calculated via a revised lump-sum valuation method - 30% of the underlying basis to the options/warrants.

As far as warrants are concerned, this means that the effective income tax burden would amount to approximately 22% of the total amount invested by the employer in the acquisition of warrants which are then granted to employees (vs. approximately 13% for warrants which are granted to employees prior to 1 January 2018).

In addition, the lump-sum valuation method is explicitly excluded when options/warrants are granted for the payment of indemnities (fixed by the law, a contract, a transaction or by the court) **in the context of the termination of the employment contract.**

Reasonable conditions

Where the employer intends to apply the lump-sum valuation method for calculating the taxable basis of warrants, the warrant plan must meet “reasonable conditions” as per the Circular Letter n104/2 dated 20 December 2012. These conditions were initially outlined in an internal note to the Tax Authorities which were then made public by the Ministry of Finance. These conditions are now part of the Circular Letter as follows:

- the participants to the warrant plan must be “cadres supérieurs” based on Luxembourg Labour Law;
- a maximum of 50% of the participant’s annual gross remuneration can be paid in warrants; and
- the price of the warrants cannot exceed 60% of the underlying basis value.

The Circular Letter clearly indicates that the 50% limit should be considered based on the annual remuneration of the year during which warrants are granted to an employee.

Should the 50% limit not be met, a regularisation of taxes will occur at the level of the employee, via the tax return or annual tax adjustment.

These conditions do not apply to the typical stock options (i.e. options where the underlying basis is the employing company) and solely relates to warrants (i.e. over the counter-options).

Reporting obligations

Based on the Circular Letter dated 28 December 2015, all incentive plans that fall within the scope of the Circular Letter 20 December 2012 must be notified to the tax authorities at least 2 months before being implemented. This upfront notification requirement is now replaced by an obligation to report such plans upon implementation via an electronic filing procedure. The Circular Letter implements different rules depending on the date of implementation of a particular plan:

1. For stock option, warrant or other incentive plans falling within the scope of the Circular Letter implemented ***between 1 January 2016 and before 31 December 2017:***

If the plan has not been duly notified to the tax authorities, it must be reported to the Préposé of the relevant RTS tax office as follows:

- Before 31 January 2018 for instruments (whether stock options, warrants or other instruments falling in the scope of the Circular Letter provisions) granted in 2016.
- Before 31 March 2018 for grants made in 2017.

Should the adequate reporting not be made in due time to the Tax Authorities, the employer will not be entitled to avail from favourable tax regime **for future grant of stock options/warrants.**

2. For the granting of freely transferable options/warrants **as from 1 January 2018:**

The upfront 2-month notification requirement will no longer apply. The employer will have to report the plan to the Tax Authorities when the income is put at the disposal of the employee (i.e. when the taxable event occurs). For freely tradable stock options and warrants, this means that the reporting must be made when options/warrants are granted to the employee.

Also, the employer must provide the Tax Authorities with information about the expected total annual gross salary of the employees for the relevant tax year.

This expected total annual gross salary should be calculated based on a best estimate of the total annual gross salary that will be paid to the employee during the year in which options/warrants are granted to the employee.

Surprisingly, if the employee changes employer during the year concerned, the employee is obliged to provide the new employer with information about salaries and options/warrants received from the former employer during the same year. Should the new employer also grant options/warrants to the employee, the employer must ensure that the 50% limit is not exceeded, taking into account options/warrants and salaries paid to the employee by the former employer. Supporting documents must be attached to the "extrait de compte de salaires" of the employee.

Should the reporting obligation not be met by the employer, the lump sum valuation method will be disregarded, triggering additional withholding taxes.

Reporting formalities

For all plans, the reporting must be made via an electronic filing procedure, by using the excel file template provided by the tax authorities and a secured website:

http://www.impotsdirects.public.lu/fr/echanges_electroniques/stock_options.html

Link to the circular

To consult the Circular Letter L.I.R. n°104/2 in its entirety, please click on the following link (available in French only):

<http://www.impotsdirects.public.lu/content/dam/acd/fr/legislation/legi17/lir-104-2-29112017.pdf>

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