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**Luxembourg – Circular
Updates Tax Treatment of
Transferable, Non-
Transferable Stock
Options**

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On 20 December 2012, the Luxembourg tax authorities issued a new circular (LIR n° 104/2) on the taxation of stock option plans. The new circular updates the previous circular (dated 2002) mainly by increasing the valuation of transferable options from 7.5 percent of the underlying stock at the moment of the granting of the option to 17.5 percent of the underlying stock at the moment of the granting of the option.

This circular is applicable as from 1 January 2013, and replaces the old circular from 11 January 2002.

Taxation of the Benefit-in-Kind

Based on articles 104 and 108 LIR, a promise made by the employer to the employee that he or she would receive a benefit under certain conditions, does not constitute taxable employment income. The promise to obtain an asset becomes taxable for the employee only when the asset is put at the disposal of the employee.

Based on prevailing case law and doctrine, a distinction is to be made between transferable (quoted or not) and non-transferable (including phantom) stock options.

Transferable Stock Options

- The employee is regarded as receiving a benefit-in-kind at the date of grant of the stock option.
- The taxable benefit is equal to the difference between the quoted or estimated sales value of the stock option at the date of grant and the price paid by the employee for this option.
- The estimated sales value may be calculated by using the Black-Scholes method¹ or another comparable financial method or in the absence of application of such a method, it can be fixed at 17.5 percent of the value of the underlying stock at the moment of the granting of the option.
- The implementation of a stock option plan has to meet a 'reasonable condition' test.

Non-Transferable Stock Options

- The employee is regarded as receiving a benefit-in-kind only at the date of exercise of the stock option.
- The taxable benefit is equal to the difference between the quoted or estimated sales value of the stock and the exercise price paid.
- In the presence of a clause of inalienability of the stock bought within the framework of such stock-option plans, a tax reduction equal to 5 percent per year of the stock value is granted (with a maximum of 20 percent).

Taxation of Capital Gains on Disposal of Options or Shares

The benefit (previously taxed as employment income) is added to the acquisition cost when computing the taxable gain on the ultimate disposal of the option or share. Basically, capital gains are only taxable under:

- Art. 99bis (speculative gain – retention period of less than six months);
- Art. 100 (gains on substantial participations and retention period exceeding six months).

The tax circular foresees that a disposal of shares within a period of seven days following the date of exercise of the option is taxed as if the option was disposed of, that is, as capital gains.

Tax Qualification of the Benefit in Case of Options Granted to Shareholders

The benefit-in-kind granted to employees who are shareholders of the company, may be taxable as employment income, if, in essence, employees who are not shareholders have similar benefits; otherwise this benefit should be regarded as a dividend if it is granted to a shareholder in respect of his or her shareholder status.

Footnote:

1 Sometimes also referred to as the Black-Scholes-Merton model. See the 1973 article by F. Black and M. Scholes, "The Pricing of Options and Corporate Liabilities," *The Journal of Political Economy*, Vol. 81, No. 3 (May - June, 1973), pp. 637-654. In addition, Robert C. Merton wrote an article concerning the mathematical understanding of the options pricing model and fashioned the term Black-Scholes options pricing model (see: R. Merton, "Theory of Rational Option Pricing," *Bell Journal of Economics and Management Science* 4 (Spring 1973): pp. 141-183).

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This article is adapted, with permission, from "New Circular on Stock-Options" in *Luxembourg Tax News*, Issue 2012-12 – December 2012, a publication of the KPMG International member firm in Luxembourg. For the complete article, click [here](#).

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