GMS Flash Alert

Global Compensation Edition

2017-186 | December 18, 2017

Luxembourg - New Guidance on Taxation of Stock Options, Warrants

Circular n°104/2, issued by the Luxembourg tax authorities on 29 November 2017, provides for changes in the taxation of transferable stock options/warrants as well as in the reporting obligations of all stock option schemes; it also clarifies to some extent the scope of application of this specific tax regime.[1]

Although the new circular applies as of 29 November 2017, most of the changes will apply from 1 January 2018.

Below we provide a summary of the key modifications.

WHY THIS MATTERS

In light of the new rules, employers will need to assess (i) the scope and extent of stock options awarded and (ii) their workforce in receipt of such incentive compensation. They will also need to revise their processes and procedures because of the new information that must be collected and the detailed reports that should be made electronically.

The higher valuation planned for the underlying unit of the options or warrants awarded means a potentially increased tax burden for recipients of such incentive compensation. This could impact employers' and employees' compensation strategies and choices.

Increased Valuation of Transferable Stock Options/Warrants from 17.5 Percent to 30 Percent

Until 31 December 2017, the taxable benefit of transferable stock options/warrants (that are not listed nor valued according to a recognised financial method) is assessed at 17.5 percent of the value of the underlying unit of an option/warrant on the grant date, multiplied by the number of options/warrants. From 1 January 2018, the valuation will be increased to 30 percent.

Reasonable Conditions – Guidelines

As with the previous tax circular, the new circular stipulates that the lump-sum valuation (at 17.5 percent until 31 December 2017 and rising to 30 percent as from 1 January 2018) for warrants, i.e., options not linked to the shares of the company, must be made in accordance with "reasonable" conditions. These reasonable conditions (as detailed by the Ministry of Finance in a response to a parliamentary question on 1 July 2013) have not changed, but have now been included in the tax circular. As a reminder, the reasonable conditions are as follows:

1. The portion allocated to warrants should not exceed 50 percent of the total gross annual remuneration package (warrants included). This percentage has to be respected individually at each scheme participant's level.

2. The scheme is applicable to "cadres supérieurs" (i.e., management) only (see article L 211-27 [5] of the Labour Code).

3. The scheme must foresee that the option price remains below 60 percent of the value of the underlying assets.

If one of the above conditions is not met, the new circular stipulates that the options must be taxed on their full purchase price (whereas the previous circular said that the Black & Scholes valuation method or another comparable financial valuation method should be used).

Employment Termination Indemnities Excluded

If transferable stock options are granted instead of an employment termination payment (whether it is a legal, contractual, transactional, or judicial severance payment), the benefit cannot be assessed on a lump-sum valuation basis (at 17.5 percent until 31 December 2017 and rising to 30 percent as from 1 January 2018), but must be taxed on the full purchase price of these options.

Pooled Stock Option Schemes

As previously stated by the Ministry of Finance in a response to a parliamentary question on 1 July 2013, the new circular specifies that pooled stock option schemes – i.e., schemes gathering employees of different companies – are allowed.

Employer's Obligations towards the Tax Authorities

New strict deadlines apply with respect to the employer's reporting obligations to the wage tax office:

1. For plans implemented in 2015 and before: a detailed report should be made upon the specific request of the relevant wage tax office (usually during a payroll audit).

2. For plans implemented in 2016: a detailed report must be made by the employer before 31 January 2018.

3. For plans implemented in 2017: a detailed report must be made by the employer before 31 March 2018.

Failure to comply with the above deadlines will trigger the exclusion of the benefit of the stock option regime as provided by the circular for 2018 and beyond.

Plans Implemented from 2018 Onwards

Timing

For plans implemented from 2018 onwards: the detailed report must be made by the employer at the time the taxable event occurs (i.e., at the exercise date of the options in cases of non-transferable options / at the grant date of the options in cases of transferable options/warrants), and not at the time the scheme is implemented. Prior notification of the plan to the tax authorities will no longer be required.

If the employer fails to make the report at the time of the taxable event, the tax authorities:

- will tax the full purchase price of the options (in cases of transferable options/warrants); and
- will not apply any discount (from 5 percent to 20 percent) in cases of non-transferable options.

Benefits taxable at the same date can be put in the same report as long as they belong to the same plan.

Format

The detailed report should be made electronically and submitted to the relevant wage tax office by using a specific form provided by the tax authorities.

Content

As from 2018, the report should not only include the taxable benefits relating to the stock options, but also the salaries of the beneficiaries.

In this respect, for beneficiaries of transferable stock options/warrants, the report should also include the annual gross salary (as expected/calculated at the grant date of the options), excluding the options.

Employees Changing Employer during the Year

Employees changing employer during the year, and having been granted warrants by their first employer, must inform their second employer of the amount of salary earned / the amount invested in warrants so far; the second employer will have to take this data into account to check whether a further allocation of warrants is possible or not, considering the expected annual salary for the whole year, and the 50-percent threshold requirement as referred to in the reasonable conditions (see above).

In cases of failure concerning the above obligations, where, as a result, the portion allocated to warrants exceeds 50 percent of the total gross annual remuneration, individual taxes would be reassessed based on article 136.5 LITL through the filing of an income tax return/tax *décompte* and under the responsibility of each concerned employee.

FOOTNOTE:

1 This circular replaces Circulars n°104/2 of 20 December 2012 and n°104/2bis of 28 December 2015, as well as service notes 104/3 of 22 May 2013 and 104/4 of 12 January 2015. For prior coverage of Circular 104/2 of 20 December 2012, see KPMG's *Flash International Executive Alert* 2013-025 (1 February 2013) – for a copy, please ask your local KPMG contact. For the new circular, see (in French): *Circulaire du directeur des contributions L.I.R. n°104/2 du 29 novembre 2017*, click here.

Contact us

For additional information or assistance, please contact your local GMS or People Services professional or one of the following professionals with the KPMG International member firm in Luxembourg.

Frédéric Scholtus
Associate Partner
Tel. + 352 22 5151 5333
frederic.scholtus@kpmg.lu

Marisa Hosnar
Senior Manager
Tel. + 352 22 5151 5425
marisa.hosnar@kpmg.lu

André Kayser
Senior Manager
Tel. + 352 22 5151 5562
andre.kayser@kpmg.lu

The information contained in this newsletter was submitted by the KPMG International member firm in Luxembourg.

www.kpmg.com

kpmg.com/socialmedia

Flash Alert is a GMS publication of KPMG LLP's Washington National Tax practice. To view this publication or recent prior issues online, please click here. To learn more about our GMS practice, please visit us on the Internet: click here or go to http://www.kpmg.com.