Employee Stock Options in the EU and the USA

FINAL REPORT

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France

Contents

France

1. General remarks

1.1 History

1.1.1 Stock option plans were first introduced in France on 31 December 1970[1]. The legislation relating to the taxation of stock options has developed through statute.

1.1.2 From 1970 through to 1987 only listed companies operated stock option plans. Stock options became more popular after 17 June 1987 when a new bill was enacted which broadened the scope of stock option plans in France (extending it to unlisted companies and foreign plans)[2].

1.1.3 The plans became popular between 1987 and 1990, but since then French tax legislation has become less and less favourable (1990: taxation of the excess discount (see section 3.2.1.1) as salary on exercise and of the exercise gain as a capital gain; 1996: the favourable rate of taxation of the exercise gain (see section 3.2.1.2) was increased from 16% to 30% or 26%; 1997: liability to social security contributions on the exercise gain if the holding period is not fulfilled)[3].

1.2 Current situation

1.2.1 Under the influence of worldwide globalisation, stock option plans are now common in France. Most multinationals have implemented global stock option plans. French multinationals are increasingly implementing global plans to benefit their French and non French subsidiaries. French subsidiaries of foreign issuing companies deal with options granted by parent companies on a regular basis.

1.2.2 Approximately 50% of French listed companies operate stock option plans, which covers around 30,000 employees.[4]

1.2.3 The taxation of stock options in France has been reformed with respect to options granted on or after 27 April 2000[5]. In response to press publicity relating to large stock option gains realised by key executives, the applicable tax rates were increased. In a move apparently to encourage stock option plans in France, some improvements were also introduced; i.e. reduction in the holding period required to obtain favourable social security contribution treatment and lower tax rates if an additional holding period is satisfied.

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1 Act n° 70-1322 dated 31 December 1970, published on 3 January 1971
including articles 208-1 through 208-8-2 in the Act dated 24 July 1966 relating to commercial companies (currently codified in the French commercial code – the Code de Commerce (L.225-177 through L.225-186) and articles 174-8 through article 174-21 in the decree dated 23 March 1967.

2 Act dated 17 June 1987 – (n°87-416, Article17)

3 Finance bill of 29 December 1989 – (n°89-935, Article 11 & 12)
Finance bill of 30 December 1995 – n°95-1346, Article 70)

4 Enquete 1999 de la Dares – Ministere de l'emploi

5 Act No 2001 – 420 dated 15 May 2001 and published on 16 May 2001

1.2.4 Further to the recent changes, decrees and instructions which may provide more detailed information on several outstanding issues (such as valuation in a unlisted company) are still awaited.

2. Key features of stock option plans

2.1 The following comments under *"Non qualifying" foreign plans* apply to plans which would not "qualify" under French law, i.e. do not fulfil the main conditions provided in articles L. 225-177 et seq. of the New Commercial Code. The legal conditions for a stock option plan to qualify in France are set out in section 2.2 under *French stock option plans or "foreign qualifying plans"*. In practice, qualification issues mainly arise for foreign plans. When the issuing company is based in France, the plan generally qualifies since the issuing company is mandatorily subject to French company law and the relevant articles L. 225-177 et seq. of the French Commercial Code.

2.2 Legal requirements to establish a stock option plan

2.2.1 *French stock option plans or "foreign qualifying plans"*

2.2.1.1 Under French law, the implementation of a stock option plan by a French company requires shareholder approval (see section 6.4).

2.2.1.2 French companies eligible to grant qualified options are "sociétés par actions" ("sociétés anonymes", "sociétés en commandite par actions", "sociétés par actions simplifiées").

2.2.1.3 The legal requirements for a qualifying plan differ in some respects for listed and unlisted companies. The following paragraphs set out the requirements for a listed company and then how those requirements differ for unlisted companies.

2.2.2 *Listed companies*

2.2.2.1 For listed companies, the new legislation (loi NRE)[6] sets out two periods of time during which options cannot be granted:

- The period of ten stock exchange sessions preceding and following the date on which the consolidated accounts are made public, or if there are no consolidated accounts the date of publication of the annual accounts.

- The period between the date the company becomes aware of information that would have a significant impact on the company's shares and the date which is ten stock exchange sessions after the date upon which the information is made public.

[6] Loi NRE no 2001-420 dated 15 May 2001 was published in the Journal Officiel no 113 dated 16 May 2002 page 7776

2.2.2.2 Neither can options be granted before the end of the period of twenty stock exchange sessions following a distribution of dividends or a capital increase.

2.2.2.3 Options can be granted to employees of:

- The company over whose shares the options are to be granted (the "issuing company").
- Companies in which the issuing company holds, directly or indirectly, at least 10% of the share capital.
- Companies which own, directly or indirectly, at least 10% of the issuing company's share capital.
- Companies in which at least 50% of the share capital is held by a company which also owns at least 50% of the issuing company's share capital.

2.2.2.4 Directors having a management function are also eligible to receive options under a qualifying plan[7], but consultants and non employee directors are not eligible to receive options under a qualifying plan. Neither can options be granted to persons who at the date of grant hold more that 10% of the issuing company's share capital[8].

2.2.2.5 The board of directors can select employees to participate, provided that the selection complies with the general principles of non discrimination, see section 6.2. A prior designation by the board of the French employing company is sometimes recommended for grants under a foreign based plan where senior executives or employees with management functions will participate, even if the plan is approved by the foreign issuing company under its applicable law. In particular, if members of the board are to be granted options under the employment contracts they have with the company or the group, prior approval of the local board could be mandatory "conventions réglementées".

2.2.2.6 Options must be granted over registered shares of the company issuing the options - options granted over bearer shares would not receive favourable treatment. Under foreign plans, the shares must be traceable[9]. A conversion to bearer form has the same social security and tax impact as a sale (see section 3).

2.2.2.7 There are restrictions on the value of shares over which options may be granted: not more than one-third of the company's total capital can be subject to (unexercised) options at any time[10]. Under French law, authorised capital is always issued. However, there may be "fully paid-up capital" and "not fully paid-up capital" ("capital libéré" and "capital non libéré). The provision refers to one-third of the total capital, whether fully or not fully paid up[11].

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7 Article L225-185 Code de Commerce

8 Article L225-182 Code de Commerce

9 Article 163 bis C of the French tax code (Code Général des Impôts)

10 Articles 174-17 of the Decree of 23 March 1967

11 Articles L.225-177 and Articles L225-179 Code de Commerce

2.2.2.8 The exercise price must be established at grant and must be adjusted only if an event specified under section L.225-181 of the new Commercial Code, occurs as follows:

- Certain capital increases in cash.
- Capital increase with distribution of shares following capitalization of premiums or retained earnings.
- Issuance of bonds giving a right to the acquisition of shares.
- Distribution of retained earnings either in cash or in shares held by the company.
- Capital reduction due to losses[12].

2.2.2.9 A discounted exercise price is envisaged by law. Any discount allowed must not exceed 20% of the average list price of the shares over the twenty stock exchange trading days preceding the grant of the options and also must not exceed 20% of the average purchase price of any shares previously purchased by the company for use in its stock option program.

2.2.2.10 Two different methods of payment of the exercise price upon exercise are allowed under French law: either in cash or by cancellation of debt (e.g. if the employer owed €100 to the employee, the employee could avoid making a payment in cash of €100 when exercising his/her options and instead cancel the debt)[13].

2.2.2.11 The law does not impose a minimum or maximum term for the options[14]. However:

- For foreign plans, the plans must qualify as stock option plans as opposed to share purchase plans[15].
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- In the case of death, the heirs must exercise the options before the expiration of a six month period starting from the date of death[16].
- Option holders cannot be required to hold the shares acquired on exercise for more than three years following exercise.

2.2.2.12 If the minimum or maximum contract terms set out in the stock option plan are breached the options will lapse and their tax favoured status will be lost.

2.2.2.13 Options are granted free and are not transferable, except in the case of death[17].

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[12] Articles L 225-181 Code de Commerce
[13] Articles L 225-178 Code de Commerce
[14] Article L225-177 Code de Commerce
[15] Instruction (Tax administration ruling) 5 F-19-88 of 6 May 1988
[16] Article L225-183 Code de Commerce
[17] Articles L. 225-183 Code de Commerce

2.2.2.14 There is no process by which qualifying plans are approved. To receive favourable tax treatment the terms must be met and it is open to the tax authorities to audit the plan at the time that relief from tax is claimed.

2.2.3 *Unlisted companies*

2.2.3.1 For unlisted companies, the requirements for a qualifying plan are the same, except as set out below.

2.2.3.2 In the case of a 10% subsidiary, eligibility to participate in a qualifying plan is restricted to employees only, and excludes directors with a management function[18].

2.2.3.3 For unlisted companies the price payable on exercise of the option (the "exercise price") cannot be less than the value of the shares at grant. The new legislation (loi NRE) provides for guidance rules to be issued on how unlisted companies should be valued in order to determine the exercise price. The new law sets out objective criteria weighting the net worth, profitability and prospects of the company. However the guidance rules have yet to be published. In the meantime it is recommended that the exercise price is determined on a basis consistent with the objective criteria set out in the new law[19]. The tax administration also requires that the same method of valuation is applied throughout the life of the option (grant, exercise and, preferably, sale).

2.2.4 *"Non qualifying" foreign plans*

2.2.4.1 There are no specific requirements.

[18] Article L225-180 Code de Commerce, Article L225-177 Code de Commerce

[19] Instructions of 21 June 1991 No. 5 F-9-91

3. Taxation

3.1 Time of taxation

3.1.1 The following table sets out the time at which a charge to tax or social security contributions can arise:

	Qualifying plan	**Non qualifying plan**
Grant	No income tax or social security contributions	No income tax or social security contributions[A]
Vesting	No income tax or social security contributions	No income tax or social security contributions
Exercise	Income tax[20],CSG, CRDS and social security contributions on the excess discount[21] (see section 3.2.1.1), if any	Income tax, CSG, CRDS and social security contributions on the taxable gain (see section 3.2.2.1)
Sale	*On exercise gain (see section 3.2.1.2)* If the holding period and filing requirements are satisfied, liable to income tax at beneficial rates (see section 3.3.1.7), CSG, CRDS and Prélèvement social[22] If the holding period or filing requirements are not satisfied, liable to income tax, CSG, CRDS and social security contributions *On sale gain (see section 3.4.1.2)* Liable to income tax at beneficial rates (see section 3.4.1.5), CSG, CRDS and Prélèvement social	Income tax at beneficial rates (see section 3.4.2.2), CSG, CRDS and Prélèvement social on capital gain (see section 3.4.2.1)

A This assumes that:

- The option is a non-transferrable right to acquire shares of a company at a pre-determined price.
- The entity granting the option is the entity issuing the underlying shares.

20 Article 80 bis II of the French tax code

21 Article L242-1 of the French social security code

22 Article 163 bis C and 200 A of the French tax code (code Général des Impôts)

- If the option were deeply discounted (e.g. a nil cost option) that this would not trigger a tax or social security contribution liability at grant, but this is far from certain and there is no relevant case law.

3.1.2 French resident taxpayers are liable to account for any income tax due. Income tax is due during the year following the year in which the income is received (exercise or sale). Two instalment payments are due before 15 February and 15 May equivalent to one-third of the income tax of the previous year. The balance is payable upon the issuance of the tax bill in September. The full amount of income tax is due in September only for the first year of taxation in France.

3.2 Taxable gain

3.2.1 *French stock option plans or "foreign qualifying plans"*

3.2.1.1 Any excess discount is taxable on exercise. The excess discount is the extent to which the fair market value ("FMV") of the shares at grant less the exercise price payable to exercise the option exceeds 5% of the FMV of the shares at grant. (Note the exercise price can be at a discount of up to 20% of the FMV of the shares at grant without the plan losing qualifying status, see section 2.2.2.9.) The FMV of the shares at grant is the average price during the twenty stock exchange sessions preceding the date of grant or the average purchase price of the shares held by the company.

3.2.1.2 When the shares are sold the exercise gain will become taxable. The exercise gain is calculated as the difference between the FMV of the shares at exercise and the exercise price, or 95% of the FMV of the shares at grant (as defined in section 3.2.1.1) if there was any excess discount. This is because the excess discount is taxable at exercise not sale.

3.2.2 *"Non qualifying" foreign plans*

3.2.2.1 The taxable gain on exercise is calculated as the FMV of the shares on exercise less the exercise price.

3.3 Type of tax

3.3.1 *French stock option plans or "foreign qualifying" plans*

3.3.1.1 Any excess discount (see section 3.2.1.1) taxable on exercise is subject to income tax, CSG, CRDS and social security contributions.

3.3.1.2 The highest marginal rate of income tax for 2001 is 52.75%.

3.3.1.3 The taxable amount is net of social security contributions and may benefit from 10% and 20% deductions if the respective ceilings (€12,229 – 10% ceiling - and €22,380 – 20% ceiling - for 2001 salaries) have not already been reached by the individual.

3.3.1.4 Social security contributions including Contribution sociale gènèralisèe ("CSG") (7.5%) and Contribution au remboursement de la dette sociale ("CRDS") (0.5%) would apply. Some of these are capped. The overall average is approximately 20-25%.

3.3.1.5 The exercise gain on the sale of the shares is liable to income tax, CSG, CRDS and Prélèvement social but not social security contributions provided that both a holding period requirement and a filing requirement (see section 5.1.1.2) are fulfilled. If either of these requirements is not fulfilled then the exercise gain is liable to income tax and social security contributions including CSG and CRDS[24]. The quotient rule, which aims to diminish the progressiveness of the tax bands is applicable (see section 11.1).

3.3.1.6 The holding period requirement for options granted before 27 April 2000 is that five years have elapsed between the grant of the option and the sale of the shares. For option grants on or after 27 April 2000 the holding period is reduced to four years[23].

3.3.1.7 Where both the holding period and filing requirement are fulfilled, no tax will be due if the gross proceeds on share sales by the taxpayer and his/her household do not exceed an annual limit (€7,650 for 2002 disposals; €7,623 for 2001 disposals) during the relevant tax year. If the annual limit is exceeded, the holding period is met, and the appropriate filings made, the total exercise gain is taxed at the following income tax rates for 2002:

- 16% (26% including surtaxes, i.e. CSG, CRDS and Prélèvement social) for options awarded before 20 September 1995 if the sale of the shares is at least five years after the grant of the options.

- 30% (40% including surtaxes) for options awarded after 20 September 1995 but before 27 April, 2000 if the sale of the shares is at least five years after the grant of the options.

- 30% (40% including surtaxes) for options awarded on or after 27 April 2000 on the portion of the exercise gain up to €152,500 if the sale of the shares is at least four years after the grant of the options, or 16% (26% including surtaxes) if the shares are held for a further two years after both the expiration of the initial four year period and the exercise of the options.

- 40% (50% including surtaxes) for options awarded on or after 27 April 2000 on the portion of the exercise gain above €152,500 if the sale of the shares is at least four years after the grant of the options, or 30% (40% including surtaxes) if the shares are held for a further two years after both the expiration of the initial four year period and the exercise of the options.

3.3.1.8 The employee may opt for taxation at progressive rates as employment income if it is more favourable to him/her than the rates set out in section 3.3.1.7.

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23 Article 150 OA of the French tax code (Code Général des Impôts)

3.3.1.9 If either the holding period or the filing requirement is not satisfied, the exercise gain (see section 3.2.1.2) will be subject to the same progressive income tax rates, surtaxes and social security contributions as for the excess discount (see section 3.3.1.1).

3.3.1.10 The rates of employee social security contributions are dependent on the employee's earnings, but on average are between 20% and 25% for the employee (including CSG and CRDS)[24].

3.3.1.11 If the option holder has died and his/her options are exercised by his/her heirs within six months of his/her death favourable tax and social security treatment is available.

3.3.2 *"Non qualifying" foreign plans*

3.3.2.1 The taxable gain (see section 3.2.2.1) on exercise is treated as compensation subject to the same progressive income tax rates, surtaxes and social security contributions as for the excess discount (see section 3.3.1.1).

3.4 Capital gains taxation

3.4.1 *French stock option plans or "foreign qualifying" plans*

3.4.1.1 Any gain on the sale of the shares (the "sale gain") is charged to income tax, CSG, CRDS and Prélèvement social, but not to social security contributions.

3.4.1.2 The sale gain is calculated as the difference between the net sales proceeds and the FMV of the shares at the exercise date[25].

3.4.1.3 The sale gain is taxed at flat rates[26].

3.4.1.4 No tax will be due if the gross proceeds on share sales by the taxpayer and his/her household do not exceed an annual limit (€7,650 for 2002 disposals; €7,623 for 2001 disposals) during the relevant tax year.

3.4.1.5 If the total sale proceeds exceed the limit, the full sale gain is taxed at:

- 16% (income tax).
- 10% (surtaxes: CSG, CRDS and Prélèvement social).

[24] Circulaire of 4 April 1997 (DSS/SDFGSS/5B/97255)
[25] Article 150 OA of the French Tax Code (Code Général des Impôts)
[26] Article 80 bis of the French tax code (Code Général des Impôts)

3.4.1.6 If the shares are sold at a loss (i.e. for less than the price paid to acquire them at exercise) the loss is offset (i) first against the exercise gain (ii) then against any other capital gains realised on the sale of other shares[27]. The portion of the loss exceeding the exercise gain can be deducted from any capital gains realised on other sales of securities of the relevant tax year and the next five years. The loss cannot be offset against other income in the year.

3.4.2 *"Non qualifying" foreign plans*

3.4.2.1 There will be a tax charge for the employee at the date of sale on the capital gain being the net sale proceeds less the FMV of the shares on exercise.

3.4.2.2 The capital gain and loss relief rules are the same for shares acquired under qualifying and non qualifying plans except that for non qualifying plans a loss cannot be offset against the exercise gain.

3.4.2.3 While there is a wealth tax in France, it is not applicable to stock options.

3.5 Tax consequences for the granting company

3.5.1 *Social security contributions*

3.5.1.1 *French stock option plans or "foreign qualifying plans"*

3.5.1.1.1 No employer social security contributions are payable at grant or vesting, whether or not the "cost" of the option is recharged to the subsidiary employing the option holders. There may be a social security contribution liability for the employer on the exercise of the option if there is an excess discount (see section 3.2.1.1) and assuming that the employee is paying French social security.

3.5.1.1.2 French social security contributions for the employer are approximately 45%.

3.5.1.1.3 Employer social security contributions will also be payable on the sale of the shares, on the exercise gain (see section 3.2.1.2) if either the holding period or filing requirements (see sections 3.3.1.6 and 5.1.1.2) are not met.

3.5.1.2 *"Non qualifying" foreign plans*

3.5.1.2.1 No employer social security contributions are payable at grant or vesting.

3.5.1.2.2 The employer will be liable for social security contributions (approximately 45%) at exercise on the taxable gain (see section 3.2.2.1) whether or not the cost of the option is recharged to the subsidiary employing the shareholders.

3.5.1.2.3 There is no liability to employer social security contributions on the sale of the shares.

[27] Article 150-0 D. of the French tax code; Article 150-0 A; Article 163bis C II. of the French tax code

3.5.2 *Corporate tax deduction*

3.5.2.1 *French stock option Plans or "foreign qualifying" plans*

3.5.2.1.1 For both qualifying and non qualifying plans general principles must be kept in mind. In order for employment expenses to be deductible for the French company, the compensation must relate to work performed for the French entity. In addition, the compensation arising from stock options when aggregated with the annual compensation of an employee must not appear to be excessive compared to compensation paid in similar companies (type of business, size and profitability) to similar employees having the same functions. If the total compensation is excessive, then the excess portion would not be tax deductible. When, in aggregate, the annual compensation paid to an executive grows more than the taxable profits of the employing company or is in excess of such profits, French tax law specifically allows the tax authorities to require economic justifications.

3.5.2.1.2 A corporate tax deduction:

- Is not available for options granted over newly issued shares.
- Is limited to the actual cost borne by the company when the options are granted on reacquired shares, i.e. to the difference between the purchase price paid by the company and the exercise price paid by the employee[28].

3.5.2.1.3 The deduction is available under general principles: expenses are deductible provided that (i) they are recorded as paid to employees working for the French entity and, (ii) the expense is actually borne by the local subsidiary.

3.5.2.1.4 A recharge of the costs will be tax deductible provided that the recharge is sufficiently documented. It is advisable to set up a recharge agreement.

3.5.2.1.5 Where applicable, the corporate tax deduction will be available at the date of the recharge.

3.5.2.1.6 The company is allowed to deduct the following expenses:

- Expenses connected with the purchase of shares.
- Expenses related to the management of the shares purchased or issued until the date the option is exercised.
- Various expenses paid in relation to the option exercise (remuneration of intermediaries, taxes related to stock exchange activities, stamp duties, etc.).

3.5.2.1.7 The above comments are also applicable to options over shares in a foreign parent or subsidiary company of the employer (if the necessary shareholding requirement conditions are met – see section 2.2.2.3). The foreign company should invoice all connected fees to the French employer who would then be allowed to deduct such fees.

[28] Provisions of article 217 quinquies of the French tax code

3.5.2.1.8 The deadlines for claiming the deduction depend on the tax year ("exercise social") chosen by the company. The deduction will apply in the year of the recharge. The cost can only be deducted if the French company has borne the cost, i.e. the cost has been recharged.

3.5.2.2 *"Non qualifying" foreign plans*

3.5.2.2.1 For a non qualifying plan, the total exercise gain, which is treated as additional compensation, should be tax deductible. However, there is conflict under French corporate tax law. It is not clear how this interacts with the basic principle that there is no deduction where options are granted over newly issued shares (dilution issues) and would depend on whether the company wanted to take a more or less conservative approach.

3.5.3 *Other*

3.5.3.1 VAT/sales tax and stamp duty/transfer tax do not have any impact on the operation of employee stock option plans in France.

4. Issues for employees

4.1 Reporting obligations

4.1.1 *French stock option plans or "foreign qualifying" plans*

4.1.1.1 There are no reporting obligations at the date of grant or vesting.

4.1.1.2 When the employee exercises his/her option any excess discount (see section 3.2.1.1) should be included in the employee's pay slip. The employee will have to report the exercise gain (see section 3.2.1.2) on his/her annual tax return (box relating to salary) to be filed in February of each year – forms 2042 and 2047. The employee must file the copy of the exercise certificate (see section 5.1).

4.1.1.3 The employee must also report any foreign accounts (including share accounts) opened, maintained and closed during the relevant tax year.

4.1.1.4 The employee will have a reporting obligation in relation to sale of the shares. The information that needs to be reported is the acquisition and sale price per share, the number of shares sold, and the dates of sale. If the holding period has not been satisfied the sale certificate issued by the employer (see section 5.1) must also be filed.

4.1.1.5 The deadline by which the information must be reported and the tax paid is February of the year following the close of the personal income tax year (1 January to 31 December).

4.1.1.6 Any capital loss (see section 3.4.1.6) must be reported in the form 2074 and annexed to the annual tax return (a special box on the form 2042 is completed if the loss is carried forward).

4.1.1.7 Claims must be filed before 31 December of the second year following:

- The issuance of the tax bill.

- The event justifying the claim.

4.1.2 *"Non qualifying" foreign plans*

4.1.2.1 There are no reporting requirements at grant or vesting.

4.1.2.2 The employee will have to report the taxable gain (see section 3.2.2.1) on exercise on his/her annual tax return (box relating to salary) to be filed in February of each year.

4.1.2.3 The employee will have to report any foreign accounts (including share accounts) opened, maintained and closed during the relevant tax year.

4.1.2.4 The employee will have a reporting obligation in relation to sale of the shares. The information that needs to be reported is the acquisition and sale price per share, the number of shares sold, and the dates of sale. The resulting gain or loss on the sale has to be included in the annual tax return.

4.1.2.5 Special form (form 2047) for foreign gains must be annexed to the annual tax return.

4.2 Cashflow issues

4.2.1 *French stock option plans or "foreign qualifying" plans*

4.2.1.1 There will be no cashflow issues for the employee if options are granted but the employee does not subsequently exercise the options since options under French qualifying stock option plans are granted for free[29].

4.2.1.2 Income tax arising at exercise for resident taxpayers is the taxpayer's responsibility. There are no methods to alleviate any cashflow problems. However income tax and social security contributions etc. will only be payable at this time on any excess discount at grant (see section 3.2.1.1).

4.2.1.3 The employer must pay the social security contributions due on the excess discount based on the usual deadlines applicable to compensation and the limits on withholding (see section 5.2).

4.2.1.4 No other provision to alleviate cashflow problems is made.

29 Articles L 225-183 Code de Commerce

4.2.2 *"Non qualifying" foreign plans*

4.2.2.1 Income tax arising at exercise for resident taxpayers is the taxpayer's responsibility. There are no methods to alleviate any cashflow problems.

4.2.2.2 The employer must pay the employee social security contributions due on exercise based on the usual deadlines applicable to compensation and the limits on withholding (see section 5.2).

4.2.2.3 No other provision to alleviate cashflow problems is made.

4.3 Change in employee's residence status

4.3.1 Cross border issues are not clear cut in relation to stock option plans. The income tax and social security contribution positions would differ according to the employee's tax residence status at grant, vesting or exercise. However, the position needs to be determined on a case by case basis.

5. Issues for employers

5.1 Reporting obligations

5.1.1 *French stock option plans or "foreign qualifying" plans*

5.1.1.1 There are no reporting requirements for the employer on grant or vesting from a tax perspective. However, grants to certain managers or to the ten employees benefiting from the highest option grants during the year must be disclosed in a report to the annual shareholder meeting (new legislation)[30].

5.1.1.2 The local employer must issue an exercise certificate by tax year and by employee at the time of exercise.

5.1.1.3 The employer may also need to prepare a report of the excess discount (see section 3.2.1.1) in the relevant monthly payslip of the individual and on the annual salary statement (DADS)[31].

5.1.1.4 The information that needs to be reported in the exercise certificate is as follows:

- The name of the company granting options and the address of the head office or main establishment, if different.
- The dates of grant and exercise.
- The number of shares which have been acquired or exercised.
- The exercise price in Euros.
- If applicable, the excess discount (see section 3.2.1.1).

[30] Articles L 225-184 Code de Commerce

[31] Article 91 bis (annex II of the French tax code)

5.1.1.5 The employer must file the certificate with the French tax centre (*"Direction des Services Fiscaux"*) which processes the company's corporate tax return. The employer must remit a copy of the certificate to the employee, to enable the employee to attach it to his/her annual income tax return.

5.1.1.6 The deadline by which the information must be reported is 15 February of the year following the close of the personal income tax year (1 January to 31 December).

5.1.1.7 In addition, exercises by certain managers or by the ten employees who exercised the most options during the year must be disclosed in a report to the annual shareholder meeting (new legislation)[32].

5.1.1.8 The employer must issue a sale certificate on the sale of the shares if the holding period is not fulfilled. The information that needs to be reported includes:

- The name of the company granting options and the address of the head office or main establishment, if different.
- The dates of grant, exercise and sale.
- The number of shares sold.
- The exercise price.
- The FMV of shares on the date of exercise[33].

5.1.1.9 The certificate must be issued and addressed to the employee and to the French tax center (*"Direction des Services Fiscaux"*) which processes the employee's individual income tax return. The information must be reported on or before 15 February following the close of the tax year.

5.1.2 *"Non qualifying" foreign plans*

5.1.2.1 There are no reporting requirements at grant or vesting.

5.1.2.2 The employer must report the exercise of the option on the relevant monthly pay slip of the individual (i.e. in the month of exercise) and on the annual salary statement (DADS) which must be issued by the company before 1 February of the following year.

5.1.2.3 There will be no reporting obligations for the employer on the sale of the shares.

5.2 Withholding obligations

5.2.1 *French stock option plans or "foreign qualifying" plans*

5.2.1.1 There is no withholding obligation at grant or vesting.

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32 Articles L 225-184 Code de Commerce

33 Article 91 bis (annex II of the French tax code)

5.2.1.2 The local employer may have a withholding obligation in relation to the exercise of options. If there is an excess discount (section 3.2.1.1) and assuming that the beneficiary is affiliated to the French social security system, French social security contributions will have to be withheld through payroll. The benefit will have to be reported on the employee's pay slip for the month of exercise and both employer and employee contributions will have to be paid to the appropriate social security administration before the usual deadlines (which depend on the number of employees and date of payment of the salaries but is generally the 5th of the month following the month of exercise).

5.2.1.3 The amount of the employee's social security contributions paid by the employer on behalf of an employee may be deducted from any outstanding or subsequent salary payable by the employer[34].

5.2.1.4 There is a portion of the salary which has to remain at the employee's disposal. This portion is determined according to a progressive scale. The portion remaining for the employee cannot, in any event, represent less than the Minimum Income ("Revenu Minimum d'Insertion") which amounts to €405.62 per month (as from 1 January 2002)[35].

5.2.1.5 Even if there is a shortfall in the withholding requirement specified above, the employer remains responsible for paying the contributions. He/she may recover the employee portion from the option holder either by direct payment or from subsequent withholdings subject to the above limitations.

5.2.1.6 The employer must fill in the URSSAF forms when making the payments within the usual deadlines.

5.2.1.7 The local employer may have a withholding obligation in relation to the sale of the shares if the holding period is not met. If applicable, the employer must withhold French social security contributions, CSG and CRDS on the exercise gain (see section 3.2.1.2). The employer must fill in the usual URSSAF forms and submit with the payments within the usual deadlines.

5.2.1.8 *Income tax for non resident taxpayers only - reporting*

5.2.1.8.1 The filing of a monthly tax return (Form 2494) by the employer and payment of the tax are due at the same time.

5.2.1.9 *Income tax for non resident taxpayers only - withholding*

5.2.1.9.1 Withholding is applicable for non residents and is due by the 15th of the month following the month in which the tax event occurs. The employer has no withholding obligation (neither social security contributions nor income tax) if the holding period is fulfilled. (See section 5.2.2 for further details.)

[34] Decision of the Social Court dated 25 February 1997

[35] Article L. 145-2 of the French labour code

5.2.2 *"Non qualifying" foreign plans*

5.2.2.1 There are no withholding requirements at grant or vesting.

5.2.2.2 Assuming that the beneficiary is affiliated to the French social security system, on exercise French social security contributions will have to be withheld through the payroll. The taxable gain will have to be reported on the employee's pay slip of the month of exercise and both employer and employee contributions will have to be paid to the appropriate social security administration before the usual deadlines.

5.2.2.3 If the employer cannot withhold the whole amount in the month of exercise (see section 5.2.1.4) these amounts may be withheld against any outstanding or subsequent salary payable by the employer[36]. The employer must fill in the usual URSSAF forms and submit with the payment.

5.2.2.4 French income tax is withheld only if the employee is non-resident for French tax purposes. The tax withholding is calculated according to a specific scale (0%, 15% and 25%). Under French regulations, non residents are subject to a withholding tax on French source salaries, at specific tax rates and under four progressive bands (annual, monthly, weekly or daily income tax bands).

5.2.2.5 The monthly band would be applicable if the employee spends a whole month in France. Generally, if the individual was employed in France full time, the annual rates would be used to withhold tax on the portion of the gain relating to the French activity.

5.2.2.6 In computing the taxable amount mandatory social security contributions are deducted from gross compensation as well as standard deductions applicable in France to salaries (10% for professional expenses and 20% standard deduction).

5.2.2.7 The employer must file a monthly tax return (2494 form) and make payment of the tax due at the same time. Withholding for non residents is due by the 15th of the month following the month in which the tax event (e.g. sale of the shares) occurs.

5.2.2.8 If the employee's compensation reaches the 25% tax bracket, he/she will also have to file an annual tax return.

5.2.2.9 The withholding tax at 0% and 15% frees the corresponding portion of net annual salary from further income tax.

5.2.2.10 There will be no withholding obligation for the employer on the sale of the shares.

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[36] Decision of the Social Court dated 25 February 1997

6. Legal issues

6.1 Process/timeframe

6.1.1 French stock option plans are governed by Articles L. 225-177 et seq. of the French commercial code. There are no general legal procedures whereby the plan is submitted to the French authorities for approval[37].

6.1.2 It is difficult to assess how long it takes to implement a stock option plan.

6.1.3 The procedures typically involved in establishing a French stock option plan include:

- Drafting of rules.
- Convocation of the board of directors.
- Board of directors' meeting: decision to submit to the shareholders the implementation of a stock option plan / decision on the date of this special meeting of shareholders / preparation of a report.
- Listed companies: publicity to be sent to the COB (Stock Exchange authorities) prior to its insertion in the BALO (official legal newspaper).
- Convocation of the shareholders and of the “Commissaires aux comptes” (Specific documents have to be at the disposal of the shareholders and sent to them upon their request) [38].
- Meeting of the shareholders to authorize the operation, to set the method of determination of the exercise price and the period of exercise.
- Submission of the report to the shareholders and the special report of the “Commissaires aux comptes”.
- Publicity (CFE).
- Meeting of the board of directors detailing the option terms.
- Publicity (“Dépôt au greffe”) of the minutes of the board of directors[39].
- Reacquisition of stock (if applicable) prior to the grant date (but not more than one year before) if reacquired shares to be used.

[37] Articles L. 225-177 through L. 225-186 Code de Commerce
Instruction (Tax administration ruling) 5 F-19-88 of 6 May, 1988
[38] L.225-177 Code de Commerce
[39] Articles L. 225-208 and L225-209 Code de Commerce

- Notice of grant to the participants together with a copy of the Plan rules.
- Recharge issues.
- Special reporting upon exercise and sale.
- Annual reporting of major grants and exercises to the shareholder meeting.

6.1.4 The procedures involved in respect of a foreign stock option plan include:

- Determination of whether the plan qualifies[40].
- Establishment of a subplan for French participants (not mandatory).
- Translation of all employee documentation into French.
- If applicable, designation of the participants by the French Board.
- Recharge issues.

6.2 Employment law

6.2.1 Whether or not a prior consultation with employee representatives ("Comité d'Entreprise") or with a trade union is required remains a grey area. The labour rules are not clear and the representatives of the employees ("Comité d'Entreprise") may have to be informed or the registration of their opinion may be necessary. The final decision will depend on (i) the scope of the Plan (broad based versus a few selected participants), (ii) the relationship with the employee's representatives, and (iii) the provisions of the plan (some hardship clauses may introduce the necessity to consult the employee representatives)[41].

6.2.2 French law prohibits discrimination between full-time and part-time employees (applicable to broad-based plans)[42].

6.2.3 The participants' rights to options and shares stem from the terms and conditions of the option plan. Therefore, vesting provisions or cancellation provisions after termination are generally enforceable. However, in cases of wrongful dismissal, the employee could have a right to damages. In a recent case an employee was awarded damages for the loss of his/her exercise gain despite an exercise prior to the dismissal[43].

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[40] Instruction (Tax administration ruling) 5 F-19-88 of 6 May 1988

[41] L. 432-1, L. 432-3 and L.132-27 of the French labour code

[42] L. 212-4-5 du Code du Travail (French labour code)

[43] Cass.soc. 9 May 2001, n° 98-42.615, Pommier c/ SA Bureau Véritas. (Decision of the Labour Chamber of the Supreme Court)
Cass. Soc. 15 January 2002, n° 99-45.979. Navarro c/ Go Sport (Decision of the Labour Chamber of the Supreme Court)
CA Paris, 8e Ch, sect B, 6 November 1997, n°95/00610, Sté LVMH c/Pichot (Decision of the Appeal Court of Paris)

6.2.4 Other issues may arise if the option grant is included in the compensation package mentioned in the employment contract or, if applicable, in the collective bargaining agreement[44].

6.2.5 For French labour law purposes, it is strongly recommended that all employee documentation be translated into French[45].

6.3 Data protection

6.3.1 Automated treatment and communication of personal information between two entities (for instance the issuing company and the subsidiary) requires registration with the CNIL ("Commission Nationale Informatique et Libertés"). Appropriate data privacy transfer authorisation in the written documents (e.g. option agreement, exercise notice) is recommended. A transfer data convention should be signed when the transfer of data involves non EU countries with an insufficient level of data protection[46].

6.3.2 Failure to register with the CNIL is a criminal offence punishable by up to five years' imprisonment and/or a fine up to €305,000. These penalties are incurred by the person in charge of the data process. The directors or the company may also be liable[47].

6.3.3 Under current practice, the CNIL allows voluntary compliance.

6.4 Stock exchange issues

6.4.1 A French company wishing to implement a stock option plan requires shareholder approval. The following documents need to be disclosed to shareholders:

- Report of the board on the proposal to issue stock options and on the method proposed to be used in determining the exercise price.

- Commissaire aux Compte's (Auditor) report on his/her opinion relating to the method suggested by the board for the determination of the exercise price.

- Other documents generally required for shareholder meetings (list of the shareholders and directors, draft of the meeting's resolutions, schedule of the meeting etc.).

6.4.2 Shares offered to more than 100 beneficiaries in France constitute a public offering requiring a prior approval from the French Securities Exchange Commission, the COB, of a prospectus.

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44 Articles L 132-7, L132-8 Code du Travail (French Labour Code); Cass. Soc. N°4244 of 31 October 2000 (Decision of the Labour Chamber of the Supreme Court)

45 Articles L 121-1 Code du Travail (French Labour Code)

46 Act of 6 January 1978, Article 16

47 Articles L.226 –16 to L 226-24, Code pénal.

6.4.3 However, the COB has expressly exempted from the prior prospectus approval process grants made to more than 100 employees under stock option plans governed by articles L 225-177 et seq. of the French Commercial Code. Therefore, no prior approval from the COB is required for qualifying plans.

6.4.4 The position is unclear for non qualifying plans. Most companies have not needed approval of their stock option plans, even where grants were made to more than 100 employees under a non qualifying plan because their plans provided that the options were not transferable and no price was payable for the grant of the option. Nevertheless, the COB may rule differently in the future in order to protect investors.

6.4.5 There are no restrictions on employees holding foreign shares (or options over foreign shares).

6.5 Securities law

6.5.1 For listed companies, the convocation of the shareholders meeting (see section 6.1) has to be sent to the COB before its publicity. There are no other COB requirements for foreign plans provided that the stock option plan is subject to foreign provisions similar to French law.

6.5.2 There are no requirements to file/register the plan[48].

6.6 Financial assistance

6.6.1 A company cannot advance funds, grant loans or security to a third party for the acquisition of its own shares[49]. In particular, this would apply to loans made to officers and directors. However, there is a limited exception under French law relating to acquisition of shares by the employees. The exception must be strictly applied. It should be noted that officers and directors have to avoid insider trading issues.

6.6.2 Criminal offences/ penalties for failure to comply with these provisions depend on the offence[50]. These issues may be avoided when implementing a stock option plan by being aware of black out periods (periods where dealing etc. may be restricted or prohibited) and avoiding the provision of financial assistance to officers and directors. Direct finance from a bank could be used instead.

6.7 Other

6.7.1 There are no foreign exchange control issues to be considered in France.

6.7.2 Employees have no voting or dividend rights prior to exercise. In addition, they cannot generally transfer their options, except in the case of death.

[48] COB Regulation n° 98-08 dated 22 January 1999

[49] Articles l. 225-216 and L. 242-24 of the Code de Commerce

[50] COB regulations n°90-04 and n°90-08; Articles l. 225-216 and L. 242-24 Code de Commerce; Art L. 612-14 of the French Monetary and Financial Code.

6.7.3 There are no formalities required to enable an employee to transfer his/her shares. Some plans (in particular when the company is not listed) include a pre-emption right enabling the company to reacquire its own shares if needed. Unlisted company plans may also include a provision enabling the employee to ask the company to reacquire the shares he/she acquired upon the exercise of the options.

6.7.4 "Droit d'enregistrement" (registration duties) may be due. They are borne by the purchaser of the shares[51].

6.7.5 In general, "cross participations" (a subsidiary holding shares in its parent) are limited under French law. The entity granting the options must be the same as the one issuing the underlying shares[52].

7. Sourcing shares for stock option plans

7.1 The company may grant options over newly issued shares or over shares that are to be purchased in the market ("reacquired shares"). The grant of stock options is one explicit case where a company is allowed to reacquire its own shares under French law[53].

7.2 Specific rules apply to options granted over reacquired shares under French stock option plans or "foreign qualifying" plans[54]:

- If the options enable employees to purchase reacquired shares the shares must be purchased by the company before grant or, under an aggressive view, before vesting, and held by the company until exercise. In principle options must be granted over the shares within 12 months of purchase.

- The exercise price must not be less than 80% of the average purchase price of any stock previously purchased by the company for use in the stock option program, whether the company is listed or not. This condition applies in addition to the usual rules applicable to the determination of the exercise price (which depends on whether the company is listed or not)(see section 2.2.1).

- The company cannot own, directly or indirectly, more than 10% of the total of its shares and not more than 10% of a determined category of shares[55].

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51 Article 726 of the French Tax Code (Code Général des Impôts)

52 Article L. 233-29 and following Code de Commerce

53 Article L225-208 Code de Commerce

54 Articles L225-179 of L225-208 Code de Commerce

55 Article L 225-210 Code de Commerce

7.3 To enable the employee to obtain his/her shares at exercise, he/she must fill in a subscription or acquisition form, notifying the exercise of the option, and pay the exercise price[56]. The board will notify the capital increase (options over newly issued shares) and in most cases delegates to the Chief Executive Officer the duty to file the appropriate publicity on the new capital increase.

8. Role and influence of existing shareholders

8.1 Under French law the introduction of a stock option plan requires shareholder approval. The approval only authorises the granting of options under the plan for a period of 38 months. Shareholders are required to approve the method by which the exercise price is determined and the period during which the options may be exercised.

8.2 There are a number of informal shareholder associations with no legal standing but which are active lobbyists. They are not Government organisations but are in contact with the Government.

8.3 As a result of extensive lobbying and a largely unregulated political environment, new corporate governance legislation was introduced in November 2001 – the "NRE" rule[57]. This provides for greater transparency of the grant and exercise of options to/by officers of a company and the ten highest awards and ten largest exercises each year.

9. Accounting

9.1 There is no specific guidance under French GAAP concerning stock option plans.

9.2 The French law gives a company two methods of granting share options to employees:

- "Article L 208-1": rights to subscribe for shares in the company. At the date the option is exercised, the company will increase its capital by issuing new shares; at the same time, former shareholders of the company have to give up their rights to subscribe for the new shares issued.

- "Article L 208-3": rights to buy shares that had been acquired by the company ("reacquired shares"). At the date the option is exercised, the company will sell to the employee some of its existing shares at a purchase price previously determined by the board of directors.

9.3 The accounting treatment is not the same for each type of share option.

[56] Articles 174-21 of the Decree of 23 March 1967

[57] Loi NRE no 2001-420 dated 15 May 2001 was published in the Journal Officiel no 113 dated 16 May 2001 page 7776.

9.4 Stock options over newly issued shares (L 208-1)

9.4.1 *Accounts of issuing company*

9.4.1.1 The grant of share options has no impact on the Profit & Loss account. When the company satisfies the options at exercise, the increase in capital is reflected by an increase in equity in the Balance Sheet. The excess price paid by the employee to exercise the option over the nominal share value will be recorded as an increase in share premium.

9.4.2 *Consolidated accounts - stock option plan involving an increase in capital at parent level*

9.4.2.1 In the consolidated statements the receipt of the exercise price appears as additional paid-in capital in stockholders' equity.

9.5 Stock options over reacquired shares (L 208-3)

9.5.1 *Accounts of issuing company*

9.5.1.1 The accounting treatment of reacquired shares depends on how the shares are classified in the accounts of the issuing company. Shares with a specific purpose, e.g. to be allocated to employees, are classified in the Balance Sheet as securities. Shares with no specific purpose are classified as investments.

9.5.1.2 Where on the exercise of the option the company transfers reacquired shares to the employee that were classified as securities on its Balance Sheet, the difference between (i) the price paid by employees to exercise the option and (ii) the cost or value of the reacquired shares in the Balance Sheet, is a gain or loss on the disposal of the required shares and is recorded in the Profit & Loss account.

9.5.1.3 Where the reacquired shares are classified as investments there is no impact on the Profit & Loss account, and the gain or loss will be recorded in equity. Nevertheless, in our opinion, if the company then decides to attribute them to employees, they should be reclassified from investments to securities in the issuing company's accounts.

9.5.2 *Consolidated accounts*

9.5.2.1 The accounting treatment in the consolidated accounts stems from the accounting treatment followed in the issuing company's accounts.

9.5.2.2 Reacquired shares accounted for as securities in the issuing company's accounts remain classified as securities (assets) in consolidated accounts.

9.5.2.3 Reacquired shares bought with no specific purpose and classified as investments in the issuing company's accounts should be presented in the consolidated balance sheet as a deduction from equity.

9.5.2.4 The grant of a stock option has no impact on the Profit & Loss or the Balance Sheet. Any impact is only required to be shown in notes in the disclosures.

9.5.2.5 Accounting for stock options has not generally been commented on. The French standards regulator (Conseil National de la Comptabilité) has no current plans to address the issue.

10. Miscellaneous

10.1 The concept of a trust is not recognised by French law. As foreign trusts are sometimes involved in stock option plans, French law includes certain provisions to qualify the gains realised through the trust without expressly defining the type of vehicle[58].

10.2 As trusts are not recognised by French law, one of the issues is to determine whether an offer of shares through a trust is a public offering, which requires a prior COB approval (from a practical standpoint, this could apply if more than 100 employees are involved or not)[59].

10.3 Recent legislation makes it possible to release funds accumulated in a Plan d'Epargne d'Entreprise (PEE) to exercise stock options. If the shares are then blocked for five years in the PEE as from the date of exercise, the exercise and capital gains are subject only to the 10% surtax[60].

10.4 Tax revenues from employee share option plans are not used for a specific purpose.

11. Special points of note

11.1 Mitigation of income tax

11.1.1 If the exercise gain is treated as salary - that is if the option was granted under a non qualifying foreign plan, or was granted under a French stock option plan or a qualifying foreign plan and either the holding period or filing requirement was not fulfilled – the "quotient rule" will apply. If an individual's income is not taxed at the highest rate (excluding the exercise gain) the tax is calculated as follows:

- Tax is calculated on the ordinary income of the taxpayer. (1)
- Tax is then calculated on the total of ordinary income + 1/n of the gain (where n is the number of years between grant and exercise). (2)

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58 Art 120-9° of the French Tax Code (Code Général des Impôts; Note n° 59 of 25 March 1981 of the tax administration relating to the old France/US tax treaty of 28 July 1967

59 COB regulation n°98-08

60 Article L. 443-6 of the French Labour Code (Code du Travail) and Circulaire Interministérielle (ministerial circular) of 22 November 2001 published on 16 February 2002 (JO N° 40 p.3039).

- The difference in tax between 1 and 2 is then multiplied by n, which gives the additional tax due on the additional income. (3)

- The total tax in 1 and the tax in 3 gives the total income tax liability.

11.1.2 This aims to diminish the progressiveness of the tax bands.

11.2 Mitigation of social security contributions

11.2.1 There are no special rules allowing for the mitigation of social security contributions on stock option plans.

11.3 Mitigation of tax on sale of shares

11.3.1 There is no scope for tax mitigation on sale of shares.

11.4 Special provisions for SMEs

11.4.1 There is legislation known as the BSPCE where warrants/options are available for the "creators of enterprises". However, this is not so much about the size of the company but more the fact about that it must be a very recent start-up with at least 25% of the company held by individuals as opposed to corporations. The effect of the legislation is lower tax rates (26%) and shorter holding periods (3 years).

Note: Individual country reports have been prepared covering employee stock options in the EU and the USA. These individual reports are of a general nature and subject to change based on individual circumstances. PricewaterhouseCoopers has also provided the EU with an overview report. This overview report sets out the basis on which the individual reports were prepared and should be referred to as necessary. In particular, it should be noted that the information in the reports is current as at 1 January 2002, unless otherwise stated. In the case of certain known subsequent changes, reference may be made on occasion but a full update exercise has not been carried out. Further information can be obtained from PricewaterhouseCoopers.