Employee Stock Options in the EU and the USA

FINAL REPORT

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The Netherlands

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The Netherlands

1. General remarks

1.1 History

1.1.1 In the 1950s, the Dutch Ministry of Finance started developing guidelines for the taxation of employee stock options. The taxable value of options was effectively set at nil, as the options were predominantly granted to US nationals (expatriates) who would pay tax on their options in the US, based on their citizenship. Later, in the 1970s and 1980s, the taxable value of the options had to be discussed with the Dutch tax inspector on a case-by-case basis.

1.1.2 In 1987, a fixed valuation was introduced into Dutch tax law, based on a valuation of the option at 7.5% of the value of the underlying shares if certain conditions were met:

- The option had to give the employee the right to acquire shares in the capital of the relevant wage withholding agent, generally the employer, or an affiliate of the wage tax withholding company.

- The option itself must not be listed on a stock exchange.

- In practice, the option had to be unconditional – that is either the option had to be exercisable at the date of grant or it would become exercisable in future without the need for any other condition (such as continuing employment) being satisfied.

- The option could be exercisable for no longer than 5 years.

- The exercise price of the option had to be equal to the Fair Market Value ("FMV") of the underlying shares on the taxable date.

1.1.3 In practice, this meant that many foreign, non-Dutch companies revised their option plans specifically for The Netherlands, in order to qualify for the conditions of the favourable 7.5% valuation. The taxable value of unconditional options not qualifying for the 7.5% valuation would still need to be negotiated with the Dutch tax inspector based on, for example, Black & Scholes option valuations[1]. If the option was conditional the date of taxation was the date on which it became unconditional, generally the date of vesting, when the taxable value would be agreed with the Dutch tax inspector.

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[1] Tweede Kamer, vergaderjaar 1986, 1987
19700 Hoofdstuk IXB nr. 58.

1.2 Current situation

1.2.1 The 7.5% valuation was replaced on 26 June 1998 by the valuation formula which is applicable today.

1.2.2 No tax favoured plans have been introduced or are supported from an official, legislative point of view.

1.2.3 In practice, in The Netherlands, the features of a stock option plan will depend on the sector in which the company implementing the plan operates. Generally speaking, during the internet boom in the 1990s, many start-up companies (ICT, telecom and internet) operated plans with unconditional options as such plans were considered most attractive from a tax perspective. Increasingly, plans with conditional options are being operated by both "new economy" companies and the more traditional companies, in view of tax law changes in 1998 and given the changed market environment. In addition, there are greater demands on Dutch companies to conform to best practice when granting options to, or operating option plans for, directors[2].

1.2.4 In 2001 research was undertaken by Towers Perrin in The Netherlands. This publicly available research indicates that virtually all of the larger companies listed in The Netherlands (AEX and Midkap) have stock options. Also in other companies, options are widely used as a way to motivate and retain executives and employees[3].

1.2.5 From 28 December 2000, a new election regime was introduced in The Netherlands, allowing employees to elect to defer taxation of the taxable benefit until the actual date of exercise, (see section 3.1 below).

1.2.6 In addition, following various judgments of the Dutch Supreme Court, the corporate tax consequences of operating a stock option plan in The Netherlands have been modified, (see section 3.5 below).

1.2.7 Finally, a new interpretation of the rules governing the taxation of stock options in cross border situations was announced on 11 February 2002, (see section 4.3 below).

1.2.8 It may be possible that further changes can be expected in the future, inter alia, to facilitate the operation of the deferral regime and possibly to facilitate the new allocation rules in cross border situations. Although there are currently no indications or discussions of such changes, the operation of the deferral regime is difficult in practice, and even more so in combination with the new rules as to the international allocation of stock option benefits. This is one of the reasons why

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[2] VNO-NCW and NCD recommendations for introducing stock option plans for managing directors (July 2001)

[3] VNO-NCW and NCD, Monitoring recommendations for introducing stock option plans for directors, 18 June 2001 (research Towers Perrin 2001)

many companies continue to operate alternative equity reward schemes (such as SARs), in order to try and circumvent the use of the deferral regime. This may trigger renewed attention for the deferral regime by the tax authorities and the Ministry of Finance.

2. Key features of stock option plans

2.1 There is no minimum term for which the stock options must be granted nor a maximum term for which the stock option can subsist.

2.2 There are no specific legal provisions in The Netherlands as to who may or may not participate in employee stock option plans. The relevant sections of the stock option plan would, therefore, govern the selection of participants for the plan. Securities laws and anti-discrimination laws may have an impact on the selection of employees (see section 6 below).

2.3 There is no general, legal principle that stipulates that all employees must always be treated on similar terms (regardless of, for example, job title, salary level, etc.). In this regard, general labour law principles with regard to the remuneration of employees would apply. Furthermore, the company must comply with the non-discriminatory rules (see section 6.2 below).

2.4 There are no restrictions under Dutch (tax) law regarding the nature of the shares over which options may be granted under a stock option plan. Nor is there any restriction on the type of company that may grant options under this type of plan (e.g. due to size, nature of business etc).

2.5 There are no restrictions over the value of shares over which options may be granted to the employee.

3. Taxation

3.1 Time of taxation

3.1.1 *Grant*

3.1.1.1 It is possible for the employee to be taxed on the grant of an option. Under Dutch tax law, options are taxed at the date the options become unconditional for the employee. Unconditional options are options that can be exercised immediately as of the date of grant, or options that are subject to a time restriction only. If an option is unconditional when granted it will, in principle, be taxed at the date of grant[4]. The employee could, however, elect to defer the point of taxation until exercise (see below).

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[4] Article 13 of the Dutch Wage Tax Act 1964 effectively renders benefits in kind subject to Dutch wage tax. This has been developed over a number of years, based on a wide range of supreme court ("Hoge Raad") decisions. We refer to, inter alia, Supreme Court decision BNB 1985/16, BNB 1992/231, BNB 1992/232.

3.1.1.2 If the option is unconditional there will also be a social security liability for the employee on the grant of the option, unless the maximum income threshold is already exceeded.

3.1.1.3 The date of grant, for Dutch tax purposes, is the date on which the employee accepts the offer of the options.

3.1.2 *Vesting*

3.1.2.1 If the options are conditional options the option will become taxable at vesting. Conditional options are options that at the time of grant are subject to a time restriction and a future uncertain event (e.g. a vesting period together with a continued employment condition), and will be taxed at the date these conditions are met and the options first become exercisable, i.e. date of vesting. The employee could, however elect to defer the point of taxation until exercise (see below).

3.1.2.2 There will be a social security contributions liability for the employee at the point at which a conditional option vests.

3.1.3 *Exercise*

3.1.3.1 In the absence of an election to defer taxation there is no tax due at the date of exercise of either conditional or unconditional options, unless the options are exercised within three years of the date of grant.

3.1.3.2 On 28 December 2000, the "election regime" was introduced, allowing employees to choose whether their options will be taxed: (i) on the date(s) the options are exercisable for the first time (i.e. the date of grant for unconditional options or the date of vesting for conditional options) or (ii) on the date(s) the options are actually exercised.

3.1.3.3 In order to defer taxation until exercise, both the employee and employer must jointly notify the wage tax inspector of such choice. The election must be received by the employer's wage tax inspector prior to the first taxable date. The notification can be done by means of an election form. Once the choice for taxation at exercise is made, it applies for each subsequent vesting date (if any). The choice cannot be reversed and has to be made per option grant (e.g. for each separate option agreement). An election to defer taxation can only be made if there is a Dutch wage tax withholding agent (see section 5.2 below.)

3.1.3.4 If the tax authorities have not received such notification prior to the first taxable date, the options will be taxed as set out in sections 3.1.1 to 3.1.3.1 inclusive.

3.1.3.5 However, if the option exercise price is less than the FMV of the underlying shares on the date of grant, tax on the discount cannot be deferred and will be taxed on the date of grant in case of unconditional options or the date of vesting in case of

conditional options. The discount will only be taxed insofar it still exists on such dates.

3.1.3.6 On the exercise of the option, there will be no Employee Insurance contributions, but National Insurance contributions may be due, if either the employee exercises within 3 years of grant or has elected to defer taxation until exercise. (See section 3.3 below.)

3.2 Taxable Gain

3.2.1 *Grant*

3.2.1.1 The taxable amount for non-quoted options is determined by a prescribed published formula, which accounts for both an intrinsic value and an expectation value. The outcome of the formula is a percentage (**P**) that is then multiplied by the FMV of the underlying shares on the date of grant, to determine the taxable value of the option. The tax liability is calculated by applying the tax rate to the total taxable value[5].

P is determined as, the Intrinsic Value (**I**) + Expectation Value (**V**)

Where:

$$I = ((W-U)/W) \times 100$$

W is the FMV of one share at the taxable date
U is the exercise price per share

$$V = (4.5 - (0.1 \times T)) \times T - (0.09 - (0.002 \times T)) \times I \times T$$

T is the length of the exercise period between the taxable date and the last date on which the option can be exercised, expressed in years or fractions of years.

P is never less than 4%
V cannot be negative – so a negative result is taken as nil
I and **V** are rounded down to whole numbers
T is a maximum of 20 years.

3.2.1.2 The formula must be used by law, although companies can provide counter evidence to try and secure a lower valuation. In practice this is rare.

3.2.1.3 The amount chargeable to social security contributions is determined by applying the same formula.

3.2.1.4 Under Dutch tax law, wage tax and social security contributions are payable at the taxable date regardless of whether the option is exercised or not. Under Dutch tax

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5 Article 20 of the Regulations (2001) to the Dutch Wage Tax Act 1964.

law, it is not possible to claim a refund for taxes paid if the options are never exercised.

3.2.1.5 If the employee paid for the grant of the option, this contribution should normally be deductible from the taxable benefit. This remains the same even if the option is never exercised.

3.2.2 *Vesting*

3.2.2.1 For a conditional option the taxable amount for non-quoted options is determined by the formula set out above, taking as the taxable date the date of vesting, as set out in section 3.2.1.1 above.

3.2.2.2 The total option benefit will be subject to social security contributions on the actual date of vesting, based on the taxable benefit as calculated in accordance with the published formula.

3.2.3 *Exercise*

3.2.3.1 There is an additional tax liability where options (regardless of whether they are conditional or unconditional) are exercised within three years following the date of grant[6]. If the option is exercised within three years following the date of grant, tax is due on the total benefit realised at exercise, being the FMV per share on the date of exercise minus the exercise price paid. Any taxable benefit previously taxed is taken into account in order to avoid double taxation on the same stock option.

3.2.3.3 A tax liability will also arise on exercise if, prior to the original taxing date, the employer and employee made an election to the Dutch wage inspector to defer taxation until exercise.

3.2.3.4 Where the employee elected to defer tax until exercise, the taxable value is (i) the FMV of the acquired shares at the date of exercise, minus (ii) the total exercise price paid and also minus (iii) any discount taxed at grant or vesting (see section 3.1.3.6).

3.2.3.5 National Insurance contributions will also be levied on the taxable amount.

3.3 Type of tax

3.3.1 The option benefit will be subject to Dutch wage tax, including National Insurance contributions.

3.3.2 The income tax liability is calculated by using the normal progressive Dutch tax rates with a top marginal tax rate of 52% (in the year 2002).

3.3.3 There are two different types of social security contributions in The Netherlands:

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[6] Article 10a, sub 3 of the Dutch Wage Tax Act 1964

- National Insurance contributions (*premies volksverzekeringen)*
- Employee Insurance contributions (*premies werknemersverzekeringen)*

3.3.4 National Insurance contributions are levied together with Dutch wage tax, and are due in respect of any taxable benefit arising for wage tax purposes. National insurance contributions are levied by the tax office.

3.3.5 Employee Insurance contributions are due (i) on the date of grant of unconditional options; (ii) on the date of vesting for conditional options. Employee Insurance contributions are not deferred even where an election to defer the taxable date is made. In addition, Employee Insurance contributions are not due if the employee exercises his option within 3 years of the date of grant. They are levied on the taxable benefit at grant or vesting, determined in accordance with the (tax) formula.

3.3.6 National Insurance contributions are levied at a rate of 29.4% on annual income up to €27,847 (2002).

3.3.7 Employee Insurance contributions are levied at different rates depending upon the type of industry. The average rate applied is 6.65% for the employee for the year 2002 on an annual income up to €41,499 (2002), including National Health Insurance ("*ZFW*").

3.4 Capital gains taxation

3.4.1 There is no capital gains tax in The Netherlands.

3.4.2 Generally, there will be no tax for the employee at the date of sale. However, this may be different for individuals with a "substantial interest" in the company ("*aanmerkelijk belang*"). A separate tax regime exists for substantial interest holders (based on a flat tax rate of 25%)[7].

3.4.3 Broadly, individuals have a substantial interest if they (together with a defined group of relatives) hold 5% or more of the share capital of the company or 5% or more of a certain class of shares in the company. In this respect, options are also regarded as share holding.

3.4.4 There will be no social security contributions liability for the employee at the date of sale.

3.4.5 From 1 January 2001, the average net value of an individual's privately held investments, including shares, is taxed annually based on the imputed return on the investment. The tax is levied on 4% of the value of the individual's net assets and this imputed return is taxed at a flat rate of 30%, resulting in an effective tax rate of 1.2%. The tax is levied regardless of the actual return on the investment. The average net value of an individual's privately held investments is calculated by

[7] See Articles 4.1 to 4.53 of the Dutch Income Tax Act 2001.

averaging the value of such assets at the beginning and end of each calendar year. An annual exemption (€18,146 for 2002) is available[8].

3.5 Tax consequences for the granting company

3.5.1 *Social security contributions*

3.5.1.1 There will be a liability for the employer to pay Employer Insurance contributions on the grant or vesting of the option depending upon whether the option is unconditional or conditional. The employer will only be subject to Employer Insurance contributions, not National Insurance Contributions.

3.5.1.2 Employer Insurance Contributions are levied at different rates depending upon the type of industry. The average rate applied is 18.66% for the year 2002, including National Health Insurance ("ZFW"). These contributions are only imposed on annual income up to €41,499 (2002).

3.5.1.3 There will be no liability for the employer to pay Employer Insurance contributions on the exercise of the option. Even where the choice to defer taxation is made, Employer Insurance Contributions will be due at the first taxable date (i.e. the date of grant for unconditional options and the date of vesting for conditional options).

3.5.1.4 There will be no social security contributions liability for the employer on the sale of the shares.

3.5.1.5 This position is not impacted if the "cost" of the option is recharged to the subsidiary employing the shareholders.

3.5.2 *Corporate tax deduction*

3.5.2.1 The employing company will be entitled to claim a deduction against its profits for corporation tax for the costs of an option plan.

3.5.2.2 The corporate tax deduction for the costs associated with employee stock options will be limited to the taxable value that is, or could be, taken into consideration on the taxable date for Dutch wage tax purposes. This is the grant date for unconditional options or the date of vesting for conditional options, not taking into account any employee election to defer tax until exercise and not taking into account the additional levy in case of exercise within three years of grant[9].

3.5.2.3 The corporate tax deduction will, therefore, be equal to the benefit taxable for the employee calculated on the basis of the legislative Dutch wage tax valuation formula. The deduction is available in the fiscal year in which the taxable benefit for the employee is (or should be) recognised in accordance with the main rules.

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[8] See Articles 5.1 to 5.23 of the Dutch Income Tax Act 2001

[9] Article 9(1), letter h of the Dutch Corporate Tax Act 1969.

3.5.2.4 There is no necessity to recharge the costs to the Dutch local entity in order to have a corporate tax deduction. However, to the extent that no recharge is made, this may trigger an informal capital contribution in the Dutch subsidiary (on which 0.55% Dutch Capital tax is due).

3.5.2.5 There are no special procedures in place for making a claim. The deduction must be included in the corporate tax return for the fiscal year concerned.

3.5.3 *Other*

3.5.3.1 *VAT / sales tax*

3.5.3.1.1 VAT / sales tax generally has no impact on the operation of employee stock option plans in The Netherlands. This would only be different if the Dutch tax authorities classified a recharge of option costs as a transaction, which is subject to VAT.

3.5.3.2 *Stamp duty / transfer tax*

3.5.3.2.1 Where a Dutch based company grants options over its own shares, an informal capital contribution is deemed to be made in the company, which is subject to capital tax (0.55% in 2002). This is based on new legislation which was recently accepted by the First Chamber and becomes effective on 29 August 2002. The taxable date for capital tax purposes coincides with the taxable date for Dutch wage tax purposes: this is the date of grant for unconditional options and the date of vesting for conditional options. The taxable amount for capital tax (i.e. the amount of the informal capital contribution to the company) is equal to the taxable benefit calculated on the basis of the legislative Dutch wage tax valuation formula, irrespective of whether or not the employee has elected to be taxed at the date of exercise. In other words: the employee's election is irrelevant for the amount of the informal capital contribution and the capital tax charge. When calculating the total informal capital contribution, the Dutch company should include all option grants, not only grants made to Dutch based employees but also grants made to employees working for a foreign subsidiary company (although those employees are not subject to tax in The Netherlands). The capital tax charge due at grant or vesting cannot be set off against the capital tax due upon the issuance of new shares following the exercise of options (where new shares are used). Otherwise, stamp duty / transfer tax has no impact on the operation of employee stock option plans in The Netherlands.

4. Issues for employees

4.1 Reporting obligations

4.1.1 The employee will have a reporting obligation in relation to the option, at any time there is a taxable benefit.

4.1.2 The employee will have no reporting obligations in relation to sale of the shares, assuming he/she has no substantial interest in the company.

4.1.3 Generally speaking, the individual is obliged to report the total taxable benefit of the option in his/her Dutch annual income tax return for the financial year in which the taxable event occurs. However, if wage tax was withheld, the taxable amount is already included on the annual income statement ("*jaaropgaaf*") and in that case it needs to be determined on an individual basis whether filing of an income tax return is obligatory (in case of a balance payable) or beneficial (in case of a balance refundable).

4.1.4 The return has to be filed before 1 April of the calendar year following the year of the taxable event. An extension for filing may be possible, if approved by the tax inspector.

4.2 Cashflow issues

4.2.1 If the employee's salary is not sufficient to pay the whole amount of any taxes due on the option benefit, the company should nevertheless remit the amount of tax due to the tax authorities and may either (i) ask the employee to reimburse the taxes paid immediately or (ii) provide a loan to the employee.

4.2.2 Providing a loan to the employee interest-free or at an interest rate below market level (set at 4.5% for 2002) is considered employee income, and therefore, a taxable benefit under Dutch tax law.

4.2.3 If the local employer pays the Dutch taxes due without recovering the amounts (or the shortfall) from the employee, the employer will be deemed to have borne the tax payable by the employee. The amount of taxes that are not recovered from the employee would then need to be grossed up.

4.3 Change in employee's residence status

4.3.1 The Dutch Ministry of Finance published a new Policy Statement on 21 February 2002 (officially dated 11 February 2002) in respect of the allocation of stock option income in cross-border situations.

4.3.2 Under the new Policy Statement, the allocation of the taxable benefit from options relating to employment duties performed or to be performed in The Netherlands is, in each specific case, reserved for the competent tax inspector. However, the guidelines set out in 4.3.3. and 4.3.4. below apply in order to provide uniformity in policy and operation:

4.3.3 *Unconditional stock options*

4.3.3.1 The main rule for unconditional options is that the taxable benefit from unconditional stock options is related to employment duties performed in the period prior to the grant date regardless of whether or not the employee may only exercise these option rights after a certain waiting period.

4.3.4 *Conditional stock options*

4.3.4.1 The main rule for conditional options is that the taxable benefit realised by the option holder is related to employment duties performed during the entire period the option remains conditional (i.e. the period between the period between the date of grant and the date the option(s) can be exercised for the first time – the vesting date).

4.3.4.2 As this Policy Statement was only published recently, there is little experience as yet as to the practical implications of the Policy Statement.[10].

5. Issues for employers

5.1 Reporting obligations

5.1.1 The local employer may have reporting obligations in relation to the grant, vesting or exercise of the option, but will have no reporting obligations in relation to the sale of the shares.

5.1.2 If the local employer is the Dutch wage tax withholding agent (see section 5.2 below), the taxable benefit must be included in the Dutch payroll administration. There is no other, separate reporting requirement to the Dutch tax authorities.

5.1.3 After having processed the monthly payslips, the local employer is responsible for filing a Dutch wage tax return ("*loonbelasting aangifte*") with the Dutch tax authorities.

5.1.4 In practice the wage tax return must usually be filed before the end of the month following the month of the taxable event. In some cases, the wage tax return can be filed on a quarterly basis.

5.1.5 The employer is also required to report the taxable benefits awarded to its employees on each individual's annual income statement ("*jaaropgave*") before January 31st of the following year.

5.2 Withholding obligations

5.2.1 The local employer will usually have a withholding obligation when a taxable event occurs. If no withholding obligation exists, an election for deferral of taxation cannot be made.

5.2.2 The local employer will have no withholding obligation in relation to the sale of the shares.

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[10] Decision of the Ministry of Finance dated 11 February 2002, nr. IFZ 2002/40M.

5.2.3 The stock option benefit is considered an irregular payment. Irregular payments are generally subject to a flat tax rate under the Dutch Wage Tax Act ("*tabel bijzondere beloningen*"). However, the wage tax withheld is only a pre-levy which is off-set against the employee's final Dutch income tax liability[11].

5.2.4 The local employer will be required to withhold the full amount of Dutch taxes from the employee's salary (subject to local employment regulations) and remit the funds to the Dutch tax authorities together with the monthly or quarterly wage tax return for the period in which the taxable event occurs.

5.2.5 Generally the tax and social security position is not impacted if the "cost" of the option is recharged to the subsidiary employing the option holders. In certain exceptional circumstances, a local employer (subsidiary of a foreign, non-Dutch parent company) may not be considered the Dutch wage tax withholding agent. The recharge of option costs can be one of the criteria in this determination. However, the absence of a Dutch wage tax withholding obligation for the Dutch employer would be exceptional.

6. Legal issues

6.1 Process/timeframe

6.1.1 The time required for the practical implementation of a stock option plan in The Netherlands could range from three months to one year but ultimately depends on the complexity of the plan and, where necessary, the tax inspector's position in providing prior approval of the tax treatment.

6.1.2 The implementation of a stock option plan will, in principle, involve the following:

- Design the Plan.
- Draft the Plan documentation (Plan Rules, Option Agreements, Notice of Exercise Forms etc.).
- Tax and Legal review of the Plan and the company's statutes. The tax work could involve securing upfront approval of the tax treatment from the Dutch wage tax authorities.
- For unlisted companies, a Foundation ("*Stichting*") and depositary receipts may be required to create an internal workable market. This requires drafting, tax review and legal review.
- For listed and some unlisted companies, a prospectus may be required for Dutch regulatory purposes.

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[11] Article 26 of the Dutch Wage Tax Act 1964

- Due diligence of tax, legal and regulatory requirements for countries outside The Netherlands if an international plan is established.

- Adoption of the Plan by the Board.

- Preparation of communication materials.

- Organisation of administration support.

6.1.3 However, this list is not intended to be a complete and detailed description of the work to be performed in order to introduce a stock option plan. This description is illustrative only. The work to be undertaken will ultimately depend on the type of the plan introduced.

6.2 Employment law

6.2.1 The Works Council may have a right of prior approval regarding the decision to implement the plan.

6.2.2 Prior approval will be required where the employee stock option plan is considered to be a remuneration scheme that applies to all or a group of employees (a group being a number of employees sharing the same functional characteristics or interest). Approval must be obtained from the Works Council before the decision to implement the scheme has been taken. Where the local Dutch subsidiary employs 50 or more individuals it is, in principle, required to establish an employee Works Council.

6.2.3 Careful analysis is required in order to ascertain whether Works Council approval is needed or not as it is not always easy to determine whether such plans qualify as remuneration plans for all employees or a group of employees. Recent case law strengthens the position that an option plan is a remuneration scheme for the purposes of the Works Council legislation.

6.2.4 There are no other regulatory or official bodies that require notification or consultation at any stage from an employment law perspective.

6.2.5 Under Dutch law and, in particular, under the General Act on Equal Treatment ("*Wet gelijke behandeling*") and the Act on Equal Treatment of Men and Women ("*Wet gelijke behandeling van mannen en vrouwen*"), companies may not exclude employees from participating in a stock option plan unless there is an objective justification for making the distinction between eligible and ineligible employees.

6.2.6 Generally speaking, Dutch law does not prohibit different treatment of employees on the basis of the number of working hours, provided that such different treatment does not constitute indirect or concealed discrimination, in breach of the two Acts mentioned above. Such a breach may, for instance, occur when the grant of options is made only to full time employees: if a large percentage of female employees is employed on a part time basis and is, therefore, excluded from the grant, this could be considered as an indirect or concealed discrimination of female employees.

6.2.7 It is generally possible to allow part time employees to participate in a stock option plan on a pro rated basis.

6.2.8 Under Dutch employment law, there is a chance that employment benefits – such as stock options – will be included in the calculation of any redundancy payment. This is the case even if the employer has explicitly stated that certain benefits should not be included in any redundancy calculation.

6.2.9 There is some case law on this issue but these cases are relatively new and have not (yet) all proceeded to the Supreme Court of The Netherlands ("Hoge Raad"). In the past, the Dutch Supreme Court ruled, for example, that upon termination of employment, the employee may have a continued right to exercise his or her stock options in the event of an unfair or unlawful dismissal (even where the options were unvested at the time of termination of employment).

6.2.10 The Supreme Court also ruled in some cases that the estimated value of the options (at the time of termination of the employment) should be regarded as part of the compensation payment upon termination of employment where the dismissal was unfair or unlawful.

6.2.11 Option benefits may be considered "fixed" employment benefits or "acquired rights" when granted regularly over a certain period of time or when they form part of the fixed, "official" terms and conditions of employment. As such the employee may have an "acquired" right to future awards of options. Such benefits cannot be withdrawn unilaterally by the employer. In order to attempt to avoid acquired rights issues, employers would, generally, include a provision in the plan stating that the grant of options in any year does not constitute a right to the grant of options in any subsequent years.

6.3 Data protection

6.3.1 In general, under Dutch data protection law, personal data may only be collected for specified, explicit and legitimate purposes. This means that the company may only process data relating to individual employees to the extent that this is necessary for the purposes of the operation of the stock option plan. The personal data must be accurate, relevant and not excessive.

6.3.2 In addition, the local employer may not transfer data to countries that do not provide the same level of protection as required under the EU Data Protection Directive without the specific consent of the individual employee.

6.3.3 For the purposes of complying with the Dutch data protection law and the EU Data Protection Directive, it is generally recommended that employers obtain a signed waiver and acknowledgement from each employee.

6.3.4 Violation of the data protection regulations may result in administrative fines and/or a criminal offence as detailed in the Act on the Protection of Personal Data (*Wet bescherming persoonsgegevens*). Such penalties can be imposed on the

"responsible person" as defined under the Act, including natural persons (e.g. directors or employees), legal entities and managing bodies. Administrative fines imposed by the official governing body of the Act ("College") can amount to NLG 10,000 maximum. Alternatively, if no administrative fine is imposed by the official governing body, criminal prosecution by the Dutch government may be possible. This could ultimately lead to a maximum of 6 months imprisonment or a fine of the "third category" if the offence was committed on purpose[12].

6.3.5 As this Act only became effective on 1 September 2001, there is as yet no significant practical experience with respect to the level of enforcement.

6.4 Stock exchange issues

6.4.1 There is no legal requirement for shareholder approval of the decision to implement a stock option plan. Whether shareholder approval is required depends on the powers of the Management Board and Supervisory Board as laid down in the company's Articles of Association.

6.4.2 Under Dutch securities law, the filing of a prospectus in The Netherlands is required in the case of a public offering of shares, i.e. if the options are options over shares listed on the Dutch stock exchange and offered to individuals outside the so-called "restricted circle".

6.4.3 Broadly, an offer of securities (i.e. grant of options) that is only made to employees would be regarded as an offer of securities within a restricted circle. Therefore, a grant of stock options to employees in The Netherlands will not qualify as a public offer, on the basis that it will fulfil the requirements needed to be treated as a restricted offer, if:

- The addressees of the offer are limited in number and defined;
- There is a relationship other than a purely financial one between the company and the offerees (i.e. the employment relationship with a group company);
- The offer contains a statement expressly limiting subscription to the individuals mentioned above.

6.4.4 Therefore, generally, where the award of stock options is made to persons within a so-called "restricted circle" there is no requirement to file a prospectus in The Netherlands. Conversely, where the award is made to persons outside the "restricted circle" and is considered a public offer of shares, a prospectus should be filed with the Dutch Securities Board ("*Autoriteit voor Financiële Markten*" or Autoriteit – FM for short).

6.4.5 There are no restrictions on employees holding foreign shares (or options over foreign shares). However, the Dutch insider trading rules may still apply.

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[12] Articles 65 through 75 of the Act on the Protection of Personal Data ("Wet bescherming persoonsgegevens")

6.5 Securities law

6.5.1 There are no restrictions under Dutch law on the number of individuals that can participate in stock option plans.

6.5.2 In principle, no filing requirements exist in The Netherlands regarding the implementation of stock option plans.

6.5.3 However, if the company is listed on a securities exchange (inside or outside The Netherlands), the Dutch insider trading rules apply to transactions in securities in or from The Netherlands. Under the Dutch insider trading rules, individuals are subject to the following prohibitions:

- Individuals are prohibited from dealing in company stock in or from The Netherlands whilst in the possession of inside information. Dealing, in this context, includes both the issuance and acceptance of shares and options, the exercise of options and the sale of the underlying shares.

- Individuals may not inform any third party of inside information or make recommendations to a third party to perform or effect transactions in or from The Netherlands in such securities.

6.5.4 Inside information is defined under Dutch securities law as: "Knowledge of specific information concerning a listed company or concerning the trade in its securities which has not been disclosed to the public and where the disclosure thereof could have an influence on the price of the securities regardless of whether the price increases or decreases."

6.5.5 There is a ministerial exemption available for stock option plans qualifying ("qualifying plans") under the terms and conditions set out in the exemption.

6.5.6 This exemption allows both the company and the individuals who possess inside information to issue and accept options and subsequently to exercise the options and sell the underlying shares subject to notification requirements and time constraints detailed as follows:

6.5.7 The grant of options under a qualifying plan will be exempt if the intention to grant the options is notified to the Securities Board of The Netherlands ("Autoriteit - FM") at least two months prior to the date of grant. In order to qualify for the exemption, the company granting the options must apply a durable line of conduct (irrespective of topical circumstances) with respect to the conditions and timing of grants under the plan, e.g. consistency in timing of (annual) grants, transparent conditions, etc.

6.5.8 The exercise of options under a qualifying plan will be exempt if (a) the option can only be exercised during the five business days prior to the date of expiry, and (b) the intended exercise is reported in writing to the granting company two months prior to the date of expiry of the options.

6.5.9 The sale of shares acquired through the exercise of options under a qualifying plan will be exempt if (a) such sale immediately follows the exercise during the above five-day period, (b) the intended sale is reported in writing to the granting company two months prior to the date of expiry of the options, and (c) the shares are actually sold immediately upon acquisition.

6.5.10 Where the option holder or shareholder is not in the possession of inside knowledge, he/she may exercise his/her options or sell his/her shares without the need to use the exemption rules.

6.5.11 Individuals are subject to prosecution by the Dutch government in the case of dealing in securities whilst in the possession of inside information.

6.6 Financial assistance

6.6.1 In practice, there are usually no prohibitions on a company giving financial assistance in the purchase of its own shares. However, if the company whose shares are involved is based in The Netherlands and is a BV rather than a NV, there may be issues with financial assistance. Dutch listed companies are always NV.

6.7 Other

6.7.1 There are no requirements to file/register the stock option plan. There are no foreign exchange restrictions in The Netherlands. However, the Dutch Central Bank must be notified of any amount over €50,000 transferred to Dutch residents from non-residents and vice versa. Where such amounts are transferred through a credit or financial institution registered in The Netherlands, this institution will be obliged to satisfy such reporting requirements. In practice, therefore, this requirement does not normally lead to any additional reporting requirements for employers or employees in The Netherlands.

6.7.2 There are no deadlines for meeting this obligation and no penalties/implications for failing to comply, assuming that the reporting requirement is handled by the credit or financial institution.

6.7.3 The option right does not give the employee the legal rights of “normal” share ownership (i.e. no voting rights, dividends, etc.). There are no shareholder rights until the options have been exercised and the legal title of the shares has been transferred to the employee.

6.7.4 There are no legal restrictions on the remuneration of directors or employees that need to be taken into account when drafting stock options.

7. Sourcing shares for stock option plans

7.1 A company can purchase its own shares from the market in order to fulfil its obligation to provide shares in connection with employee stock option plans. Such a purchase will be regarded as a temporary investment. This rule applies for dividend tax and surtax. Due to this "temporary investment" qualification, the shares will not be regarded as redeemed. This qualification remains valid during the term of the option obligation (i.e. during the period in which the employees can exercise their options) and will expire three months after the cancellation of the option obligation. During the three months after the cancellation of the option obligation, the company can dispose of the shares purchased as a temporary investment without any tax consequences.

7.2 There are no formalities for the transfer of shares in a Dutch NV ("*Naamloze Vennootschap"*), listed on the Dutch stock exchange. As such, under Dutch law options can even be exercised (and shares transferred) by simply making a phone call. However, where the shares are in a Dutch BV ("*Besloten Vennootschap*") and are - therefore - not listed, a notarial deed will be required in order to effect such a transfer. Dutch civil law obliges Dutch BVs to include certain "blocking" regulations with respect to the transfer of shares (obliging shareholders to, for example, offer their shares for sale to other BV shareholders first).

7.3 It is possible for a subsidiary to hold shares in its parent.

7.4 It is for the employer and employee to decide who bears the costs of the transfer of shares to the employee (e.g. the costs for a notary and a stock broker). However, typically, the employer bears all transfer costs at the time of exercise, whereas the employee bears the transfer costs associated with the sale of the shares.

8. Role and influence of existing shareholders

8.1 Currently, the role of shareholders with respect to employee stock options is relatively limited. There is no legislation requiring shareholder approval for the granting of stock option rights. Furthermore, Dutch shareholders are not always in the position to actually influence the membership of the Supervisory Board or the Executive Board (who effectively decide on stock option matters). For example, companies with a so-called "structure regime" (these are always NVs) are effectively controlled by the Supervisory Board of the company: the Supervisory Board appoints itself (through a system called "co-optatie") and also appoints the Executive Board of the company.

8.2 However, there are a number of legislative proposals which have not yet become effective, aimed at increasing the role of shareholders. The range of proposed measures include:

- The obligation for companies to publish details as to the number of stock options granted to, and outstanding for, Board Members;

- The proposed revision to have members of the supervisory Board in "structure regime NV's" appointed by shareholders; and

- The possibility for shareholders to vote on the company's top executive remuneration policy.

8.3 Another development is the current activity of the "Stichting Corporate Governance Onderzoek voor Pensioenfondsen" ("SCGOP"). This is the foundation started in 1998 by a number of large Dutch pension funds. The SCGOP aims to increase the Dutch shareholder influence of large institutional investors.

8.4 Lastly, we note that Dutch media have paid a great deal of attention to stock options and top executive remuneration over the past years. This has increased pressures on Dutch companies to move to greater transparency in this regard.

8.5 It is expected that measures and activities such as these will, gradually, lead to increased influence for shareholders in the area of top executive remuneration and stock options.

9. Accounting

9.1 Dutch GAAP rules in relation to stock options are currently rather extensive. Very recently, the Dutch Civil Code (articles 383a through 383e) has been changed, making it mandatory that detailed information of all plans is disclosed in the notes of the annual accounts, effective from 2002. This information is to be given for all members of the Managing Board and Supervisory Board individually.

9.2 Where the shares are newly issued the company must charge the difference between the FMV of the shares on the date of grant and the exercise price (the intrinsic value) to the Profit & Loss account in the year in which the grant takes place[13]. If the exercise price is reduced after the date of grant (option repricing) this will result in variable plan accounting.

9.3 The company is also required to provide information about the manner in which it wishes to cover and is covering the position in treasury stock.

9.4 The guideline introduces provisions for more extensive notes on employee stock options. Companies are required to include a clear breakdown of the number of outstanding options at the beginning of the period, the number of newly granted options, the number of expired options and the closing balance. The notes must include detailed information about options outstanding and exercised for each individual managing and supervisory director. The same information should be disclosed in respect of employees, but on a general basis only.

9.5 Before the introduction of the new accounting treatment, Dutch accounting rules did not require the intrinsic value to be charged to the company's Profit & Loss

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[13] Guidance for Annual Reporting article 271.7

account. Company management viewed this favourably. There is little experience yet with the new guideline.

9.6 Where shares to be acquired on exercise are held by a trust, the detailed position requires investigation. Generally, the option accounting provisions should be in accordance with the new guidelines.

10. Miscellaneous

10.1 Trusts

10.1.1 The Netherlands recognises the use of trusts. However, trusts are not commonly used in The Netherlands.

10.1.2 Trusts cannot be established under Dutch (civil) law.

10.1.3 Under Dutch law, the legal structure of a Foundation ("Stichting Administratie Kantoor") is commonly used for the implementation of stock option plans in The Netherlands where the employing entity is a Dutch BV (i.e. not listed on the stock exchange).

10.1.4 When a Foundation is used, the employee will receive (upon exercise of his/her stock options) Depositary Receipts over shares in the company rather than the actual shares. The shares are held by the Foundation. The employee is entitled to the full economic benefits of the underlying share(s), but the voting rights are held and exercised by the Board of the Foundation. As such, use of a Foundation allows the company (and/or the employees) to concentrate the voting rights in respect of the "employee shares" in one body.

10.1.5 The advantage for the employee is that the transfer of Depositary Receipts does not require a public notary deed (as does the transfer of shares in a Dutch BV) and can, therefore be effected without additional costs.

10.1.6 Tax revenues from employee stock option plans are not used for a specific purpose.

11. Special points of note

11.1 Mitigation of income tax

11.1.1 There is no provision under Dutch tax law aimed especially at mitigating taxes due in connection with stock options benefits. However, there is a general provision in Article 3.154 of the Dutch Income Tax Act 2001 that allows for "averaging" of an individual's so-called "Box-1 income" over a period of three calendar years. Box-1 income includes, inter alia, taxable income from employment.

11.1.2 The “averaging” rule of Article 3.154 is subject to a number of conditions and requirements, such as certain thresholds that must be exceeded before the individual can actually realise a benefit under this Article. However, it essentially means that an individual can add up the taxable income earned over the period of three consecutive calendar years chosen by the taxpayer. The total taxable income is then divided by three, and the amount of income tax due per year is re-calculated based on the revised, average taxable employment income per year. This may be beneficial is part of an individual’s income can thus be shifted from a year in which it is subject to the highest top marginal tax rate (52% in 2002) to a lower top marginal tax rate in another year in which the taxable income did not exceed top threshold.

11.2 Mitigation of social security contributions

11.2.1 There is no scope for mitigating the social liability that arises on the grant, vesting or exercise of an option.

11.3 Corporate Savings Schemes

11.3.1 Under Dutch corporate savings schemes (“spaarloonregeling”), the employee can save tax free from his/her gross salary up to an annual maximum of EUR 788 (2002). The employer, however, must pay a lump sum wage tax of 15% on the total savings. A number of conditions must be met in order for this favourable tax treatment to apply, among which a blocking of any amounts saved for four years.

11.3.2 Savings can be held not only in the form of cash but also in the form of options. Where the corporate savings scheme is used to grant options, the amount of the annual exemption can be doubled to €1,576. Please note however, that the new Dutch government is planning to abolish the Corporate Savings schemes with effect from 1 January 2003.

11.4 Special provisions for SMEs

11.4.1 There are no special provisions for SMEs.

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.