

Employee Stock Options in the EU and the USA

FINAL REPORT

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Sweden

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Sweden

1. General remarks

1.1 History

- 1.1.1 Since the end of the 1980s, the use of stock option plans in Sweden has become more and more common.
- 1.1.2 The taxation of stock options in Sweden has developed through statute and case law¹.
- 1.1.3 For options that had not vested by 30 June 1998, employee stock options were taxed at vesting. The taxation of options classified as marketable securities (see section 2 below) was the date on which they were awarded.

1.2 Current situation

- 1.2.1 New legislation was introduced driven by demands from a group of large multinational companies. The new legislation defines employee stock options as rights which are not in themselves classified as marketable securities (see section 2 below)². The new legislation took effect for employee stock options vesting on or after 1 July 1998, and deferred the tax point until exercise of the option.
- 1.2.2 Stock option plans are quite common among Swedish companies, although there is no definitive quantitative data in this respect³. Both employee stock options and marketable securities are used.
- 1.2.3 Employee share options are typically not transferable and lapse if the employment is terminated. In practice stock option plans used by multinational companies have generally been employee share options under Swedish law.
- 1.2.4 Due to the fact that the taxable value in general is lower at grant than at exercise there is a tendency to move towards marketable securities when planning stock option plans. This is particularly common with Small and Medium sized enterprises ("SME's). Listed companies with subsidiaries abroad tend to work more with employee stock option plans.

2. Key features of stock option plans

- 2.1 The key features of stock option plans detailed below apply to stock option plans in general⁴.

¹ Legislation (Income Tax Law 1999:1229), case law.

² Income Tax Law (1999:1229), chapter 10, paragraph 11.

³ General practice.

⁴ Income Tax Law (1999:1229), chapter 10, paragraph 11

- 2.2 There is no minimum term for which the stock options must be granted nor a maximum term for which the stock options must subsist.
- 2.3 According to the Securities Council, board members should not participate in stock option plans unless there are special reasons for their participation. The Securities Council is independent body whose function is to secure good practice in the Swedish securities market. The Council has issued a statement regarding incentive programs. The Council's statements are binding only for listed companies but also impact unlisted companies since their statements are a guideline for good market practice⁵.
- 2.4 There are no restrictions on the nature of the shares over which options may be granted under a stock option plan nor on the type of company that may grant options.
- 2.5 There are no restrictions on the value of shares over which options may be granted to an employee.
- 2.6 The concept of a marketable security is not defined in statute, so that guidance has to be sought in case law. Conditions such as the options lapsing if the employment ceases, or options only becoming exercisable after a certain time period, would cause an option to be classified as an employee stock option. Thus, such conditions cannot be applied if it is intended to create a marketable security. However, a pre-emption clause where the employee is forced to offer the company the opportunity to buy his options (at market value) if he leaves employment, has been accepted without the option losing its status as a marketable security. If a marketable security is subject to conditions similar to those of employee stock options, the taxable moment might be deferred until exercise.
- 2.7 To sum up, the concept of a marketable security and its associated taxation is unclear and thus a thorough analysis is recommended to anyone who intends to offer employees marketable securities, especially if conditions restricting the employees' rights to dispose of the option are being considered.
- 2.8 Generally to be classified as employee stock options, the options will be non-transferable and will be subject to conditions providing that options may only be exercised after a period of time, and only if the employees' employment continues.
- 2.9 There are no special provisions for SMEs.

⁵ Securities Council

3. Taxation

3.1 Time of taxation

3.1.1 Marketable securities

3.1.1.1 If the option is classified as a marketable security there will be a tax charge at the date of grant (assuming that the employee does not pay market value for the option)⁶.

3.1.1.2 There may be an employee social security contributions liability. However, Swedish individuals only pay minor social security contributions on all salary income and benefits received. The main part of the social security contributions charges lies with the employer.

3.1.1.3 There is no income tax or social security contributions for the employee at the point the option vests or is exercised⁷. There is also no employee social security contributions at vesting.

3.1.2 Employee stock options

3.1.2.1 If the option is classified as an employee stock option, there will be no tax or social security liability at grant or vesting. A tax charge and social security contributions will be due on the date of exercise⁸.

3.2 Taxable gain

3.2.1 Marketable securities

3.2.1.1 The tax liability is based on the value of the taxable benefit received at grant. This benefit is calculated as the fair market value ("FMV") of the option less any price paid by the employee. FMV is generally interpreted as the economic value of the option calculated according to the Black Scholes formula. There is no concept of a tax market value. If the employee pays market value for the option, there is no tax liability at the date of grant.

3.2.1.2 Social security contributions apply to the same taxable benefit received but are subject to an income cap.

3.2.2 Employee stock options

3.2.2.1 The taxable benefit is calculated as the difference between the FMV of the shares at exercise of the option and the exercise price.

⁶ Income Tax Law (1999:1229) chapter 10, paragraph 11.

⁷ Income Tax Act (1999:1229), chapter 10, paragraph 11.

⁸ Income Tax Law (1999:1229), chapter 10, paragraph 11.

3.3 Type of tax

3.3.1 *Marketable securities*

3.3.1.1 Income tax is payable on the grant of a marketable security at rates up to 56%⁹.

3.3.1.2 Social security contributions are also applicable. Swedish individuals only pay a pension fee of 7 % on income up to SEK 313,116 (2002). All salary income and benefits received are included in this base. 75% of the pension fee can be set against the employees' tax liabilities as a tax credit, and 25% is tax deductible.

3.3.1.3 A recharge of costs does not impact the taxation of employees.

3.3.2 *Employee stock options*

3.3.2.1 When the option is exercised income tax will be payable at rates up to 56%. In addition, social security contributions at 7% are payable up to an earnings ceiling of SEK 313,116 (2002). This is not affected by whether or not a recharge of costs is in place.

3.4 Capital gains taxation

3.4.1 On disposal of shares acquired under a marketable security or an employee stock option any capital gain arising is chargeable to capital gains tax at a flat rate of 30%¹⁰.

3.4.2 The taxable gain is the difference between the sales price and the acquisition value of the shares. Any costs in connection with the purchase or sale of the shares are also deductible from the sales price. The acquisition value corresponds to the price paid by the employee plus any taxable benefit.

3.4.3 There will be no social security contributions liability at the date of sale.

3.4.4 If the shares are sold at a loss, the loss can be set against other capital gains arising in the same year. If the capital gains relate to shares or units in securities funds, the loss can be fully offset. Where the gain relates to other assets the set off is restricted to 70% of the loss. If the employee has no other gains against which to set the loss, he may claim a tax credit against the income tax due on his employment or business income. The rate at which the tax credit is calculated is 30% on losses up to SEK 100,000 and 21% on losses exceeding SEK 100,000¹¹. The credit is calculated automatically by the tax authorities¹².

3.4.5 There is no deadline for making any claims that may be available in respect of capital losses.

⁹ Income Tax Law (1999:1229)

¹⁰ Income Tax Law (1999:1229), Section VII.

¹¹ Income Tax Law (1999:1229), section VII.

¹² Law (2001:1227) re: tax return and income statements.

- 3.4.6 The employee has to report the loss in his tax return in the usual manner. If he for any reason does not include the loss in his tax return when it is duly filed, he may apply for a correction to the tax return within five years following the year when the return was assessed.
- 3.4.7 If an option classified as a marketable security lapses unexercised, the price paid for the option gives rise to a capital loss. For an employee stock option, the price paid can be deducted against other employment income for the year in which the option lapses.
- 3.4.8 Individuals resident in Sweden are subject to Swedish wealth tax. In principle, the taxable wealth is the value of all the taxpayer's assets reduced by his debt, calculated as at 31 December each year. The wealth tax amounts to 1.5% on the taxable wealth exceeding an amount of SEK 1,500,000, (SEK 2,000,000 for husband and wife and partners who were previously married or have a child together). Stock options are not considered as a taxable asset for wealth tax purposes. The shares received following the exercise of options are as a general rule taxable, however, different provisions apply to the valuation of the shares. The valuation depends on, inter alia, if the shares are registered on the stock exchange or not.

3.5 Tax consequences for the granting company

3.5.1 *Social security contributions*

3.5.1.1 *Marketable securities*

3.5.1.1.1 If there is a taxable benefit, the local employer has to pay social security contributions on the taxable benefit. The applicable rate of social security contributions is 32.82%. This is not affected by whether or not the cost of the option is recharged to the subsidiary employing the option holders.

3.5.1.1.2 There is no social security liability for the employer at the date of vesting.

3.5.1.1.3 There are no social security contributions payable by the employer on the sale of the shares.

3.5.1.2 *Employee stock options*

3.5.1.2.1 Any taxable benefit arising on the exercise of the stock option is subject to social security contributions at 32.82%.

3.5.1.2.2 This is not impacted by whether or not the cost of the option is recharged to the subsidiary employing the shareholders.

3.5.1.2.3 There are no social security contributions payable by the employer on the sale of the shares.

3.5.2 *Corporate tax deduction*

- 3.5.2.1 In principle, the employing company will be entitled to claim a deduction against its profits for corporation tax for the costs of a stock option plan. All actual costs that are related to the business in the local company are deductible for tax purposes. However, there is significant debate about the deductibility of costs associated with shares and a recent ruling that such costs are deductible for corporation tax purposes is being appealed.
- 3.5.2.2 Recently introduced provisions state that if a Swedish company sells its own shares, any capital gain is not taxable. Consequently a loss is not deductible. One of the issues in this respect is whether this provision is also applicable where the employing company transfers shares to employees as a part of their participation in a stock option plan. If so, the cost would not be deductible. There are some applications for rulings pending and we believe that a ruling on this issue may be reviewed some time in 2002.
- 3.5.2.3 There are no specific requirements / formalities for securing this deduction.
- 3.5.2.4 If the costs related to the stock option plan are deductible they are treated as a deduction from taxable profits incurred in the business during the financial year when they arise according to generally accepted accounting principles. If the company for any reason does not make the deduction during this year, the company may apply for a correction of its tax return within the five years following the year when the income was assessed.

3.5.3 *Other*

- 3.5.3.1 There could be VAT issues due to recharges from the parent company to the local company¹³. Stamp duty / transfer tax does not have any impact on the operation of employee stock option plans.

4. Issues for employees

4.1 Reporting obligations

4.1.1 Marketable securities

- 4.1.1.1 In respect of marketable securities, if a foreign company, which is not the employee's employer grants an option, the employee must report the receipt of the benefit, in writing, to his Swedish employer within one month following the grant of the option, in order to make it possible for the Swedish employer to fulfil its reporting obligations, provided that the option is connected with the employment.
- 4.1.1.2 The information that needs to be reported is the date of grant and the market value of the option at that time.

¹³ VAT Law (1994:200).

4.1.1.3 The employee must also report any taxable benefit received in his annual tax return.

4.1.1.4 The employee's annual tax return should be filed either by the end of March in the year following the income year (special tax return) or by 2 May in the year following the income year (simplified tax return).¹⁴ From 2003, all tax returns (special and simplified) will need to be filed by the 2 May deadline.

4.1.1.5 There will be no reporting obligations for the employee at vesting. However, please see section 4.3 below in relation to a change in the employee's residence status.

4.1.2 *Employee stock options*

4.1.2.1 There will be a reporting obligation for the employee in relation to the exercise of the stock option¹⁵. The employee has to report the benefit to the local employer within the month of exercise, as well as to the tax authority in his annual tax return. The information to the employer should include the number of shares acquired, the exercise price, the market value of the underlying shares and the taxable benefit. The same information also has to be included in the tax return. The tax return deadlines are as set out above in section 4.1.1.

4.1.3 *Share sales*

4.1.3.1 The employee will have a reporting obligation in relation to sale of the shares for shares acquired from marketable securities and employee stock options. The information that needs to be reported in each calendar year is the number of shares sold, the sale price, the acquisition value and any costs in connection with the sale. The employee has to report the sale of the shares in his annual tax return. The tax return deadlines are as set out above in section 4.1.1.

4.2 **Cashflow issues**

4.2.1 The employer may lend money to the employee to alleviate cash flow problems for the employee as a result of incurring a tax liability at the date of grant in respect of marketable securities. However, this could create a taxable benefit for the employee if the loan is not granted on market terms¹⁶. There are no common methods used to alleviate cash flow problems in respect of the employee social security contributions charge.

¹⁴ Law on income tax returns and invoice statements (2001: 1227); Law on social security charges (2000: 980); Law on payment of tax (1997:483)

¹⁵ Law (2000:980) regarding social security charges.

¹⁶ General practice.

4.3 Change in employee's residence status

- 4.3.1 For employee stock options there are certain rules regarding taxation when an option holder moves in or out of Sweden. An individual who moves to Sweden and has vested options is not taxed in Sweden if the options are exercised whilst in Sweden. If an individual moves from Sweden he is taxed on departure as if he exercised his option, if the options were vested at the time the employee left Sweden. If taxation is triggered when moving out of Sweden, the employee has to report the taxable benefit. The decisive factor in these situations is whether the options have vested at the time the individual moves in or out of Sweden¹⁷. As marketable securities are taxed at grant changes to an employee's residence status are not relevant. If an employee in Sweden exercises his employee stock options and has to pay taxes both in Sweden and in another country he is allowed to reduce the Swedish tax by the amount of the foreign tax.¹⁸

5. Issues for employers

5.1 Reporting obligations

5.1.1 Marketable securities

- 5.1.1.1 The local employer has to report any benefit at grant in the employee's annual statement of income. The information that needs to be reported includes the date of grant and market value of the option at that time. The deadline by which the information must be reported is 31 January in the year following the income year.

- 5.1.1.2 The local employer will have no reporting obligations at vesting or exercise of the option, nor on sale of the shares.

5.1.2 Employee stock options

- 5.1.2.1 The local employer will have a reporting obligation in relation to the exercise of the stock options. The local employer has to report any benefit in the employee's annual statement of income. The deadline by which the information must be reported is 31 January the year following the income year.

- 5.1.2.2 The local employer will have no reporting obligations at grant or vesting of the option, nor on sale of the shares.

5.2 Withholding obligations

5.2.1 Marketable securities

- 5.2.1.1 The local employer will have a withholding obligation in relation to the grant of the option. The local employer must withhold income tax on the benefit. This applies irrespective of whether the local employer has granted the option or if it has

¹⁷ Income Tax Law (1999:1229) chapter 10, paragraph 11 and chapter 11, paragraph 16.

¹⁸ Law / 1986: 468 / regarding reduction of foreign tax

been granted by the foreign parent company (or other foreign company within the group). The withholding rate is the applicable tax rate depending on the employee's earnings.

5.2.1.2 Withholding can only be made from cash payments. To the extent that there is a shortfall with the withholding requirement this is the employee's responsibility. Thus, the employee has to pay the remaining tax via a supplementary tax payment or by agreeing with the employer about making extra tax withholdings in the following months.

5.2.1.3 The tax must be remitted to the tax authorities on the "tax declaration" once a month. All taxes withheld on the employee's salary, benefits etc are remitted via this tax declaration, as well as all social security contributions. The "tax declaration" is filed once a month on the 12th.

5.2.1.4 The amounts should be withheld during the month of grant or during the month when the local employer is informed about the benefit (see section 4.1.1).

5.2.1.5 The local employer will have no withholding obligation on vesting, exercise or sale.

5.2.2 *Employee stock options*

5.2.2.1 The local employer will have a withholding obligation in relation to the exercise of the stock option. The local employer has to withhold income tax according to the applicable income tax rates on the taxable benefit¹⁹. The applicable rate depends upon the employee's earnings.

5.2.2.2 Withholding can only be made from cash payments. To the extent that there is a shortfall with the withholding requirement this is the employee's responsibility. Thus, the employee has to pay the remaining tax via a supplementary tax payment or by agreeing with the employer about making extra tax withholdings in the following months.

5.2.2.3 The tax withheld must be remitted to the tax authorities on the "tax declaration" once a month. All taxes withheld on the employee's salary, benefits etc are remitted via this tax declaration, as well as all social security contributions. The "tax declaration" is filed once a month on the 12th.

5.2.2.4 The withholding should occur during the month when the benefit arises or during the month when the employer is informed about the benefit. (See section 4.1.2.)

5.2.2.5 The local employer will have no withholding obligations on grant, vesting or sale.

¹⁹ Law (1997:483) regarding payment of tax.

6. Legal issues

6.1 Process/timeframe

6.1.2 The implementation of a stock option plan in Sweden, from commencing drafting the plan rules to the date when the first option may be granted, may take approximately two to six months, depending on the level of complexity of the plan²⁰.

6.1.3 The key steps are as follows:

- Drafting of rules and adoption by the board.
- Questions regarding the issue of warrants/shares have to be dealt with by the shareholders at the shareholders meeting.
- There are no requirements for any submissions to authorities, etc.

6.1.4 There are no rules regarding how to establish a stock option plan (employee share options) as such in Sweden and no authorities need approve the plan. However, the following steps can be identified:

- Discussion as to whether options should be structured as marketable securities or employee share options.
- In case of marketable securities, the company issuing the options has to be valued in order to calculate the FMV of the options.
- Agreement of the principles for the allocation of options amongst the employees.
- Production of the necessary documents; e.g., in the case of marketable securities the rules stated in the Companies Act regarding the issue of warrants must be followed. The issue of warrants requires a decision at a general shareholders meeting.
- As far as employee stock options are concerned; drafting of option agreements and plan conditions.
- Decision regarding how to deliver shares on the exercise of stock options.
- Discussion regarding any hedging arrangement in order to hedge the costs of social security charges (employee stock options).
- Drafting of information documents to employees.
- Informing employees about the plan.²¹

²⁰ General practice

²¹ General practice, Legislation (Companies Act (1975:1385))

6.2 Employment law

- 6.2.1 Trade union involvement in respect of the implementation of a stock option plan is not required but is recommended.
- 6.2.2 There is no employment law expressly relating to the award of options in Sweden. However, in principle the law on equalisation between men and women could be applicable²².
- 6.2.3 According to the general principles relating to damages arising as a result of unlawful dismissal etc., an employee should be able to claim for damages against the value of stock option awards. However, we are not aware that any such case has been tried in court.

6.3 Data protection

- 6.3.1 In principle, there are no data protection issues that may hinder the operation of a stock option plan in Sweden. However, the processing of personal data via computers requires consent from the individual in question²³.
- 6.3.2 The penalties for contravention of the data protection laws are fines or imprisonment from six months up to two years. These penalties will be imposed against the controller of the personal data.
- 6.3.3 We are not aware if any such penalties have been enforced.

6.4 Stock exchange issues

- 6.4.1 If warrants or shares are to be issued, shareholder approval is necessary. Otherwise, shareholder approval is recommended if the stock option plan is substantial. In all other cases, the board may make decisions regarding stock option plans. (This is according to a recommendation from the Securities Council that is an independent body that issues recommendations regarding good practice on the securities market. These recommendations apply to listed companies but are followed also by unlisted companies as they reflect this good practice)²⁴.
- 6.4.2 There is no requirement for a company to issue a prospectus or other form of disclosure when implementing a stock option plan.
- 6.4.3 There are no restrictions on employees holding foreign shares (or options over foreign shares).

²² Law on equalisation between men and women. (1991:204)

²³ Personal Data Law (1998:204).

²⁴ Companies Act (1975:1385); General Practice; Securities Council.

6.5 Securities law

- 6.5.1 There are no securities law issues to consider in Sweden regarding stock option plans²⁵.
- 6.5.2 There are no requirements to file/register the plan if the holdings of individual shareholders is considered minor.

6.6 Financial assistance

- 6.6.1 There are no financial assistance prohibitions provided that the individual concerned is a minor shareholder. Minor in this instance would be a holding of 500 shares. In addition, financial assistance would not be prohibited if a loan of less than SEK 75,000 is made and the offer of loans was made to at least 50% of the company's employees. The loan should be repayable by amortization within 5 years.

6.7 Other

- 6.7.1 There are no foreign exchange control filings required in Sweden in relation to stock option plans.
- 6.7.2 An employee normally has no voting or dividend rights until he is actually a shareholder, i.e. when he has exercised his options and purchased the shares.
- 6.7.3 There are no other legal requirements and/or issues that may affect the adoption and/or operation of stock option plan in Sweden.

7. Sourcing shares for stock option plans

- 7.1 The actual mechanics of obtaining the shares is for the company implementing the plan to decide. How the shares are delivered depends on whether the shares are newly issued (and delivered from the issuing company) or if the shares are purchased on the stock market and then delivered to the employee. In our experience the employee generally receives the shares delivered to his own deposit or a deposit kept for each employee, which the employer has arranged. The shares may also be kept in a deposit through a nominee shareholder. As regards Swedish companies, the employee has to be registered as a shareholder in the companies' share register. From a Swedish point of view, exercise of share options means that the employee is the legal owner of the shares and treated as such from a tax and legal point of view²⁶.

²⁵ Companies Act (1975:1385), chapter 7 and 12.

²⁶ General Practice, Companies Act (1975:1385).

7.3 It is possible for Swedish listed companies to hold their own shares, according to the Swedish Companies Act, but subsidiaries in Swedish groups may not hold shares in their parent company. However, this legislation does not include Swedish subsidiaries with foreign parent companies²⁷. The purchase of its own shares by a Swedish company requires shareholder approval.

7.4 There are no special formalities required to enable an employee to transfer his shares. There are no costs associated with such transfer.

8. Role and influence of existing shareholders

8.1 Where a stock option plan involves the issues of warrants or shares, shareholder approval is required. Shareholder approval is also recommended if the stock option plan is considered substantial. There have been instances where shareholders have rejected a plan on the basis that the proposed dilution is too high.

9. Accounting

9.1 Sweden has no accounting rules with respect to stock option plans except for Stock Appreciation Rights ("SARs"). The grant of stock options has no impact on the Profit & Loss account or the balance sheet.

9.2 The options are not recognised in the main accounts regardless of whether or not the shares will be newly issued shares or treasury shares. However, the stock option plan should be disclosed in the notes to the accounts.

9.3 From 1 January 2002, it is our opinion that SIC 12, which requires the consolidation of the assets of a trust, should be applied when a company is accounting for shares held by a trust.

10. Miscellaneous

10.1 Swedish law does not recognise trusts as legal bodies.

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

²⁷ Companies Act (1975:1385), chapter 7

11. Special points of note

11.1 Mitigation of income tax

- 11.1.1 In Sweden there exists a general possibility to mitigate progressive employment income taxes on income that accrues over several years²⁸. The income will be divided by the number of years over which it accrued; the maximum number of years taken into account is ten. The tax is then established by applying the tax rate schedule to the amount of income thus calculated and multiplying the result by the number of years.

11.2 Mitigation of social security contributions

- 11.2.1 There is no scope to mitigate social security contributions.

11.3 Mitigation of tax on sale of shares

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

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.

²⁸) Income Tax Act (1999:1229), chapter 66, paragraph 1