

# **Employee Stock Options in the EU and the USA**

*FINAL REPORT*

**AUGUST 2002**

Luxembourg

# Contents

	Page
<b>Luxembourg</b>	
<b>1. General remarks</b>	<b>1</b>
1.1 History	1
1.2 Current situation	1
<b>2. Key features of stock option plans</b>	<b>2</b>
<b>3. Taxation</b>	<b>2</b>
3.1 Time of taxation	2
3.2 Taxable gain	3
3.3 Type of tax	3
3.4 Capital gains taxation	4
3.5 Tax consequences for the granting company	7
3.5.1 Social security contributions	7
3.5.2 Corporate tax deduction	7
3.5.3 Other	8
<b>4. Issues for employees</b>	<b>8</b>
4.1 Reporting obligations	8
4.2 Cashflow issues	9
4.3 Change in employee's residence status	10
<b>5. Issues for employers</b>	<b>10</b>
5.1 Reporting obligations	10
5.2 Withholding obligations	11

<b>6.</b>	<b>Legal issues</b>	<b>12</b>
6.1	Process/timeframe	12
6.2	Employment law	13
6.3	Data protection	14
6.4	Stock exchange issues	16
6.5	Securities law	16
6.6	Financial assistance	17
6.7	Other	17
<b>7.</b>	<b>Sourcing shares for stock option plans</b>	<b>18</b>
<b>8.</b>	<b>Role and influence of existing shareholders</b>	<b>18</b>
<b>9.</b>	<b>Accounting</b>	<b>18</b>
<b>10.</b>	<b>Miscellaneous</b>	<b>20</b>
<b>11.</b>	<b>Special points of note</b>	<b>20</b>
11.1	Mitigation of income tax	20
11.2	Mitigation of social security contributions	21
11.3	Mitigation of tax on sale of shares	21
11.4	Special provisions for SMEs	21

## **Luxembourg**

### **1. General remarks**

#### **1.1 History**

- 1.1.1 There is no specific domestic legislation dealing with stock options. Because of the central economic position of Luxembourg and its international exposure, stock option plans set up by foreign parents of Luxembourg companies have historically been the main stock option plans in which Luxembourg employees have participated. However, over the last couple of years, local Luxembourg employers have also started to implement stock options plans<sup>1</sup>.
- 1.1.2 Luxembourg tax legislation does not specifically deal with stock options. Therefore, one has to refer to general tax principles. Historically, to gain certainty of tax treatment, the practice was to request a confirmation from the Luxembourg tax authorities. In January 2002, the tax authorities issued a circular letter that sets out the main tax rules<sup>2</sup>. Whilst the circular letter contained some new rules on the tax treatment of stock options, the main principles established by practice were not changed<sup>3</sup>.
- 1.1.3 The government has not sought to introduce stock option plans aimed at particular industries or with certain policy goals. Employers seeking to develop employees' loyalty implement "potential option plans". Those seeking to reduce the employees' tax burden implement "tradable option plans" (see section 2). Tradable options are relatively uncommon.

#### **1.2 Current situation**

- 1.2.1 No quantitative data is available in Luxembourg as to how widely stock option plans are used. However, it is estimated that approximately 25% of all companies based in Luxembourg have a stock option plan for either all, or for selected employees. Our experience shows that stock option plans are more commonly used in the financial sector. The trend clearly shows a sharply increasing number of stock option plans in recent years.
- 1.2.2 There is currently no known discussion, either in academic, legal or political circles, on possible future changes to the taxation of stock options.

---

<sup>1</sup> General practice.

<sup>2</sup> Luxembourg tax authorities' practice and circular Letter (LITL No.104/2) dated January 11, 2002.

<sup>3</sup> Administrative circular letter (LIR No. 104/2) dated January 11, 2002.

## **2. Key features of stock option plans**

- 2.1 There are two types of stock option plan in Luxembourg: the “Plan on Potential Options” and the “Plan on Tradable Options”. Potential options are not tradable, and usually employees can only realise value when the option is exercised. Tradable options can be sold by employees and cannot be forfeited. However, tradable options are not very common.
- 2.2 The key features of plans involving potential options and tradable options are the same.
- 2.3 There is no minimum or maximum term for which an option may or must subsist.
- 2.4 There are no provisions setting out who may or may not be granted options under stock option plans, provided the anti-discrimination rules are not breached (see section 6.2). It is generally accepted that the choice of participants in a plan has to be determined on an objective basis.
- 2.5 There are no restrictions on the nature of the shares over which options may be granted, or on the value of shares over which options may be granted to employees. There are no restrictions on the type of company that may grant options.

## **3. Taxation**

### **3.1 Time of taxation**

#### *3.1.1 Potential options*

- 3.1.1.1 There will be no liability to income tax or social security contributions for the employee at grant or vesting of the option<sup>4</sup>.
- 3.1.1.2 There will be income tax but no social security contributions for the employee at the date of exercise of the option<sup>5</sup>.

---

<sup>4</sup> Art. 95/108 LITL (Luxembourg Income Tax Law) + administrative circular letter dated January 11, 2002. Position of Luxembourg social security authorities. Following the Circular Letter from the Tax Authorities, it is likely that the Social Security Authorities will formalize their position with respect to Stock Option Plans in the future. This may generate a change of the social security treatment compared to today's practice.

<sup>5</sup> Articles 95/104/108 LITL + administrative circular letter dated January 11, 2002. Position of the social security authorities, confirmed in writing in the past. This position is likely to be changed in the near future.

### 3.1.2 *Tradable options*

- 3.1.2.1 There will be an income tax liability but no social security contributions will be due for the employee on the grant of a tradable option if the option is granted at a discount<sup>6</sup>.
- 3.1.2.2 There will be no tax for the employee at the date of exercise of the option if the exercise results in shares rather than cash being delivered to the employee. If cash is received within six months after exercise (that is to say, the employer delivers cash rather than shares to the employee), the exercise is deemed to be a sale of the options. Depending on the particular case the capital gain arising from such deemed sale may or may not be taxable (see section 3.4).
- 3.1.2.3 There will be no social security contributions payable for the employee at exercise.

## 3.2 **Taxable gain**

### 3.2.1 *Potential options*

- 3.2.1.1 The taxable benefit at exercise is the difference between the Fair Market Value (“FMV”) of the shares at exercise and the exercise price paid by the employee to acquire the shares<sup>7</sup>.

### 3.2.2 *Tradable options*

- 3.2.2.1 The taxable benefit at grant (if any) is equal to the value of the option at the date of grant, minus the acquisition price paid by the employee.
- 3.2.2.2 Tradable options can be quoted or non-quoted. The taxable value of non-quoted options can be determined on the basis of the Black & Scholes method or any comparable recognised financial method stated in the plan rules. If the plan rules do not refer to Black & Scholes or any other financial method, options are valued at 7.5% of the market value of the underlying shares. To avoid high professional fees being regularly incurred in valuing the shares, the plan may refer to a simpler method than those referred to previously. In such a case, it is advisable to request the approval of the tax authorities to avoid the simpler method being challenged<sup>8</sup>.

## 3.3 **Type of tax**

- 3.3.1 Income tax is charged at progressive rates varying from 0% to 38.95% (including a solidarity surtax of 2.5%)<sup>9</sup>. It is currently the practice of the social security authorities not to levy social security contributions for either the employee or the employer.

---

<sup>6</sup> Position of Luxembourg social security authorities, confirmed in writing in the past. Following the Circular Letter from the tax authorities, it is likely that the social security authorities will formalize their position with respect to stock option plans in the future. This may generate a change of the social security treatment compared to today’s practice.

<sup>7</sup> Article 104 LITL + administrative circular letter dated January 11, 2002.

<sup>8</sup> Article 104 LITL + administrative circular letter dated January 11, 2002.

<sup>9</sup> Articles 95/104/118 LITL. (Luxembourg Income Tax Law).

3.3.2 Wealth tax is payable by Luxembourg residents on their net assets. Tradable options are net assets for these purposes and are treated as share participation (see section 3.4.4).

3.3.3 Capital gains are not subject to a specific tax. When taxable, gains are subject to personal income tax together with the taxpayer's other income.

### **3.4 Capital gain taxation**

3.4.1 Tax is payable on the sale of shares. At sale there may be an income tax liability and a dependency contribution will be due from the employee.

3.4.2 For both potential options and tradable options, a dependency contribution liability arises at the date of sale or deemed sale of the shares acquired on option exercise. The dependency contribution is 1% and is computed on the net amount of taxable capital gains, before application of the deduction of €50,000 (€100,000 for married taxpayers taxed jointly) for sale profits<sup>10</sup>.

#### *3.4.3 Potential options*

3.4.3.1 There may be tax for the employee at the date of sale<sup>11</sup>. Capital gains are taxed in the hands of Luxembourg taxpayers only if either:

- The sale occurs within a six month period following the acquisition of the shares ("speculative profit") and the total gain from such sales exceeds €500 over the year<sup>12</sup>; or
- The seller holds an important participation in the company; generally, a shareholding is deemed to be an important participation when the taxpayer (together with his spouse and minor children) holds or has held, directly or indirectly, over the 5 years prior to the date shares are disposed of, more than 10% of the share capital of the company<sup>13</sup>.

3.4.3.2 If the shares are sold within a six months period following their acquisition (speculative profit), personal income tax applies on the capital gain and is computed at progressive tax rates (rising from 0% to 38.95%). The taxable benefit is equal to:

- The sale price, minus
- The acquisition cost of the shares and associated costs of acquisition<sup>14</sup>.

3.4.3.3 If taxation occurs as a result of the holding of an important participation (sale profit), a reduced tax rate applies, provided the total amount of sale profits exceeds

---

<sup>10</sup> Article 378 of Luxembourg Social Security Code

<sup>11</sup> Articles 99 bis/100 LITL.

<sup>12</sup> Article 99 bis LITL

<sup>13</sup> Article 100 LITL

<sup>14</sup> Article 99 bis LITL

€250 for the year. The reduced tax rate corresponds to half of the taxpayer's average income tax rate (i.e. to a maximum of 19.475%)<sup>15</sup>. The taxable benefit is equal to:

- The sale price, minus
- The acquisition cost as re-evaluated and associated costs of acquisition<sup>16</sup>.

3.4.3.4 Specific rules apply if the shares are sold within seven days following the exercise of the options. In such a case the employee is deemed to have sold the options. The practical effect of this new rule is not yet fully known. Assuming that the employee does not hold an important participation and that the options were held for more than six months, the capital gain arising will not in any event be taxable<sup>17</sup>. If tax is payable when shares are sold within seven days following the exercise, the benefit previously taxed, as employment income is included in the acquisition cost<sup>18</sup>.

3.4.3.5 With respect to the sales profit a deduction of up to €50,000 (€100,000 for married taxpayers taxed jointly) is available. These deductions are utilised cumulatively over ten years (i.e. they are not annual deductions) and entitlement to these deductions is renewed every ten years.

---

<sup>15</sup> Articles 131 / 132 LITL

<sup>16</sup> Articles 100/102/130 bis LITL.

<sup>17</sup> Administrative circular letter (LIR n°104/2) dated January 11, 2002. Articles 131/132 LITL.

<sup>18</sup> Administrative circular letter (LIR No. 104/2) dated January 11, 2002



3.4.3.6 The table below summarises the tax treatment set out in this section.

Taxation of sale of shares acquired as a result of exercise of potential options				
Circumstances of sale	Speculative profits (shares sold within six months of share acquisition and gains exceed €500 in a year)	Important participation (tax payer plus spouse and minor children directly or indirectly hold or have held more than 10% of share capital of company during five years prior to sale).	Sale within seven days of acquisition if the options had not been held for six months (new rule)	Sale that is not speculative profit, important participation or within seven days of acquisition or if within seven days of acquisition option had been held for six months
Timing of tax	Sale of shares	Sale of shares	Sale of shares	No tax
Rate	Progressive rates from 0% to 38.95%	If profits exceed €250 for the year reduced rate up to a maximum of 19.475%.	Progressive rates from 0% to 38.95%	No tax
Taxable benefit	Sale price less acquisition cost of shares and incidental acquisition expenses	Sale price less acquisition cost as re-evaluated of shares and incidental acquisition expenses	Sale price less acquisition cost as re-evaluated of shares (including benefit previously taxed as employment income) and incidental acquisition expenses	No tax
Deductions	In respect of the sales profit a deduction of up to €50,000 (€100,000 for married taxpayers taxed jointly) is available. Entitlement is renewed every ten years.			
Dependency contribution	1% on net amount of taxable capital gains, before €50,000/€100,000 deduction			

#### 3.4.4 Tradable options

3.4.4.1 If the employee receives a cash settlement on exercise of the option, the exercise is deemed to be a sale of option.

3.4.4.2 If a capital gains tax liability does arise, the taxable gain will be the cash settlement reduced by the amount taxed as employment income at grant. Tax rules applicable to capital gains derived from the sale of options are the same the ones that apply to capital gains derived from the sale of shares, i.e.:

- If the sale occurs within the six months period following the acquisition of options, a speculative profit arises and is taxable as set out in paragraph 3.4.1 above<sup>19</sup>.
- If the sale occurs after six months from acquisition, the profit is only taxable if the seller holds an important participation in the issuing company.

<sup>19</sup> Articles 131/132 LITL

3.4.4.3 If the sale is after six months from acquisition and the shareholding was not an important participation, the capital gain is not subject to tax.<sup>20</sup>

#### 3.4.5 *Loss Treatment*

3.4.5.1 If shares are sold at a loss (i.e. for less than the price paid to acquire them at exercise), the loss can be offset against other capital gains arising in the same year<sup>21</sup>.

3.4.5.2 Losses can be offset only if a capital gain arising in the same circumstances would have been taxable. Please note that each category of losses (i.e. speculative losses or sales losses) is offset against profits of the same category, before being creditable against profits in the other category. The offset is made within the scope of the annual income tax return, to the extent that the employee is subject to this filing obligation.

3.4.5.3 The loss cannot be offset against other income in the year or carried forward for offset against future gains.

#### 3.4.6 *Wealth tax*

3.4.6.1 Wealth tax exists in Luxembourg. It is payable at 0.5% on net assets exceeding an annual exemption of €2,500 per person. Share participation up to €75,000 (double if spouses file jointly) is exempt from the tax. Tradable options are subject to wealth tax but count as share participation. Potential options are not subject to wealth tax.

### 3.5 **Tax consequences for the granting company**

#### 3.5.1 *Social security contributions*

3.5.1.1 No social security contributions will be payable by the employer on the grant, vesting or exercise of potential or tradable options or on the subsequent sale of the options or shares<sup>22</sup>.

#### 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. Both the administrative cost of implementing and administering the plan, and the costs of sourcing the shares to meet option exercises can be deducted, assuming that stock options are granted to employees working for the Luxembourg company.

---

<sup>20</sup> Article 99 bis LITL

<sup>21</sup> Article 102 LITL.

<sup>22</sup> Position of the social security authorities, confirmed in writing in the past. This position is likely to be changed in the near future.

- 3.5.2.2 There are no specific requirements or formalities for securing the deduction. However, the arrangements should be documented in writing.
- 3.5.2.3 Corporate tax deductions are made through the filing of the corporate tax return that must be filed by 31 May of the year following the end of the income year (calendar year).
- 3.5.2.4 If costs are recharged by a Luxembourg parent company to a foreign company, they are not deductible for the Luxembourg company. The reimbursement will constitute a taxable profit for the Luxembourg company.
- 3.5.2.5 If costs are recharged to the Luxembourg company by a foreign parent company, they are deductible provided the costs relate to stock options granted to employees of the Luxembourg company.
- 3.5.2.6 These inter company charges should be computed according to arms length rules.
- 3.5.3 *Other*
- 3.5.3.1 The reimbursement of costs may lead to a Value Added Tax (“VAT”) charge. Stamp duty and transfer tax have no impact on the operation of stock option plans in Luxembourg).

## **4. Issues for employees**

### **4.1 Reporting obligations**

- 4.1.1 In Luxembourg, not all taxpayers have to file an annual income tax return. An employee would usually be subject to a filing obligation if his/her net taxable capital gains (after deduction of the €50,000/€100,000 for sale profits) exceed €600<sup>23</sup>. If a taxpayer is subject to a filing obligation, the amount of any taxable benefit arising in relation to stock options must be reported on his/her annual income tax return or on the request for a yearly calculation if the employee makes such a request.
- 4.1.2 If an employee is not subject to a filing obligation, he/she may request a yearly calculation if certain conditions are met. The purpose of such a request is to obtain a refund of excessive payroll taxes (if any). Such a request must be filed prior to 31 December of the year following the end of the income year<sup>24</sup>.
- 4.1.3 The elements that are taken into consideration to determine if a taxpayer is liable to file an income tax return or may request a yearly calculation are:
- Residency status.

---

<sup>23</sup> Articles 116/153 LITL + accompanying measures.

<sup>24</sup> Articles 116/153/145 LITL + accompanying measures.

- Tax class.
- Level of income.
- Income type.
- The period spent in Luxembourg over the year<sup>25</sup>.

4.1.4 Annual income tax returns must be filed before 31 March of the year following the end of the income year. Yearly calculations have to be filed before 31 December of the year following the end of the income year. Income tax has to be paid within a month following the tax notice.

#### 4.1.5 *Potential options*

4.1.5.1 Employees have no reporting obligations in relation to the grant or vesting of potential options.

4.1.5.2 Employees have no reporting obligations in relation to the exercise of the option and sale of shares unless they are already required to file an income tax return. The exercise of an option and sale of shares are not sufficient to cause a filing requirement unless that individual was subject to a filing requirement anyway, or tax is payable in relation to the option.

#### 4.1.6 *Tradable options*

4.1.6.1 Employees will have no reporting obligations in relation to the grant of the option unless an employee is required to file an income tax return for other reasons (in which case the option grant must be reported).

4.1.6.2 The employee will not have reporting obligations in relation to the exercise of the option, provided shares are delivered or there is no cash settlement within 6 months after acquisition of the options, and the employee is not deemed to have held an important participation.

4.1.6.3 The employee will have reporting obligations in relation to sale of the shares if net capital gain exceeds €600 and a tax liability arises.

## 4.2 **Cashflow issues**

4.2.1 In order to alleviate cash flow problems for employees as a result of incurring a tax liability, the employer may grant an interest free-loan to the employee. The taxable benefit of an interest free loan is valued on the basis of a prescribed fixed interest rate. This rate is currently 5.5% per year. This benefit is taxed at progressive tax rates as employment income. Such income is exempt up to €500 per year (or €1,000 for spouses filing jointly<sup>26</sup>).

<sup>25</sup> Articles 116 / 153 / 145 LITL + accompanying measures.

<sup>26</sup> Article 115-22 LITL + Decree dated August 11, 2001 + Decree dated December 11, 1991

- 4.2.2 If an employee has paid money for the grant or acquisition of an option, or has been taxed on grant, but then does not go on to exercise the option, the price paid and the tax suffered is not reimbursed to the employee.

### **4.3 Change in employee's residence status**

#### **4.3.1** *Potential options*

- 4.3.1.1 If an employee is not tax resident for the whole period between grant and exercise, in our opinion and subject to double tax treaty provisions, it could be argued that a part of the benefit is not taxable in Luxembourg, to the extent that it could be linked to professional activities carried out abroad.

#### **4.3.2** *Tradable options*

- 4.3.2.1 The income tax and social security contributions treatment will not change if employees' tax residence status changes between grant and exercise.

## **5. Issues for employers**

### **5.1 Reporting obligations**

#### **5.1.1** *Potential options*

- 5.1.1.1 The local employer will have no reporting obligations in relation to the grant or vesting of the option or the sale of shares.
- 5.1.1.2 The local employer will have reporting obligations in relation to the exercise of the option. There are no reporting obligations specific to the options, but the employer has to comply with normal payroll administration<sup>27</sup>.
- 5.1.1.3 The information that must be reported on the salary account includes: date of exercise, type of remuneration, value of the benefit, taxable amount, and payroll taxes withheld. The information that must be reported on the monthly payslip relating to the month during which options are exercised and on the annual certificate of remuneration includes type of remuneration, taxable amount and payroll taxes withheld.
- 5.1.1.4 Reporting to the employee is made through the monthly payslip and the annual certificate of remuneration. Reporting to the tax authorities is made through monthly forms to be filed for payroll taxes purposes (see section 5.2.3) and through the annual certificate of remuneration.
- 5.1.1.5 A monthly payslip must be remitted to the employee at the end of each month. An annual certificate of remuneration must be remitted to the tax authorities before 1

---

<sup>27</sup> Article 136 LITL + accompanying measures (decree dated December 27, 1974).

March following the end of the income tax year. No deadline is provided for the remittance of a copy of this certificate to the employee.

#### 5.1.2 *Tradable options*

5.1.2.1 The same reporting obligations apply to tradable options as apply to potential options (as set out in 5.1.1), except that:

- Reporting obligations arise at the grant of the option rather than exercise.
- The information that must be reported should include the date of grant rather than the date of exercise.

5.1.2.2 The local employer will not have any reporting obligations in relation to the exercise of the option or the sale of the shares.

### 5.2 **Withholding obligations**

5.2.1 For potential options, the local employer will have a withholding obligation in relation to the exercise of the option. The employer must withhold the tax arising on the taxable benefit arising at exercise<sup>28</sup>.

5.2.2 For tradable options, the local employer will have the withholding obligation in relation to the grant of the option. Again, the employer will have to withhold the tax arising on the taxable benefit.

5.2.3 The income tax to be withheld will be based on a fixed rate or progressive rates (up to 38.95%) depending on the employee's personal situation. If an employee receives the sole employment income of the household, income tax is computed based on progressive tax rates. If the spouse receives several sources of employment income, the highest income is subject to payroll tax rates at progressive rates whereas tax on the additional income is computed pursuant to a fixed rate. The fixed rate is determined based on the family status of the taxpayer and varies from 0% to 33%.

5.2.4 Tax withheld must be declared and paid within a ten-day period following the end of the month during which options are granted or exercised (as applicable), together with regular payroll taxes on other salary items.

5.2.5 Tax should be withheld on the cash remuneration paid for the month during which the options are granted or exercised (as applicable). If the remuneration is not sufficient, the employee should provide the employer with the necessary funds. If the employee refuses to provide the employer with sufficient funds, the employer is entitled to reduce the benefit in kind to the extent necessary to cover the payroll taxes.

---

<sup>28</sup> Articles 136 to 138 LITL + accompanying measures.

## **6. Legal issues**

### **6.1 Process/timeframe**

- 6.1.1 In the absence of any Luxembourg legislation relating to stock option plans, the general provisions of civil and commercial law are applicable, in particular the law of contracts<sup>29</sup>.
- 6.1.2 Implementation of a plan takes approximately three to six months, depending on the complexity of the plan design and whether the stock option plan qualifies as a public offer of shares<sup>30</sup>.
- 6.1.3 The procedures involved in establishing a plan are as follows:
- Drafting of the stock option plan.
  - Decision of the management (board of directors in case of Société Anonyme) to convene a general meeting of shareholders.
  - If there is doubt as to whether or not the stock option plan is a public offer, confirmation of the nature of the offer (private/public) by the Commission de Surveillance du Secteur Financier at least fifteen days before the grant of the options.
  - If there is doubt on the tax treatment, request to the tax authorities and a meeting with the tax authorities if necessary.
  - Preparation of auditor's report.
  - Extraordinary general meeting of the shareholders.
  - Agreeing to and approving the stock option plan.
  - Giving the authorisation and the powers to the management (board of directors in case of Société Anonyme).
  - Determining the terms and conditions and the beneficiaries of the plan, if the stock option plan provides for management to have such authority.
  - Manage the stock option plan.
  - Decision authorising the management to increase the share capital of the company and modifying the Bylaws of the company; in which case, the general meeting of shareholders has to be held before a notary.
  - Submission of the stock option plan to the beneficiaries.

---

<sup>29</sup> General provisions of civil and commercial law  
<sup>30</sup> General Practice

- Decision to increase the share capital of the company either, as appropriate, by a general meeting of the shareholders of the company or in case of already authorised capital, by a decision of the management (Board Directors for Société Anonyme).
- Increase of the share capital of the company.
- Grant of the options.

## 6.2 Employment law

- 6.2.1 Under the statutory provisions on worker's representatives, "délégués du personnel" (to be organised where there are fifteen or more workers) and Works Councils, "comité d'entreprise" (to be organised where there are 150 or more workers), there is no express requirement to obtain the formal agreement of these two institutions before implementing a plan. However, the Works Council and the workers' representatives have a legal general right to be provided with economical and financial information on the Luxembourg company as well as to provide their comments on the work conditions of employees. As these rights are very general and may be interpreted widely, it is advisable to provide the Works Council and the workers' representatives with prior information about the stock option plan<sup>31</sup>.
- 6.2.2 Luxembourg law does not have a general principle of non-discrimination between employees, but regulates discrimination based on sex, part-time employment and duration of employment<sup>32</sup>.
- 6.2.3 In the case of unfair dismissal, a judge may grant a special indemnity based on the loss of participation in stock option plans<sup>33</sup>.
- 6.2.4 Under current Luxembourg case law, a benefit granted to employees becomes a vested right if it can be considered as general, fixed and constant. Hence, a successive and regular participation in stock options plans could allow the courts to conclude that the employees are entitled to further participation in the plans. This also means that in the absence of the employees' consent, in order to put an end to or to amend the stock option plan the employer has to comply with Article 37 of the Luxembourg Employment Contract Act of 24 Ma 1989 which provides for a formal procedure when an employer decides to amend substantially the employment contract in a way that is unfavourable to an employee<sup>34</sup>.

---

<sup>31</sup> Law of May 18, 1979 reforming worker's representation.

Law of May 6, 1974 establishing Works Council in undertakings of the private sector and organising the representation of employees in limited liability companies

<sup>32</sup> Regulation of July 10, 1974 relating to the equality of remuneration between men and women. Article 8 of the law of February 26, 1993 concerning voluntary part time work. Article 14 of the law of May 24, 1989 on the employment contract.

<sup>33</sup> Case law (labour court March 12, 1999).

<sup>34</sup> Case law (C.S.J. (Superior Court of Justice) October 17, 1996, n°16890)



6.2.5 However, under current Luxembourg case law, an express stipulation that the grant of an award is discretionary, is considered sufficient to exclude any claim based on vested rights on the part of an employee. Although not free from doubt the fact that a stock option plan stipulates that it is discretionary and can be amended, suspended or terminated at any time should avoid it being considered as fixed, general and constant<sup>35</sup>.

6.2.6 A common issue raised in stock option plans is the deduction of the grant or exercise price of the options from the employee's salary. Under Luxembourg case law the employer is only allowed to make deductions from salaries in specific cases<sup>36</sup>. No agreement may be concluded between an employee and an employer providing for a deduction in circumstances that are not covered by article 5 of the law of 1970, and any grant or exercise price cannot therefore be deducted from salary<sup>37</sup>.

### **6.3 Data protection**

6.3.1 Historically, the applicable legislation with respect to the issue of Data Protection has been the Data Protection Act of 31 March 1979 ("DPA"). However, some provisions of the European Directive 95/46/CE of 24 October 1995 on Data Protection, although not yet integrated in the Luxembourg legislation, also need to be considered<sup>38</sup>.

6.3.2 A Luxembourg parliamentary bill is currently pending and is aiming, inter alia, to integrate the provisions of the European Directive. It is expected that this will be adopted during the year 2002 (the "Directive")<sup>39</sup>.

6.3.3 The DPA provides protection for individuals or entities against the abusive use of registered data on computer support systems. The DPA is applicable to:

- All personal databases used on the Luxembourg territory.
- All personal databases installed on the Luxembourg territory, even if the data is only used abroad.
- All personal databases installed abroad, which are accessible in Luxembourg through a terminal.

6.3.4 Pursuant to the DPA, the creation and the use of any database concerning personal data is subject to prior authorisation by the competent Minister.

6.3.5 Such authorisation covers the use of the database as specified in the application. However, if the data is to be used for a purpose other than the one stated, or if it is

---

<sup>35</sup> Case law (C.S.J. October 24, 1994, n°18257).

<sup>36</sup> Article 5 of the law of November 11, 1970 with respect to the transfer and seizure of salaries (article 5)

<sup>37</sup> Case law (C.S.J. June 9, 1994)

<sup>38</sup> Data Protection Act of March 31, 1979.

<sup>39</sup> Parliamentary bill No. 4735 of December 7, 2000, relating to the protection of persons with respect to the treatment of their personal data.

to be transmitted to a third party not mentioned in the initial request, a new request will have to be filed with the competent Minister.

- 6.3.6 The obligation to obtain a prior authorization from the competent Minister does not delay the implementation process in practice, as such authorization is commonly not delivered and the request is therefore more of a notification procedure.
- 6.3.7 Personal data cannot be collected through fraudulent, unfair or illicit means. The collection of data relating to political, trade union (unless explicitly authorized by the person concerned), philosophical or religious activities or opinions, or linked to the privacy of the person, is forbidden.
- 6.3.8 Furthermore, the individuals whose data is collected need to be informed of the following:
- The purpose of the recording of data.
  - Whether a response to the questions is obligatory or optional.
  - The consequences if no response is given.
  - The identity of any third party receiving the information.
  - Their right to obtain disclosure of all personal information stored on the database.
  - Their right to correct any false information recorded.
- 6.3.9 The collection of data in relation to the implementation of a stock option plan has to be carried out in compliance with the rules mentioned above.
- 6.3.10 Certain criminal penalties are applicable when the DPA is infringed, e.g., a person who creates, operates or uses a personal database without authorization can be sentenced to a term of imprisonment from eight days to six months and/or subject to a penalty ranging from €251 to €12,500<sup>40</sup>.
- 6.3.11 Criminal liability also extends to a holder of personal data who, at the time of its recording, classification, transmission or any other form of processing, changes it from its form as defined in the authorization, or knowingly transmits it, or allows its transmission, to third parties, without the appropriate authorization.
- 6.3.12 The Luxembourg Criminal Code does not recognise the criminal liability of the company so the breaches may be imputed to the relevant individuals within the company.

---

<sup>40</sup> Article 32 of the Data Protection Act of March 31, 1979.

- 6.3.13 To our best knowledge, the criminal courts of Luxembourg are not currently actively concerned with such issues and the penalties are not strictly enforced. The situation may change with the adoption of the Directive and the set up of a specific commission. This commission will be in charge of the notification/authorization procedures and have specific powers such as an investigating power and the power to punish guilty parties by administrative sanctions. It will also have the capacity to sue the party concerned or to divulge the infringement to the Public Minister<sup>41</sup>.

## **6.4 Stock exchange issues**

- 6.4.1 A company wishing to implement a stock option plan in Luxembourg requires shareholder approval. The issue of new shares by a Luxembourg company requires approval at a general meeting of shareholders and the disclosure of the draft of the stock option plan. For a Société Anonyme, shareholders' approval is not required for an increase in the issued share capital, determined by management, if such shares are part of the authorised share capital.
- 6.4.2 Neither Luxembourg Stock Exchange regulations nor Luxembourg Commercial Company Law give a legal definition of a "public offer" of shares. However, the doctrine and oral statements of the Luxembourg Stock Exchange provides that a public sale of shares which targets a limited number of known beneficiaries (e.g. where an employer provides share benefits to employees) should not be considered a public offer of shares. If that is the case none of the formalities for a public offer need to be complied with. However if an offer were subject to significant publicity (e.g. notice in the local or international press asking retired or former employees to come forward if they wish to subscribe to the offer), it would be regarded as a public offer.
- 6.4.3 Companies often submit a request to the Luxembourg authority ("Commission de Surveillance du Secteur Financier") to obtain confirmation of the nature of the offer being made under a stock option plan.
- 6.4.4 The fines for failing to comply with the filing requirements for public offers are from €500 to €25,000<sup>42</sup>. The fine for the infringement of the public offer condition is from €125 to €3,125<sup>43</sup>.
- 6.4.5 There is no restriction on Luxembourg residents holding shares or options over shares in a foreign company, whatever the qualification of the offer (public or private offer).

## **6.5 Securities law**

- 6.5.1 There are no securities law restrictions on the number of individuals who can participate in stock option plans.

---

<sup>41</sup> General Practice.

<sup>42</sup> Article 163 of the Luxembourg Commercial Company Law.

<sup>43</sup> Article 22 of the Grand Ducal Regulation of December 28, 1990.

## **6.6 Financial assistance provisions**

- 6.6.1 There is a general principle under Luxembourg Commercial Company law prohibiting a company from advancing funds or making loans or providing securities to enable a third party acquire its shares. There are exceptions where the transaction is entered into to enable the acquisition of shares by or for employees of the company<sup>44</sup>. The fine for failing to comply is from €5,000 to €25,000, and/or a term of imprisonment ranging from one month to two years.<sup>45</sup>

## **6.7 Other**

### *6.7.1 Foreign exchange control filings*

- 6.7.1.1 The “Banque Centrale de Luxembourg” (“BCL”) and the “Service Central de la Statistique et des Etudes Economiques” (“STATEC”) are in charge of collecting information in order to establish the balance of payments and the global external position of Luxembourg. The BCL is responsible for collecting information from institutions in the financial sector and the STATEC has responsibility for all other institutions.<sup>46</sup>
- 6.7.1.2 Luxembourg residents are under a legal obligation to communicate to the BCL and/or STATEC all their monetary operations with counterparts in other countries.
- 6.7.1.3 If a Luxembourg financial institution is involved in a transaction as an intermediary, this intermediary should fulfill the reporting obligations, instead of by the Luxembourg residents for whom the institution is acting. This intermediary should be in possession of all the following information: (i) the nature of the transaction; (ii) the currency; (iii) the amount; and (iv) the country of residence of the co-contractor.
- 6.7.1.4 If the transaction exceeds €12,500 (or its equivalent in another currency), the intermediary must also be provided with details of the nature of the operation.
- 6.7.1.5 If the transaction does not involve a Luxembourg financial institution as an intermediary, with respect to professional operations, regardless of the amounts, residents must provide the information directly to STATEC (Central Services for Statistic and Economic Studies) on a specific form. This information has to be provided within fifteen working days following the month during which the transactions were carried out.
- 6.7.1.6 There are fines for non-compliance of from €2,500 to €25,000 and/or potential imprisonment from four months to two years<sup>47</sup>.

---

<sup>44</sup> Article 49-6 of the Luxembourg Commercial Company Law.

<sup>45</sup> Article 168 of the Luxembourg Commercial Company Law

<sup>46</sup> Law of June 28 2000 modifying the Grand Ducal Regulation of November 10 1999 on foreign exchange control.

<sup>47</sup> Grand Ducal Regulation of January 30, 1947.

## **7. Sourcing shares for stock option plans**

- 7.1 A Luxembourg Company can choose whether to use newly issued shares or market purchase shares to meet the exercise of share options and there are no restrictions on when shares are bought or issued for these purposes.
- 7.2 A company cannot generally hold its own shares, either directly or indirectly. There are exceptions to this general rule in certain specific circumstances, subject to strict conditions: e.g., the holding of shares to be distributed to the company's employees<sup>48</sup>. A company can redeem its own shares in specific circumstances or issue redeemable shares<sup>49</sup>.
- 7.3 When the options are issued, companies often arrange for an auditor's report to be prepared<sup>50</sup>.
- 7.4 At the exercise of the option the share register is updated and a share certificate is issued.

## **8. Role and influence of existing shareholders**

- 8.1 The only involvement of shareholders in the implementation of a stock option plan is in the approval of a plan as mentioned in section 6.4.

## **9. Accounting**

- 9.1 Luxembourg generally accepted accounting principles ("GAAP") does not address how to account for options granted to employees.
- 9.2 There are several ways in which stock options are accounted for, depending on the terms of the proposed scheme.
  - 9.2.1 *Options to acquire shares bought on the market*
    - 9.2.1.1 *Company not holding its own shares*
      - 9.2.1.1.1 Upon grant of the option, any premium received is deferred until the option expires. At the expiration date, the deferred premium is recorded as income in the income statement.
      - 9.2.1.1.2 During the life of the option, the potential risk (being the difference between the cost of the shares to be acquired and the exercise price of the option) has to be provided as a provision in the company's accounts, in the income statement. At

---

<sup>48</sup> Article 49-2 and 49bis of the Luxembourg Commercial Company Law.

<sup>49</sup> Articles 49-2 and 49-8 of the Luxembourg Commercial Company Law.

<sup>50</sup> Article 32-4 of the Luxembourg Commercial Company Law.

year-end, in practice the provision will equal the difference between the market price on the Stock Exchange where the company is listed and the exercise price.

#### 9.2.1.2 *Company holding its own shares*

9.2.1.2.1 Upon grant of the option, any premium received is deferred until the option expires. At the expiration date, the deferred premium is recorded as income in the income statement.

9.2.1.2.2 During the life of the option, the potential risk (being the difference between the acquisition cost of the own shares; and the strike price of the option) has to be provided as a provision in the company's accounts, in the income statement. At year-end, in practice the provision will equal the difference between the market price on the Stock Exchange where the Company is listed and the exercise price.

#### 9.2.2 *Options over newly issued shares*

9.2.2.1 During the life of the option, the terms of the commitment given to the employees under should be disclosed.

9.2.2.2 The issue of new shares has to be accounted for as a capital increase with the creation of additional capital and possibly share premium. Common practice holds that any dilutive effect for the existing shareholders (being the difference between the FMV of the shares and the exercise price) should not affect the company itself and is therefore not recorded as a charge in the income statement.

#### 9.2.3 *Disclosures*

9.2.3.1 In all cases, a detailed description of the stock option plan has to be made in the notes to the accounts and should include inter alia:

- The potential beneficiaries.
- The grant conditions.
- The plan limits.
- The exercise price.
- The expiration date.
- The movements in the number of share options (issued, exercised, expired, etc...)

9.2.3.2 The International Accounting Standards Committee has published a discussion paper on the subject. Only Luxembourg listed companies will be obliged to adopt the International Accounting Standard ("IAS"). No decision has been made yet by

Luxembourg authorities to impose IAS for both entity accounts and consolidated accounts of non-listed companies.

## **10. Miscellaneous**

### **10.1 Use of a trust**

- 10.1.1 The Luxembourg jurisprudence has determined the conditions under which a trust set up abroad may be recognised in Luxembourg as well as the limitations for recognition of foreign trusts<sup>51</sup>.
- 10.1.2 A Luxembourg parliamentary bill is currently pending which aims to ratify the Hague Convention on the law applicable to Trusts and their recognition of 1 July 1985<sup>52</sup>.
- 10.1.3 Luxembourg implemented the concept of a fiduciary relationship (the “Fiducie”), in 1983, which is quite similar to that of a trust.
- 10.1.4 A fiduciary relationship is one under the terms of which a person (the “Fiduciant”) agrees to transfer to a Luxembourg credit institution (the “Fiduciaire”) some of his patrimonial rights (the “Fiduciary Assets”). The exercise by the Fiduciaire of those patrimonial rights is limited by the obligations set out in the Fiduciary Agreement<sup>53</sup>.
- 10.1.5 Trusts are not commonly used in conjunction with employee stock option plans in Luxembourg.
- 10.1.6 There are no other mechanisms that are commonly operated in conjunction with share option plans in Luxembourg.

### **10.2 Other**

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

## **11. Special points to note**

### **11.1 Mitigation of income tax**

- 11.1.1 There are no specific provisions enabling income that accrues over several years to be mitigated.

---

<sup>51</sup> Case law:

- Luxembourg Court of appeal May 22, 1996;
- Luxembourg Court January 21, 1971.

<sup>52</sup> Parliamentary bill n°4721.

<sup>53</sup> Grand-Duchy Regulation of July 19, 1993

## **11.2 Mitigation of social security contributions**

11.2.1 Currently this is not relevant.

## **11.3 Mitigation of tax on sale of shares**

11.3.1 Assuming that the employee does not hold an important participation, capital gains are exempt provided either:

- The shares are sold more than six months from their acquisition<sup>54</sup>;
- The shares are sold within seven days following the exercise of options and the employee has held the options for more than six months<sup>55</sup>.

11.3.2 Capital gains taxation is usually avoided.

11.3.3 To mitigate tax on sale the employer may also redeem tradable options without tax consequences for the employee if the employee did not hold an important participation and he held the options for more than six months. This remains true even when the redemption is made for cash<sup>56</sup>.

## **11.4 Special provisions for SMEs**

11.4.1 There are no special provisions relating to stock option plans for SMEs.

---

<sup>54</sup> Article 99 bis / 100 LITL

<sup>55</sup> Administrative circular letter (LITL No. 104/2) dated January 11, 2002

<sup>56</sup> Article 99 bis / 100 LITL





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.