

Employee Stock Options in the EU and the USA

FINAL REPORT

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Spain

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Spain

1. General remarks

1.1 History

- 1.1.1 Spanish legislation does not specifically cover the taxation of stock options as a form of remuneration for employees. Therefore, the rules applicable to such plans are the general rules applicable to earned income as set out in the Spanish Personal Income tax law.
- 1.1.2 The first reference to share based plans in Spanish legislation was in the Spanish Personal Income tax law (Law 18/1991), which exempted from tax the benefit derived from the provision of shares by a company to its employees. However this exemption was withdrawn.
- 1.1.3 The taxation of stock options has now been clarified through various rulings issued by the Spanish General Directorate of Tax (“GDT”), based on general tax rules.

1.2 Current situation

- 1.2.1 There are approximately 40 Spanish companies that have established stock option plans in Spain. Of these, 21 are listed on the IBEX 35. Foreign companies providing stock options to employees of Spanish subsidiaries are more common.
- 1.2.2 The Spanish government has announced the introduction of new tax benefits for stock option plans which will take place in 2003 in the next reform of the Spanish Personal Income tax law.

2. Key features of stock option plans

- 2.2 There are no specific requirements for employee stock option plans in Spain. From a regulatory point of view, there is no minimum term for which stock options must be granted nor a maximum term for which stock options must subsist.
- 2.3 However, the selection of participants should be based on objective criteria and the decision must be made on a non-discriminatory basis (see section 6.2).
- 2.4 There are no restrictions on the nature or value of the shares over which options may be granted and there are no restrictions on the type of company that may grant options under a stock option plan.

3. Taxation

3.1 Time of taxation

3.1.1 Grant

3.1.1.1 There may be an income tax charge for employees at the date of grant of options.

3.1.1.2 As Spanish legislation does not specifically cover stock option plans, most of the comments below are based on tax rulings issued by the GDT.

3.1.1.3 According to these tax rulings, generally, the grant of an option, which is non transferable, and is merely an opportunity to acquire shares, will not be subject to taxation in Spain. In these circumstances, the GDT has interpreted the rulings to mean that the employee will not be subject to taxation until the shares are due and payable, which is considered to be the exercise date.

3.1.1.4 However, if the options can be freely transferred (which is also sometimes referred to as being tradable) the GDT interpretation has been that there will be tax at grant¹.

3.1.1.5 If an option is transferable and as such taxable on grant, social security will also be due.

3.1.2 Vesting

3.1.2.1 Income tax and social security contributions would only arise at vesting if the option itself became transferable at that point, when it had previously not been transferable.

3.1.3 Exercise

3.1.3.1 If the options are not transferable, taxation will take place at exercise². Employee social security contributions would also be due at this time, if there is a tax liability. Providing certain conditions are met, it may be possible to exclude part of this exercise gain from tax. See section 11.1 for more information.

3.1.3.2 If the options were taxable at grant or vesting, there will be a capital gain (or loss) on exercise, i.e., the exercise would be treated as a disposal of the option. However if the exercise takes place within one year of the taxable date (grant or vesting date, as appropriate) any gain arising on exercise would be taxed at ordinary income tax rates. If the exercise takes place more than one year after the taxable date, the gain would be taxed at a flat capital gains tax rate of 18%. No social security contributions would be due.

3.1.3.3 Transfers of shares or interests in a company, or in any company of the group, up to a maximum value of €3,005 (500,000 Ptas) per year, or €6,010 (1,000,000 Ptas) over the last five years to current employees, free of charge, is not considered a taxable benefit in kind. To enjoy this tax benefit, all of the following conditions must be met.

¹ General Directorate of Tax (GDT): 25 of May 1999; 5 of May 1999; 13 of March 2001.

² General Directorate of tax: 12 of January 2001; 16 of March 2000.

- The share plan must operate under the general remuneration policy of the company.
- The employee, his spouse or relatives up to the second grade cannot have direct or indirect participation of more than 5% in the company.
- The shares must belong to the employee for at least a three year period³.

3.2 Taxable gain

- 3.2.1 Where an income tax charge arises at grant the amount chargeable to income tax and social security contributions will be the difference between the fair market value (“FMV”) of the options at grant and any price paid for the option⁴. There is no set methodology for valuing options for tax purposes. Accordingly an independent expert would normally be instructed to carry out the valuation.
- 3.2.2 When the option is subsequently exercised, the capital gain or loss on disposal of the option is measured as the difference between the FMV of the shares at exercise and the acquisition cost (exercise price plus the amount subject to taxation before exercise).
- 3.2.2 Where the option first becomes taxable at exercise, the difference between the FMV of the shares at exercise and the exercise price will be treated as a benefit in kind subject to taxation in Spain as earned income⁵.

3.3 Type of tax

3.3.1 *Tradable options or transferable options*

- 3.3.1.1 Personal income tax and social security contributions will be due on options that are transferable when granted or become transferable on vesting. The income is considered earned income⁶.
- 3.3.1.2 If the exercise then takes place within one year of the taxable date (grant date or vesting date as appropriate), any gain arising on exercise would be taxed at ordinary income tax rates. If the exercise takes place more than one year after the taxable date, the gain would be taxed at a flat capital gains tax rate of 18%. No social security contributions would be due.

3.3.2 *Non tradable or non transferable options*

- 3.3.2.1 Income tax and social security contributions will be payable on the gain at exercise⁷.
- 3.3.2.2 Income tax rates for the year 2002 vary from 18% to 48%.

³ (Law 40/1998) Article 43.2.

⁴ General Directorate of Tax (GDT): 25 of May 1999

⁵ Spanish Personal Income tax law (Law 40/1998): Article 53.2

⁶ Spanish Personal Income tax law (Law 40/1998): Articles 50 and 53.2.

⁷ Budget Law for year 2002: (Law 23/2001).

3.3.3 *Social security contributions*

3.3.3.1 Social security contributions are capped in Spain. For 2002 the maximum monthly contribution base has been fixed at €2,574.9 (Pesetas 428,427). These ceilings may vary based on an employee's professional category.

3.3.3.2 An employee's social security contributions are calculated by applying certain percentages, fixed annually by the Spanish Government, to a base. The base is the real salary received by the employee.

3.3.3.3 The employees' social security rates for 2002 are:

- 6.35 % to be applied to the contribution base for employees on independent employment contracts.
- 6.4% to be applied to the contribution base for employees on temporary contracts (this percentage applies for full time and part time contracts and to contracts made through temporary employment agencies).

3.3.3.4 Where an employee does not realise earned income from options on a periodic basis, or does so only once in any year, the value of the benefit obtained by the employee will be prorated over the twelve months of the year in which the benefit is obtained. Social security contributions for past months should be made as complementary contributions from January to the month when the employee effectively obtains the benefit. For current and future months, the social security contribution base will be increased by the relevant monthly part of the benefit obtained.

3.3.4 *Wealth tax*

3.3.4.1 Wealth tax is payable by Spanish residents if their worldwide net wealth exceeds set limits. The value of unexercised transferable options and the value of the shares acquired on exercise are taken into account for these purposes. Wealth tax rates vary between 0.2 and 2.5%⁸.

3.4 **Capital gains taxation**

3.4.1 A capital gain or loss equal to the difference between the sale price and the acquisition cost (effectively the FMV of the shares at exercise) may arise when the shares are sold⁹.

3.4.2 If the employee had held the shares for one year or less, this will be treated as a short term capital gain and be subject to tax at ordinary income rates (see section 3.3).

3.4.3 If the shares are held for more than one year, this will be treated as a long term capital gain and be taxed at a flat capital gains tax rate of 18%.

⁸ Spanish Wealth tax law (Law 19/1991): Articles 4.9 and 28.2.

⁹ Spanish Personal Income tax law (Law 40/1998): Article 53.2

3.4.4 If a capital loss arises, the treatment differs depending on the period for which the shares were held¹⁰:

- Capital losses arising on the sale of shares within one year of exercise may be offset against any capital gain generated in the same period of time. Any remaining capital losses may be used to offset up to 10% of other regular income. The rest of the capital losses may be carried forward over the next four years and set against future short term capital gains.
- Capital losses arising on the disposal of shares more than one year after exercise may be offset against any capital gain generated in the same period of time. Any remaining capital losses may be carried forward over the next four years and set against future long term capital gains.

3.5 Tax consequences for the granting company

3.5.1 Social security contributions

3.5.1.1 Employer social security contributions will be due on the date of grant or vesting, if there is an income tax charge for the employee (see section 3.1) or the date of exercise, if the option was not previously taxed¹¹.

3.5.1.2 Social security contributions are capped in Spain. For 2002 the maximum monthly contribution base has been fixed at €2,574.9 (Pesetas 428,427). These ceilings may vary based on the employee's professional category.

3.5.1.3 Employer's social security contributions are calculated by applying percentages, fixed annually by the Spanish Government, to a base. The base is the real salary received by the employee.

3.5.1.4 Employer's social security contribution rates for 2002 are:

- 30.6% to be applied to the contribution base for employees hired on indefinite employment contracts.
- 31.3% to be applied to the contribution base for employees hired on temporary full time contracts.
- 32.3% to be applied to the contribution base for employees hired on temporary part time contracts.
- 32.3% to be applied to the contribution base for employees hired through a temporary employment agency (this percentage applies for both full time and part time contracts).

¹⁰ Spanish Personal Income tax law (Law 40/1998): Articles 38 and 39.

¹¹ Budget Law for year 2002: (Law 23/2001).

- 3.5.1.5 Where an employee does not realise earned income from options on a periodic basis, or does so only once in any year, the value of the benefit obtained by the employee at exercise will be prorated over the twelve months of the year in which the benefit is obtained. Social security contributions for past months should be made as complementary contributions to the social security system from January to the month when the employee effectively obtains the benefit. For current and future months, the social security contribution base will be increased by the relevant monthly part of the benefit obtained.
- 3.5.2 *Corporate tax deduction*
- 3.5.2.1 Spanish companies can only obtain a corporation tax deduction for expenses incurred for the benefit of the Spanish company.
- 3.5.2.2 Costs involved in the administration of the plan and employer social security contributions are deductible, providing an invoice supports them.
- 3.5.2.3 A deduction is not available for the lost opportunity cost associated with issuing new shares. When shares are purchased or a cost is incurred under a recharge arrangement with a foreign parent, the costs may be deducted, provided an invoice to evidence the cost supports the claim. If a foreign parent recharges a local subsidiary for the spread on exercise, (i.e. the difference between the FMV on exercise and the exercise price) and the local subsidiary wishes to claim a corporate tax deduction for this charge, it is generally recommended that the shares are market purchased and not newly issued. If they are newly issued, it is not clear that a deduction would be available. Any payment to a parent company should be made under a written agreement setting out the terms of the recharge and, ideally, the agreement should be entered into before the options are granted by the parent company. Recharged costs are not normally deductible until employees have received taxable income from the options.
- 3.5.2.4 Article 14 of Spanish Corporate Tax law establishes that “The following expenses will not be tax deductible: (g) service expenses corresponding to operations performed, directly or indirectly, with persons or entities resident in countries or territories statutorily classified as tax havens, or which are paid through persons or entities resident therein, unless the taxpayer proves that the expense accrued corresponds to an operation or transaction which has actually been carried out.”
- 3.5.2.5 Even though normally an expense is calculated based on accounting rules, for related companies, article 16 of Spanish Corporate Tax law sets out a special rule. In such circumstances the Spanish Tax Administration may impose normal open market values between the parent and subsidiary. If the recharge is made on an arms length basis, no adjustment would be made¹².

¹² Corporate tax law: Article 14 and 16.

3.5.3 *Other*

- 3.5.3.1 If the Spanish employing company makes a payment under a recharge arrangement, VAT will be payable, but this should be matched by an equal deduction. If the payment is for the cost of providing shares, no VAT is payable.¹³.

4. Issues for employees

4.1 Reporting obligations

- 4.1.2 There are reporting obligations for income tax and wealth tax purposes on grant or vesting if there is a tax charge¹⁴.
- 4.1.3 The employee would have to include the value of the benefit in kind in his/her Personal Income Tax return for the year in which the tax event took place.
- 4.1.4 If the employee is obliged to file a Wealth Tax return, see section 3.3.4, he/she will have to include the value of options in this return.
- 4.1.5 If the employee is considered non tax resident and a foreign company in kind provides the benefit, the employee will still have to report this income.
- 4.1.6 At exercise, reporting obligations will arise for income tax and wealth tax purposes:
- If the benefit of the options was taxed before exercise, the employee will have to include the capital gain or loss on exercise in his/her Personal Income Tax return.
 - If the options were not transferable, the employee will have to include the value of the benefit in kind obtained on exercise in his/her Personal Income tax return for the year in which the exercise took place.
- 4.1.7 If the cost of withholding tax (see section 5.2) is borne by the local employer, the withholding itself is a benefit and must be grossed up.
- 4.1.8 If the employee bears the cost of the withholding, it is not treated as income.
- 4.1.9 If the employee is obliged to file a Wealth Tax return, the employee will have to include the value of the shares at exercise in this return.
- 4.1.10 The employee is also required to include the taxable capital gain or loss arising on the sale of the shares in his Personal Income Tax return for the tax year in which the share are sold.

¹³ Value Added tax law (Law 37/1992)

¹⁴ Ministerial Order which approves the Personal Income tax return form (Form for year 2001 has not been approved yet).

4.1.11 The tax return should be filed with the Spanish tax authorities before 20 June of the year following that in which the income was subject to taxation if there was any tax due, or before 2 July of the subsequent year if there is a tax refund¹⁵.

4.1.12 If the employee is regarded as non tax resident in Spain and appropriate withholding is operated (see section 5.2) the employee will have no reporting obligations.

4.2 Cashflow issues

4.2.1 If there is a tax charge at the date of grant, companies may either provide finance to their employees to cover the market value of the options so that the employee can pay market value and avoid a tax charge at grant or loan funds to cover the tax liability.

4.2.2 If the employee paid money for the grant of the share option, but he/she does not then go on to exercise the option, according to a tax ruling issued by the Spanish General Directorate of tax regarding warrants, a capital loss will arise¹⁶.

4.3 Change in employee's residence status

4.3.1 Where an employee is tax resident in Spain at vesting, and he is subject to taxation at vesting (see section 3.1 above), he will have to include the benefit in kind in his Personal Income tax return for the year when the options vest.

4.3.2 Non tax resident individuals in Spain are only subject to taxation on the income and capital gains obtained or generated within a Spanish "territory", at a flat tax rate of 25% for earned income; 35% for capital gains, and 18% for interest and dividends.

4.3.3 Spanish legislation provides that income "obtained or generated within a Spanish territory" includes earned income when derived directly or indirectly from work performed in Spain, or where the earnings are paid by entities resident in a Spanish territory.

4.3.4 Earned income obtained at vesting, derived from work performed abroad between the grant date and the vesting date, is tax exempt in 2002 up to a maximum of €60,101.2 (Ptas 10,000,000) if it has been subject to taxation abroad under a tax similar or identical to Spanish Income tax. This exemption would not apply if the work was performed in a country legally classified as a tax haven¹⁷. Any excess amount would be taxed at a rate of 25%.

4.3.5 The income should be prorated to calculate the amount that is subject to taxation in Spain. The law does not set out how this prorating should be done but it can be based on the number of days spent in Spain. Any other economic argument, which can justify an allocation of income to Spain, may also be acceptable.

¹⁵ Ministerial Order which approves the Personal Income tax return form (Form for year 2001 has not been approved yet).

¹⁶ Spanish General Directorate of Tax: 29 May 2001

¹⁷ Spanish Personal Income tax law (Law 40/1998): Article 7.

- 4.3.6 If an employee is not resident in Spain at vesting, and the income is paid and borne by a company abroad, then subject to the appropriate double tax treaty it may not be subject to taxation in Spain¹⁸.
- 4.3.7 On exercise, the income tax and social security contributions implications would be as follows for the two scenarios set out below:
- (1) Where the employee is tax resident at the exercise but was not tax resident at the date the option was granted:
 - If the options were transferable before exercise taxation at exercise would be unchanged.
 - If the options were not transferable, the employee would have to include the benefit in kind in his Personal Income Tax return for the year when the options were exercised. He would be taxed as a Spanish resident except to the extent that a part of the income obtained at exercise was derived from work performed abroad between the grant and the exercise dates. Earned income received for work performed abroad, up to a maximum of €60,101.2 (Ptas 10,000,000) for 2002, is tax exempt provided that it has been subject to taxation abroad under a tax similar or identical to Spanish Income tax. This exemption would not apply if the work had been performed in a country legally classified as tax haven¹⁹.
 - (2) The employee is not tax resident at exercise but was tax resident at grant; or the employee was not tax resident at grant, is not tax resident at exercise but was tax resident in between:
 - If the options were transferable prior to the date of exercise the gain would not be subject to taxation at exercise where the shares were shares in a foreign company.
 - If the options were not transferable, he would only subject to taxation on income and capital gains obtained or generated within a Spanish territory, at a flat tax rate of 25%; 35% for capital gains, and 18% for interest and dividends.
- 4.3.8 If part of the income at exercise was obtained for work performed in a Spanish territory, the rules described above for prorating would apply.

5. Issues for employers

5.1 Reporting obligations

- 5.1.1 If there is a taxable benefit at grant or vesting there will be a reporting obligation at that time.

¹⁸ Spanish Personal Income tax law for non-tax residents (Law 41/1998)

¹⁹ Spanish Personal Income tax law (Law 40/1998) Article 7.

- 5.1.2 The Spanish employer must operate payments on account or withholding on benefit in kinds provided to its employees (see section 5.2).
- 5.1.3 The company will have to declare the value of the benefit in kind and the corresponding payments on account²⁰.
- 5.1.4 The local company must report all amounts paid to, and withheld from, its employees through a quarterly tax return (Form 110). However, if the company's turnover in the preceding year exceeded Ptas 1.000 million, then a monthly tax return should be filed (Form 111). Form 111 must be filed by the 20th of the month immediately following the withholding, together with a remittance for the tax due. Form 110 should be filed on the following dates: 20 April, 20 July, 20 October and 20 January.
- 5.1.5 In addition, an annual summary tax return (Form 190), reporting withholding and payments on account, must be filed within the first 20 days of January of the following year. If the company files this form on magnetic tape, the deadline to file the return will be extended until 20 February.
- 5.1.6 The local employer must report any benefits awarded under a stock option plan on an employee's annual wage statement before the beginning of the tax submission period.
- 5.1.7 Social security contributions must be reported to the Spanish social security authorities by filing form TC1 and form TC2 and any outstanding amounts must be remitted to the Spanish authorities in the month immediately following the date of exercise.
- 5.1.8 If the employee is considered non tax resident, the Spanish company is obliged to file an annual summary of remuneration, withholdings and payments on account for the preceding calendar year within the first twenty days of January using Form 296.
- 5.1.9 If the options were not transferable, the company would be required to report the benefit in kind subject to tax at exercise.
- 5.1.10 There is no reporting obligation for the employer in respect of the sale of the shares.

5.2 Withholding obligations

- 5.2.1 If there is a taxable benefit at the date of grant or vesting, the employer is obliged to pay a withholding tax on this benefit.
- 5.2.2 The cost of this withholding tax can be borne by the company or by the employee. If the cost is borne by the employer, the withholding will have to be added to the benefit in kind as additional income and therefore grossed up.

²⁰ Spanish Personal Income Tax regulation (Royal Decree 214/1999): Articles 71, 101

- 5.2.3 If the employee bears the cost of the withholding, no additional income arises, i.e. there is no gross up.
- 5.2.4 If the employee is considered non tax resident and the benefit in kind is provided by a Spanish company (or the cost is borne by a Spanish company) there will be a withholding tax obligation for the company equal to 25% of the benefit in kind²¹.
- 5.2.5 Withholding at exercise is required if the option was not transferable at grant or vesting. Where withholding is due, the same rules apply as for withholding at grant or vesting.
- 5.2.6 There are no withholding obligations for the local employer in respect of the sale of the shares.

6. Legal issues

6.1 Process/timeframe

- 6.1.1 Depending on the type of company and the complexity of the plan, the implementation of a stock option plan in Spain could take between five months and one year.
- 6.1.2 The following implementation steps are typical when establishing a stock option plan:
- Drafting the rules of the plan and the communication documents.
 - Preparation of a document setting out the terms and conditions of the proposed plan and the way in which the shares will be provided to the employees. The document should also include the reasons for implementing the plan. This document is issued to the board of directors and to shareholders.
 - Approval of the plan by the board of directors of the company and by the shareholders in general meeting.
 - Filing and prior registration of the documents before the National Stock Exchange Commissions (the “*Comisión Nacional del Mercado de Valores*” or “CNMV”).
 - Informing the employees and their representatives of the terms and conditions of the stock option and, if necessary, obtaining the relevant approvals (see section 6.2).

6.2 Employment law

- 6.2.1 The selection of the participants should be based on objective grounds and the decision must be made on a non discriminatory basis. According to Spanish labour

²¹ Spanish Personal income tax law for non tax residents (Law 41/1998)

law, the exclusion of certain employees from participating in the plan on the basis of their part time or temporary working status would be considered as discriminatory.

- 6.2.2 In addition, the exclusion of employees from participating in the plan based on sexual, religious, political, ideological, or other such reasons would also be considered to be discriminatory. In such cases, the Spanish judicial courts could declare the plan null and void if the employees of the company brought a claim against it.
- 6.2.3 It is possible to select employees who have completed a minimum period of service, or to select the participants in the Plan in accordance with other criteria which would be considered valid and objective, e.g. professional category, performance of management functions, specialisation at work, etc.
- 6.2.4 The employees' legal representatives are entitled to receive the same information about the plan as the company's shareholders and would have to be informed about the plan's terms and conditions.
- 6.2.5 If a stock option plan is regarded as a new incentive plan, the employees' legal representatives would be entitled to issue a report setting out their opinion before it is finally implemented²². The company should ask for this report within a reasonable period prior to the plan's implementation (15 days to one month). Nevertheless, the report is not be binding on the company.
- 6.2.6 If the plan is intended to replace some part of a previous remunerative system, it may constitute a substantial modification of the employees' legal conditions. In such circumstances, a special procedure and approval by the employees' legal representatives as set out in article 41 of the Workers' Statute would have to be followed.
- 6.2.7 In accordance with this article, if (i) the options/shares are to be granted to company employees and (ii) are to be one of the labour conditions included in a Collective Bargaining Agreement affected by the implementation of the plan, it would be necessary to reach an agreement with the Works Council to allow the new remuneration system to be substituted for the old. The information that the company must provide to employees and the Works Council should be included in the terms and conditions of the plan.
- 6.2.8 The plan cannot affect the minimum and compulsory conditions established under the Collective Bargaining Agreement in force within the company, not even by reaching an agreement with the employees' legal representatives.

²² (Article 64.4 (e) of the Workers' Statute).

6.3 Data protection

- 6.3.1 Under Spanish Data Protection legislation, generally the use of personal data requires the prior consent (express, tacit or even implied) of the person whose data is affected²³.
- 6.3.2 This consent is not necessary where general personal data (not sensitive data) is required to draft an employment contract or is essential for the development of an employment relationship.
- 6.3.3 The company is not allowed to use the data obtained as a consequence of the employment relationship for purposes other than those referred thereto.
- 6.3.4 The employees' personal data can only be supplied to third parties when the transfer is done in order to comply with the legitimate functions of the transferor and transferee, and always requires the prior consent of the employee whose data is supplied to third parties.
- 6.3.5 Data protection law imposes different penalties depending on the degree of the infraction.

6.4 Stock exchange issues

- 6.4.1 If the company implementing the plan is a Spanish company, it will be necessary to obtain shareholder approval and the agreement of the board of directors. They must also approve the way in which the shares will be provided to employees. The company should issue a document setting out the terms and conditions of the issue and the main objectives of the plan. This document then needs to be approved by the board of directors and the shareholders.
- 6.4.2 There are no restrictions on employees holding foreign shares (or options over foreign shares), and no stock exchange issues arise

6.5 Securities law

- 6.5.1 Spanish securities law does not impose any restrictions on the number of individuals who can participate in the plan.
- 6.5.2 Royal Decree 291/1992, "Issue of Securities and Public Sale of Shares", sets out the reporting requirements a company must satisfy where there is a public offer of securities (which includes stock options plans).
- 6.5.3 Under the regulation, a public offer takes place when a sale of securities (to take place wholly or partially in a Spanish territory), offered to the public by a person holding them either on his own behalf or on behalf of a third party (or parties), is advertised. The concept of advertising for these purposes is very broad and includes any kind of communications activity.

²³ Spanish Data Protection law (Organic Law 15/1999); Article 44 and 45.

- 6.5.4 On 18 December 1998 Royal Decree 2590/1998, which modifies some of the articles of Royal Decree 291/1992, was published in the Spanish Official Gazette. Royal Decree 2590/198 states that where the offer is made exclusively to employees, or to former employees now retired, of the issuing company or a group company, then the reporting requirements that must be followed are reduced. In this instance the reporting requirements are as follows:
- Communication to the CNMV in respect of the issue.
 - Filing and prior registration of the documents stating the terms and conditions of the issue. These documents will be adapted to the law of the country under which the issuer is established, and must be filed in a public document duly granted before a Notary Public of that country. In addition the documents accrediting the issuing company together with its Bylaws must be filed with the CNMV.
- 6.5.5 If the plan is implemented by a foreign company then all of this documentation must be docketed with the Apostille of The Hague Convention and translated into Spanish.
- 6.5.6 Recently, in addition to those conditions mentioned above, stock option plan filings to the CNMV have also had to include additional documentation. This additional documentation required included copies of the document communicating the offer to employees and the contract to be signed with employees, and a legal opinion about the accuracy of the plan and the agreements adopted by the company.
- 6.5.7 Finally, where the number of potential subscribers to the offer in Spain is “low” (considered to be less than 1,000) and the shares that are offered are not quoted on any Spanish Stock Exchange Market, the CNMV considers that the Royal Decree is not applicable and no reporting requirements need be observed.

6.6 Financial assistance

- 6.6.1 Under article 81.1 of the Stock Corporations Act, a company may not advance funds, grant loans, extend guarantees or provide any kind of financial assistance for the acquisition of its own shares or shares of its holding company by third parties²⁴.
- 6.6.2 The provisions mentioned in the preceding paragraph do not apply to transactions to facilitate the acquisition of shares in a company or a company in the same group by employees (“personnel”) of the company. Therefore, the employer may provide financial assistance to employees to exercise stock options. There is no limit on the level of financial assistance that can be provided to employees.
- 6.6.3 Where financial assistance is provided to directors, a case by case review should be made to ensure that director falls within the general definition of “personnel” set out in the financial assistance exemption. Generally, only employees that are

²⁴ Stock Corporations Act; Article 81.1.

exclusively linked to the company through an employment contract may receive such financial assistance.

6.7 Other

- 6.7.1 The acquisition of shares in a non resident company by employees of a subsidiary in Spain does not require prior authorisation of the Exchange Control Authorities, although it must be declared. This declaration should be made within one month of acquisition of the shares by the Spanish resident employee.
- 6.7.2 For shares acquired in a quoted foreign entity, the declaration should be carried out by:
- The Spanish investor if a securities account in a foreign entity is held by the investor or if the titles are directly held and under custodian of the investor.
 - An investment services company, a credit entity or other resident entity that carries out similar activities, if it acts for the investor.
- 6.7.3 If the declaration is to be made by the investor, the official model D-6 should be filed before the Exchange Control Authorities. If the communication is to be made by a financial intermediary entity, several communications about the monthly flows of investments, and annual balances of deposits accounts, should be carried out periodically.
- 6.7.5 Failure to comply with these requirements may result in a penalty being imposed on the Spanish investor.
- 6.7.6 The employee does not have any voting or dividend rights prior to the exercise of stock options.
- 6.7.7 In principle, shares can be transferred without any prior formalities unless there is a limitation contained in the company's Bylaws or in the stock option plan. There are no costs associated with the transfer of shares apart from the commissions of the broker.

7. Sourcing shares for stock option plans

- 7.1 It may be possible for a company to hold its own shares, if they were acquired from a third party, subject to certain limits and conditions, e.g., the nominal value of shares acquired by a company may not exceed 10% of its share capital. The same rules apply in respect of a subsidiary holding shares in its parent company. Typically, companies issue new shares as it cheaper. Also most Spanish plans tend to be irregular / one-off awards so it easy for a company to calculate the number of shares needed and get approval for a capital increase. Companies can purchase shares on the market although this is unusual and if it does happen would normally be done via a bank or a third party. The timing of this is a company decision.

- 7.2 The provisions for obtaining shares when the options are exercised are contained in the agreements signed with the employees. The transfer is typically handled by a bank, which will handle all the necessary reporting requirements to the Bank of Spain. Shares are transferred into individual electronic accounts. There are no other formalities after the capital increase has been approved by shareholders and the reporting requirements are satisfied.

8. Role and influence of existing shareholders

- 8.1 Shareholders have no further influence outside that outlined in section 6.4.
- 8.2 Until three or four years ago, shareholders had no influence although this has now changed and shareholder approval is required.

9. Accounting

- 9.1 There are no specific regulations concerning the accounting treatment of stock option plans in Spain.
- 9.2 Typically, at the time of grant, the Spanish company will record as a potential accounting expense the difference between the FMV of the shares at grant and the exercise price that will be paid by the employee. This potential expense, if any, is charged over the years in which the options can be exercised.

10. Miscellaneous

- 10.1 The concept of a trust is not recognised in Spain.
- 10.2 The approval of the employees' legal representatives' is not required for a new stock option plan provided it does not replace any part of the current remuneration paid by the company.
- 10.3 The 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 Spanish legislation provides that an employee is entitled to exclude 30% of the spread at exercise from tax if options have a vesting period of more than two years and if the options are not granted annually.

- 11.1.2 The amount of income which can be excluded cannot exceed 30% of average annual salary (the average annual salary for year 2002 is €17,400) multiplied by the number of years from grant to vesting²⁵.
- 11.1.3 The interpretation of the first requirement is not clear. In the personal income tax legislation that was applicable until 1999, it was also a requirement that the shares must be offered to every employee, and that there should be no discrimination. In 1999 this requirement was deleted from the wording of the article, and it is not clear if the wording of the new legislation implies a less restrictive position or if the position remains the same.
- 11.1.4 Recently (in November 2001) the Spanish Tax Authorities published two rulings which state that in order to qualify for this exemption it is necessary that the offer is made to all the employees of the same group which are subject to Spanish Personal Income tax (although this is something which is not stated in the wording of the law, and therefore it could be subject to discussion)²⁶. Even so, one of the rulings accepts that some employees, for example, employees who have not worked for the company for a specified period of time, may be excluded from the offer.
- 11.1.5 Therefore, there is no clarity on the possibility of excluding certain employees from the offer, if it is to be made on a discretionary basis. The exemption is not available if participation is purely discretionary.
- 11.1.6 If all requirements are met, the exempt amount will not be subject to income tax or social security contributions. However, the employer will have to report both the amount of benefit in kind that is considered tax exempt, and the excess.
- 11.1.7 If the above requirements are met and the option income exceeds €3,005 (Ptas 500,000), or €6,010 (Ptas 1,000,000) in the last five years, only the excess would be treated as taxable income.
- 11.1.8 It could be preferable to implement a plan with taxation at grant in order to tax the income at exercise as a capital gain at an 18% tax rate (if it has been generated in more than 1 year) see sections 3.2 and 3.4 for further details.
- 11.1.9 This tax rate could be more favourable than the rate applicable to the benefit in kind if it was considered earned income.

11.2 Mitigation of social security contributions

- 11.2.1 The reduction in taxable income for income earned over more than two years (see section 11.1) also applies for the calculation of social security contributions.

11.3 Mitigation of tax on sale of shares

- 11.3.1 If shares have been held for more than one year, the capital gain would be taxed at an 18% tax rate.

²⁵ Spanish Personal income tax law (Law 40/1998) Articles 17.2

²⁶ General Directorate of Tax (GDT): 13 of March 2001.

11.4 Special provisions for SMEs

11.4.1 There are no special provisions or policies 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.