HR and tax alert

Switzerland

New Federal Law on the taxation of equity based compensation schemes to be introduced in 2012

Executive summary
The new Federal Law on the taxation of equity based compensation schemes sets out the timing of the taxation of equity based compensation (including restricted stock, stock options, restricted stock units, stock appreciation rights, etc.) as well as the reporting and withholding obligations for “imported” and “exported” equities belonging to internationally mobile employees. The Swiss Tax Harmonization Act obliges all Swiss Cantons to implement the new Federal Law, with the consequence that the tax treatment will be the same irrespective of which Canton the employee is tax resident within. Nevertheless, based on the approved wording of the new Federal Law, there is still room for interpretation and practical implementation.

On 6 December 2010, after six years of debate regarding the wording, the Federal Parliament voted for the new Federal Law on the taxation of equity based compensation schemes. The new Federal Law is likely to be implemented from 1 January 2012, unless a citizens’ initiative is undertaken. The proposed transitional rules, which have not yet been finally approved by the Federal Council of Switzerland, stipulate that equity grants made prior to that date are still taxed under the current Cantonal and Federal rules respectively, in accordance with existing tax rulings. However, if the tax year in which the taxable event occurred is not yet finally assessed, the taxpayer can make a claim for a revised tax treatment under the provisions of the new law. All equity grants made after the new law comes into force will be taxed in accordance with it. Existing rulings that either do not fall within the scope of the new legislation or are not in contradiction with it are still valid.

The timing of the taxation of restricted stock, restricted stock units and phantom plans (i.e., non-genuine participation rights) essentially remains unchanged, at both at Federal and at Cantonal level, under the new Federal Law. However, the main changes relate to the taxation of stock options, especially in the French speaking part of Switzerland, and in cross-border situations.

According to the new Federal Law, a differentiation is made between unrestricted and restricted stock options, as well as between tradable and non-tradable stock options.

The point of taxation of employee stock options
Unrestricted and tradable stock options are taxable at the date of grant and the taxable value equals the fair market value of the option at grant. Any gain from selling or exercising the option is considered to be a tax-free private capital gain (unless the beneficiary qualifies as a commercial security dealer).

However, restricted stock options that are not tradable are taxed at the date of exercise. Consequently, the gain realized at exercise (i.e., the difference between the exercise price and the fair market value of the underlying share at exercise) is deemed to be employment income and is taxed accordingly.

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Based on the current wording of the new Federal Law, it is debatable whether stock options that have a restriction period but become tradable after the restriction lapses become immediately subject to tax based on their fair market value at the first trading day (i.e., taxation at vesting) or if they are also subject to tax at exercise/sale.

Stock options that entitle an employee to receive a cash payment instead of acquiring actual shares (either voluntarily or mandatorily) are regarded as non-genuine participation rights and are therefore exclusively taxed at exercise. It is debatable whether an option that is tradable but envisages a cash settlement is taxable at grant or at exercise/sale.

**Taxation of equity based compensation plans in cross-border situations**

Where stock options with a vesting period partially vest whilst a taxpayer is tax resident in Switzerland, the portion of the benefit taxable in Switzerland has to be calculated on a time-apportionment basis. The allocation is based on the time spent in Switzerland during the vesting period as a proportion of the total vesting period. This rule follows the OECD recommendation published in 2004. In this regard, it has to be further analyzed how the cross-charge of related costs between foreign and Swiss based companies within the same group will impact the allocation method. This is due to the Directive issued by the Cantonal tax authorities of Zurich in October 2009 which states that the amount charged back to Switzerland is the minimum amount subject to income tax in Switzerland. A further question is whether Switzerland must have a valid double taxation treaty in place with the country from which the equities are being exported and imported to Switzerland. Presently, the Canton of Zurich only grants an exemption on a time-apportionment basis for imported equities if the exemption is claimed under a double tax treaty.

It is also interesting that the new Federal Law only addresses stock options for cross-border situations. Consequently, the Cantonal tax authorities can still apply their own cross-border taxation rules for restricted stock units, stock appreciation rights etc.

**Extended withholding taxation**

According to the new Federal Law, any gain that is realized when a taxpayer is no longer tax resident in Switzerland but where a portion of the realized gain is subject to tax in Switzerland based on the time-apportionment rules (i.e., if the taxpayer was at least partially tax resident in Switzerland during the vesting period), the Swiss based company is obliged to withhold Federal tax at a flat rate of 11.5%. On top of the Federal tax, the employers also need to withhold the Cantonal/Municipal taxes. In this regard, it is still unclear what tax rates the Cantons will apply (flat or progressive rates).

**Next steps**

Employers should review their current equity based compensation schemes and related tax rulings in light of the new Federal Law in order to guarantee compliance from a reporting and withholding perspective. Special attention is required for internationally mobile employees because of the possible trailing liabilities in Switzerland and other countries. Whenever employees have been resident in Switzerland during the vesting period or at exercise, special attention is required.