Taxation in the Canton of Zurich

The taxation of employee stocks

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Information sheet of the Cantonal Tax Authorities Zurich concerning the taxation of employee stocks for the purposes of the Zurich cantonal and communal taxes and the direct federal tax

For official use please refer to the German original

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(September 30th, 2013; ZStB I No. 13/302)

1  General information and scope of the information sheet

The taxation of employee stocks is principally based on the corresponding circular sheet Nr. 37 of the Federal Tax Authorities dated July 22nd 2013 which refers to the Federal Tax Act concerning the taxation of employee stocks dated December 17th 2010 (AS 2011 3259).

For the attestation of employee stocks the corresponding regulations in the decree dated June 27th 2012 regarding the attestation responsibility for employee stocks (Mitarbeiterbeteiligungsverordnung, MBV; SR 642.115.325.1) generally apply.

The taxation of exported employee stocks is based on the information sheet issued by the Cantonal Tax Authorities regarding the source taxation of pecuniary benefits from exported employee stocks according to § 100a StG (ZStB Nr. 29/510).

2  The taxation of employee stocks

2.1  Income tax

2.1.1  General

"Employee stocks" within the meaning of this information sheet are stocks of the employing company or a group company (hereinafter referred to as the "Employer") which are transferred to an employee on the basis of his employment relationship. Other participation certificates that enable the employee to participate in the company capital are to be treated analogously.

If employee stocks are transferred on preferential terms, the corresponding pecuniary benefit represents taxable income from gainful employment (§ 17 para. 1 Zurich Tax Act and Art. 17 para. 1 Direct Federal Taxation Act).

Instruments by means of which the Employer undertakes to grant employee stocks to an employee at a later date – generally when certain subjective and objective conditions are met – represent merely a contingent right to acquire employee stocks since the employee has no irrevocably acquired assets (e.g. restricted stock units) until the conditions are met or until the transfer of the stocks is completed.

Regardless of any conditions the granting of contingent rights to the acquisition of employee stocks does not entail an income tax liability. The deciding factor is the exclusive acquisition of the employee stock.

2.1.2  Types of employee stocks

Free employee stocks are employee stocks over which the employee has complete freedom of disposal.

Blocked employee stocks are employee stocks which carry contractual conditions attached to the terms of employment and have therefore a reduced value. In the majority of cases this concerns employee stocks with a temporal limited prohibition on disposal (blocking period) or that are subject to an obligation to return, which may be time-limited or not.
2.1.3 Defining the tax point and the taxable income

Free employee stocks are taxed at the time of issue, which means at the time of the acquisition of title. The difference between the fair market value or the formula value of the employee stocks respectively and the lower issuing price represents taxable income.

Blocked employee stocks are also generally taxed at the time of issue that means at the time of the acquisition of title. According to the blocking period a reduction amounting to 6 percent per blocked year will be considered on the fair market value or the formula value respectively. The difference between the discounted fair market value as per the Discounting Table (section 2.2.3) and the lower issuing price represents taxable income. In the case of an unlimited obligation to return, the employee stocks are treated as if they had a 10-year blocking period at the time of issue.

In the case of listed employee stocks the fair market value is deemed to be the stock market price on the day of acquisition of title. If the offering and the acceptance do not correspond and if the participation plan provides subscription periods, the following applies:

- Within a subscription period of as much as 60 calendar days the definite fiscal market value corresponds to the final stock price on the first day of the subscription period. In certain reasonable cases and as agreed by the corresponding tax authorities it is possible to divert from that market value.

- Within a subscription period of more than 60 calendar days the definitive fiscal market value corresponds to the final stock price on the day the offer has been accepted.

In the case of unlisted employee stocks the current value which then can be considered as the current market value is usually not definable. In such case the fiscal value must be calculated on the basis of a method (formula value) which is established and recognized. Should there be, as an exception, a real time market value available, then this value generally is considered as the definitive market value. In individual cases the employer can lodge an application for the formula value in spite of the availability of a market value. This exception thus assumes that the employer has an unlimited right to buy back the employee stocks on the basis of the same identical formula value.

2.1.4 Early end to the blocking period

If the blocking period ends early, the employee at this time realizes a pecuniary benefit based on the employment relationship, i.e. taxable income from gainful employment. The reason that the blocking period has ended early is not significant. It is also deemed insignificant if the employee stock was originally acquired at a price above the fair market value or the formula value respectively that was discounted for tax purposes.

The unblocking of employee stocks with an unlimited obligation to return will be taxed the same way as if it concerned employee stocks with a blocking period amounting to 10 years, i.e. at the end of a holding period of more than 10 years no further taxation will occur due to the expiration of the blocking period.

The taxable income is the difference between the non-discounted fair market value or the formula value of the stock respectively at the time that the blocking period ceases to apply and the discounted value based on the residual blocking period. Partial years within the blocking period are to be included on a pro rata basis.

2.1.5 Sale of employee stocks held as private property

As a matter of principle, a profit made from the sale of employee stocks held as private property represents a tax-free private capital gain (§ 16 para. 3 Zurich Tax Act and Art. 16 para. 3 Direct Federal Taxation Act) or a fiscally negligible private capital loss.

The tax-free private capital gain corresponds to the difference between the market value at the time of delivery and the market value at the time of sale or the difference between the formula value at the time of delivery and the formula value based on the same pricing method at the time of sale respectively. A possible excess profit due to a different pricing method or to a switch from the formula principle to a mar-
ket value based principle is considered as additional income from employment which is to be taxed at the time of sale.

If the incident that triggers the switch from the formula principle to the market value based principle occurs after the expiration of a five year holding period of the employee stocks, then a possible excess profit will not be taxed additionally.

### 2.1.6 Return of employee stocks

If an employee has to return the employee stocks to the employer due to regulatory or contractual commitments which have been settled at the time of purchase respectively, either an economic loss based on the employment or taxable income from gainful employment may result.

The employee realises taxable income from employment in the positive difference between the return price and the (incidentally corresponding to the discounted value based on the residual blocking period) market value or formula value respectively.

If the employee stocks must be returned gratuitously to the employer or at a price lower than the current (incidentally corresponding to the discounted value based on the residual blocking period) market value or formula value respectively then the employee can claim a production cost deduction in the taxing period of the return. The production cost deduction corresponds to the negative difference between the return price and the (incidentally corresponding to the discounted value based on the residual blocking period) market value or formula value respectively.

### 2.1.7 Import of employee stocks in an international context

#### 2.1.7.1 Employee stocks

Imported employee stocks are deemed to be stocks which the employee has received in another country and brings with him when he moves to Switzerland.

If the employee stocks are to be taxed at acquisition as set out in this information sheet, their import into Switzerland (subject to the tax consequences according to section 2.1.4 until 2.1.6) entails no income tax liability.

#### 2.1.7.2 Contingent rights to the acquisition of employee stocks

Imported contingent rights to the acquisition of employee stocks are deemed to be instruments which an employee has received in another country, has brought with him to Switzerland and then realized here for tax purposes by acquiring employee stocks.

If employee stocks are acquired in Switzerland on the basis of imported contingent rights, in principle the entire pecuniary benefit is generally deemed to be taxable income in Switzerland.

If the contingent rights come with subjective conditions according to which the employee has to earn the contingent rights first, then only that part of the obtained pecuniary benefit – subject to tax progression - is to be taxed as income from gainful employment based on a working activity in Switzerland or which had to be earned in Switzerland respectively (§ 17d Zurich Tax Act and Art. 17d Direct Federal Taxation Act):

\[
\text{total pecuniary income} \times \frac{\text{working days in Switzerland within the vesting period}}{\text{number of days within the whole vesting period}}
\]

\(^1\) The vesting period represents the period of time in which the employee has to earn the employee stock, particularly by fulfilling certain job-related objectives or by not terminating the contract of employment before a given time period expires. The end of the time period is called „vesting“ (compare BGr, 2C_138/2010 dated June 2nd 2010, E. 2.2).
2.2 Wealth tax

2.2.1 Employee stocks

Employee stocks are subject to wealth tax at the fair market value or formula value respectively. In the case of blocked employee stocks it is possible to apply a discount to the fair market value in line with the residual blocking period as per the Discounting Table (section 2.2.3). Incomplete years within the blocking period are to be calculated on a pro rata basis. The corresponding reduction will be granted by the authorities on formal application only.

Employee stocks which have an unlimited obligation to return are to be taxed as if it concerned employee stocks with a blocking period amounting to 10 years, i.e. after a holding period of more than 10 years no discount will be granted.

2.2.2 Contingent rights to the acquisition employee stocks

Contingent rights to the acquisition of employee stocks are not subject to wealth tax because they do not represent definitively acquired assets.

2.2.3 Discounting table

<table>
<thead>
<tr>
<th>Blocking period</th>
<th>Discount</th>
<th>Reduced fair market value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 year</td>
<td>5.660%</td>
<td>94.340%</td>
</tr>
<tr>
<td>2 years</td>
<td>11.000%</td>
<td>89.000%</td>
</tr>
<tr>
<td>3 years</td>
<td>16.038%</td>
<td>83.962%</td>
</tr>
<tr>
<td>4 years</td>
<td>20.791%</td>
<td>79.209%</td>
</tr>
<tr>
<td>5 years</td>
<td>25.274%</td>
<td>74.726%</td>
</tr>
<tr>
<td>6 years</td>
<td>29.504%</td>
<td>70.496%</td>
</tr>
<tr>
<td>7 years</td>
<td>33.494%</td>
<td>66.506%</td>
</tr>
<tr>
<td>8 years</td>
<td>37.259%</td>
<td>62.741%</td>
</tr>
<tr>
<td>9 years</td>
<td>40.810%</td>
<td>59.190%</td>
</tr>
<tr>
<td>10 years or more</td>
<td>44.161%</td>
<td>55.839%</td>
</tr>
</tbody>
</table>

Partial years within the blocking period can be included on a pro rata basis. The reduced fair market value is calculated using the formula \((100/1.06^n)\), where \(n\) is the number of blocking period years remaining on the valuation date.

3 The taxation of employee options

3.1 Income tax

3.1.1 Time of taxation and determination of taxable income

Free listed employee options will be taxed at the time of issue. If these employee options are issued gratuitously or under preferential terms then the positive difference between the market value and the issue price is to be considered as employee’s taxable income from employment.

The rest of the employee options will be taxed at the time of realization or exercise. The whole profit from realization or profit from exercising respectively after a deduction of possible prime cost is taxable.

3.1.2 Import of employee options in an international context

Imported employee options are deemed to be options which a taxpayer has been awarded in another country, takes with him in the course of moving to Switzerland and realizes fiscally here.
Imported employee options which are to be taxed at grant in accordance with the provisions of this information sheet can be realized free of tax in Switzerland.

Imported employee options which are to be taxed at sale or at exercise in accordance with the provisions of this information sheet are to be taxed in Switzerland in principle.

If the imported employee options have subjective conditions attached according to which the employee has to first earn the employee option then only that part of the realized pecuniary benefit – subject to progression – is to be taxed as income from employment which is based on a job performance in Switzerland or has to be earned in Switzerland respectively. The taxable income from employment in Switzerland is to be calculated as follows:

\[
\text{whole taxable income} \times \frac{\text{amount of working days in Switzerland within the vesting period}}{\text{number of days within the whole vesting period}}
\]

3.2 Wealth tax

Free listed employee options are subject to wealth tax from the time of delivery. The market value (final market price) at the end of the tax period is relevant.

All the remaining employee options which are taxed at exercise or at sale respectively are not subject to wealth tax during their holding period.

Employee options issued under tax regulations preceding the regulations outlined in this paper and which have been taxed at grant or vesting before January 1st 2013 are subject to wealth tax with its financial-mathematically calculated market value at the end of the tax period, but at a minimum with the intrinsic value (difference between the market value of the underlying and the exercise price).

4 The taxation of fictive employee participation

4.1 Income tax

4.1.1 Time of taxation and extent of taxable income

Pecuniary benefits arising from the granting of fictive employee holdings are to be taxed at the time of their accrual. The whole pecuniary benefit after a deduction of possible prime costs is to be subject to income tax as income from employment.

4.1.2 Import of fictive employee participation in an international context

For the import of fictive employee holdings the provisions regarding the import of contingent rights on the purchase of employee stocks (section 2.1.7.2) apply equally

4.2 Wealth tax

Fictive employee holdings are not subject to wealth tax since they do not represent definitively acquired assets.
5 Obligation to cooperate

5.1 Employer

The obligation for attestation follows the terms of the MBV.

The obligation for attestation is legitimately fulfilled, when the employee holdings according to the provisions in the MBV are to be reported in the salary certificate and in the supplement sheet of the salary certificate.

If the pecuniary benefit exceptionally is realized after the termination of employment then the relevant employer has to directly provide the Cantonal Tax Authorities with the attestation in accordance of § 137a Zurich Tax Act and Art. 129 para.1 letter d Direct Federal Taxation Act.

In so far as there is a provisional ruling (section 3.2.5.3) regarding the taxation of the employee holdings, the cantonal office that made the provisional ruling and the date on which the ruling was made are to be noted in the salary certificate.

5.2 Taxpayer

The taxpayer is responsible for completely and correctly declaring any received employee holdings in his tax return.

Employee stocks, free listed employee options and employee options which have been taxed at delivery or vesting before January 1st 2013 are to be declared in the securities and deposit statement with the market value or formula value.

All the remaining employee holdings are to be declared in the securities and deposit statement as “pro memoria” i.e. without a value.

5.3 Ruling between the employer and the tax authorities

5.3.1 General points and responsibility

Employers domiciled in the Canton of Zurich can submit their employee participation plans for review and approval (Ruling) to the tax authorities with the aim of determining the definitive taxation point as well as the particular stock’s valuation.

Rulings from other cantons will be recognized provided that their contents correspond with this information sheet.

The following office is responsible: Cantonal Tax Authorities Zurich, Securities Department, Bändliweg 21, 8090 Zurich.

5.3.2 Preconditions for a ruling

All relevant plan and contract documents must be submitted to the responsible office. The Employer makes a tax assessment and submits a relevant request on the basis of these documents, including precise references to the key sections of the text.

The provisional ruling relates solely to facts contained in the request. As a matter of principle, the tax office will generally not undertake any more extensive review of the participation plan.

If the ruling is requested by an agent, then the agent in question must furnish a corresponding power of attorney from the employer.
5.3.3 Implementation of the ruling

Once the ruling regarding the tax implications has been made, these are to be included in the participation contract. The tax authorities assume in all cases that the employee is aware of the tax implications relating the employee holdings.

5.4 Contact

The point of contact for questions relating to the implementation of this information sheet is the following office: Cantonal Tax Authorities Zurich, Securities Department, Bändliweg 21, 8090 Zurich.

5.5 Entry into force

This information sheet is effective from the tax period 2013 and replaces the information sheet of the Cantonal Tax Authorities regarding the taxation of employee stocks for the purpose of the cantonal and communal taxes and the direct federal taxes dated October 21st 2009 (ZStB Nr. 13/201).