



# Incentive Plans for Employees

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# Sommaire



1. Introduction
2. Legal Framework
3. Tax Consequences
  - A. Tax Obligation
  - B. Taxable Income
  - C. Value
  - D. Generalities
  - E. Holding of the Shares
  - F. Call Option of the Company
4. Type of Plans
5. Certification OPart
6. Advantages and Disadvantages
7. Role of Art. 156 CO
8. Conclusion



# 1. Introduction

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- ❖ Incentive plans for managers and employees (MIP) are usually implemented by companies in order to align the interests of the employees with the interests of their employer, to incentivize the employees on the upside of the company and to remunerate employees without having to spend cash for the employer.
- ❖ MIPs may take several forms.
- ❖ The tax consequences, for the employees and the employer, of MIPs may vary depending on the forms chosen by the company.
- ❖ Each kind of MIP has its advantages and disadvantages, from a process point of view and from a tax perspective.
- ❖ References to “Shares” in this presentation shall include all equity-like instruments such as participation certificates.



## 2. Legal Framework

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- ❖ The ordinance on participations of employees entered into force in 2013 (the “Opart”).
- ❖ The federal tax administration issued a circular n°27 dated October 30, 2020 to deal with the taxation of MIPs (the “MIP Circular”).
- ❖ In addition, the circular n°28 dated August 28, 2008 (as updated in December 2022) issued by the Tax Swiss Conference provides for rules applicable to the calculation of the value of equity instruments (the “Valuation Circular”).
- ❖ On May 4, 2018, the federal tax administration issued the circular 37A relating to the tax treatment of MIPs at the level of the employer.
- ❖ Cantonal tax authorities may also issue directives or circulars applicable to MIPs, such as Canton of Vaud.
- ❖ The general tax rules also apply, in particular with respect to the treatment of capital gains. We draw the attention of the reader to the general Swiss tax principle according to which capital gains achieved by individuals are in general tax free.



# 3. Tax Consequences



## 3.A. Tax Consequences – Tax Obligation



# 3.A. Timing of the Taxation

## ❖ Shares

- The Shares are taxed at the time of the effective acquisition and/or issuance (the “Grant”) of the Shares (the “Share Grant”).

## ❖ Options other than freely and negotiable options (“Options”)

- Options are not taxed at the time of their Grant but at the time of their exercise and, therefore, at the time of the Share Grant resulting from the exercise of the Options.

## ❖ Expectations on Shares (*e.g.*, unvested Shares)

- The tax liability arises when the vesting conditions are met and the Share Grant is effective. So long as the Share Grant is not effective, expectations on Shares are treated like the Options.
- In order to accelerate the taxation, the company may immediately complete the Share Grant and create a reverse vesting by having a call option exercisable on the economically unvested portion of the Shares. In such a case, the Shares are taxed at the time of the effective Share Grant vs. the time the vesting conditions are met.

## ❖ Listed and freely negotiable options (“Negotiable Options”)

- The Negotiable Options are taxed upon Grant.

## ❖ Phantom Stock

- The amount paid under a phantom stock plan is taxed upon receipt.



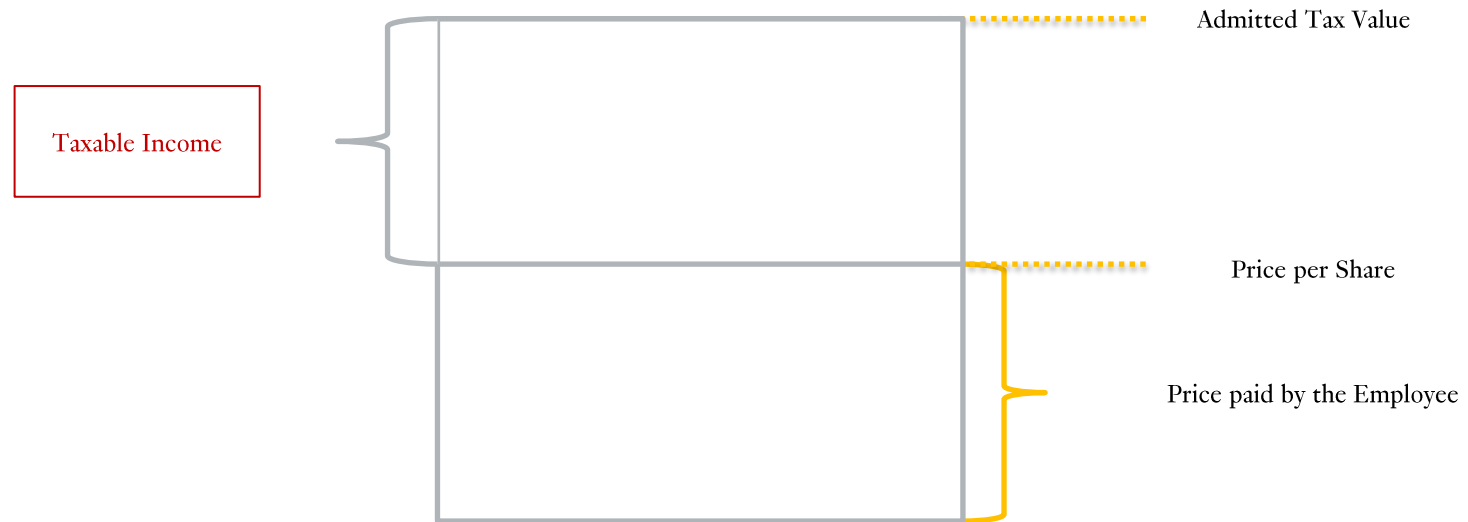
## 3.B. Taxable Income

## 3.B. Taxable Income

### ❖ Generalities.

- The difference between (i) the tax value of the Share Grant (the “Tax Value”) and (ii) the price at which the Share Grant takes place (the “Price”) shall be taxed as an income.
- The Tax Value, if calculated once a year, can be used as the relevant Tax Value if the Share Grant takes place within six months following the date on which the Tax Value is based. If it is not the case, the Tax Value shall be calculated based on the next period.
- The Price may be freely determined by the parties and may be paid by the employee depending on the structure of the MIP chosen. The most relevant consideration is (i) cash or (ii) vendor loan (minimum interest rate is applicable).
- For example: if the Price amounts to CHF 0, the employee will pay income taxes on the full Tax Value. If the Price amounts to CHF 50 and the Tax Value amounts to CHF 100, the employee will pay income taxes on CHF 50.

# 3.B. Taxable Income



## 3.B. Taxable Income

### ❖ Negotiable Options

- The difference between the tax value of the Negotiable Options at the time of the Grant and the price paid by the employee for the Negotiable Options is taxable as income.

### ❖ Options

- The difference between the exercise price of the Option and the Tax Value at exercise is taxed as income. The same methodology applied to the Share Grant is applicable to the Tax Value at the time of the exercise.

### ❖ Expectations on Shares

- The taxation occurs at the time the Share Grant becomes effective. Then, the taxable income is equal to the difference between the Tax Value and the Price as for a Share Grant.

### ❖ Phantom Stock

- The amount received under a phantom stock plan is taxed as an income.



# 3.C. Tax Value

## 3.C. Determination of the Tax Value – Listed Securities

### ❖ Listed Securities

- For listed Shares, the Tax Value shall be equal to the stock price at the closing of the day of the Grant.
- If the MIP provides for an acquisition period during which the employee shall confirm his/her acceptance of the offer:
  - (i) the Tax Value shall be equal to the stock price at the closing of the day on which the employee accepts the offer if the subscription period exceeds 60 days, or
  - (ii) the Tax Value shall be equal to the stock price at the closing of the first day of the subscription period if the subscription period is equal to or shorter than 60 days.

# 3.C. Determination of the Value – Non-Listed Shares

## ❖ Non-listed Shares – Existing Market Value

- A market value for non-listed Shares (the “**Market Value**”) exists if, within twelve months prior to the Share Grant (i) a substantial transfer of shares, *i.e.*, a secondary transfer of 10% of the share capital between third parties or between related parties but at arm’s length, occurred (the “**Secondary Substantial Transfer**”) or (ii) a substantial financing round, *i.e.*, a capital increase of 10% of the share capital, occurred (the “**Primary Substantial Transfer**”). A Secondary Substantial Transfer and a Primary Substantial Transfer are referred to as a “**Substantial Transfer**”).
- In case of Substantial Transfer, the Tax Value shall be equal to the Market Value (*i.e.*, acquisition or subscription price paid by the acquirer or the subscriber, respectively).
- By way of exception, if (i) the employer is a **start-up** and (ii) no Secondary Substantial Transfer occurred, the Tax Value may be determined based on the net asset value of the company even if a Primary Substantial Transfer occurred. The net asset value may be used so long as the company is considered as a start-up (*i.e.*, no recurring profits).
- By way of exception, if a Market Value exists, it is always possible to apply an *ad hoc* appropriate method to determine the Tax Value provided that the MIP entitles the employer to exercise an unlimited call option on the Shares at a price calculated based on the *ad hoc* method.



# 3.C. Determination of the Value – Non-Listed Shares

## ❖ Non-listed Shares – No Existing Market Value

- If no Market Value exists with respect to non-listed securities, the Tax Value shall be usually determined pursuant to the rules of the Valuation Circular.
- The Valuation Circular provides that the Tax Value of start-ups, and for as long as they don't make recurring profits, shall be equal to the net asset value (the “Start-up Valuation”)\*.
- With respect to the other companies, the Valuation Circular provides that the Tax Value shall be calculated based on the formula of the so called Méthode des praticiens (i.e.  $((2 * \text{capitalized value} + \text{net asset value}) / 3)$ ) (the “Tax Practician Method”).
- Upon request of the employer lodged with the tax authorities, it is possible to determine the value based on an *ad hoc* formula (the “Formula”). Such Formula shall be appropriate and is subject to limitations.
  - It is questionable whether the Start-up Valuation and/or the Tax Practician Method qualifies as a Formula for the purpose of the taxation or as a market value.
  - The qualification difference is material since the Formula is vested with several limitations while the Market Value is not.

## 3.C. Appropriate Method

- ❖ If a request is lodged with the tax authorities in order to determine the Tax Value based on a Formula, such Formula shall be appropriate.
- ❖ When working on a Formula, the company shall bear in mind the fact that if the employee takes risks as an investor would (*e.g.*, if the employee pays more than the nominal value, that the purchase price is not financed or not entirely by a vendor loan, etc.), the tax authorities may be less reluctant to approve a Formula maximizing a future tax-exempted capital gain.
- ❖ The interests of the parties are opposed: the employee wishes to have a Formula which gives the lowest possible Tax Value in order to pay less taxes and maximize a future tax-exempted capital gain and the tax authorities wish to have a Formula which is the closest possible to the market value of the Share Grant and the highest possible which will minimize a future tax-exempted capital gain and will increase the income tax if the Price paid is lower than the Tax Value, which is usually the case.
- ❖ The Start-up Valuation (*i.e.*, NAV) is considered as an appropriate Formula to the extent it shall not be considered as a Market Value. The NAV may also be used for mature companies in the following instances, and, in specific circumstances: (i) the NAV reflects the goodwill, (ii) the company agrees not to hoard profits, and/or (iii) the company has an unlimited call on the Shares at a price set based on the Formula.

## 3.C. Appropriate Method and Limitations

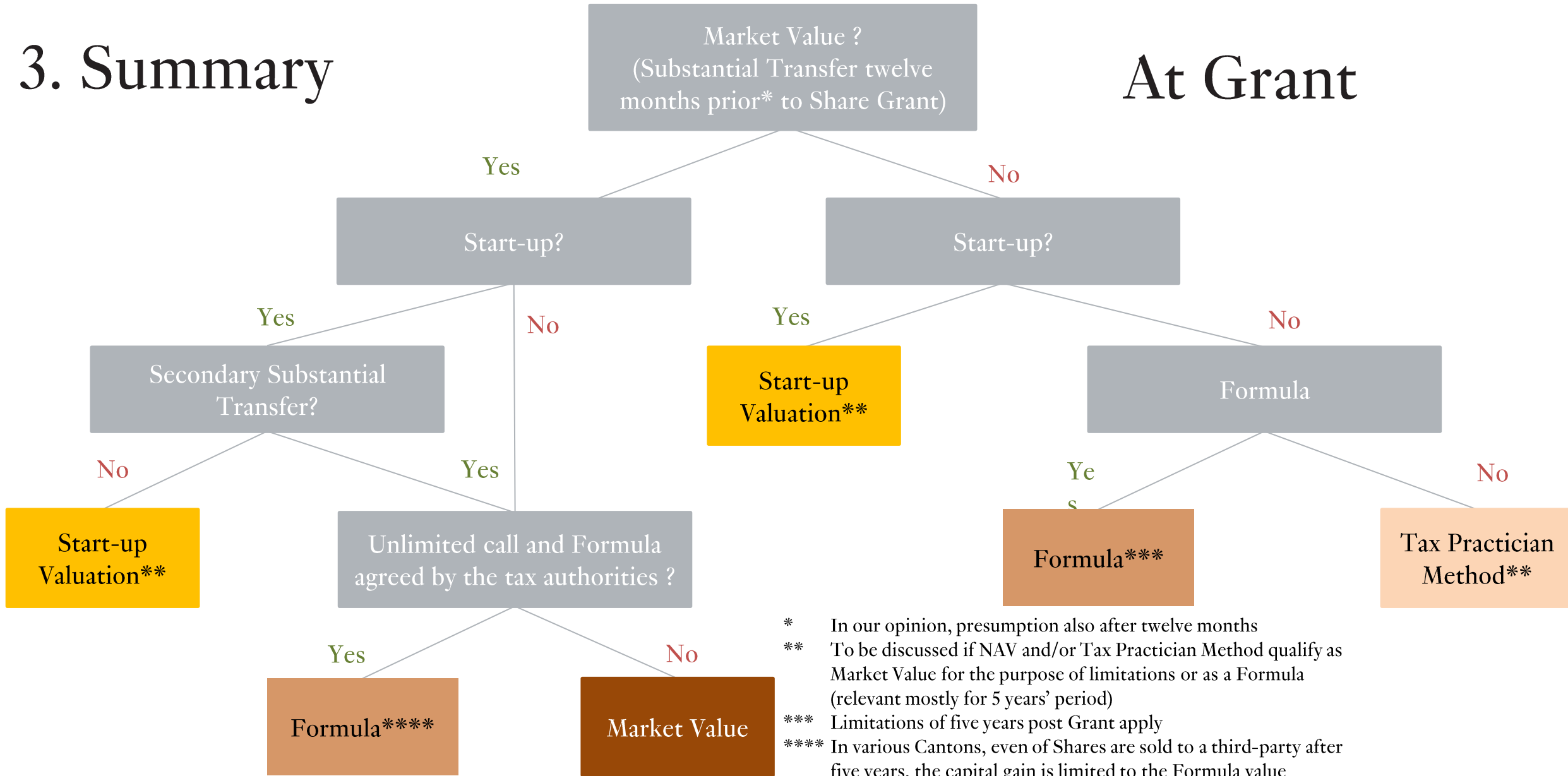
- ❖ When approving a Formula, the tax authorities frequently impose limitations. If the limitations are not complied with, tax consequences arise.
- ❖ These limitations aim to limit the tax exempted capital gain at the time the Shares are sold.
- ❖ If one of the limitations conditions is fulfilled, the tax exempted capital gain will be limited to the value of the Shares given by the Formula as computed at the time the Shares are sold. By way of example, if Shares are sold at a price of CHF 100 and the Formula gives a price of CHF 50, the difference between CHF 100 and CHF 50 will be considered as taxable income.
- ❖ The most common limitations conditions are the following:
  1. the Formula is amended;
  2. the Shares are sold before the expiration of a period of five years following the Share Grant;
  3. an IPO occurs within five years (event if the Shares are not sold at that time) following the Grant Share, it being specified that the taxation occurs at the end of the lock-up period as the case may be. In our opinion, this limitation condition should never constitute a limitation so long as the employee does not sell his/her Shares;
  4. (i) a Substantial Transfer, or (ii) any other event which may trigger a change from the Formula to the Market Value, occurs within five years following the Share Grant (event if the Shares are not sold at this time). It is important to note that a Primary Substantial Transfer does not constitute a limitation for start-ups. In our opinion, a Substantial Transfer should never constitute a limitation so long as the employee does not sell his/her Shares;
  5. the Shares are sold to the employer, whatever the period;
  6. early unblocking;
  7. indirect partial liquidation;
  8. dividends, benefits, liquidation proceeds or any other in kind advantages shall be paid.

## 3.C. Appropriate Method – Critics of Limitations

- ❖ As mentioned before, if a Market Value exists, the employer may still apply a Formula in case the employer has an unlimited call option on the Shares of the employee based on a Formula. In various Cantons, if the employee sells her/his Shares to a third-party, but such a Formula was applied at the Share Grant, then the employee may only achieve a tax-exempted capital gain on the value of the Shares as computed by the Formula at the time of the sale. This practice is questionable in a light of the rules set forth in the MIP Circular. Employers should be careful in drafting MIPs excluding the call option in case of a sale of the company unless the call option has to qualify as unlimited call option (*e.g.*, Market Value exists and nevertheless company wishes to apply specific Formula).
- ❖ The aforementioned limitations 3. and 4. should in our opinion be vigorously rejected for all companies. They are indeed limitations “punishing” employees who (i) have relied on an acquisition price equal to a Formula with a view to achieve a tax exempted capital gain after a period of five years, and (ii) have no influence on the occurrence of the Substantial Transfer. So long as such employees do not sell their Shares at the time of the Substantial Transfer, they should continue to remain entitled to achieve a tax exempted capital gain at the time of the sale (*e.g.*, after five years at a price higher than the Formula).
- ❖ In our opinion, a Substantial Transfer occurring within twelve months after the Share Grant should be treated as follows with respect to a Formula:
  - Re. a Primary Substantial Transfer for start-ups, this should have no impact on the Tax Value at the Share Grant and on the limitations. This reflects today’s situation;
  - Re. other Substantial Transfers, the Market Value should cast a presumption according to which the Formula computed at the time of the Share Grant for the purpose of determining the Tax Value should be re-assessed in line with the revised Market Value. Hence, the tax income of the employee would be reevaluated. There would be no reassessment in case of an unlimited call option granted to the employer;
  - The presumption could be rebuffed by the employer (*e.g.*, no existence of plans of Substantial Transfer known to the employer at the time of the Share Grant).

# 3. Summary

# At Grant



\* In our opinion, presumption also after twelve months  
 \*\* To be discussed if NAV and/or Tax Practician Method qualify as Market Value for the purpose of limitations or as a Formula (relevant mostly for 5 years' period)  
 \*\*\* Limitations of five years post Grant apply  
 \*\*\*\* In various Cantons, even of Shares are sold to a third-party after five years, the capital gain is limited to the Formula value

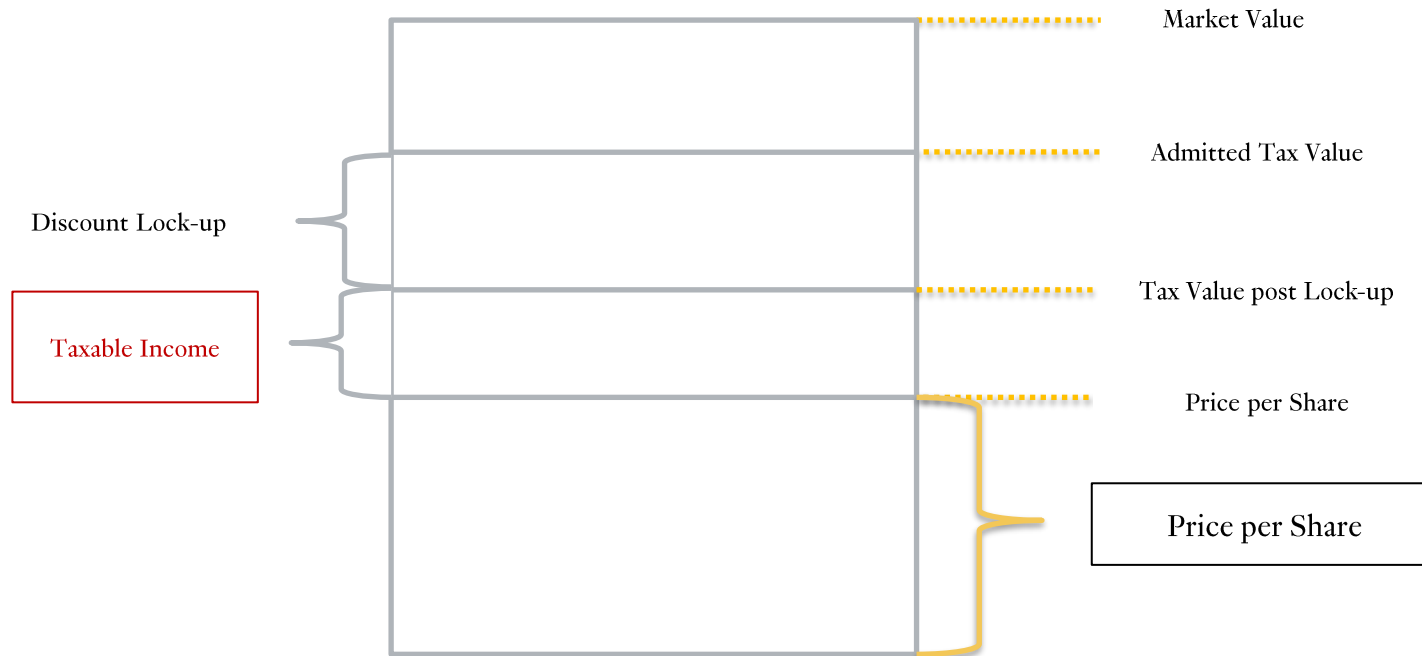


# 3.D. Generalities

## 3.D. Generalities

- ❖ The Tax Value may not be lower than the nominal value or lower than NAV with respect to start-ups.
  
- ❖ Blocked Shares
  - The Tax Value of blocked Shares benefits from a discount on its tax value of 6% per year with a maximum of ten years. Such discount also applies to Shares issued upon exercise of Options if the Shares are blocked.
  
  - The taxable income is reduced by the discount since the Tax Value is reduced.
  
  - In case of early unblocking, i.e., the Shares are unblocked prior to the end of the blocking period, the difference between the undiscounted value of the Shares at the time of the unblocking and the discounted value of the Shares corresponding to the remaining years of the blocking period shall be taxed as income. The impact of such early unblocking may be very large so employers should be careful not to block the Shares for a period longer than a reasonable anticipated exit period.

# 3.D. Generalities





## 3.D. Generalities

### ❖ Restitution of the Shares

- In case a call option is exercised by the employer, the positive difference between the exercise price of the call option and the Tax Value (discounted, if applicable) shall be taxed as an income. If the difference is negative, the loss may be deducted as a general cost on the income.

### ❖ Sale of Shares

- In case of sale of Shares which are held in the private wealth of the employee, the employee realizes a tax-exempted capital gain or a non-deductible loss.

### ❖ Social Contributions

- The taxable income is subject to ordinary social contributions. The payment of pension plan contributions depends on the plan in place.

### ❖ Pension Plan

- To reduce the impact of the taxable income, employees should be informed of the possibility to buy-back pension fund missing contributions. Such buy-backs reduce the taxable income if they are done before Dec. 31. This outcome is only possible if the employee has a pension deficit and if such employee receives cash proceeds at the time of the exercise of Options or of a Share Grant.



## 3.E. Holding of the Shares

## 3.E. Holding of the Shares

- ❖ The dividends received by the employees shall be taxed as an ordinary income. If the employees holds more than 10% of the shares capital of his/her employer, he/she may benefit from a privileged taxation of the dividends.
- ❖ For the period during which the employee holds shares, the Value of said shares shall be included in the calculation of the taxable wealth as well as the vendor loan which will decrease such wealth.
- ❖ The relevant Value with respect to the taxable wealth shall be discounted by 30% if the shares held represent a percentage of the shareholding in the employer lower than 50%. The discount does not apply to employee who holds a shareholding lower than 50% but may exercise a decisive influence within the company. The discount may not apply to Value calculated based on an ad hoc formula or based on the net asset value for the start-ups.
- ❖ The deduction for blocked shares also applies to the relevant Value for the calculation of the wealth tax. Such deduction may not be cumulated with the 30% discount.
- ❖ In this respect, it should be noted that the tax authorities of Geneva apply the ad hoc formula, if any, to calculate the value of the shares with respect to the wealth tax.



# 3.F. Call Option of the Company

## 3.F. Call Option of the Company

- ❖ In most MIPs, the company benefits from a call option on the Shares granted to the employee exercisable pursuant to certain conditions and with different exercise prices depending on the circumstances of the termination (*i.e.*, good leaver, bad leaver, poor performer). Employers should be careful in drafting the call option in order to avoid the qualification of an unlimited call option if having such unlimited call option is not necessary for tax purpose (*i.e.*, otherwise there is the risk for the employees not to achieve a capital gain for the portion exceeding the Formula in case of a sale after five years).
- ❖ After the exercise of the call option, the company will own treasury Shares, it being specified that treasury shares are subject to the following limitations:
  - the company may not own more than 10% of its own share capital, 20% with respect to Shares whose transfer is restricted respectively which shall be the case of Shares acquired in the context of a MIP;
  - the shareholding between 10% and 20% shall be decreased to 10% within the two years following the acquisition of the Shares by the company, either by way of a capital decrease, either by a sale to a third party, a shareholder or an employee.

## 3.F. Call Option of the Company

- ❖ In order to acquire treasury Shares, a company shall have freely available reserves in the amount of the purchase price.
- ❖ The acquisition of treasury Shares raises the problem of a partial direct liquidation for the employee and the company.
- ❖ A partial direct liquidation arises in the following three cases:
  - the company destroys immediately the Shares purchased (capital decrease) or the acquisition was made with this intent; or
  - the company does not re-sell the Shares within six years following the purchase (extended by six years in case a MIP is in place); or
  - the purchase of treasury shares exceeds the threshold of corporate law.
- ❖ The consequences of a partial direct liquidation are:
  - the tax-exempted capital gain realized at the time of the sale by the employee is requalified as taxable income, the latter corresponding to the difference between the purchase price and the nominal value (plus the pro rata capital contribution, if any) of the Shares; and
  - the liquidation surplus is subject to a withholding tax with a 35% rate.



# 4. Type of Plans

# 4. Type of Plans - Generalities

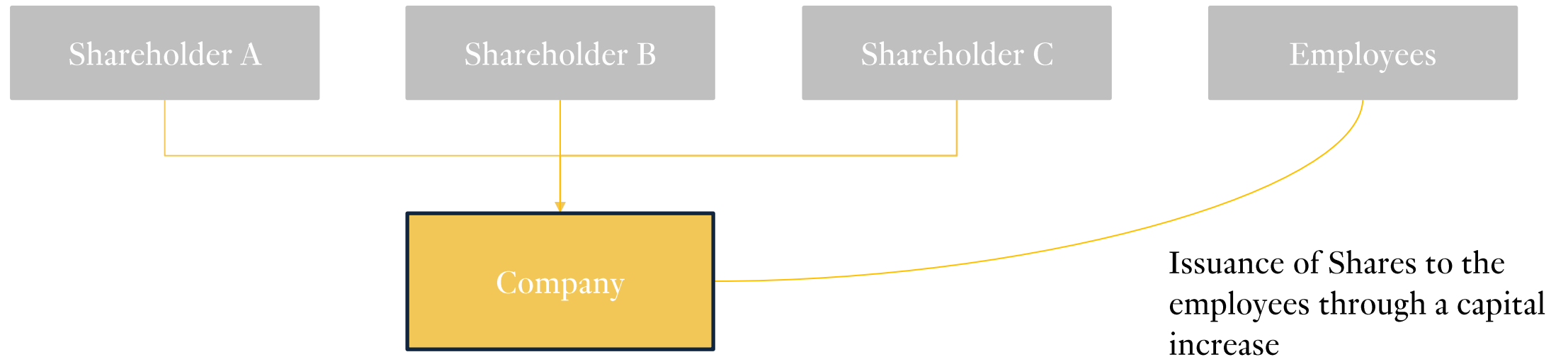
- ❖ Shares/participation certificates incentive plans
  - Shares freely negotiable
  - Blocked shares
  - Shares issued through ordinary, authorized or conditional capital increase (issued to the employees or to the company)
  - Shares granted by the company which owns treasury shares
  - Shares purchased by the company to its shareholders and sold to the employees
  - Options exercisable immediately
- ❖ Options plans
  - Options freely negotiable
  - Listed options
  - Blocked options
- ❖ Expectative on shares
- ❖ Phantom stock plans/Restricted stock unit
- ❖ Shares sold by the shareholders of the employer
- ❖ Shares held by the employees through a vehicle
- ❖ LBO





## 4.A. Types of MIPs – Shares granted by Employer

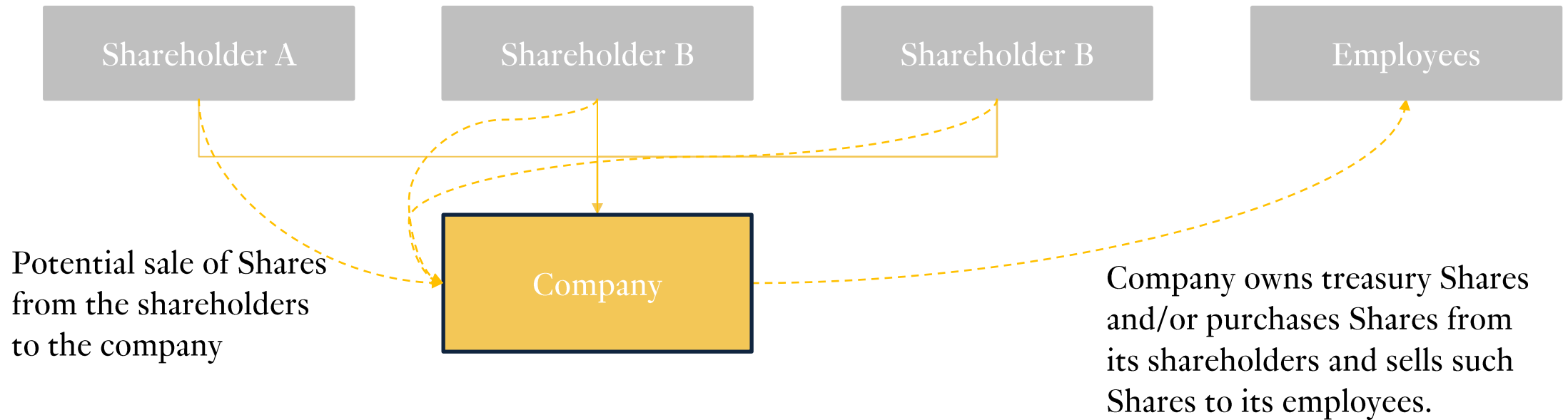
## 4.A Type of Plans – Issuance of Shares



## 4.A Type of Plans – Issuance of Shares

- ❖ A company may grant Shares to its employees through the issuance of Shares.
- ❖ The Shares may be issued through an ordinary capital increase, a conditional capital increase or through the capital band.
- ❖ Implementing an ordinary capital increase is a process more complicated than a conditional capital increase or an increase through capital band. In addition, it is costly for a company to implement an ordinary capital increase each time it wishes to issue Shares to employees.
- ❖ We underscore that an issuance of the Shares through a conditional capital increase is likely to be the most efficient way to issue the Shares. From a technical perspective, the employer allocates Options which are immediately exercisable. Since the taxation of the Options is triggered at the time of the exercise and the exercise occurs at the same time as the Grant, the employee will pay taxable income on the basis of the Tax Value of the Shares at the time of the exercise. If the exercise price is equal to CHF 50 and the Tax Value is equal to CHF 100, the taxable income is equal to CHF 50. The result is equivalent to a subscription or acquisition of Shares at a Price of CHF 50 (*i.e.*, assuming a Tax Value of CHF 100).
- ❖ A stamp tax duty of 1% will be levied on any amount paid by a subscriber of Shares in excess of an aggregate amount of CHF1,000,000 (including all preceding share issuances).
- ❖ In case of an ordinary capital increase, the employee will have to pay at least 20% of the nominal value of the Shares (provided that the share capital of the company has been paid-in for a minimum amount of CHF 50,000). Should it not be the case, the employee will have to pay at least 50% of the nominal value of the Shares). Such amount may not be financed through a vendor loan.
- ❖ With respect to the taxable income, the subscription price paid by the employee in relation to the capital increase is considered to be the Price.

# 4. Types MIPs – Sale of Shares



## 4. Types of MIPs – Sale of Shares

- ❖ The company may sell treasury Shares it owns to its employees or may purchase Shares from its shareholders in order to sell such Shares to the employees.
- ❖ The advantage of procuring treasury Shares in order to sell them to employees is that the company may provide leverage to the employees by selling such Shares against a vendor loan subject to an arm's length interest. By way of example, if the Tax Value of the Share Grant is equal to CHF 100, the company may sell those Shares to the employee against the following Price (i) a cash portion of CHF 20, and (ii) a vendor loan of CHF 80. As a result, the employee does not have any taxable income at the time of the Share Grant since the Price is equal to the Tax Value. The Tax Value may also be further reduced by a blocking discount. Employees should nevertheless be aware of the risk of reimbursement, in particular if the company goes bankrupt.
- ❖ If the company does not already own treasury Shares, it will have to purchase its own shares from existing shareholders. In order to acquire treasury shares, the company shall have sufficient freely available reserves.
- ❖ From a tax perspective, the difference between the purchase price (acquisition cost) and the Market Value at the time of the Grant is considered as a tax-deductible expense or as a taxable profit. The difference between the Market Value at the time of the Grant and the Price paid by the employee constitutes a tax-deductible expense.
- ❖ Please also note that, if the company purchases Shares from existing shareholders for zero consideration or for a consideration lower than the Tax Value of the Shares, the shareholders are deemed to make a contribution into the reserves. However, if the price paid is higher than the Tax Value of the Shares, the company pays a hidden dividend to the shareholders which is subject to withholding tax and the difference between the price paid and the Tax Value shall be reintegrated into the taxable benefit of the company.
- ❖ The consideration owed by the employee to the company will be considered to be the Price with respect to the determination of the taxable income.

## 4. Types of MIPs– Sale of Shares

- ❖ Since, in general, all shareholders should be diluted by a MIP, the company will tend to increase its share capital in order to create the treasury Shares (*i.e.*, shareholders will not be willing to contribute Shares for a free and often the company will not be willing to disburse cash to acquire Shares from shareholders).
- ❖ There are two ways to get the intended result: (i) the company subscribes to its own Shares, or (ii) a nominee acting on behalf of the employees subscribes to the Shares at the nominal value and contributes them into the reserves of the company. Then, the company may sell such treasury Shares to the employees and, if needed, achieve leverage for the employees through a vendor loan. From a tax perspective, if the Price of the Shares that are sold to the employee is equal to the Market Value of the Shares and that part of the Price is financed by a vendor loan, the employer may realize a taxable profit on the difference between the subscription price of the Shares and the sale price. In such a case, since it is a pure sale, the booking of contribution reserves for tax purposes will in principle not be possible unless a tax ruling is obtained (see below for an alternative scenario that is more tax efficient).
- ❖ If the company subscribes to its own shares, the corporate procedure re. the transformation of reserves into share capital shall be complied with and the nominal value of the Shares issued will be subject to the withholding tax.
- ❖ On a side note, if the company has sufficient cash and available reserves, the following may also be implemented: (i) the company loans a portion of the subscription price to the employee, (ii) the company increases its share capital, and (iii) the employee subscribes to the newly issued Shares using the portion of the loan received by the company. In such a case, the company will create leverage for the employee and in addition the subscription price might be considered as contribution reserves for tax purpose. When using this procedure, we recommend to materially comply with the corporate rules governing the transformation of reserves into share capital.



## 4.B. Types of MIPs – Participation Certificates

## 4.B. Type of Plans – Participation Certificates

- ❖ As a type of Shares, a company may decide to issue participation certificates to its employees.
- ❖ Participation certificates do not carry voting rights.
- ❖ Participation certificates' holders have the same economic rights as shareholders and, in addition, they are entitled:
  - To receive the annual report and the auditor's report
  - To take note of the content of the invitation to the shareholders' general meeting, of the agenda and of the proposals
  - To take note of the decisions of the general meeting of the shareholders



## 4.B. Types of MIPs – Participation Certificates

- ❖ Participations certificates' holders do not have any voting right or any right associated such as:
  - The right to require the convening of a general meeting of the shareholders
  - The right to attend the general meeting of the shareholders
  - The right to information
  - The right of inspection
  - The right to submit motions
  
- ❖ Beneficiaries from MIPs usually don't hold a significative share of the capital of the Company sufficient to allow them to influence the result of any vote and/or election. Therefore, the Grant of participation certificates instead of “shares” do not make a big difference for the beneficiaries but has the advantage to not dilute the voting rights of the other shareholders and ease the organization of the general meeting of the shareholders. Restructuring measures and/or corporate reorganizations are also easier to implement.



## 4.C. Types of MIPs – Options

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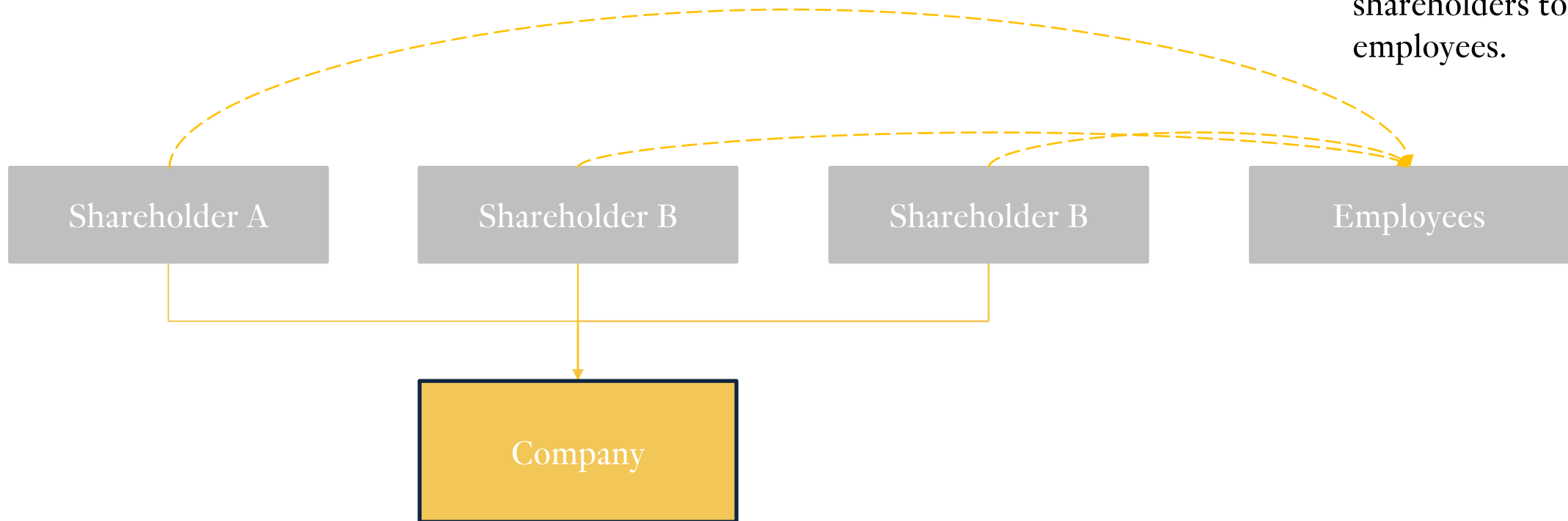
- ❖ Instead of Shares, a company may decide to grant Options.
- ❖ The Shares issued upon exercise of the Options may be issued from the capital conditional or may be sourced from treasury Shares.
- ❖ Condition share capital has the advantage to make the issuance of Shares automatic upon dispatch of a notice of exercise. The issuance process is easier than with an ordinary capital increase, in particular if the company has several shareholders. In addition, the shareholders do not have pre-emptive rights (*i.e.*, preferential rights of subscription).
- ❖ If the Shares are not issued through a conditional capital increase but are sourced from treasury Shares, the effective Grant of the Shares upon exercise of the Options will be dependent on acts to be performed by the employer.
- ❖ Upon exercise of the Options, the Shares shall be taxed pursuant to the general principles described above.



## 4.D. Types of MIPs – Grant of Securities by Shareholders

## 4.D. Types of MIPs – Securities Granted by Shareholders

Sale of Shares by the shareholders to the employees.



## 4.D. Types of MIPs – Securities Granted by Shareholders

- ❖ The employee may acquire Shares and/or Options from the shareholders of his/her employer.
- ❖ The Price may be freely set so long as the value corresponds to the Market Value and may be paid in cash, through a vendor loan or through a combination of the two. The Price might also be qualified as a Formula in case it is below the Market Value (*e.g.*, because of a shareholders' agreement). If the Price is lower than the Tax Value, then the difference will be taxable income.
- ❖ The OPart might in principle applicable to such a Grant and the general tax principles might apply, but if the shareholder is a physical person, this has to be reviewed on a case by case basis. If the shareholder is an entity, it is likely that the OPart does apply. According to a Supreme Court precedent, if the Shares are sold by an entity controlling the employer, then the OPart is applicable.
- ❖ Even if the OPart is not applicable to the Grant of securities by the shareholders of the employer (at least when the shareholders are physical persons), the MIP Circular provides that the assessment of a potential significant cash advantage (*avantage appréciable en argent*) shall be determined pursuant to the MIP Circular applicable *mutatis mutandis*.

## 4.D. Types of MIPs – Securities Granted by Shareholders

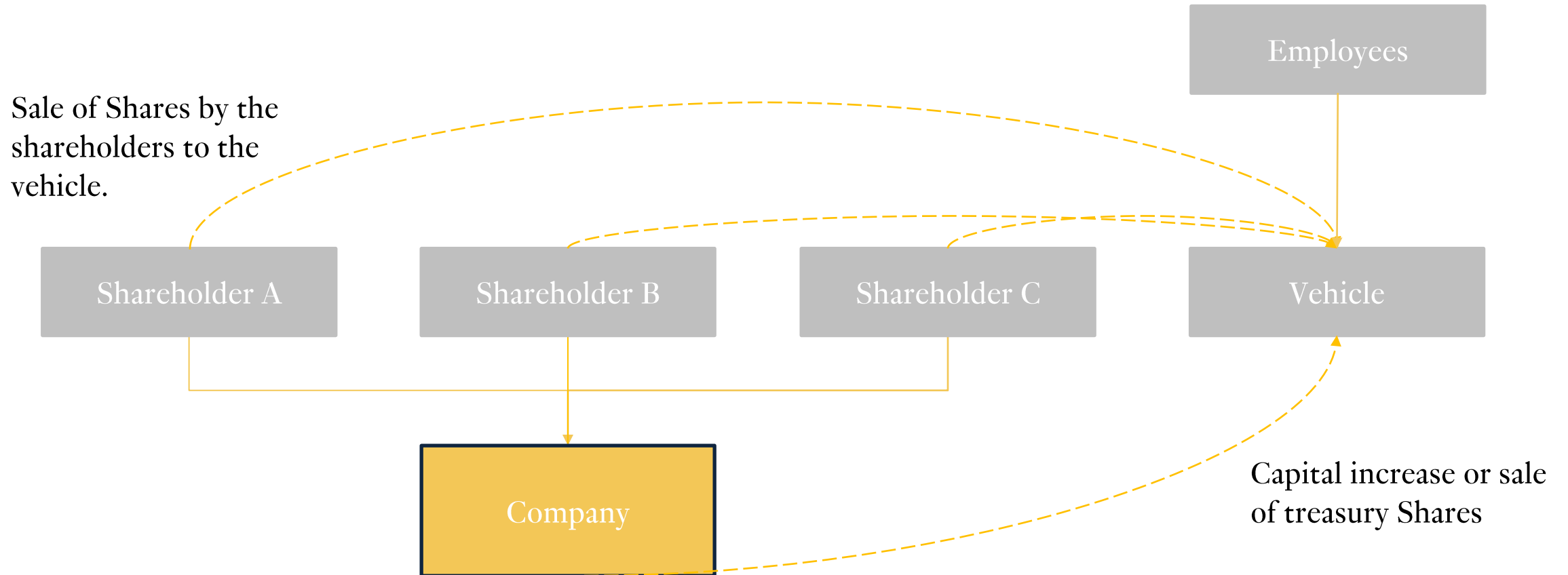
- ❖ The problematic of a hidden dividend shall not arise in this context. However, if the employee already was a shareholder prior to the grant, the problematic of a hidden dividend may arise if the transaction is not concluded at arm's lengths and that the company is impoverished. The structure of the Grant shall always be analyzed in this respect.
- ❖ If a discount is applied to the Price paid by the employee and so long as the rules of the OPart do not apply, the difference between the Price paid and the Tax Value of the Share shall not be taxed as an income except is it is deemed to be an income from an independent lucrative activity. In such a case, the employee will have to pay the relevant related tax contributions.



## 4.E. Types of MIPS – Grant of Shares to a Vehicle



## 4.E. Types of MIPs – Shares Granted to a Vehicle



## 4.D. Types of MIPs – Shares Granted to a Vehicle

- ❖ The OPart is usually applicable to such Grant and the general tax principles apply.
- ❖ The considerations developed in Section 4.C also apply in the context of Shares granted to a vehicle.
- ❖ In case of a sale by the employee of the shares of the vehicle, the employee may achieve a tax-exempted capital gain. However, the parties shall pay attention to a potential indirect partial liquidation which would have for consequences the re-qualification of the tax-exempted gain into a taxable income.
- ❖ In case of a distribution of dividend by the employer to the vehicle, the latter will benefit from a tax reduction at both the federal and cantonal levels; the so-called reduction for participations. To benefit from the reduction for participations the following conditions shall be fulfilled: (i) the vehicle holds at least 10% of the share capital of the employer or (ii) the fair market value of the participation held by the vehicle in the employer amounts to at least CHF 1 million.
- ❖ In case of a sale of all the employer's Shares, the vehicle will also benefit from the reduction for participations mechanism if the following cumulative conditions are fulfilled: (i) at the moment of the sale, the vehicle holds at least 10% of the share capital of the employer and (ii) the Shares have been held at least one year (*i.e.*, minimum holding period) by the vehicle). In case of a partial sale of the employer's Shares, if the percentage of the participation falls below 10% as a result of a partial sale, the reduction for participations for each subsequent sale may also apply if the participation had a market value of at least CHF 1'000'000 at the end of the tax year preceding the subsequent sale and that, before that subsequent sale, a participation of at least 10% had already been sold by the vehicle.
- ❖ In case a management company is set up, a call option should be granted to the employer in order to buy back the shares of the employee leaving the employer. The same holds true with respect to other exit provisions which should be carefully reflected at the level of the agreement between the shareholders of the management company and the employer.



## 4.F. Types of MIPS – LBO Context

## 4.D. Types of MIPS – Shares Granted to a Vehicle

- ❖ If the employees acquire shares in the acquisition vehicle in the context of an LBO, such acquisition may be deemed a “co-investment” completed at Market Value. If, in the context of this co-investment, the employee benefits from a low value of the equity of the vehicle because the vehicle is levered, the gain realized through a sale may be re-qualified as taxable income to the extent the levered instruments exceed 70% of the balance sheet and/or the managers subscribe to equity instruments not *pari passu* with the fund.
- ❖ A very simplified balance sheet may look as such:

Uses	CHF	Sources	CHF	%
Target Shares	100M	Term Loan	50M	
		Convertible debt	20M	
		Equity	30M	100%
		▪ Fund	27M	90%
		▪ Manager	3M	10%

- ❖ It should be noted that the paid out curve intended may to a certain extent be reflected in the convertible features of the convertible debt. The convertible debt may also be replaced by preferred shares with a capped pay out plus interest.
- ❖ Finally, the fund may even increase the leverage of the employees by selling them the Shares against a vendor loan.



# 5. Certification OPart

# 5. Certification OPart - Shares/Participation Certificates

- ❖ The employer shall deliver a certification pertaining to the tax period during which the employee received Shares and shall at least mention:
  - designation of the MIP;
  - Grant date;
  - calculation of the taxable amount;
  - blocking period as well as possible restitution of the Shares or unblocking;
  - Price if the Shares are not freely granted;
  - number of Shares;
  - taxable amount calculated shall be mentioned in the salary certificate or in the withholding tax count;
  - Market Value, if any, and the transaction on which it is based or the Formula.

# 5. Certification OPart - Shares

- ❖ If the Shares were blocked and are unblocked, the employer shall deliver a certification pertaining to the tax period during which the shares have been unblocked and the certification shall cover the tax period during which the early unblocking takes effect. The certification shall include :
  - designation of the MIP;
  - ordinary end of the blocking period, *i.e.*, without any unblocking;
  - date of the early unblocking;
  - discount for the remaining time of the ordinary blocking period, rounded to the thousandth;
  - Market Value or Tax Value determined pursuant to the relevant Formula at the time of the unblocking;
  - difference between the undiscounted value of the Shares at the time of the unblocking and the discounted Tax Value of the Shares corresponding to the remaining years of the blocking period per share;
  - number of Shares:
  - difference between the undiscounted value of the Shares at the time of the unblocking and the discounted Tax Value of the Shares corresponding to the remaining years of the blocking period per share certified in the salary certificate or withholding tax count.

## 5. Certification OPart - Shares

- ❖ In case of a restitution of the Shares, for example following the exercise of a call option by the employer, the employer shall deliver a certification pertaining to the tax period during which the employee gives back the Shares. The certification shall include the acquisition costs of the income.



# 5. Certification OPart – Negotiable Options

- ❖ The employer shall deliver a certification pertaining to the tax period during which the employee acquires Negotiable Options. The certification shall include:
  - designation of the MIP;
  - grant date;
  - calculation of the taxable amount;
  - blocking period as well as possible restitution of the shares or unblocking;
  - Price if the Negotiable Options are not freely granted;
  - number of Options;
  - taxable amount calculated shall be mentioned in the salary certificate or in the withholding tax count;
  - Market Value.

# 5. Certification Opart - Options/Expectations/Phantom Stock

- ❖ The employer shall deliver a first certification pertaining to the tax period during which the employee is granted Options. The certification shall include:
  - designation of the MIP;
  - Grant date of the Shares of the employee;
  - date of the exercise right. Usually, the end of the blocking period shall be attested. Since a blocking period is not always provided, the exercise right arises at the end of the vesting period. If it can be determined, the date of the arising of the exercise right shall be certified. Depending of the clauses of the MIP, it is not always possible to determine to exact moment when the exercise right arise. It is recommended to settle this question in the context of the request of advance information.
  - number of Shares acquired by the employee.

## 5. Certification Opart – Options/Expectations/Phantom Stock

- ❖ The employer shall deliver a second certification pertaining to the tax period during which the employee exercises his/her Options. The certification shall include:
  - designation of the MIP;
  - Grant date of the participation;
  - exercise date, date of the sale or of the conversion;
  - value established pursuant to the non-listed Shares Formula upon the exercise, sale or conversion;
  - exercise price, purchase price or conversion price;
  - number of participation exercised, sold or converted;
  - advantage mentioned in the salary certificate or in the withholding tax count.



# 6. Advantages and Disadvantages

# 6. Advantages/Disadvantages

- ❖ If an employer grants its own treasury Shares to its employees, the purchase of the Shares may be financed by a vendor loan which has the advantage of creating leverage and limiting the cash impact for the employee.
- ❖ In case of a capital increase, the employee will have to pay at least an amount corresponding to 20% total nominal value of the Shares to be issued without having the possibility to finance such subscription amount by a vendor loan. The amount above of 20% may be financed through a contribution to be paid by the employee upon request of the employer, which is not equivalent to a vendor loan.
- ❖ The ordinary capital increase is more costly and requires more documentation than a capital band or conditional capital increase. In addition, shareholders may have pre-emptive rights, which limit the flexibility of the employer.
- ❖ Shares may be granted through Options exercisable immediately, the advantages of such solution are the following:
  - Shares are issued immediately upon exercise of the Options without any other formality
  - Duration of the conditional capital is not limited contrary to the capital band.
- ❖ Phantom shares and restricted stock unit have the disadvantage to not allow the employee to make a tax-exempted capital gain.
- ❖ We recommend to have two MIPs: Share Grant for executive managers (*i.e.*, taxes at Grant) and Options for the remaining employees (*i.e.*, taxes at exercise). In our experience, employees are reluctant to pay taxes at Grant and in case of leverage to face the reimbursement obligation of the vendor loan.



# 7. Role of Art. 156 CO

# 7. Role of the Art. 156 CO

- ❖ MIPs often provide for conditions which have to be met in order for the employee to effectively acquire the Shares or the Options granted by the employers.
- ❖ Art. 156 CO provides that a condition is deemed fulfilled where one of the parties has prevented its fulfilment by acting in bad faith.
- ❖ In 2006, an employer lodged an appeal before the Federal Court with respect to the vesting of options granted to an employee in relation to the termination of the employment agreement of said employee. The employment agreement had been terminated in 2002, a tranche of options should have vested in 2003 and a last tranche should have vested in 2004.
- ❖ The Federal Court ruled that, since the employment agreement was wrongfully terminated, the employee had been prevented to keep working with its employer which prevented the vesting of the options. Therefore, art. 156 CO applied and the employee had been entitled to exercise its options (vested or not).



# 8. Conclusion



# 7. Conclusion

- ❖ MIPs may take various forms.
- ❖ Each MIP has different tax consequences, its advantages and disadvantages.
- ❖ The practice of the different cantonal tax authorities may vary.
- ❖ The analyze of a MIP is therefore complex and should cover the type of securities, the structure of the grant, the cantonal tax authorities competent, etc.



Thank you for your attention

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