
New Policy Statement on Dutch taxation of employee stock options in cross-border situations

*by Prof. W.H. Keesomlaan 1
PricewaterhouseCoopers N.V.
Human Resource Consulting
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• Contributed By: **Navjeet Rosenthal-Gill**

On 21 February 2002, the State Secretary of Finance published the long awaited Policy Statement, with respect to the allocation of stock option income in cross-border situations, on the Ministry of Finance website. Broadly, the Policy Statement, dated 11 February 2002, confirmed that in cross-border situations the allocation of stock option income for Dutch tax purposes is primarily based on the relationship between the stock option grant and the employment duties performed by the employee.

1. What is the scope of the Policy Statement?

The Policy Statement applies to all options that become unconditional after 1 January 2002. Therefore, the notice dated 19 August 1994 (no. IFZ 94/705.2) containing an earlier interpretation of the rules, is no longer valid in respect of such options. Consequently, for options that became unconditional prior to 1 January 2002, the 1994 notice will still apply.

2. What has changed?

Under the previous 1994 notice, stock option income was fully taxable in The Netherlands provided the employee was living and working in The Netherlands on the taxable date under Dutch tax law. No Dutch taxes were payable where the individual was living and working outside The Netherlands on the taxable date. Under the new Policy Statement, the tax authorities may apply a pro-rata allocation to the stock option income based on the time spent (i.e. day count) by employees performing employment duties in The Netherlands.

3. Summary of the new rules

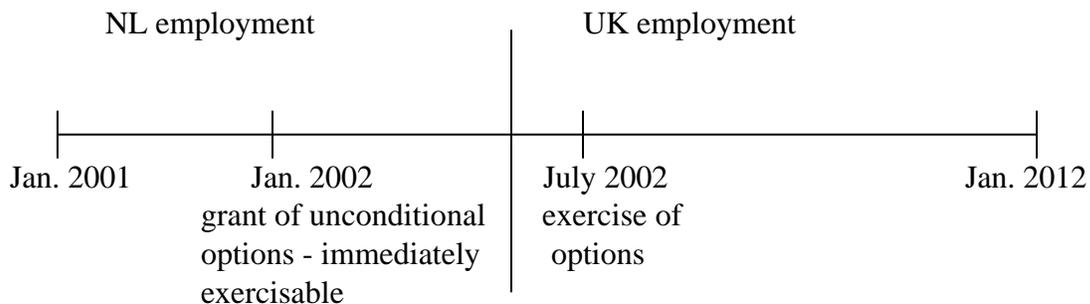
Under the new Policy Statement, the allocation of the taxable benefit from options relating to employment duties performed or to be performed in The Netherlands is, in each specific case, reserved for the competent tax inspector. However, the following guidelines apply in order to provide uniformity in policy and operation:

(i) Unconditional stock options

The main rule for unconditional options is that the taxable benefit from unconditional stock options is related to employment duties performed in the period prior to the grant date regardless of whether or not the employee may only exercise these option rights after a certain waiting period. The rationale for this is that the exercise of unconditional stock options is, generally, not dependent on the performance of employment duties in the period following the grant date.

Example 1*:

An employee is granted unconditional stock options whilst resident in The Netherlands on 2 January 2002 as remuneration for employment activities performed in The Netherlands in the year 2001. In June 2002, the employee is assigned to the UK and exercises the options in full in July 2002. Under the new Policy Statement, the taxable benefit at the date of grant of the options would be taxable in full in The Netherlands as the unconditional options relate to the performance of employment activities in The Netherlands in the period prior to grant.

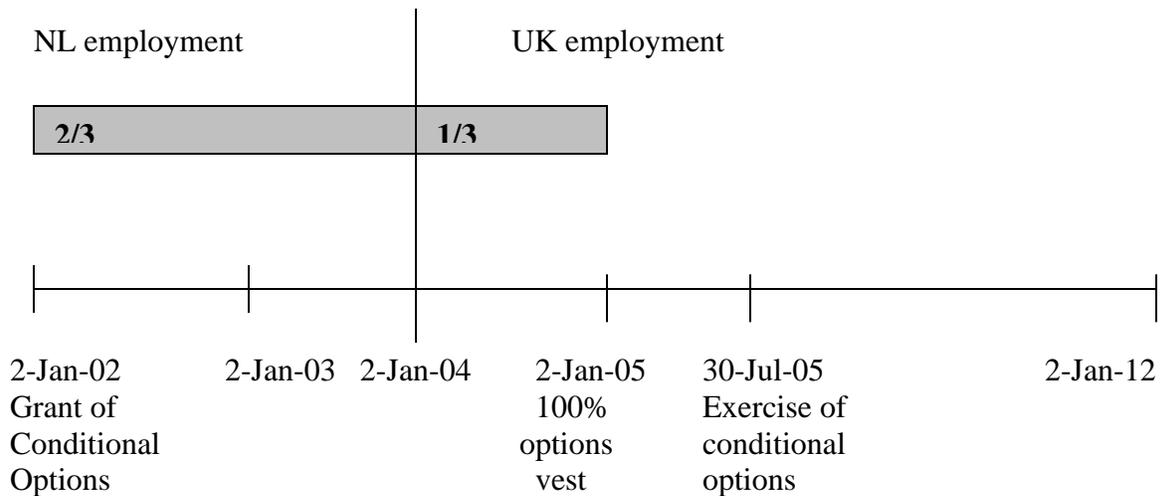


(ii) Conditional stock options

The main rule for conditional options is that the taxable benefit realised by the option holder is related to employment duties performed during the entire period the options remain conditional (i.e. the period between the date of grant and the date the option(s) can be exercised for the first time – the vesting date). The reason for this is that the exercise of conditional stock options is subject to the option holder's continued employment during this period.

Example 2*:

An employee is granted conditional stock options in The Netherlands on 2 January 2002. 100% of the options vest on 2 January 2005 provided the employee is still employed by the company on that date. On 2 January 2004, the employee is assigned to the UK. The employee later exercises all of the options on 30 July 2005 whilst on assignment in the UK. According to the new Policy Statement, 2/3 of the taxable benefit at the date of vesting would be subject to taxation in The Netherlands and 1/3 of the taxable benefit would be allocated to the UK.



(iii) Exception to the main rule on conditional options

An exception to the main rule on conditional stock options may be possible if the facts and circumstances of the case indicate that the conditional stock options were granted for a specific period (remuneration period) that differs from the vesting period.

Example 3*:

An employee is granted conditional stock options in The Netherlands on 2 January 2002 on the basis of employment activities performed in the years 2001 to 2005 inclusive. 100% of the options vest on the third anniversary of the grant date (2 January 2005) provided the employee is still employed by the company. On 2 January 2004 the employee is assigned to the UK. The employee later exercises all the options on 30 July 2005. According to the new Policy Statement, 3/4 of the taxable benefit would be subject to taxation in The Netherlands and 1/4 of the taxable benefit would be allocated to the UK.



* Please note that these examples are for illustrative purposes only. International cross-border tax rules may differ and should be reviewed in the specific countries.

4. What does this mean for companies?

The main significance of the new Policy Statement is that the distinction between unconditional and conditional options is accentuated. The importance of this distinction was somewhat eroded with the introduction of the deferral regime in December 2000 whereby Dutch taxes can be deferred until the date of exercise. Under the election rules, an election to defer taxation can be made regardless of whether the options are considered unconditional or conditional for Dutch tax purposes provided an election form is received by the tax authorities prior to the first vesting date.

Given the renewed importance in distinguishing between unconditional and conditional options for Dutch tax purposes, companies should determine whether the nature of options they grant to their employees is clear from the company's own stock option plan documentation and/or if this is supported by a ruling secured with the Dutch tax authorities. Where there is any ambiguity as to the nature of the options, it is recommended to obtain independent advice.

In addition, companies should also think about withholding procedures where the taxable date falls during the period the employee is assigned abroad, in particular where conditional options vest during such a period. Withholding obligations are less onerous where taxation has been deferred until exercise since this can be organised via the broker.

5. What should companies do to ensure the changed policy is introduced?

According to the new Policy Statement, the term cross-border situation is widely interpreted. As such, the rules shall apply to an employee who, after the date the stock options are granted, is seconded from The Netherlands or is assigned to The Netherlands from abroad within the group company structure.

Therefore, where companies have employees in cross-border situations, it is recommended to review all options held by such employees on a tranche by tranche basis. Since the new rules are applicable only for options that become unconditional after 1 January 2002, it will be important to separate, in the administration records, those options falling under the previous 1994 announcement and those falling under the new guidelines.

6. Conclusion

In conclusion, the new Policy Statement changes the Dutch tax treatment of employee stock options in a cross-border situation. Therefore, companies should be aware of their increased responsibilities in respect of employees entering The Netherlands or employees who are assigned abroad and hold employee stock options.

