Stock options

Employee stock options have a strange attraction. For those who do not get them they sound like a ticket to greater wealth reserved to the fat cats in multinationals. And the allegations that some Fortune 500 executives have abused stock options have not done their reputation any good. Things have changed though. Stock options are no longer reserved for the executive suite. They have become a widespread means for attracting, motivating and keeping employees.

What is an employee stock option? It is a piece of paper on which your employer gives you the right to buy ("exercise") a certain number of shares of your employer's stock at a stated price (the "grant", "strike" or "exercise" price) over a certain period of time (the "exercise" period). It is a bit like a lottery ticket. You have the right to buy, say, 100 shares at a price of € 10 per share with an exercise period of five years. That means that in 2010, you can buy these shares for € 1,000.

Whether that is good depends on the price of the shares then. If the stock has tumbled to € 5 in 2010, it is not. Even at € 12, you may not be keen to buy. How do you pay for these shares and will you ever make any serious profit when you sell the shares in ten years' time? Of course, if the stock has risen to € 50, you should not hesitate. You pay € 1,000 for shares that are worth € 5,000. You can even sell 200 shares to finance the exercise of the option. The rest is pure profit.

When it comes to taxing stock options, the tax authorities have two possibilities. They can tax the employee when he receives the stock option, or when he exercises his option in 2010 and buys the stock. The second option is obviously better for the taxpayer: he only pays if he makes a profit.

Before 1999, that was what Belgium was trying to do, but the legislation was badly written. Now Belgium taxes the option when the employee receives it. If the employee takes the options, he pays tax on a value that usually is between 7.5 and 10 percent of the current value of the stock. That means that he may have to pay tax even if he does not make a profit in the end. The tax regime may be quite favourable, but still it always is a gamble. It's like with a lottery ticket. That is not worth anything until the draw.

Since 2001, most countries have opted for taxing the profit upon exercise of the option. It is unlikely that Belgium is going to change the rules again soon. The tax authorities are still trying to clean up the mess from before 1999.

The Belgian tax authorities could not tax stock options, but that does not mean that they did not try. It was not until 2003 that the Supreme Court has finally decided in favour of the taxpayer on pre 1999 stock options. The Belgian tax authorities are bad losers though. They are trying to convince the Supreme Court to reverse its case law on conditional stock options.

There is indeed a tendency recently that employers link stock options to employee and company performance. Most US stock option plans are conditional. This means that the employee may have to wait a year before he can exercise his stock option. The taxman is now asking the Supreme Court to say that conditional stock options are only granted when the conditions are met.

It is unlikely that the tax authorities will succeed, but in the meantime, many employers have been overcautious and they have withheld tax. In some cases they even made their employees reimburse the withholding tax in the belief that everything would be sorted out once the Supreme Court rendered its long awaited decision. But that will take another year or so to come.

What many employees did not realise is that they needed to claim back the withholding tax in their tax returns. Unfortunately many tax advisers simply copied salary statements and have omitted to claim back the withholding tax.

The only way then is to file a separate demand for reimbursement. But the clock is ticking.

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13 December 2004