



The modifications to the Belgian stock option regime: practical issues

The Act of 24 December 2002 has modified certain provisions of the 1999 tax regime for options granted under an employee stock option plans (ESOP) (for prior coverage see document 2002-28005). These modifications were needed because it appeared that this new tax regime had not taken account of the possibility that the economic climate might deteriorate as much as it did in the last years.

Since the new tax regime was introduced by Act of 26 March 1999, numerous stock option plans were set up ; over 60 % of all listed Belgian companies had set up employee stock option plans for their employees. In order to minimise the income tax due, most ESOPs were drafted in such a way that the ESOP was limited to five years and that the beneficiaries would be able to exercise their stock options after the end of the third calendar year following.

Under such a plan the only tax due is the individual income tax due at the time the stock option is granted; the tax is due on a percentage of the value of the shares and for most ESOPs that is 7.5 per cent. There is no further tax when the employee exercises his option or when he sells the shares. Moreover, no social security is due.

When he exercises his option, the employee can realise a capital gain that is tax exempt. There is only one snag: he has to pay tax in advance calculated on the value of the current price of the stock at a marginal rate of about 53 per cent, while he does not know yet whether he will make a profit. In a bull market, granting stock options is most tax effective and profitable for the employee.

When stocks tumbled, realisation grew that the legislator had not considered the possibility that the economic climate might deteriorate and that the beneficiaries might not even be able to recover the tax that they had paid when the stock options were granted.

Most ESOPs have been set up in 1999 and 2000, and will expire in 2004 or 2005. It would take a miracle for the stock market to pick up enough so that it remains worthwhile exercising the options.

The legislation was patched up at the end of 2002 with the following measures :

1. Verbal offers of stock options are simply excluded.

To avoid any confusion as to whether a stock option is granted, stock options can only be granted in writing.

2. The beneficiary must explicitly accept the extension

Some employees, in particular when they were made redundant, considered that they had been taken advantage of and some turned against their employers. They claimed that the stock options had been imposed on them and that they had not accepted them. Some even claimed damages from their employers to cover the loss they had incurred, in particular the tax they had paid.

This is the major reason why stock options will have to be accepted in writing by the beneficiary.



3. Extension of the exercise period

In order to give the stock market time some to recover, the first measure was that for ESOPs launched between 1 January 1999 and 31 December 2002, parties can agree that the period for exercising the option can be extended for a period of up to three years even if that means that the exercise period of warrants would exceed ten years (which is prohibited by art 499 Company Code).

It is specifically provided that such agreement would not constitute a grant of a new stock option. Indeed, under the existing legislation, the tax authorities tend to take the view that any change to the terms and conditions of an existing ESOP constitutes the grant of a new stock option benefit which is liable to tax again.

It is this measure, in particular, which has raised a number of questions.

As most ESOPs qualify under the legislation governing the public offering of securities, the Banking Commission has issued a set of instructions on 4 March 2003 in order to ensure the transparency of the market and the protection of the investors. On 28 April 2003, the Belgian Tax Authorities have also issued an administrative note to explain their view on the modifications.

Which ESOPs ?

The Tax authorities explain that ESOPs can only be extended if they are still current: i.e. their exercise period must not have lapsed and the beneficiary may not have accepted them.

Moreover, for practical reasons, they will accept the extension of the exercise period for all ESOPs issued between 2 November 1998 and 31 December 2002. The reason is that stock options are deemed to have been granted on the sixtieth day, so that stock options granted in the last sixty days of 1998 are deemed to have been granted in 1999 and had not been refused within sixty days (see 2). The same rule applies for the last sixty days of 2002.

Form of the decision to extend the exercise period

The Banking Commission distinguishes contractual stock options from stock options issued in the form of warrants.

For contractual stock options the board of directors will have to take a formal decision for the extension of the exercise period.

Warrants are securities that represent a right to subscribe a delayed capital increase. For those, the Banking Commission requires the board of directors to attach an explanation of the interest of the extension of the exercise period for the company (e.g. an explanation that the employees are not able to exercise the warrants in due time so that the objectives of the ESOP (motivation of the employees) will not be achieved

In particular, the board of directors will have to be careful to justify why it would only extend the exercise period for those employees that are liable to the Belgian individual income tax. This does, indeed, constitute an infringement of the rules relating to the



equal treatment of the owners of securities issued at the same occasion.

Formalities for the employer

The Banking Commission suggests that the employer would seek the approval of each individual beneficiary involved so that one beneficiary's refusal would only affect his own situation. The Banking Commission points out that from a strictly legal point of view, even a tacit acceptance could be taken into account if it were undeniable. However, it recommends that the employer require a written acceptance within sixty days with a presumption of refusal if the acceptance has not been given in writing.

Any ESOP that is offered to fifty or more beneficiaries is considered a public solicitation of investments and normally requires a prospectus or an addition to the prospectus. The Banking Commission points out that an addition to a prospectus is only required during the issue period and that a new prospectus must be published for a new issuance of securities. In the case of an extension of the exercise period, neither is required.

The employer must, however, inform the beneficiaries, but the Banking Commission must not approve the notice to the beneficiaries. Nevertheless, the Banking Commission appreciates being copied in on such notices.

Finally, as the decision is relevant for the stock market, it must be made public, but this may be done in the report of the board to the annual accounts.

The beneficiary must have accepted the extension.

In front of the Parliament, the Minister of Finance had suggested that this condition meant that all the beneficiaries had to approve the extension preferably in one written document.

The Banking Commission considered that this condition was too stringent. The commission suggested that the employer contact each of the beneficiaries directly and inform them of the suggested change, the corporate body that would enact the change, the justification and the tax implications and how the beneficiary could approve the modification of the ESOP.

The tax authorities admit that it would be sufficient that the employer only seeks the acceptance of those beneficiaries who are affected by the extension. He does not need to obtain the approval of all the beneficiaries of the ESOP. And the fact that not all the beneficiaries have explicitly agreed cannot block the extension of the exercise period for those beneficiaries that have accepted in time.

Before 30 June 2003

The extension of the exercise period must be agreed before 30 June 2003 and notified to the tax authorities before 30 July 2003. The information to be provided to be provided must include:

- A precise identification of the ESOP and all relevant information relating to the options granted (underlying shares, exercise price and period, the major terms and conditions of the ESOP);



- The terms and conditions of the extension;
- The identification of the beneficiaries for whom the ESOP has been extended.

The tax authorities confirm that it is the company that has offered the stock options that must notify the extension its own tax office. A foreign company without an establishment in Belgium which has offered the stock options to the staff of its Belgian subsidiary, must notify the extension to the subsidiary's tax office.

Marc Quaghebeur, 17 June 2003

The modifications to the Belgian stock option regime: practical issues, *Tax Notes Int'l*, 28 July 2003, p. 325.