Global Employer Services

Global Rewards Update:
Germany – Shares acquired at a reduced price - Federal Court Decision regarding valuation

January 2015

Background

The Federal Tax Court (BFH) recently considered whether the acquisition of shares **at a reduced price** represents employment income. Although certain elements of the Court's decision were consistent with prior case law, the BFH seems to have departed from its previous position on the timing of the valuation of the benefit.

The court's decision

Tax point

In accordance with previous decisions, the BFH confirmed that a benefit in kind resulting from the acquisition of shares at a reduced price represents employment income only if it qualifies as consideration for providing services within the broad scope of the employment.

The court also confirmed its previous decisions as to when the tax liability arises, i.e. at the time the employee acquires the economic authority to dispose of the shares, which is when legal and economic ownership of the shares is transferred to the employee (generally at the time the shares are booked into the employee's custody account).

Taxable amount

However, deviating from its previous position, the BFH ruled that, when calculating the taxable benefit in kind, a taxpayer no longer should value the benefit at the time of the taxable event (i.e. when ownership transfers to the employee), but rather at the time of the legally binding sales transaction, when the employee and employer finally agree on the acquisition of the shares (e.g. generally at the time the employee notifies the employer they would like to exercise their share options or purchase discounted shares). According to the BFH, any change in value between the time of the sales transaction and the actual transfer of ownership is no longer based on the employment, but simply derives from the market.

Impact of the court's decision

As the BFH decision applies to shares acquired at a reduced price, it may impact discounted share options plans, share purchase plans where shares are purchased at a discount, or sharesave plans where the employee receives a discount to the option exercise price.

When applying the new valuation approach to standard employee share option plans, for example, the taxable option gain should be calculated by reference to the share quotation (i.e. the lowest listed price quoted on the relevant stock exchange) on the day the option is exercised (as this likely would be considered the legally binding sales transaction, in the case of an option exercise), and no longer at the time ownership in the shares transfers to the employee following the exercise of the option (when the shares are booked into the employee's custody account). The new valuation approach may make the fiscal administration of employee share plans easier in practice, since employers will no longer have to determine when the ownership of the shares is actually transferred to the employee when determining the taxable amount. Instead, they may simply look to the time of the legally binding sales transaction (e.g. exercise, in the case of share options).

Additionally, employers would no longer have to differentiate between different settlement methods. For example, for share options, prior to the BFH's decision the approach was as follows:

1. "*Sell all" transactions* (where all shares are immediately sold upon exercise) have always been valued by reference to the share price at exercise.
2. "*Keep all*" *transactions* (where the employee retains all of their shares following exercise) were generally valued by reference to the share price at the time the shares were released to the employee (i.e. booked in the employee's custody account) following exercise.
3. "*Sell to cover" transactions* (where, on exercise, some of the shares are sold to cover the tax due and the exercise price) required a combination of both valuation approaches.

According to the BFH, employers should now be in a position to simply use the share price on the day of exercise to calculate the taxable benefit in kind, irrespective of the chosen exercise method listed above.

Deloitte's view

The BFH's decision has been published in the Federal Tax Gazette but it is not yet clear whether the German tax authorities will follow the new valuation approach adopted by the BFH in practice, as the decision referred to a case where a third person, not the employee (a close member of his family), acquired the shares.

Action

Employers that would like to apply the new approach in the wage tax withholding procedure should consider requesting a binding wage tax ruling from the tax authorities.

Even if an employer continues to follow the former valuation rules, employees may apply to determine the benefit in kind in accordance with the new valuation approach in their annual income tax return, if this would result in a lower taxable benefit in kind. Any amount overwithheld by the employer would be refunded to the employee.

People to contact

For assistance with these issues, or any other issue related to the operation of your global equity plans, please contact your local Deloitte adviser or email us at **globalshareplans@deloitte.com**, and an adviser will contact you.

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