



Global Rewards Update

Denmark – Reintroduction of tax advantaged treatment for employee share plans

Background

On 12 May 2016, the Danish Parliament passed a bill reintroducing tax advantages for employee share plans (section 7P of the Danish Tax Assessment Act). This provision is similar to a previous tax rule, known as "section 7H", which was abolished in 2012.

The new provision, which will be effective from **1 July 2016**, applies to shares, conditional share awards, stock options and warrants (i.e. rights to receive newly issued shares) granted to employees under an employee share plan. Similar to the previous rule, under the new provision employees will be able to agree with their employer to receive tax efficient awards up to a total value of 10% of their annual salary, if certain conditions are met.

These changes will also impact employer corporate tax deductions and payroll tax obligations.

Provisions of section 7P

Currently, income tax is due at marginal rates of up to 56% on shares acquired through an employee share plan. The tax point depends on the type of award under consideration – it would generally be exercise for stock options and warrants, and vest for conditional share awards.

Under section 7P, the tax point will be deferred to the date the underlying shares are sold by the individual. Any gains from

the sale of shares would be taxed as share income at a rate of 27% up to DKK 50,600 for individuals (approximately USD 7,600) and 42% for amounts exceeding this threshold. The threshold is doubled for spouses filing together.

In order for section 7P to apply, the following conditions must be met:

- Both the employee and the employer must enter into an agreement for section 7P to apply and such agreement must generally be made before the award is granted.
- The agreement must specifically identify the nature of the award (e.g. whether it consists of shares, conditional share awards, stock options or warrants; the company whose shares underlie the award; the terms for receiving the award etc.).
- The value (using Black Scholes for options/warrants) of an award cannot exceed 10% of the employee's annual salary as at the time when the section 7P agreement is entered into.
- The award must be provided by the employing company or a related group company.
- The award must provide a right to shares, stock options or warrants in the employing company or a group company.
- The underlying shares must be ordinary shares.
- Stock options and warrants must not be capable of being transferred.
- All awards must give the employee a right to receive shares.
- Regardless of award, shares must actually be delivered (e.g. the same day sale of non-listed shares may be deemed to be cash settled).

Where a section 7P agreement has been entered into, the employer will be required to report the grant of all awards and the subsequent vesting (conditional share awards)/exercise (stock options or warrants) to the Danish tax authorities.

Internationally mobile employees

The new legislation will have an impact on employees who are subject to the exit tax charge rules when permanently departing Denmark. Generally an exit tax charge would not occur where the value of shares held by an individual does not exceed DKK 100,000 (approximately USD 15,000) or if they have been tax resident in Denmark for less than seven of the past 10 tax years. However, under the new rules an individual will be subject to the exit tax charge on all shares they hold in a particular company if any of those shares was acquired by them under a section 7P agreement.

Employer tax impact

Employers who enter into section 7P agreements will no longer be able to claim a corporate tax deduction in relation to the costs of the awards. However, employers who are generally subject to Danish payroll tax ("lønsumsafgift") will no longer be liable to pay this on awards where a section 7P agreement has been made. This is on the basis that the awards are deemed to be share income as opposed to salary income.

Deloitte's view

The reintroduction of preferential tax treatment for employee share plans is a welcome change.

Although section 7P will result in corporate tax deductions not being available, this may not be of much concern to companies that have limited income, tax loss carry forwards or major R&D costs. Section 7P agreements may also be favourable where the main objective of an employee incentive plan is for employees to retain shares after vesting (as there will be no requirement to sell shares to cover taxes).

As section 7P will take effect from 1 July 2016, employers granting any awards from this date may wish to consider the advantages and disadvantages of entering into section 7P agreements ahead of this date.

Contacts

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

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