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Update on the Taxation of Employee Share Plans

Good news for startup companies – on 30 October 2020 the Swiss Federal Tax Administration published the amended Circular Letter No. 37 “Taxation of Employee Shareholdings”. The amendments will lead to a competitive tax treatment of startups and will enhance the predictability of the tax consequences of their employee share plans.

In General

The amendments to the [Circular Letter No. 37](#) as published on 30 October 2020 (**Circular Letter No. 37**) include clarifications on core elements of the taxation of employee shares of non-listed companies and will apply as of 1 January 2021. The definition of employee shares remains the same and refers to any participation rights obtained or acquired at typically preferred conditions by an employee of his/her former, current or future employer or an affiliated company (**Employee Shares**).

Basically, Employee Shares are taxed at acquisition on the difference between the fair market value and the preferred acquisition price. When the shares are sold later, another taxable event may occur on the capital gain, if non-listed Employee Shares are sold at a price that is not determined based on the initial evaluation formula. However, the updated Circular Letter No. 37 now provides for a tax-free capital gain in case the Employee Shares have been held for more than 5 years. For the avoidance of doubts, this relief will not apply if the Employee Shares are returned to the employer or an affiliated company.

Valuation of non-listed Employee Shares

Shares of startup companies typically have no fair market value. Thus, the relevant formula value is determined on a method suitable and recognized for the respective employer. For the valuation of unlisted Employee Shares the Circular Letter No. 37 now refers to the valuation method pursuant to [Circular Letter No. 28](#) of the Swiss Tax Conference as a suitable and recognised method. Accordingly, non-listed shares may be valued by applying the so-called practitioner method (i.e. the average of the double weighted capitalised earnings value and the

net asset value). Nevertheless, companies may still apply a different valuation formula. Thus, we recommend to agreeing upon such valuation formula with the competent cantonal tax authorities to exclude the risk that the price paid in a financing round could be considered as the fair market value of the Employee Shares.

Taxation upon Acquisition of Employee Shares

At the time of grant/acquisition of Employee Shares, the difference between the formula value and the acquisition price is subject to income tax and social security contributions.

Taxation upon Sale of Employee Shares

In case of a sale of the Employee Shares or an exit, the employee may benefit from a tax-free capital gain provided that the same valuation methodology is applied for determining the sales price. In the event this condition is not met, thus, if another valuation method is applied, in particular if the market value is paid or credited to the employee, resulting in a higher value than the one determined by the initial valuation method, the holding period has to be taken into account:

- a) the resulting gain will be taxed as income if the sale or exit occurs within 5 years since the grant/acquisition of the Employee Shares;
- b) the disposal of the Employee Shares after the lapse of the 5 years holding period allows for a tax-free capital gain in most of the Cantons in Switzerland.

These clarifications were already practice in several Cantons; however, it remains to be seen if in fact all Cantons are going to adjust their practice aligning it with the amended rules outlined in that Circular Letter No. 37: to date, some Cantons have disregarded the holding period of the Employee Shares, and, therefore, taxed the difference between the initial and the modified valuation method in any event. Hence, it may still matter in which Canton the employee benefiting of Employee Shares is tax resident.

Further Clarifications – Founders Shares and dealing at arm's length

Circular Letter No. 37 now explicitly clarifies that

- a) shares the employees subscribed for at the company's incorporation; and
- b) shares which were acquired at conditions granted also to a third-party (such as investors), thus, at arm's length, do not qualify as Employee Shares at all.

At the disposition of such shares, the employee, therefore, can realize a tax-free capital gain, regardless of their respective holding period.

Conclusion

The Circular Letter No. 37 provides for a welcome clarification and harmonization. Startup companies and their employees throughout Switzerland have a clearer view of the tax consequences and the possibilities to achieve tax-free capital gains. However, we still recommend applying for a tax ruling to obtain certainty. Because such requests can refer directly to the amended Circular Letter No. 37, less discussions with the competent cantonal tax authorities will be required.

Blum&Grob's Startup and Tax-Team is at your disposal for proactive advice and analysis of your employee participation program as well as any other legal support you may need.

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