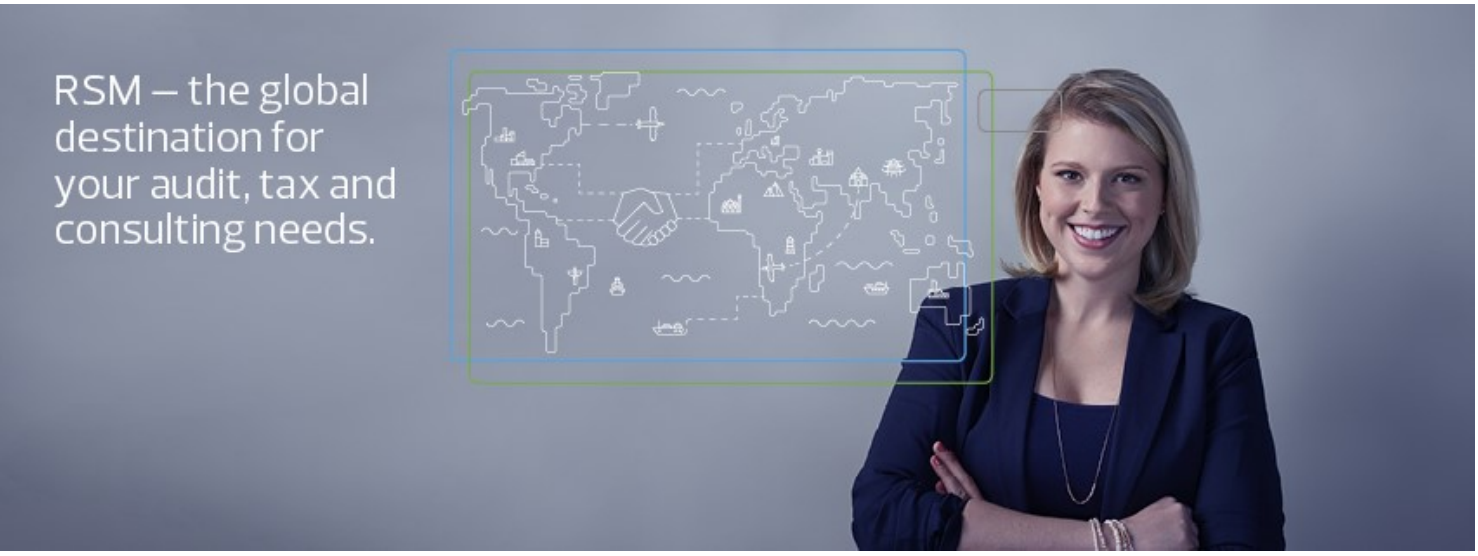

Management stock options PIT-taxed three times?

Tax Alert

Dear Readers,

We would like to draw your attention to the judgement of the Supreme Administrative Court (hereinafter: SAC) of 23 August 2016, file ref. No. II FSK 1811/14, related to the profitability of the implementation of incentive programmes for employees in the form of a company's stock options allocation as perceived through the perspective of taxation. In the judgement in question, SAC determined whether granting the stock options under an incentive programme for employees gives rise to a revenue.

A few months ago, in one of our publications (Tax Alert 15/2016), we described the controversial judgement of the Supreme Administrative Court of 13 April 2016, file ref. No. II FSK 668/14 on double taxation of financial instruments received under incentive programmes. In its judgement, the court ruled that the execution of stock options received from a company as part of an incentive programme, gives rise to a revenue for an employee, and once again the revenue arises when an employee sells the shares, but cannot reduce it by the cost equal to the revenue received from the conversion of the stock options. The judgement which, in fact, allows the double taxation of income from the realization of derivative instruments, has been a breach in the established jurisprudence. In this context, allowing the taxation of such income at another stage – when receiving the options could become especially worrisome for taxpayers introducing and using incentive programmes. The above has been recognized as justified by:

- Director of the Tax Chamber in Bydgoszcz in an individual interpretation dated 12 June 2013, ref. No. ITPB2/415-260/13/IB,
- Director of the Tax Chamber in Bydgoszcz in an individual interpretation dated 20 August 2013, ref. No. ITPB2/415-547/13/IB,
- Director of the Tax Chamber in Poznań in an individual interpretation dated 8 April 2014, ref. No. ILPB2/415-42/14-2/TR.

Triple PIT tax according to the tax collector...

The taxation of benefits received by an employee in connection with the participation in an incentive programme, in the light of the above listed individual interpretations, would be as follows.

1. An employee receives stock options:
   - a revenue from unpaid benefits should be recognized, classified as income from other sources. The tax base is the market value of the options; the tax is calculated according to the scale (Article 20.1 in connection with Article 10.1 item 9 of the Personal Income Tax Act (hereinafter: PITA).
2. The employee exercises the options, taking up the shares:
   - a revenue from capital gains arises – from exercising the rights resulting from derivative financial

instruments, which is subject to the PIT tax of 19 percent (Article 17.1 item 10 in connection with Article 10.1 item 7 PITA).

3. The employee sells the shares:
   - a revenue from capital gains arises – from the sale of the shares, which is subject to the PIT tax of 19 percent (Article 17.1 item 6 Letter a in connection with Article 10.1 item 7 PITA).

It should be noted, however, that in no case there is a possibility of deducting the revenue taxed at an earlier stage from the tax base.

And according to the SAC?

The case that is the subject of the judgement of 23 August 2016, file ref. No. II FSK 1811/14, referred to above concerned a taxpayer – an employee of a Polish company belonging to an international group of companies, who was covered by an incentive programme organized by a Finnish company belonging to a group and adopted by resolution of the general meeting of shareholders. The programme consisted in unpaid, conditional granting to selected participants (including employees) the company's stock options which, hypothetically, allowed to acquire/purchase the company's shares or sell the options themselves in the future (after a defined time that a participant is required to have worked in the companies belonging to the group). In fact, the dispute came down to determine whether granting the stock options to the incentive programme participants generates a tax revenue from other sources within the meaning of Article 10.1 item 9 PITA.

SAC ruled that at this point the income does not arise, because no rights (property donation with a specific financial dimension) that a taxpayer could dispose of as their owner has become the taxpayer's property. The taxpayer is a participant of an incentive programme and in accordance with its rules and regulations, he only is promised that, after a certain time and under certain conditions, he will be able to exercise the options by the acquisition/purchase of the company's shares, or to sell the options themselves. The above arguments lead to the conclusion that we cannot talk about the creation of a tax benefit for the employee who receives stock options at the very time of receiving the options. The mere obtaining a promise is not a definitive and real financial benefit of an individual.

Lack of revenue also upon the exercise of stock options

In the judgement in question, the SAC also raised the issue of the formation of an employee's income upon the exercise of stock options.

According to Article 24.11 PITA, due to the acquisition/purchase of the shares, a revenue in the amount equal to the market value of the shares acquired/purchased arises, as well as the tax deductible expenses in the form of the expenses incurred for the acquisition/purchase of the shares. Secondly, the resulting revenue is not subject to taxation at the time of the shares acquisition/purchase. Thirdly, the principle applies to the shares acquired/purchased by eligible persons pursuant to a resolution of the general meeting.

The tax authority argued that the shares received by the taxpayer as a result of the exercise of the options do not meet this provision, as the basis for their receipt is not a resolution of a general meeting but the option issuer's commitment to exercise them.

The court did not share the tax authority's opinion and stated that the wording of the interpreted provision does not limit the possibility of using the deferral of the revenue taxation only to the situation of acquiring/purchasing the shares of the company taking up a resolution on their transfer to entitled persons. The court stressed that at the time of receiving the shares on preferential conditions the resulting benefit gained by a person, regardless of the source and cause of obtaining the benefit, is only potential. The (free, partly free) acquisition/ purchase of shares is neutral in tax terms on the date of the event, but it is subject to taxation on the moment of the paid sales of the shares pursuant to Article 17.1 item 6 letter a PITA. Only at this point is the actual revenue from the acquisition of the shares revealed.

It should be noted that the judgement of the Supreme Administrative Court dated 20 May 2016, file ref. No. II FSK 1234/14, issued in the same state of the facts suggests that any person whose right to acquire shares results from the resolution of the general meeting of shareholders (even if it concerned the granting of the stock options) may benefit from a tax deferral until the disposal of the shares.

It is to be hoped that the judgement of the Supreme Administrative Court under discussion will contribute to the change of the tax authorities' interpretation that often refused to allow taxpayers to use the deferral provided for in Article 24.11 of the PITA when the shares were purchased on the basis of the resolution of the general meeting of shareholders, but as a result of the execution the options granted on the basis of the resolution, and it will curb the potential future aspirations of tax authorities towards the taxation of such employees' benefits already at the stage of receiving stock options.

Should you wish to discuss the above mentioned amendments in detail, feel free to contact us:

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