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In this article, the authors examine recent efforts by the Dutch government to amend the tax treatment of stock option plans, noting that the changes are welcome but might not solve all liquidity concerns.

On May 31 the Dutch government started a public internet consultation by releasing a draft bill and explanatory memorandum to amend the tax treatment of stock option plans in the Netherlands. The proposal consists of amendments to the Dutch Wage Withholding Tax Act 1964 (Wet op de loonbelasting 1964) to make it more attractive for employers to grant stock options to their employees by shifting the moment the stock options become taxable. The goal is to attract and retain more employees, especially entrepreneurs and technical and IT specialists, and make the Netherlands more competitive compared with other countries for start-ups and scale-ups. In March the Dutch government published its "Country Investigation of Tax Treatment of Stock Option Plans for Employees," which analyzes other jurisdictions' tax treatment of stock option plans and was a source of inspiration when drafting the proposal. The government plans to implement the proposed rules as of January 1, 2022.

The consultation period ended June 30, and reactions submitted by interested parties will be taken into account during the legislative process. This article also discusses the Dutch Association of Tax Advisers' (Nederlandse Orde van Belastingadviseurs) reaction to the proposal.

I. Current Treatment of Stock Option Plans

Under the Dutch Wage Withholding Tax Act 1964 (and the Dutch Personal Income Tax Act 2001 (Wet inkomstenbelasting 2001)), employees of a Dutch entity are in principle subject to Dutch wage taxes (and personal income taxation) for any wage (*loon*) or remuneration in connection with their employment relationships. That includes salaries, wages in kind, discounts, bonuses, and some remuneration through stock options. Stock option plans are generally structured as equity incentives giving the stock option holder (the employee) the right to purchase shares from the company (the employer or an affiliated company) later, usually against a fixed price or a discount.

Stock options are generally subject to Dutch wage taxes and social security contributions (if applicable) or personal income taxes (in box 1[1]) on

[1] Under the Dutch Personal Income Tax Act 2001, box 1 income is generally referred to as income from work and homeownership. Progressive rates up to 49.5 percent apply (2021 rates).

their exercise or sale.[2] The taxable amount is the difference between the fair market value of the shares on exercise or sale and the purchase or exercise price paid by the stock option holder.[3] The determination of the shares' FMV on exercise or sale is often subject to debate with the Dutch tax authorities, especially in the case of unlisted companies. After the exercise of the options, any results deriving from the shares would no longer qualify as wages or (box 1) income for tax purposes, and the shares will usually be taxed as box 3 income for Dutch personal income tax purposes.[4]

In 2018 a partial exemption of Dutch wage taxes was introduced to make the granting of stock options by "innovative" start-ups and scale-ups more attractive. Stock option holders that do not exercise more than €50,000 in stock options annually are allowed to claim only 75 percent of the FMV of the shares received on exercise in the tax year if (1) the employer has obtained a so-called research and development declaration from the Dutch government (S&O-verklaring); and (2) a minimum of 12 months and a maximum of five years have passed since the granting of the stock options.[5] However, that partial exemption did not have the envisaged effect, and only a few companies were able to use it.

The main problem with the current tax treatment of stock option plans is that at the moment Dutch wage taxes or personal income taxes are due, the stock option holder (or the company) does not always have sufficient liquidity to pay the tax claim — for example, as a result of some transfer restrictions (lock-up periods) that often apply to shares, or because the shares are unmarketable. As a result, the stock option holder is confronted with a tax claim and may thus not be able to exercise stock options at all. That has not made the Netherlands attractive for start-ups and scale-ups, and the Dutch government wants to solve that liquidity problem via the proposed rules.

II. Proposed Treatment of Stock Option Plans

The proposed rules as laid down in the consultation document provide that stock options would become taxable once the shares obtained on exercise or sale are tradable by the holder. The obtained shares are considered tradable as soon as any transfer restrictions have been lifted and the holder is able to sell them. It is not relevant whether the former stock option holder actually sells the obtained shares on receipt or shortly thereafter. By linking the taxable moment to the moment the shares become tradable, the former stock option holder would now have the possibility to have sufficient funds available to satisfy its tax liability.

The proposed rules provide that the taxable amount would need to be determined based on the difference between the FMV of the shares once becoming tradable and the purchase price or exercise price paid by the stock option holder. Given a potential increase in value over time, that may result in a higher taxable amount than under the current regime, also taking potential future tax rate increases into account. However, the proposed rules offer the stock option holder the possibility to (partially) opt for taxation on exercise, in which case taxation occurs in accordance with the current regime as described above.

The stock option holder should report his choice in writing to the company at the moment of exercise or sale of the stock options. If the holder has sufficient funds available, it may be beneficial to opt for the current regime if the shares' FMV is expected to be lower on exercise compared with the (future) moment the shares will become tradable. That option may, however, be complicated and burdensome for the company, which should administer and track its employees' choices.

It is also unclear how partially opting for taxation on exercise and partially opting for taxation on becoming tradable would practically work because the proposal does not set out how that should be administered by the company. In its comments, the Dutch Association of Tax Advisers asked the legislature to clarify that aspect.

[2] Dutch wage taxes are in principle to be withheld by the employer and are a pre-levy of Dutch personal income taxation. Some stock option holders that do not qualify as employees but are subject to Dutch personal income taxation would be taxed for income deriving from stock options through their personal income tax returns.

[3] *See* article 10a of the Dutch Wage Withholding Tax Act 1964.

[4] Under the Dutch Personal Income Tax Act 2001, box 3 income is income from savings and investments. A flat rate of 31 percent applies over a deemed return on investment (progressively determined).

[5] *See* article 10a, para. 9 of the Dutch Wage Withholding Tax Act 1964.

Immediate taxation on exercise or sale will still apply if the stock options do not have any contractual transfer restrictions and would thus be immediately tradable on exercise or sale. The tax treatment as described above will then apply.

The proposed rules further provide that for listed companies, transfer restrictions on shares are deemed to be lifted five years after the shares have been acquired or after the initial public offering. At that moment, the shares will be deemed tradable, and the contractual restrictions would no longer be respected for tax purposes. Thus, the taxable moment would automatically be triggered after five years. That would mean that the taxable amount is then determined based on the difference between the FMV of the shares at the moment of becoming (deemed) tradable and the purchase price or exercise price paid by the stock option holder. Given the pros and cons of using that proposed deferral of taxation, the process should be carefully done. As noted by the Dutch Association of Tax Advisers, it is unclear where the five-year period comes from (why not, for example, 10 years?), especially in view of the purpose of the proposal: If the contractual restrictions would still apply after five years, the stock option holder may still face a liquidity problem. In that case, it would be preferable to link the taxable moment to the moment the shares actually become tradable in all cases.

Further, the proposal provides that stock options and acquired shares from the exercise of stock options not yet eligible for sale are in principle transferred without Dutch wage tax being triggered in a stock-for-stock merger, a demerger, an acquisition of an entity, or an acquisition of more than 50 percent of an entity's shares. Say, for example, that in view of those transactions, options A will be converted into options B, and shares A will be converted into shares B. The new options B and shares B will then become subject to tax only if the acquired shares on exercise become eligible for sale (unless the employee has opted for application of the current regime).

The proposed legislation in principle applies to stock option plans only. Other types of equity incentives, such as restricted stock units, seem to be excluded.

It is unclear why the Dutch legislature has chosen a regime in which stock options become taxable once the shares become tradable. From the March country investigation report that inspired the proposal, several (maybe better) alternatives would have been possible — for example, a regime like the United Kingdom and United States have, in which shares may be taxed later (for example, on an exit) and treated as a portfolio investment instead of as regular income from employment.

III. Conclusion

The proposed rules are welcomed by Dutch start-ups and scale-ups because they create a more balanced regime to tax stock option plans. The proposal aligns the moment of taxation — to an extent — with the moment income is actually generated from stock options, and in many cases will work. However, liquidity problems may still exist when the shares become tradable but are not actually sold by the shareholder or have become deemed tradable under the five-year fiction for listed companies. It would also be good if the legislature could align the tax treatment of other types of equity incentives with the proposed rules for stock option plans. That said, the proposed rules are a good step toward a more attractive tax regime for stock option plans in the Netherlands. ■