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Employee Incentive Schemes

To succeed, an organization must attract and retain high-performing employees. Companies often therefore introduce employee incentive schemes which grant employees the right to participate in the success of the company's business.

Such employee incentive schemes can be structured in a variety of ways. However, employee incentive schemes are typically set up as **employee share plans/employee share option plans** or **phantom share plans/phantom share option plans.**

Employee Share (Option) Plans

In case of employee share (option) plans, the company (i.e. the employer) grants its employees actual shares in the company or options to buy such shares. The employee, therefore, has the chance to become a shareholder in the company at once, or later on when he/she exercises the options pursuant to the terms of the employee share option plan. As a shareholder, the employee receives dividend payments and may participate with voting rights in the general meetings of shareholders. Further, depending on the canton of residence and the time of any eventual sale of shares in the company, the employee may realize, to a certain extent, a tax-free capital gain on the shares acquired under the employee share (option) plan; which is not the case with phantom share (option) plans *(see below)*.

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Phantom Share (Option) Plans

In case of phantom share (option) plans, the company (i.e. the employer) does not grant a right to acquire actual shares in the company. Instead, the employee receives "virtual" or "phantom" shares, which only mirror the value of the actual shares, i.e. the increase in value of the actual shares. In other words, with virtual shares the employee receives the right to a cash/bonus payment. The amount of such bonus payment, however, depends on the value of the actual shares (i.e. on their increase in value). The pay-outs to the beneficiary (i.e. the employee) under phantom share (option) plans are usually triggered by a so-called "exit event". An exit event is most commonly defined as an initial public offering or a trade sale.

The beneficiary of a phantom share (option) plan is treated as a shareholder from an economic point of view, but never becomes formally a shareholder. Hence, phantom share (options) plans may help founders to keep the shareholder base small and manageable. From a tax perspective, it needs to be noted that the bonus payments made to an employee under a phantom share (option) plan always qualify in their entirety as salary payments and, as a consequence, are subject to income tax and social security contributions.

Vesting Scheme

Employee share (option) plans as well as phantom share (option) plans regularly contain so-called vesting clauses or vesting periods. Vesting periods are time intervals during which the employee has to earn his/her options, shares or bonus entitlements, e.g. by not terminating his/her employment contract. If the employee leaves the company or is terminated before the end of the applicable vesting period, he or she loses and/or has to give back – depending on the structure of the employee participation plan – some or all his/her shares, options, or virtual participation rights for no consideration or for a pre-defined consideration.

Conclusion

Employee incentive schemes are useful and effective tools to attract and motivate employees. Since companies have a great deal of leeway in designing such incentive plans, the plans may be tailored to the respective needs of each company. It is important always to keep taxes and social security contributions in mind, however, as the qualification of employee participations for tax and social contributions purposes may vary depending on the structure of the employee incentive scheme. For instance, companies regularly overlook the fact that participations (shares, virtual shares etc.) granted to an employee need to be stated on the employee's salary statement. The Company is, therefore, in case of employee share (option) plans, regularly well advised to obtain a tax ruling from the competent tax authorities.

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