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Q&A

Please provide a brief overview on how an ESOP in a start-up is usually structured in your jurisdiction (of particular interest: virtual or real participation programs, market practice with regard to vesting, participation (exits, proceeds and dividends) and voting rights).

In Switzerland, both employee stock option plans (ESOP), as well as phantom stock option plans (PSOP), are used. The board of directors enacts a plan and grants options to selected beneficiaries based on an option agreement to be agreed between the company and the beneficiaries. The plan defines the general conditions such as the group of beneficiaries, the granting of options, the vesting period, the exercise and termination of options, the restrictions as to transferability of options as well as taxation and social security contributions. In the option agreement, the individual number of options granted, the exercise price and the expiration date are determined. A frequently used vesting period is four years, where for example, 25% of the options vest after the cliff of one year and thereafter an additional 6.25% vest each quarter following the cliff.

For tax reasons, as described in more detail below, ESOP usually allow the employee an early exercise of all options granted combined with reverse vesting. Upon exercise of the option, the beneficiaries receive common shares and can vote at the shareholder meetings. The common shares also entitle the holder to a dividend. The acquisition of the shares usually requires the beneficiary to accede to the existing shareholders' agreement. If the beneficiary leaves the company prior to the end of the vesting period, the company is frequently entitled to repurchase the shares. The price for the repurchase distinguishes between bad and good leaver. For bad leaver, the purchase price is usually one Swiss franc in total for all shares or the nominal value of the shares. For a good leaver, the purchase price usually corresponds to the fair value for all vested shares and the exercise price (at least the nominal value) for the shares which have not yet vested but were already acquired due to the early exercise.

Phantom shares confer no voting rights. The structuring of property rights is fundamentally subject to contractual freedom. Under a PSOP, each virtual option typically leads to the virtual purchase of one common share upon the closing of an exit. An exit is frequently defined as either the transfer of more than 50% of the share capital or the voting rights, the transfer of all or substantially all of the company's assets or an IPO. Prior to an exit, beneficiaries of phantom shares usually do not receive any benefits.

Please provide an overview of the respective tax situation an employee finds him-/herself in when he/she participates in a real/virtual equity investment program (applicable taxes and approximate tax burden (a) at the time of the investment and (b) at the time when revenues therefrom are received).

The granting of options does not result in any taxes or social contributions in Switzerland. The real shares are taxed when the option is exercised. The assessment base for the tax corresponds to the difference between the market value of the shares and the exercise price for the shares. For real shares, the market value is often calculated based on a formula value to be agreed in advance with the tax authorities in a tax ruling [frequently (2x the capitalized earrings value + 1x the net asset value) : 3]. The taxation of virtual shares is due in the year the compensation is paid, i.e., typically at the closing of an exit. For virtual options, the employee does not have to pay the taxes and social contributions until he or she receives the benefit out of it.

Particularly attractive in Switzerland is the basic possibility of achieving a tax-free capital gain. Founders can benefit from a tax-free capital gain at any time and employees five years after they have exercised the options and acquired the real shares provided that the respective conditions are fulfilled. For this reason, employees are often given the opportunity to make an early exercise of the options granted to purchase the shares. This allows the employee that the five-year period ends earlier, and the shares are acquired when they are worth less and thus trigger lower taxation and social contributions. Before the expiration of the five-year period, a tax-free capital gain for employees, who are not founders, can only be achieved within the formula value. Such formula value must be agreed upon by the Cantonal Tax Authority at the seat of the company, and if different, at the employee's place of residence. It allows the company and the employee to precisely predict the applicable taxation and social security contributions. Within the formula value, a tax-free capital gain can be achieved, whereas a surplus is subject to income tax and social security contributions. A comparison between the Cantons can be useful because Cantons have different practices on how to treat founder and employee shares as well as different tax rates.

The tax burden depends strongly on the circumstances. In the case of real shares, there may be no taxes and social security contributions at all, namely if the shares are founder shares, if the shares are acquired at the formula value and sold at or below the formula value or if the sale takes place more than 5 years after the acquisition of the shares and certain conditions are fulfilled. In the case of employee shares where no tax-free capital gain is possible or in the case of phantom shares, the tax burden is often between 20% to 30%, depending on the residence Canton and income of the employee, plus 12.8% social security contributions.

Such tax and social contributions, if any, are calculated on the difference between the market value (or formula value) and the exercise price for the options.

Are there any tax advantages for an employee if the revenues based on the equity investment are reinvested in start-ups or other companies?

As a rule, capital gains on privately held shares of individuals are entirely tax exempt in Switzerland. Dividends, on the other hand, are subject to income tax. There are no special fiscal advantages for investing in start-ups or other companies, except for qualified participations. In general, taxation in Switzerland is moderate when compared to most other European countries.

Are there any tax advantages for the company if an ESOP is established in the company?

The company does not have to pay any taxes on an ESOP, only the employer's social security contributions when the options are exercised. In the case of a PSOP, the payments made by the company are a business-related expense and therefore reduce the taxable profit of the company. In both cases, normal rates apply to social security contributions.

Please highlight one pro and one con of the legal set up with regard to ESOPs in your jurisdiction.

A great pro is that founders and employees who hold real shares can realize a tax-free capital gain under certain conditions.

A con is that employees often must pay taxes and social security contributions when they acquire real shares although they have not made any money with these shares yet.