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By PwC Deutschland | 05. Januar 2011

No stock option expense before exercise

The Supreme Tax Court has held that a company incurred no expense in the issue of free-of-charge stock options to its staff.

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A company granted stock options to selected employees. The options were exercisable over a two year period after a waiting period of two years. Exercise was also conditional on a rise in the stock market price of the company's shares of at least 20% over the waiting period and on the employee's still being with the company at the time of exercise. The option price was to be 50% of the average market price of the shares. Thus, at the time of grant, exercise was uncertain, although if exercise did take place, there was bound to be a benefit for the new shareholder. The company took the estimated benefit to expense over the following two years, taking the credit to capital reserve. The tax office, and now the Supreme Tax Court, refused to allow tax recognition of the expense.

The court's main point was that the grant of the option was without cost to the company. The exercise of the option was to be satisfied with the issue of new shares at a substantial discount off the stock market price. There would therefore be a dilution in value of the existing shares. However, this dilution was too unspecific to be seen as a capital contribution by existing shareholders, and its cost could not be taken to capital reserve or otherwise recorded as an increase in capital. The court then added that this view did not change if one saw the option grant as employee motivation; even accepting the principle, the option holders were under no obligation to remain in the company's employ, or, for that matter, to work harder during or after the waiting period. Thus any share dilution had not let to the acquisition of an asset by the company. Lastly, the court made the point that any IFRS requirement for a different treatment was irrelevant, as taxable income was not based on IFRS accounting principles. This last point is noteworthy, as it is made here by the Supreme Tax Court for the first time. (AM)

Supreme Tax Court judgment I R 103/09 of August 25, 2010 published on December 1

Schlagwörter

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