



Malta

June 2007

*On 1 June 2007, Legal Notice 147 of 2007 introduced an amendment to the Fringe Benefit Rules in respect of the provisions dealing with share options. This was given some publicity in the press, among others because of the increasing popularity of the granting of such share options by employers as an innovative manner of employee compensation and as a manner in which employees can effectively share in the success of the business.*

*This Newsalert sets out some brief notes in respect of the amendment introduced by Legal Notice 147 of 2007.*

### Amendment to the Taxation of Share Options

In terms of the Fringe Benefit Rules, a fringe benefit may arise upon the exercise of a share option by an employee. Prior to the amendment, the Rules laid down that the fringe benefit value would amount to the excess of the market value of the shares at the time of exercise over the option price of the said shares.

The Rules laid down that tax was chargeable at the time of exercise of the option (i.e. not at the time of the grant of the option) and the chargeable income was ascertained on the basis of the following calculation:

Market value of the shares at time of option **less** option price paid by employee, if any.

The amendment reduces the amount chargeable to tax (the fringe benefit value) on an exercise of a share option to 42.85% of the excess of the market value of the shares at the time of exercise over the option price. For employees subject to the highest marginal income tax rate of 35%, this amendment results in an effective tax burden of 15% of the excess of the market value of the shares at the time of exercise over the option price of the said shares.

The amendment is effective as from year of assessment 2007 and should therefore first apply to share options exercised (or shares transferred under a share award) during the calendar year 2006.

By way of example to illustrate the tax treatment of share options after this amendment, an employee exercising an option to acquire 1,000 shares at Lm5 each at a time when the market value of such shares is Lm6.50 should generate a fringe benefit value of Lm642.75 [(Lm6.50 – Lm5.00) x 1,000 x 42.85%].

In the event that the employee is taxable at the highest marginal income tax rate of 35% the tax withheld by the employer from the employee's salary in terms of the Final Settlement System (FSS) Rules during the month of exercise should amount to Lm224.96 (Lm642.75 x 35%). This is effectively equal to approximately 15% of the excess of the market value of the shares at the time of exercise over the option price.

\* connectedthinking

# Amendment to the Taxation of Share Options

A practical issue arises in respect of any tax that was withheld by the employer under the FSS Rules during the year 2006. Such tax was withheld in terms of the FSS Rules on the basis of the fringe benefit rules as they stood at the time. Thus the effect of the new rule results in the previous fringe benefit value exceeding materially the fringe benefit as calculated under the new rules (i.e. under the 42.85%/ 15% rule).

In such cases, one would need to address the best way in which to claim the benefit of the amendment to the Fringe Benefits Rules for share options exercised in 2006. One possibility could involve doing this through the income tax return for year of assessment 2007, but one may need to address specific issues on a case-by-case basis.

We understand that in practice, the Inland Revenue Department may in some cases have agreed with some employers the value of the adjustments to be effected and thus an employee may have already received a tax statement reflecting an amended fringe benefit value for the share options (or share awards). Employees should confirm with their employers whether or not an adjustment is required through the submission of an income tax return.

Other fringe benefit rules in respect of share options have not changed. Thus for instance the fringe benefit continues to arise at the time when the option is exercised and the cost of acquisition for the purposes of calculating the capital gain on a subsequent transfer of shares acquired through a share option (or share award) is the market value of the shares on the date the share option was exercised.

The notes are designed to keep readers abreast with financial and tax developments. They are not intended to be a definitive or comprehensive analysis of the subject and should not be acted upon without prior consultation with the Partners or Senior Consultants of the firm. For further details please do not hesitate to contact:



167, Merchants Street, Valletta VLT 1174, Malta  
Tel: +356 21 247 000 Fax: +356 21 244 768

[www.pwc.com/mt](http://www.pwc.com/mt)