



Tax treatment for stock options in Mexico

Rolando Díaz and Tania Salinas. July 2022.



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Speakers



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Agenda

- Compensation concept
- Stock Options Definition and classification
- Advantages for the employers
- Tax effect on employer & employees
- Other considerations



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Compensation

Compensation

Compensation refers to monetary payment given to an individual in exchange for their services.

It consists in:

- Wages.
- Short term incentive (STI).
- Long term incentive (LTI).
- Benefits.





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Long Term Incentive (LTI)



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LTI's objective

- To create milestone-based enticements
- To involve the employees in the value creation for the company.
- To encourage employees to stay in the company.



LTI payments

- Stock options.
- Purchase of shares at a reduced value.
- Obtaining shares for free.
- Compensation deferral.





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Stock options: definition and clasification.

Types of shares

1

Stock options.

2

Restricted Stock Units (RSU's).

3

Stock appreciation rights (SAR's).

4

Phantom stock.

5

Matching shares.

Basic concepts in shares plans





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Advantages for the
employers.

Advantages for companies

- Improves the remuneration conditions of the staff.
- Establishes an incentive aligned with the interests of the entity and the shareholders.
- Employees act like owners.
- Talented employees are retained.
- The employee obtains a greater benefit when the market value of the shares increases.





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Tax effects on employees and employers

Employees

Income tax law, article 94



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Salaries and other compensation deriving from a labor relationship [...] are deemed revenues from the rendering of subordinated personal services. The following revenues are assimilated to the foregoing for purposes of this tax:

VII. Revenues of individuals exercising the option granted by the employer or by a party in a relationship with the employer, to acquire (including through subscription) shares or negotiable instruments representing assets, at no cost or at a price lesser than or equal to the market value of such shares or negotiable instruments on the occasion of exercise of the option, regardless of whether such shares or negotiable instruments have been issued by the employer or by a party in a relationship with the employer.





Cumulative income:

Price established when the option is granted.

Market value of the shares (at the moment of exercising the option)

Employees

Income tax law, article 94:



Employees

Regulations of the Income
tax law, article 170



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The amount of the premium paid for holding the option to purchase shares or securities that represent assets may be reduced from the cumulative income referred to in said precepts received by the taxpayer. The amount of the premium may be updated for the period from the month in which it was paid and until the month in which the option is exercised.

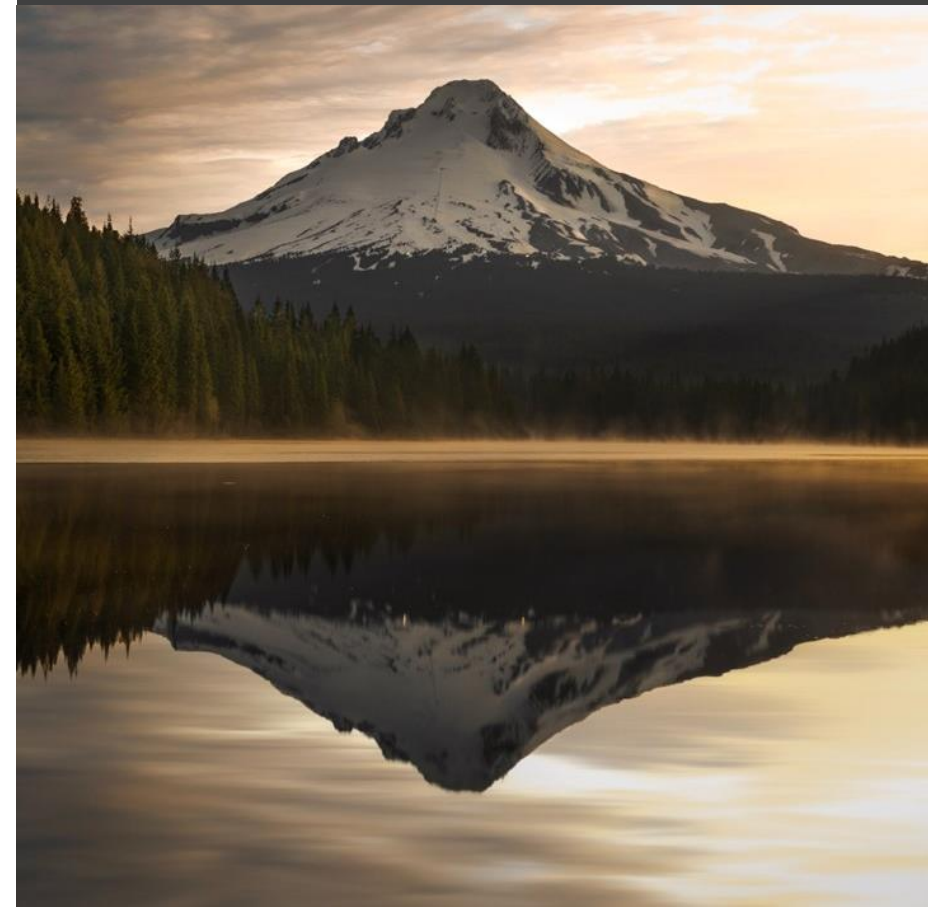


Income taxed in other country. Avoid double taxation.

Persons residing in Mexico may apply such Income Tax as they have paid abroad on revenues proceeding from sources located abroad, as credit to the tax payable by them hereunder, provided, that such revenues be of the nature on which there is obligation to pay tax hereunder. The application as credit referred to in this paragraph shall only be in order when Income Tax paid abroad is included in the revenue obtained or earned and accrued as taxable

Incomed Taxed

Income tax law, Article 5.



Employers: payment abroad with charge to Mexico



The employer that grants the option to purchase shares at a price lower than the market price, will have the following tax obligations:

- Determine, withhold and pay the corresponding income tax for the exercise of the option to the worker.
- Issue the corresponding Digital Tax Receipt by Internet (CFDI).
- Submit the "Notice to provide information on persons who chose to acquire shares or securities, at no cost or at a price less than or equal to the market price" (51/ISR), no later than February 15 of the following year .
- To pay local taxes on payroll up to 3%
- To pay social security fee on the amount of shares.



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Employers. Deducibility.

- Strictly indispensable.
- Registered in accounting.
- Withhold and pay the tax by third parties.



Employers. Recommendations.

Employers: payment abroad with charge to Mexico.

- To have a secondment agreement between the foreign company and the Mexican subsidiary.
- Have an inventory of the personnel who participate in the share plan.
- The invoices through which the foreign company intends to recover the amount of the benefit received by the employee.

Employers: payment abroad with no charge to Mexico.

- Salary received from abroad.
- The tax payment must be made no later than the 17th of the following month.
- Employee responsibility.



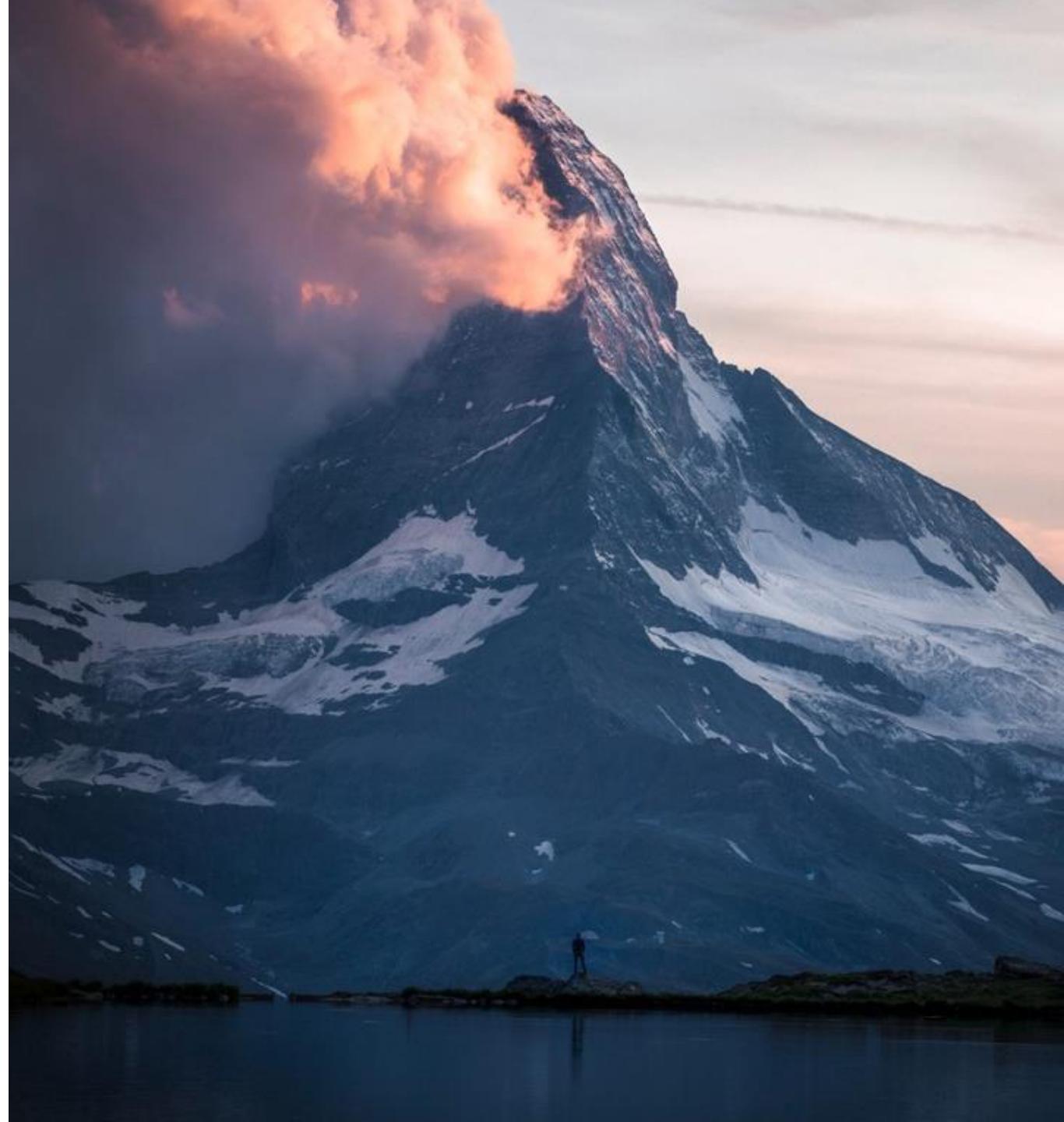
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Other considerations



Sell to cover.

In some cases, the executives does not have sufficient funds to cover the total cost of the actions exercised, as well as the tax that is generated; in these situations, the employee may sell some shares to obtain the funds and cover the total amount of the option exercised.



Tax implication at sale.

Consider:

- Updated purchase cost.
- Time owned the shares.
- Sale price.



Tax
loss

May be decreased from other income except salaries and bussiness activities.

Tax
profit



35%





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Other considerations

1. Gather all the support information of the transaction.
2. Confirm which entity is paying for the LTI, and who is responsible for paying the taxes (employee or employer). If the company will cover the tax payment, do not forget to grossed up the income amount.

Other considerations.

3. Confirm the tax residency of the employee at the moment of the exercise of the option.
4. Confirm if the tax payment must be made through payroll withholding or a monthly tax return.





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Let's talk!

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