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Whitepaper – January 2021

Salary bonus: Cash or shares?

Many employers have an employee share ownership plan in place and let their employees decide whether they would like to get their annual bonus as cash or employee shares. Those share ownership plans can be quite different from each other, mostly though they set beneficial conditions to purchase or receive company shares. Companies use this method to bind their employees on a long-term basis. Even though the bonus options seem to be fairly straight forward on a first glimpse, many employees struggle taking a reasoned decision. You should consider the following aspects when taking your own decision.

Personality

Investing in shares has nothing to do with a game of luck. Nevertheless, many people feel uncomfortable thinking of share price fluctuation and therefore preferring cash as the less volatile option of saving. You should feel comfortable with your decision, trust your own gut feeling. You should not be persuaded by your friends and coworkers to any option you have, instead you should take your very own decision. Your friends and colleagues may have totally different reasons to take their decisions, which are not applicable to your personal situation.

Sort of share participation

In order to be able to take a well-founded decision, you truly need to understand the type of share participation you are offered. The most commonly used kind of participation offered by employers are company shares where you are a stakeholder in the company's equity. Nevertheless, employers also offer other sorts of participation option such as options or even artificial shares (e.g. "Restricted Stock Units"; "phantom shares"; "Stock Appreciation Rights SAR" etc.). If you are not entirely sure what kind of participation options you are offered, please ask your employer of financial advisor for more details and clarification.

All the mentioned kinds of participations fundamentally differ in terms of taxation practice, cashflow, tax benefits, evaluation and handling. **This whitepaper explicitly deals only with regular company shares.**

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Cashflow issue

If you are currently subject to taxation at source (taxes are deducted from your monthly salary by your employer), the decision to take your bonus as company shares can lead to a significant cashflow issue. The value of shares acquired is subject to income tax although the value does not relate to a cash income. As a result, a cash amount is deducted to pay taxes from a non-cash income. If this cash drain cannot be compensated with other cash salary, for instance your regular monthly salary, it might even be possible you owe cash to your employer for that month. The following practical examples demonstrate this cashflow issue. For simplification, further salary deductions such as social security payments will not be taken into consideration.

	Example 1	Example 2	Example 3
Monthly salary (cash)	10’000	10’000	10’000
Bonus (Value of shares)	10’000	30’000	50’000
Taxable income	20’000	40’000	60’000
./. Taxes	- 4'000 (20%)	- 10'000 (25%)	- 18'000 (30%)
Net salary	16’000	30’000	42’000
Cash paid out to you	**6’000**	**0**	**- 8’000**

If you are not (or no longer) subject to taxation at source, this cashflow issue will not be applicable to your situation. Nonetheless you need to be aware of the share value being subject to regular income tax. As these employee shares are mostly blocked for a defined period, no shares can be sold to cover the additional tax liability and you have to rely on cash savings to pay those taxes.

Tax benefit

Employee shares are mostly subject to a pre-defined blocking period. During this “vesting period”, these shares cannot be sold. As a result, they are in any case subject to share price fluctuation during the blocking period. That is why tax law sets certain tax benefits for blocked employee shares acquired. The taxable income is based on the share value, however being discounted by 6% for each blocking year. If the obtained shares are blocked for 5 years, the discounted share value equals 74.726% (1 / 1.06^5).

If you are receiving shares with a current value of CHF 20’000, being blocked for 5 years, the discounted taxable income equals CHF 14’945 (CHF 20’000 x 74.726%). In this calculation, you get a **tax-free income of CHF 5’055.**

But: what happens if you leave the company after 3 years? At this stage, your shares would still be blocked for another 2 years. Normally, blocked shares are automatically deblocked in case you leave the company. The initial discount you received for 5 blocking years is now

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proportionally re-calculated and added as taxable income for the remaining 2 blocking years. In the above-mentioned example, an amount of CHF 1’847 would be added up as taxable income as the shares have not been blocked for only 3 years instead of 5. In case of leaving the company, it is always recommended to pro-actively clarify the handling of blocked shares with the employer.

Share price development

The decision to obtain company shares as your annual bonus is also a decision to actively invest in your employer’s business. That said, you should think about the potential share price development. An expected share price increase promotes the option of obtaining company shares. A negative share price forecast would rather favor the option of getting a cash bonus and invest alternatively.

Please consider you will not be able to sell your shares during the blocking period. The longer the vesting period, the less reliable the predictions from financial institutions are. Long-term investments should also consider industrial development, social and geopolitical trends as well as the company’s position in the market.

Summary

Acquiring employee shares without a doubt has numerous benefits, though you should be aware of potential cashflow issues. If you struggle taking a decision, please consult your employer or professional financial advisor. Your personal preferences as well as your personal and financial background should be considered to find the appropriate option for you.

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