

# Chapter 3.3: Stock-Based Compensation Election

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## Learning Objective

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After completing this chapter, you will be able to evaluate whether the stock-based compensation election is beneficial for each jurisdiction and apply the election mechanics correctly, including recapture provisions.

### 1. The Stock-Based Compensation Problem

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Stock-based compensation (SBC) creates a significant book-to-tax difference that can distort the GloBE ETR calculation.

#### Why SBC Creates a Problem

Treatment	Basis	Timing
<b>Accounting (IFRS 2)</b>	Fair value at grant date	Expensed over vesting period
<b>Tax (many jurisdictions)</b>	Market value at exercise/vesting	Deducted at exercise/vesting

**Result:** If share price increases between grant and exercise, the tax deduction exceeds the accounting expense. This difference is **permanent**—it will never reverse.

## Impact on GloBE ETR

Without intervention:

$$\text{GloBE Income} = \text{Financial Accounting Net Income} + \text{Tax Expense} - \text{Other AdJUSTments}$$

If accounting SBC expense is lower than tax deduction:

- GloBE Income is higher (smaller expense deducted)
- Covered Taxes reflect actual tax paid (based on larger deduction)
- ETR = Covered Taxes ÷ GloBE Income = artificially LOW

**Risk:** A jurisdiction could become "low-taxed" purely due to SBC timing differences, triggering Top-Up Tax.

## The Article 3.2.2 Election

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### What the Election Does

The election allows an MNE to **substitute** the tax-deductible amount of SBC for the accounting expense when calculating GloBE Income (*Article 3.2.2*).

Approach	GloBE Income Impact
<b>Default (no election)</b>	Use accounting expense (IFRS 2)
<b>With election</b>	Use tax deduction amount

### Effect of the Election

Default:

GloBE Income uses  
lower accounting expense



Higher GloBE Income



With Election:

GloBE Income uses  
higher tax deduction



Lower GloBE Income





**Key insight:** When tax deduction exceeds accounting expense, the election typically **decreases** GloBE Income (larger deduction reduces net income), which **increases** ETR and **reduces** Top-Up Tax risk.

## Election Mechanics

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### Scope

The election applies to compensation paid in the form of: - Shares/stock - Stock options - Stock warrants - Equivalent instruments

### Jurisdictional Application

Feature	Requirement
<b>Level</b>	Per jurisdiction
<b>Coverage</b>	All Constituent Entities in that jurisdiction
<b>Consistency</b>	Must apply to <b>all</b> SBC in the jurisdiction

### Five-Year Election

Characteristic	Detail
<b>Duration</b>	Remains in force for minimum 5 years
<b>Automatic continuation</b>	Continues indefinitely until revoked
<b>Early revocation</b>	Not permitted within first 5 years

Characteristic	Detail
Re-election after revocation	Not permitted within 5 years of revocation

## Tracing Requirement

Only **one** Constituent Entity may deduct SBC in excess of the financial accounting amount, and only if that CE is allowed a tax deduction for such SBC under local tax law.

**Example:** If UK parent grants options to employees of German subsidiary: - Germany must have a local tax deduction for the SBC - Only the German CE can claim the excess deduction for GloBE purposes

## Timing Scenarios

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### Scenario 1: Share Price Increases (Most Common)

**Facts:** - Options granted when share price = €10 - Options exercised when share price = €18 - 100,000 options

Item	Accounting	Tax
Per-option expense/ deduction	€3 (Black-Scholes at grant)	€18 (market value at exercise)
Total	€300,000	€1,800,000

**Without election:** - GloBE Income deduction: €300,000 - Tax deduction: €1,800,000 - Covered Taxes reflect €1,800,000 deduction - **Result:** ETR depressed

**With election:** - GloBE Income deduction: €1,800,000 - Tax deduction: €1,800,000 - **Result:** Aligned; ETR not distorted

## Scenario 2: Share Price Decreases (Shortfall)

**Facts:** - Options granted when share price = €20 - Options exercised when share price = €12 - 100,000 options

Item	Accounting	Tax
Per-option expense/ deduction	€5 (Black-Scholes at grant)	€12 (market value at exercise)
Total	€500,000	€1,200,000

**Analysis:** Even with share price decline, the tax deduction (€1.2M) exceeds accounting expense (€500K) in this example because the Black-Scholes value was lower than intrinsic value at exercise.

**Note:** In some cases where accounting expense exceeds tax deduction, the election would **reduce** GloBE Income, potentially **lowering** ETR. This requires careful analysis.

## Scenario 3: Options Expire Unexercised

**Facts:** - Options granted: accounting expense €400,000 - Election made: tax deduction of €0 taken each year (no exercise yet) - Options expire unexercised in Year 5

**With election in place:** - Years 1-4: No tax deduction, so €0 deducted from GloBE Income - Year 5: Options expire → Must **add back** €400,000 to GloBE Income

**Recapture rule:** If options expire without exercise, the total amount previously deducted under the election must be included in GloBE Income for the fiscal year of expiry (*Article 3.2.2*).

# Mid-Stream Election Adjustment

## The Problem

If an MNE makes the SBC election **after** some accounting expense has already been recorded in GloBE Income, an adjustment is required to prevent double-counting.

## The Rule

When making the election mid-stream, include in GloBE Income:

Adjustment = Cumulative accounting expense already deducted  
- Cumulative amount that would have been deducted under elec

## Worked Example

**Facts:** - SBC program started Year 1 - Election made in Year 3 - Vesting period: 4 years

Year	Accounting Expense	Tax Deduction	Already in GloBE Income
1	€250,000	€0	€250,000
2	€250,000	€0	€250,000
3	€250,000	€0	— (election year)
4	€250,000	€1,500,000	—

**Year 3 adjustment (election year):**

Cumulative accounting expense (Years 1-2): €500,000  
Cumulative tax deduction (Years 1-2): €0  
Adjustment to add to Year 3 GloBE Income: €500,000

**Effect:** The €500,000 previously deducted is added back; from Year 3 onwards, only tax deductions are used.

## Revocation of the Election

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### When Revocation Applies

An MNE may revoke the election after 5 years if circumstances change (e.g., SBC programmes discontinued, jurisdiction becomes high-tax).

### Revocation Adjustment

On revocation, include in GloBE Income:

Adjustment = Amount deducted under election

- Financial accounting expense accrued

(for SBC where final tax deduction has not yet been determined)

### What Revocation Does NOT Affect

- Options already exercised (deduction finalised)
- Prior year GloBE Income calculations

### Worked Example

**Facts:** - Election revoked in Year 8 - Outstanding unvested options with: -

Cumulative deduction under election: €0 (no exercise yet) - Cumulative accounting expense: €600,000

#### Revocation adjustment:

Amount deducted under election: €0

Less: Accounting expense accrued: €600,000

Adjustment: (€600,000)

**Effect:** Reduce GloBE Income by €600,000 in revocation year (effectively reverting to accounting treatment).

## Deferred Tax Implications

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### GloBE Carrying Value Requirement

When the SBC election is made, deferred tax must be recalculated based on **GloBE carrying values**, not financial accounting values (*Administrative Guidance, July 2023*).

### What This Means

Without Election	With Election
DTA based on accounting expense	DTA based on expected tax deduction
Standard IFRS 2 / IAS 12 treatment	Recalculated for GloBE purposes

### Practical Impact

The deferred tax adjustment amount in Adjusted Covered Taxes must align with the SBC treatment in GloBE Income. This ensures consistency between numerator (Covered Taxes) and denominator (GloBE Income).

## Decision Framework: Should You Elect?

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### Step 1: Identify Jurisdictions with Material SBC

Question	If Yes
Does the jurisdiction have significant SBC programmes?	Continue to Step 2
Is SBC immaterial in this jurisdiction?	No election needed

## Step 2: Determine Local Tax Treatment

Question	If Yes
Does local tax law allow SBC deduction at exercise/vesting?	Continue to Step 3
Is SBC not deductible for local tax?	Election provides no benefit

## Step 3: Assess ETR Position

Jurisdiction ETR	Recommendation
<b>Well above 15%</b> (e.g., 25%+)	Election likely not needed; jurisdiction is high-tax regardless
<b>Near 15%</b> (e.g., 13-17%)	<b>Analyse carefully;</b> election may prevent Top-Up Tax
<b>Well below 15%</b> (e.g., <10%)	Election may help but won't eliminate Top-Up Tax entirely

## Step 4: Project Share Price Movement

Expected Movement	Impact
Share price likely to <b>increase</b> significantly	Election beneficial (larger tax deduction)
Share price stable or declining	Election may have neutral or mixed impact
High employee turnover / forfeitures expected	Consider recapture risk

## Step 5: Evaluate Administrative Burden

Consideration	Impact
Need to track tax deductions separately	Increased compliance cost
Multiple SBC programmes	Complex tracking
Options may expire unexercised	Recapture risk

## Decision Matrix

ETR Position	Share Price Trend	Recommendation
Near 15%	Rising	<b>Strongly consider election</b>
Near 15%	Stable/Falling	Analyse case-by-case
Well above 15%	Any	Election likely unnecessary
Well below 15%	Rising	Election helpful but insufficient alone
Any	High forfeiture risk	<b>Caution:</b> recapture exposure

## Stratos Worked Example

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### Background

Stratos Group plc has a global equity incentive programme granting stock options to employees. The tax team must evaluate the SBC election for each jurisdiction.

### Jurisdiction Analysis

#### Singapore (ETR: 12.5%)

Item	Value
SBC accounting expense (FY 2025)	€850,000
SBC tax deduction (FY 2025)	€620,000
Share price trend	Declining

**Analysis:** - Tax deduction < Accounting expense - Election would **increase** GloBE Income (using smaller €620K deduction instead of €850K) - Higher GloBE Income → Lower ETR → **Worse** outcome

**Recommendation:** Do NOT elect for Singapore

#### Germany (ETR: 28%)

Item	Value
SBC accounting expense (FY 2025)	€1,200,000
SBC tax deduction (FY 2025)	€1,850,000
Share price trend	Rising

**Analysis:** - Tax deduction > Accounting expense - Election would increase GloBE Income (€1.85M vs €1.2M) - Higher GloBE Income → Minimal ETR impact (already high-tax)

**Recommendation:** Election is **neutral**; may elect for consistency or skip

#### Ireland (ETR: 12.5% before QDMTT)

Item	Value
SBC accounting expense (FY 2025)	€450,000
SBC tax deduction (FY 2025)	€720,000

Item	Value
Share price trend	Rising
QDMTT status	Ireland has QDMTT

**Analysis:** - Tax deduction > Accounting expense - Election would increase GloBE Income - However, Ireland's QDMTT already collects Top-Up Tax domestically

**Recommendation:** Election is **neutral** given QDMTT; consider for future planning

### United Kingdom (ETR: 24%)

Item	Value
SBC accounting expense (FY 2025)	€2,400,000
SBC tax deduction (FY 2025)	€3,100,000
Share price trend	Rising

**Analysis:** - UK is high-tax jurisdiction - Election increases GloBE Income but ETR remains above 15%

**Recommendation:** Election is **optional**; may elect for consistency across group

### Stratos SBC Election Summary

Jurisdiction	ETR	Elect?	Rationale
Singapore	12.5%	No	Tax deduction < accounting; election worsens ETR
Germany	28%	Optional	High-tax; minimal impact
Ireland	12.5%	Optional	QDMTT applies

Jurisdiction	ETR	Elect?	Rationale
UK	24%	Optional	High-tax; minimal impact

## 7. Common Pitfalls

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### Pitfall 1: Assuming Election Always Helps

**Error:** Making the election in all jurisdictions without analysis.

**Problem:** If tax deduction < accounting expense, the election **lowers** GloBE Income, reducing ETR and potentially triggering Top-Up Tax.

### Pitfall 2: Forgetting the Recapture Rule

**Error:** Not tracking options that may expire unexercised.

**Problem:** Full recapture to GloBE Income in expiry year can cause unexpected ETR volatility.

### Pitfall 3: Missing the 5-Year Lock-In

**Error:** Planning to revoke the election after 2 years when circumstances change.

**Problem:** Revocation is not permitted within the first 5 years.

### Pitfall 4: Inconsistent Application Within Jurisdiction

**Error:** Applying election to some SBC programmes but not others in the same jurisdiction.

**Problem:** Election must apply to **all** SBC in the jurisdiction.

### Pitfall 5: Ignoring Deferred Tax Recalculation

**Error:** Using standard accounting deferred tax figures when election is made.

**Problem:** Deferred tax must be recalculated using GloBE carrying values.

## Documentation Requirements

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When making or analysing the SBC election, document:

Item	Purpose
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