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Luxembourg introduces new stock option tax rules and an innovative start-up incentive regime

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On 1 July 2026, the Luxembourg Government submitted a draft law to Parliament with the aim of strengthening the attractiveness of Luxembourg's innovation ecosystem by introducing a dedicated tax regime for employee stock options granted by innovative start-ups (the "**Draft Law**"). The reform is intended to help young innovative companies attract and retain highly qualified employees by allowing them to participate in future value creation under a tax framework that is both competitive and legally certain.

At the same time, the Draft Law clarifies and codifies the tax treatment applicable to stock option plans under the ordinary rules. This codification addresses a number of long-standing uncertainties resulting from the withdrawal, in December 2020, of the administrative Circular L.I.R. n°104/2 dated 29 November 2017 (the "**2017 Circular**") and the absence of an explicit statutory framework thereafter.

The proposed rules are expected to apply to options granted as from tax year 2027.

This Alert outlines the main takeaways from the proposed stock option reform.

At a Glance

- A **new preferential stock option** regime is proposed for qualifying **innovative start-ups,** meeting specific innovation, size and age criteria.
- Under this regime, taxation would generally be **deferred until the employee disposes of the shares acquired** through the stock option plan.
- The gain realised upon disposal would qualify as **extraordinary income** and benefit from taxation at one **quarter of the employee's marginal tax rate**.
- The Draft Law also introduces a **clear statutory framework** for the taxation of **stock options under the ordinary regime**.
- Subject to parliamentary approval, the new rules are expected to apply to stock options **granted as from tax year 2027**.
- **Virtual options** and **phantom stock** plans would remain **excluded** from the stock option regimes.

Stock option regime for innovative start-ups

SPECIAL TAX REGIME

The Draft Law introduces a new tax regime applicable to stock option plans established by qualifying innovative start-ups.

The key feature of the regime is a deferral of taxation until the disposal of the shares acquired through the stock option plan. In addition, the benefit in kind arising upon exercise of the options is deemed to be EUR 0, thereby avoiding any upfront taxation before liquidity is realised. Unlike the ordinary regime, neither the grant of the options nor their exercise would trigger a taxable benefit. Instead, taxation occurs only when the employee ultimately sells the shares.

The taxable income corresponds to the difference between:

- the sale price of the shares; and
- the amount paid by the employee to acquire those shares (i.e. the option exercise price).
  - The amount paid by the employee to acquire the shares corresponds to the option exercise price specified in the option plan. This is the price the employee pays when exercising the options to obtain the shares. The Draft Law does not impose any rules on how the exercise price must be determined. The Draft Law does not prescribe a minimum exercise price. Accordingly, the exercise price may, in principle, be fixed at EUR 0, provided it is clearly specified in the relevant stock option plan.

Accordingly, no assessment of the estimated market value of the shares is required, unlike in a regime where taxation is triggered upon the exercise of the options.

This gain would qualify as extraordinary income and would benefit from taxation at **one quarter of the employee's marginal tax rate**, resulting in an effective tax rate of roughly 11.45% maximum, which is a significantly more favourable treatment than ordinary employment income.

CONDITIONS TO BENEFIT FROM THE REGIME

Conditions relating to the employer

To qualify, the employer must constitute a young innovative collective entity which meets several cumulative requirements:

- it must be either a fully taxable resident of Luxembourg or a resident of another EEA Member State that is subject to a tax equivalent to Luxembourg corporate income tax and operates through a permanent establishment in Luxembourg
- it must have been incorporated for less than ten years;
- the entity must have fewer than 150 employees; and
- its annual turnover or total balance sheet must not exceed EUR 30 million.

If the employing entity belongs to a group, compliance with the three criteria must be determined on a group-wide basis.

An activity is regarded as innovative where:

- at least two full-time equivalent employees work for the company; and
- research and development expenses represent at least 15% of operating expenses during at least one of the preceding three financial years. The 15% threshold must be certified by a qualified auditor or accountant.

Except when options are granted during the first financial year of the entity, these conditions must be met at the end of the financial year immediately preceding the one during which the options are granted. Importantly, eligibility for the favourable start-up regime is assessed at the time of grant, i.e. the date on which the options are formally awarded to the employee, as evidenced by the relevant contractual or corporate documentation.

This date is distinct from the **vesting date**, when the options become exercisable following the satisfaction of specific conditions, such as continued employment. Consequently, options granted while the company satisfies the above mentioned conditions may continue to benefit from the regime even if the options vest or are exercised several years later, after the company has ceased to meet those conditions.

Conditions relating to the employee and the plan

The regime is available only if:

- the options are non-transferable and non-listed;
- the options grant employees the right, subject to certain conditions, to subscribe for or acquire equity interests in the employing entity or in another entity belonging to the group of which the employing entity forms part. Most notably, this excludes so-called virtual options or phantom stock plans from the stock option regime because they do not provide a right to acquire actual equity interests.
  - "Equity interests" include shares, other equity interests, profit-sharing certificates, and other forms of equity participation issued by the employer or an affiliated company.
- the employee receives employment income from the qualifying employer;
- the employee did not hold, directly or indirectly, more than 25% of the capital, voting rights or profit rights of the company (or its group) at grant date or at any time during the preceding 24 months; and
- the options are not granted as a substitute for existing remuneration. This anti-abuse provision provides that this requirement will be regarded as fulfilled where an employee receiving stock options continues to receive annual remuneration, inclusive of all salary components and benefits, that is at least equal to the remuneration received in the year preceding the grant of the options.

Excluded businesses

The regime does not apply to certain sectors or entities, including:

- law firms;
- audit and accounting firms;
- real estate businesses;
- SICARs;
- listed companies; and
- entities created through certain merger or demerger transactions.

Compliance requirements

The employer must formally elect into the regime and submit certain information electronically to the tax authorities before 1 March of the year following the **grant** of the options. The employer may elect the application of this regime on an option plan-by-option plan basis, and any such election applies to the relevant option plan in its entirety.

Failure to comply with the reporting obligations results in the loss of the special regime.

Furthermore, the employer must keep available for the competent payroll tax office (RTS office) all supporting documentation demonstrating that the conditions for applying the regime are satisfied.

COMMENTS:

This Draft Law represents one of the most significant developments in Luxembourg's employee participation framework in recent years. The newly proposed start-up regime follows a growing European trend aimed at encouraging entrepreneurship and facilitating access to talent for high-growth companies.

The most attractive feature is undoubtedly the combination of:

- taxation only upon a liquidity event; and
- taxation at a reduced rate equal to one quarter of the marginal tax rate.

For start-ups and scale-ups that cannot yet compete with large corporate employers on salary levels, the proposal could become a powerful tool for attracting and retaining key employees. At the same time, the numerous eligibility and reporting requirements should ensure that the measure remains targeted at genuinely innovative businesses.

Ordinary regime for other stock option plans

Overview of the regime

The Draft Law also codifies the general tax treatment applicable to stock options granted by companies that do not qualify for, or do not opt into, the start-up regime. As a result, the Draft Law transposes, in substance, most of the 2017 Circular principles, with the exception, however, of the aspects relating to the flat-rate valuation of benefits in kind for freely transferable options, which have been abolished further to the withdrawal of the 2017 Circular in 2020 and which have not been reintroduced by the Draft Law.

The general regime applies more broadly than the special regime provided for start-ups. It applies to options granted by any employer or affiliated company, regardless of size or date of incorporation. Options may be freely negotiable (listed or freely transferable) or non-freely negotiable (not listed and not freely transferable).

Under this ordinary regime, stock options remain taxable as employment income through the recognition of a taxable benefit in kind.

Conditions and special features

To qualify under the ordinary regime, the options must be granted by the employer or a related company.

As under the specific stock option regime for innovative start-ups, options grant employees the right, subject to certain conditions, to subscribe for or acquire equity interests in the employing entity or in another entity belonging to the group of which the employing entity forms part. Virtual or phantom stock plans are thus excluded from the stock option regime.

The regime applies only where the beneficiary is an employee receiving employment income from the employer. In addition, stock options may not be granted as a substitute for existing remuneration.

Timing of taxation

The timing of taxation depends on the nature of the options:

Freely transferable options

For listed or otherwise freely transferable options, taxation occurs at the grant date. The taxable benefit corresponds to the difference between:

- the market value (or fair market value) of the option; and

- the amount paid by the employee for the option.

Subsequent gains realised upon disposal of the options or shares remain subject to the ordinary Luxembourg rules applicable to capital gains and speculative transactions.

The employer must submit certain information electronically to the tax authorities before 1 March of the year following the **grant** of the options.

Non-freely transferable options

For non-transferable options, taxation occurs at the exercise date. The taxable benefit is equal to the difference between:

- the market value (or estimated fair value) of the underlying shares at exercise; and
- the exercise price paid by the employee.

Except when the employer opts to apply the innovative start-up regime, the employer must submit certain information electronically to the tax authorities before 1 March of the year following the **exercise** of the options.

VALUATION

For non-listed options, the fair market value must be determined using a recognised valuation methodology, such as the Black-Scholes model or another comparable financial valuation method. The valuation may be performed either by the issuing company or by an independent expert. Importantly, the draft law confirms that no flat-rate valuation of the taxable benefit is permitted, meaning that a case-by-case valuation is required.

Where acquired shares are subject to a lock-up period, a valuation discount of 5% per year of restriction, capped at 20%, may apply when calculating the taxable benefit, provided the employer fulfils the relevant reporting obligations.

SUBSEQUENT DISPOSAL OF OPTIONS OR SHARES

Subsequent gains realised upon disposal of the options or shares remain subject to the ordinary Luxembourg rules applicable to capital gains and speculative transactions.

For the purpose of calculating any taxable capital gain on the subsequent disposal of the shares or options, the amount previously taxed as a benefit in kind, as described above, is added to the acquisition cost of the shares/options. This prevents the same economic benefit from being taxed twice, as the value already subject to employment income taxation increases the employee's tax basis in the shares (or options).

COMMENTS

Beyond the introduction of a favourable regime for innovative start-ups, the Draft Law is noteworthy because it finally introduces a clear legal framework for the Luxembourg tax treatment of employee stock options. Until now, much of the practical framework governing stock option plans derived from administrative guidance rather than explicit legislative provisions. Following the withdrawal of the 2017 Circular in 2020, taxpayers and employers were left to rely principally on general tax law principles and administrative practice. The new provisions therefore aim at enhancing legal certainty by codifying the principal rules directly in the law.

In particular, the Draft Law expressly confirms:

- the distinction between freely transferable options and non-freely transferable options;
- the taxation timing applicable to each category (grant versus exercise date);
- the methodology for determining the taxable benefit in kind;
- the availability of a discount for lock-up periods; and

- the reporting obligations applicable to employers.

The reform also resolves certain areas that were subject to discussion until now. Most notably, the Draft Law expressly excludes so-called **virtual options** or **phantom stock plans** from the stock option regime. Such arrangements are treated as cash remuneration rather than rights to acquire actual shares and therefore remain taxable under the ordinary employment income rules when paid. This clarification eliminates any residual uncertainty regarding the qualification of these instruments.

Furthermore, the Draft Law confirms that no favourable lump-sum valuation mechanism is available, and that non-listed options or shares must be valued using recognised valuation methodologies. This reflects the position generally adopted by the Luxembourg tax authorities after the withdrawal of the 2017 Circular and provides a statutory basis for valuation requirements that had until now relied largely on administrative interpretation.

The codification may also reduce disputes regarding the timing of taxation. The new provisions clearly establish that freely negotiable options generate taxable employment income upon grant, whereas non-freely negotiable options are taxed only upon exercise. This distinction was broadly acknowledged in practice, but the absence of an explicit legal provision occasionally raised interpretative questions.

Overall, the proposed rules should be welcomed as a significant improvement in terms of predictability and legal certainty. While they do not fundamentally change the tax treatment applicable under the ordinary regime, they provide employers and employees with a much clearer legislative framework and reduce reliance on administrative doctrine and case-by-case interpretations.

What's next?

The Draft Law was submitted to the Luxembourg Parliament on 1 July 2026 and will now follow the legislative process. As currently drafted, the new rules would apply to stock options granted as from tax year 2027.

Employers considering the implementation of employee participation plans should monitor the progress of the legislative process closely and assess whether existing plans may need to be adapted to align with the forthcoming framework

Questions?

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