

# The China / India Syndrome



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## Agenda

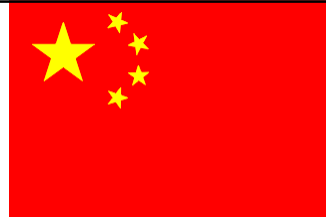


### China

- SAFE Registration Who & What?
- Survey Data
- Pieces of the Puzzle: Challenges and Concerns for Issuers
- Special Considerations for Option Exchanges
- Leverage Your Vendor

### India

- Overview
- Survey Data
- Challenges and Concerns for Issuers
- Special Considerations for Option Exchanges
- Leverage Your Vendor



## CHINA SAFE REGISTRATION

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### China SAFE Registration: What & Who?



#### What is SAFE?

- State Administration of Foreign Exchange
- Governing body which directs and controls all foreign exchange regulations in China

#### Who is impacted?

- Equity incentive plans offered by multinational companies to Chinese national employees must be registered with SAFE
- Regulations apply to options, restricted stock, RSUs, SARs, and ESPPs
- Cash plans offered by the parent company

4

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## China SAFE Registration What & Who? (cont'd)

### Who must register their plans?

- Public multinational corporations
- Registration not possible for non-public companies

### What is required?

- Establish a foreign exchange account through which all funds for purchase or from sale of equity must flow
- Meet ongoing reporting requirements
- *Note: Requirements may vary by local SAFE bureau!*

5

## What Information is Needed for Registration?

### Plan documents

#### Summary of award types being granted

- Include anticipated award types

#### Types of entities

- Representative offices not covered; branch offices may be covered

#### Entity to file

- Only Chinese subsidiaries can file

#### Forced sale or restricted sale

- Alternatives



6

## What Documents Are Needed?

- Application
- Plan Summaries
- Agreement with broker
- Board resolution approving stock plan(s)
- Translated copies of plans and agreements
- Risk management and internal controls for repatriation of funds
- Letter confirming labor relationship with participants
- List of employees by entity
  - ESPP: actual participants
  - Options/RSUs: anticipated participants



7

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## China: Survey Data

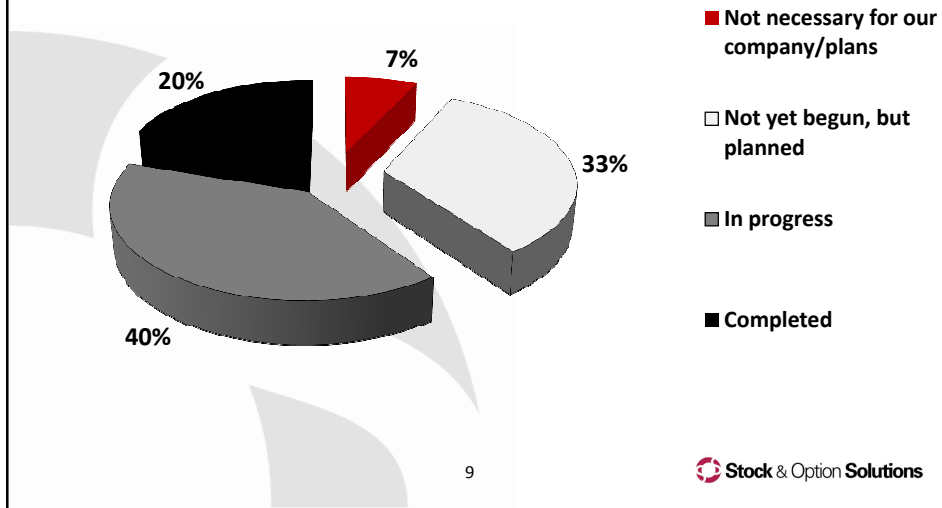
- Survey conducted by SOS in March, 2009
- 84 responses from issuing firms
  - 22 firms currently grant or have granted in China
- Follow up interviews conducted with some companies
- Public vs. Private company respondents:
  - 89% Public
  - 11% Private

8

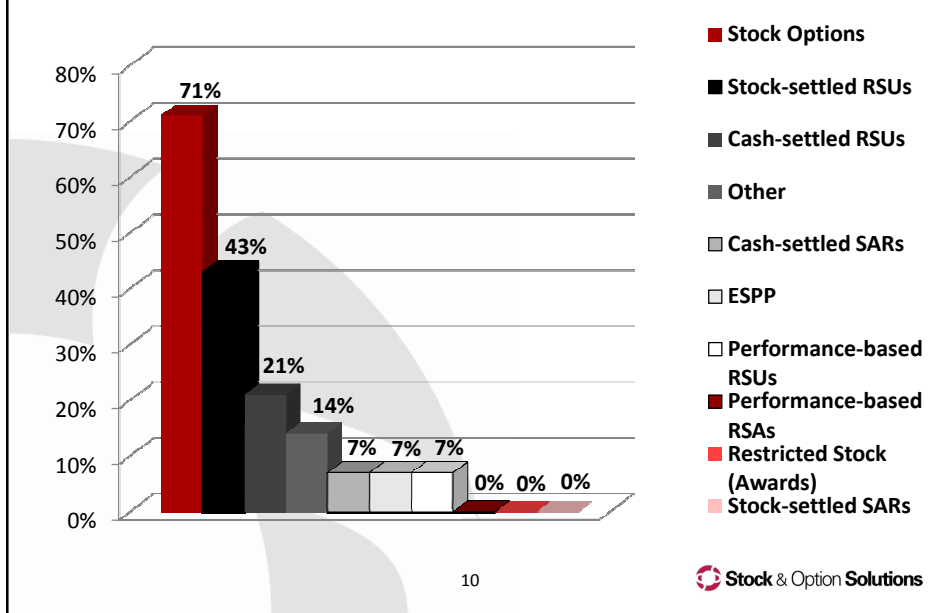
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## Survey Data: SAFE Registration Status

What is your SAFE registration status?  
(15 responses)

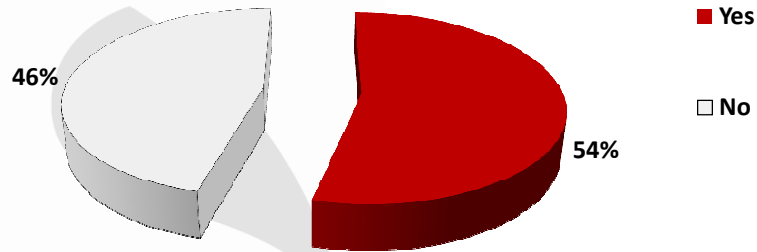


## Survey Data: Types of Equity



## Survey Data: Immediate Sale

For stock-settled awards in China, do you force an immediate sale of those shares at the time of exercise/vest/purchase?

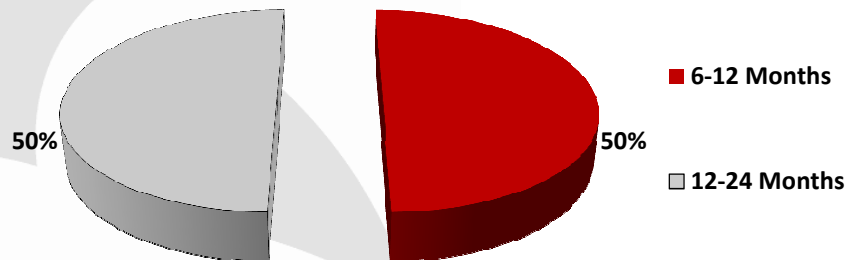


11

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## Survey Data: Process Length

How long did the SAFE registration process take, start to finish?



12

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## Pieces of the Puzzle: Challenges and Concerns for Issuers

Local SAFE offices may not have clear processes

Varying requirements between SAFE offices

- Extent of plan documentation

Translations

Terminated employees

- Forced sale or broker arrangement to repatriate funds
- Ensure all funds flow through corporate foreign exchange account

Coordination of SAFE registration with Circular 35 filing

Monitoring foreign exchange account

- Anticipating quarterly account quotas
- Coordinating transfer of funds to individual accounts



13

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## Challenges and Concerns (cont'd)

Communications within your Company

- Ensure all stakeholders are on same page
- Local buy-in plus parent company

Costs

- Monetary
- Resources

Corporate culture considerations

- Forced sale of equity

Risk tolerance of Company

Consider alternatives

- Local cash bonus program
- Phantom program

Cost/benefit analysis



14

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## Special Considerations for Option Exchanges: Legal and Regulatory

- Exchange may trigger modification of original approvals from SAFE
- May be additional reporting requirements for cancellation of old grants
- Cash-out of old awards must be transferred through foreign exchange account
- Many companies seem to be excluding Chinese participants from exchanges



15

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## Special Considerations for Option Exchanges: Administrative

- Resource impact of doing SAFE registration at same time as TO
- Timely distribution/collection of documents
  - TO required to be open for 20 business days
    - Most companies keep open only 20 business to minimize incremental expense due to market movement
  - Re-filing with SAFE will take longer than 20 days!

16

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## Leverage Your Vendor

Questions to ask your vendor :

- Is the broker willing/able to open accounts for Chinese nationals?
- Can they restrict available tax election methods for RSU grants?
- Can they suppress tax withholding on proceeds?
- Can the Company implement mandatory same-day sale for option exercises?
- Can the vendor deliver all proceeds to a corporate bank account?
- Can the Company mandate forced sale on termination?
- Can the vendor track shares held by terminated employees?

Your Vendor May Be Able to Help

17

## In Summary...

Registration process is:

- Time-consuming
- Expensive
- Slow
- Frustrating
- Inconsistent between provinces

But...

- Required in order to be fully-compliant

Consider alternative compensation methods before proceeding!

18





## INDIA FRINGE BENEFITS TAX

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### India FBT Overview

What is the Fringe Benefits Tax (FBT)?

- Employer tax covering non-cash benefits in kind

What types of equity are included?

- All equity awards settled in shares
  - Stock options
  - ESPP
  - Restricted Stock Awards & Units
  - Stock-Settled Stock Appreciation Rights



What is the effective date?

- Changes effective for all taxable events as of April 1, 2007
  - Option Exercise
  - ESPP Purchase
  - Restricted Stock Awards / Units Release

20

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## India FBT Overview (cont.)



### When is the tax payable?

- FBT payable by employer upon taxable event, but calculated on spread at vest
- Spread on vest calculated using Category I registered merchant banker valuation; may not be Company FMV
  - Valuation for options must be obtained for each vesting date (beware of monthly vesting schedules!)

### No grandfathering for outstanding grants

- All outstanding grants subject to FBT

21

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## FBT Pass Through



### Employer may pass through FBT to employee

- Pass-through does not eliminate employer's legal liability for payment of FBT
- Employer is liable for payment of FBT regardless of whether tax is passed through to employee
- Implementing pass-through on existing awards will likely require a modification of award terms
- Differing views regarding accounting treatment of awards for which FBT is passed through
  - Confirm accounting treatment with company auditors prior to implementing pass-through

22

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## FBT Survey Data

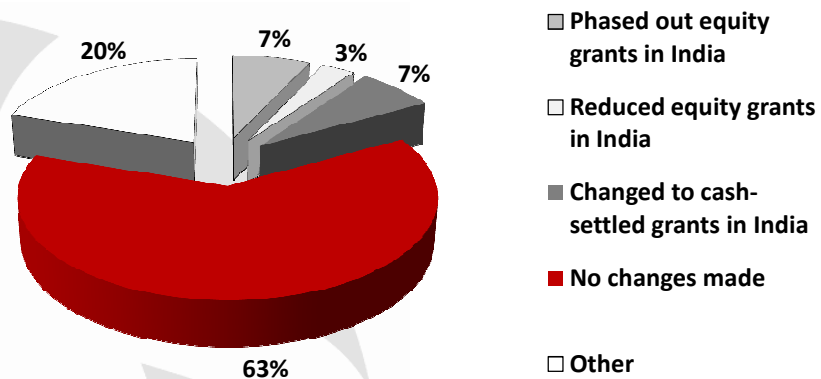
Survey conducted by SOS in October 2008  
30 responses from companies with equity awards  
in India

23

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## Changes to Granting Practices

Have you made any changes to your granting practices in India  
because of the FBT changes?

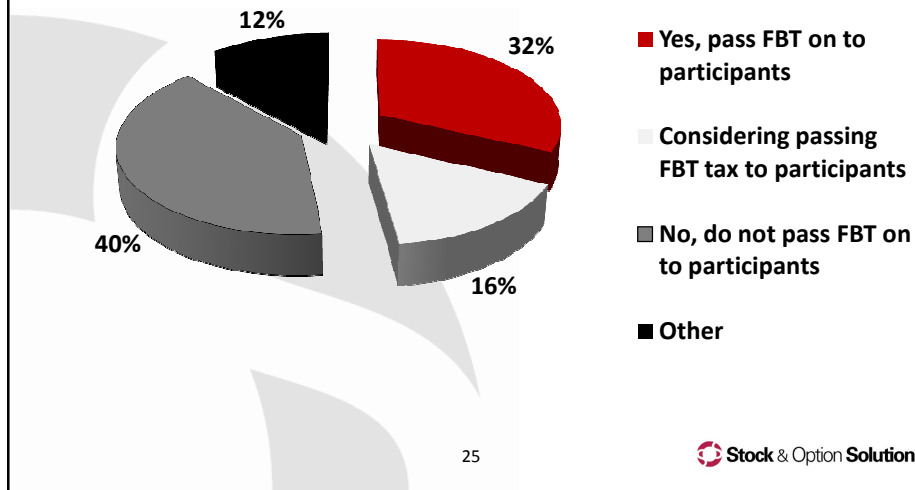


24

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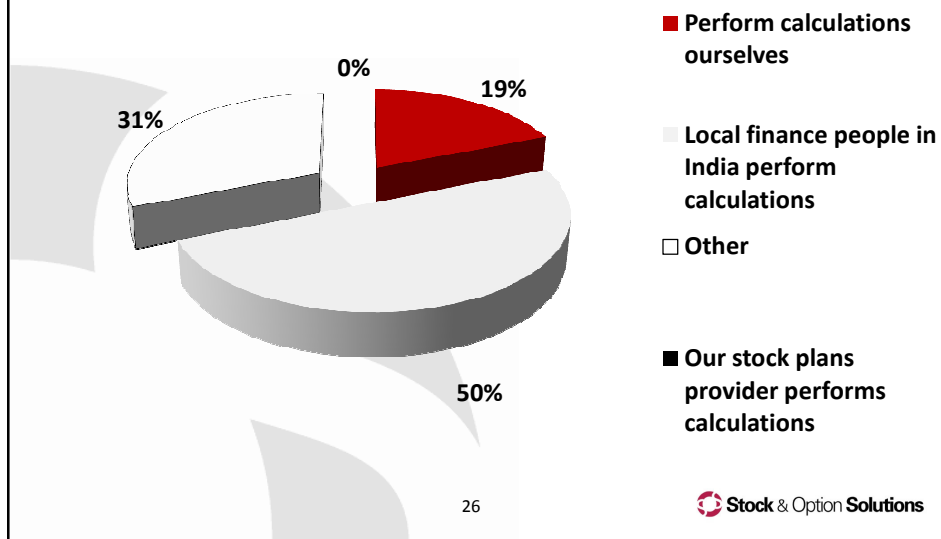
## Passing through FBT

Do you pass the FBT tax on to your participants in India?



## Calculating FBT

How do you calculate FBT tax?



## Challenges and Concerns for Issuers



Valuation at vesting for foreign companies must be specified by a Category I Merchant Banker registered with the Securities & Exchange Board of India (SEBI)

- Merchant Banker must take listed price into consideration
- However, Merchant Banker's final valuation may not equate to company's definition of FMV

Spread on date of vesting

- Manual and time consuming calculations
- Most systems do not store spread at vest

Market value used for purposes of FBT calculation must be communicated to employees timely

- Market value becomes cost basis for employee capital gains calculations, regardless of pass-through

27

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## Additional Challenges



Rules for mobile employees

- Allocation of income based on work days in India between grant and vest
  - Company must track work days in India
- Tax credits – may be possible for mobile employee foreign tax credit for any FBT recovered by Indian employer, depending on other countries' tax regulations

Unclear how to recover FBT from employee

- Payroll?
- Sales proceeds?

Handling pass-through/tax payment when stock price has declined

- Spread at exercise may be less than sum total of spread at each vesting tranche resulting in negative benefit to employee

28

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## Special Considerations for Option Exchanges: Legal and Regulatory

Confirm with tax advisors whether exchange would be considered a taxable event for FBT purposes

- Neutral exchanges typically do not trigger tax event

Consider impact of vesting schedule of replacement awards

29

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## Special Considerations for Option Exchanges: Administrative

Special communications may be required if new awards are subject to pass-through, but old awards were not

- May be required in TO filing with SEC

Timely distribution/collection of documents

- Electronic distribution and elections



30

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# What Questions Do You Have?



*Thank you for your participation!*

33

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34

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