Stock & Option Solutions

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You Never Step into the Same River Twice: Changes in International Equity Compensation

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Agenda

- Australia
- China
- France
- India
- Italy
- Spain

Australia

Australia: Tax Law Changes

- New tax law effective for grants made on or after July 1, 2009 but some rules apply even to grants made before this date
- Tax generally at grant but deferred until no longer "real" risk of forfeiture (i.e., typically until vesting)
  - Ok for RSUs/free shares (unless certain types of retirement provision) and ESPP but problem for options (especially if under water at vesting)
- Taxation at the earliest of:
  - When there is no longer a real risk of forfeiture (i.e., typically vesting)
  - Cessation of employment
  - 7 years from grant

Australia: Tax Law Changes

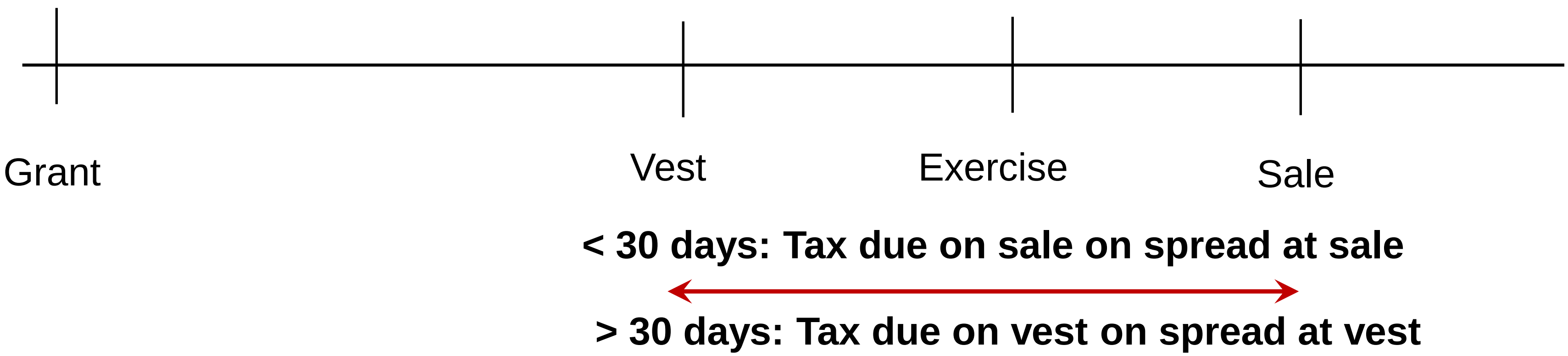
- For options, tax may be further deferred if option under water at vesting and, by its terms, may not be exercised until option is in the money
- Value of rights/awards based on market value or on valuation pursuant to statutory formula (but more guidance expected)
- Tax reporting at tax year end (June 30) and possibly withholding (only if employee fails to provide tax file number or Australian Business Number)
- Tax refund generally available if award later forfeited, but not if forfeiture occurs as result of taxpayer's choice (e.g., by not exercising)
- If refund not available, capital loss may be available

Australia: Survival Tips

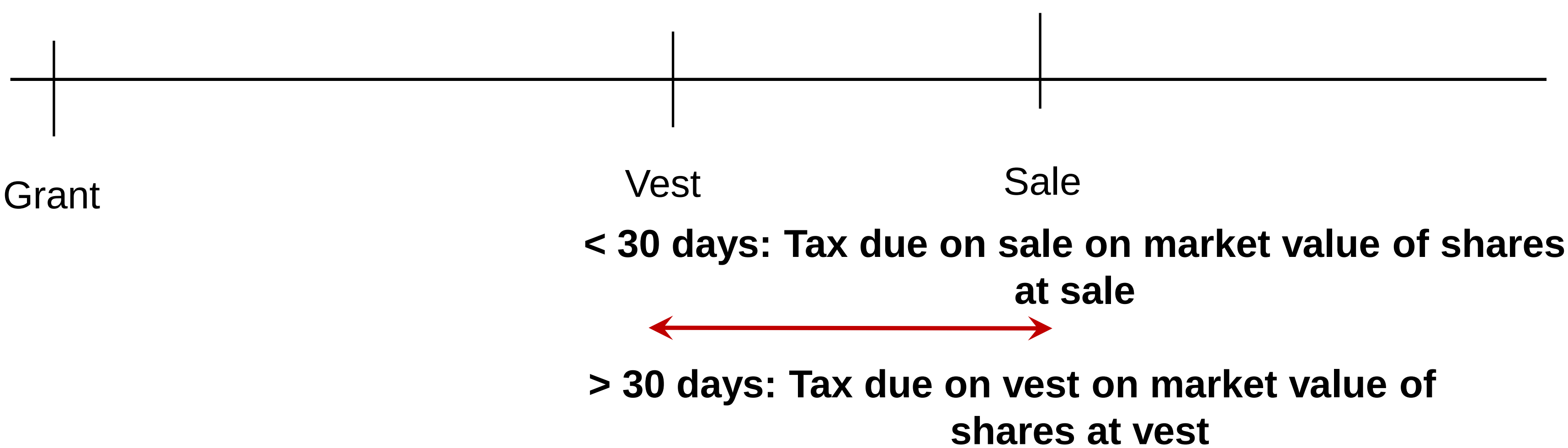
- If possible, grant RSUs going forward, not options
- If options continue to be granted on or after July 1, 2009
  - Ensure grant agreements state option may not be exercised if under water
    - Check with legal counsel if a threshold can be applied, i.e., options must be at least $1 in the money to be exercisable
    - Update all grant documents and file with ASIC
  - Identify all Australia grants with taxable event of vesting in equity database or spreadsheet
  - Implement process to check equity database monthly/ quarterly for awards taxed at vesting (e.g., options taxable at vesting rather than grant, RSUs taxable at vesting) so taxable gain can be calculated and to check for options exercised, RSUs vested, and the underlying shares sold within 30 days of vest

Australia: Timelines

- Stock Options granted on or after July 1, 2009



- RSUs



Australia: Survival Tips

- For options granted on or after July 1, 2009
  - Use consistent, formulaic methodology to calculate taxable gain at vest: custom report from equity database, formula-based spreadsheet or Access queries
  - Avoid manual calculations!
  - Ensure local entity has Tax File Number (TFN) for every employee with option grants so that employer withholding is *not* required
  - Educate employees on changes in taxation, reporting and 30-day rule

China

China: Circular 78

- Circular 78 substantially modified the exchange control laws for equity awards
  - SAFE approval is required for all “equity plans” (from local and/or central SAFE depending on type of plan) if PRC national
  - Dedicated foreign exchange bank account through which all funds into or out of China must be remitted
  - Annual quotas required for inward and outward remittances (in some provinces)
  - Must repatriate proceeds from sale of shares

China: Key Developments

- Cash-settled awards now viewed as subject to SAFE requirements (distinction between payment from parent versus through local payroll)
- Shanghai SAFE may not accept post-termination exercisability period of more than 6 months (in some cases, 90 days)
- Shanghai SAFE will permit only one quarterly conversion of funds from dedicated foreign exchange account
- All SAFEs require prior approval of conversion of funds and some have long approval processes (e.g., Beijing – 20 working days to approve)
- Some SAFEs may require funds be distributed directly to employees and not be funneled through payroll – makes tax withholding difficult!
- Some SAFEs require additional individual licenses for employees after company receives approval

China: Survival Tips

- Circular 78 does not apply to awards made to non-PRC nationals
- Consider cash awards paid locally, funded locally and offered locally for PRC nationals
- Carefully choose the SAFE district in which you will submit application, if possible
- Companies are no longer taking a “wait and see” approach, so every company needs to develop a compliance plan in China as soon as possible

China: Survival Tips

- Identify participants who are PRC Nationals in equity database or a spreadsheet for tracking purposes
- Review/update grant agreements to enforce:
  - Mandatory sale of shares on termination
  - Repatriation of dividends
  - Cashless exercise of options
  - Shorter time frame for post-termination exercise (if necessary)
- Discuss cost/benefit analysis of offering equity in China with management
  - Is it necessary? What are the goals?
  - Can different compensation vehicles be used?

China: Survival Tips

- Before initiating SAFE filing develop internal processes for handling flow of funds for employee proceeds and tax withholdings
  - Involve local HR/Finance/Payroll and get consensus on any new or changed processes
- Discuss with broker what tools/process they have which can be utilized to reduce administrative burden
- Determine who will be responsible for actual filing from local entity
  - Establish regular communications through entire process
- Update employee communications to reflect any changes to processes

France

France: Qualified versus Non-Qualified Plans

Pros:

- Significant cost savings to local entity for most of employer portion of social taxes (up to 46% of the gain)
- Significant savings for most of employee portion of social taxes (up to 23% of the gain), income tax deferred to *sale* of underlying shares
- Qualified awards are subject to specific reporting requirements but these are less burdensome than for non-qualified awards

Cons:

- Qualified awards are subject to certain legal and tax requirements to be provided in a subplan at grant, including holding periods and minimum vesting period for RSUs
- Tracking holding periods may be difficult unless vesting period is adjusted to match requirements
- Black out periods apply to option and RSU grants/sale of shares acquired through RSU vesting
- Pricing requirements for options
- Minimum coverage requirements may apply to RSUs

France: Managing Qualified Plans

- Consider using vest schedules that match share holding period requirements, i.e., 4-year cliff vesting for options, 4 years for first vesting of RSUs (2 year vesting + 2 year hold)
- Work with broker or transfer agent to move vested RSU shares into escrow account for duration of share holding period
- Restrict option exercises to cash-only until holding period has been met and work with broker or transfer agent to move acquired shares into escrow account for duration of holding period
- Be aware of when financial statements will be published to avoid granting during closed periods
  - Plan ahead with Legal, HR, and Finance to calendar grant dates which might fall during closed periods

France: Corporate Officer Restriction

- Clarification on the Law dated 12/31/2006 on corporate officers restriction on sale of shares:
  - Options: French <u>tax and social authorities</u> have confirmed this law does not apply to qualified options granted to corporate officers of subsidiaries (provided they are not officers of the parent granting company)
  - RSUs: Only <u>social authorities</u> have confirmed that this law does not apply to qualified RSUs granted to corporate officers of subsidiaries (provided they are not officers of the parent granting company)

France: Broad-Based Grant Requirement

- Law dated 12/3/08 introduced a broad based grant requirement or improvement of profit-sharing French schemes if grant of qualified options/RSUs to corporate officers of listed companies
- Likely not applicable to options granted by US issuer unless local entity is a branch office
- Law will likely apply to tax-qualified RSUs
  - Determine the scope of the requirements for your French grants:
    - Corporate officers concerned (which entity are they employees of?)
    - Plans concerned (which entity is offering the award?)
    - Awards concerned (date of Plan, options vs. RSUs)
    - Subsidiaries concerned (what is corporate structure: branch office, > 50% owned subsidiary, etc?)
  - Coordinate with Legal and Tax to gather data
  - Consider:
    - Expanding RSU program to be broad-based
    - Granting non-qualified RSUs
    - Grant qualified options to corporate officers instead of RSUs

India

India: FBT Eliminated

- Employer-paid fringe benefit tax (“FBT”) eliminated for all vestings/purchases/exercises on or after April 1, 2009 irrespective of grant date (Indian tax year April 1 to March 31)
- Employees now subject to ordinary income tax on gain at vesting/purchase/exercise
  - For options, tax due on spread at exercise (not vesting, as was the case under the FBT regime)
- Employer has a withholding obligation
  - Withholding obligation is retroactive to April 1, 2009
- Guidance issued December 16, 2009 provides that, if shares not listed on a recognized stock exchange in India, merchant banker valuations are required

India: Survival Tips

- Engage a merchant banker, if not done yet
  - Prices have come down; reasonable choice of bankers who are familiar with regulations and working with US issuers
- Update employee communications to reflect new taxation rules
  - Provide numerical tax calculation examples for merchant banker valuation higher and lower than company FMV on date of taxable event
- Consider how merchant banker valuation will be communicated to employees
  - Company/regional intranet
  - Individual exercise/release confirmation emails or letters
- Determine tax withholding method
  - Withhold at maximum rate and true-up through payroll
    - May be problematic if withholding shares for taxes for RSUs
  - Release 100% of shares/proceeds to employee and withhold through payroll
    - How to handle tax withholding greater than paycheck

Italy

Italy: Broadening of Social Tax Exemption

- In June 2008, Law Decree 112 provided that social insurance contributions are not due on stock options exercised on or after 6/25/2008; decree did not address any other type of award
- Circular letter 123 issued at the end of 2009 appears to broaden the application of decree. It states: “As no statutory definition of stock options exists under Italian law …, the exemption from social contributions applies also to stock plans different from the broad-based plans … which, upon meeting certain requirements … provides for the grant of shares.”
- This means exemption only available to awards other than options if broad-based plan exemption is not (which does not make a lot of sense as the broad-based exemption is limited to €2,065)
- Probably not applicable to ESPPs, but will apply to RSUs if not broad-based grants

Italy: Survival Tips

- Consider granting RSUs only to select employees to enable application of social tax exemption
  - Options can be granted to all employees (social tax exemption still available)
  - Apply broad-based plan exemption to ESPP
- Inform employees and local entity of new tax treatment
  - Applies to any shares issued on or after December 11, 2009
  - Could seek social tax refund for shares issued since effective date of Law Decree 112
  - Update employee communications to reflect new tax treatment

Spain

Spain: Availability of 40% Exemption

- In April 2009, a Spanish Supreme Court ruled that the 40% exemption may be available where grants are made more frequently than annually
- Instead of looking at grant frequency alone, look also at frequency of option exercise—the exemption is available as long as options not exercised on a frequent or recurrent basis, e.g., annually or semi-annually
  - Requirement that the option must be exercised more than two years after the grant date still applies
- Recent proposed legislation would reinstate the requirement that grants cannot be made more than annually
- The legislation was approved by the Spanish government and is awaiting approval by Parliament

Spain: Survival Tips

- Be careful when addressing the 40% issue in tax supplements being prepared while the legislation is pending
  - Check tax supplements for language that refers to 40% exemption
- Consider withholding tax on 100% of option gain, especially if multiple types of awards are granted to employees (options, RSUs, ESPP)
  - Administratively difficult to track time frames
    - RSU vest or ESPP purchase may be considered as "frequent" or "recurrent", even if option is not exercised for 2 years, disqualifying employee from using exemption
  - Example: if you have an ESPP with 2 purchases per year, assume 40% exemption does not apply and withhold on 100% of option gain
    - Better to over-withhold because of difficulty of getting under-withheld amounts from employee and employee can get over-withheld amounts back

Questions?

- *Thank you for your participation!*

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