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The Wonderful World of Payroll

Session Title: Global Equity

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Agenda

- Grant considerations
- Common types of equity awards
- General tax treatment
- Global tax issues
- Global withholding
- Corporate tax deductibility
- Global chargebacks
- Securities / Regulatory issues

Grant Considerations

- Where to Grant; What to Grant
  - Peer Group Comparison
  - Expected Participants
  - Cost of Administration
  - Cost of Compliance
  - Tax-Advantageous Plan Availability
  - Global Considerations

Grant Considerations

- Questions to consider when offering equity:
  - Will you grant globally?
  - What are the tax implications in each jurisdiction?
  - Are there cross border / mobile employees?
  - Will / does the company recharge / deduct plan costs?
  - Are there any securities/regulatory hurdles (cost review)?

Common Equity Award Types

	Stock Options (SOs)	Employee Stock Purchase Plan (ESPPs)
Definition	• When an employee is granted the "right" or "option" to acquire shares at a fixed price.	• Employee is allowed to purchase company stock at fixed intervals throughout the year, generally at a discount.
Grant/ Offer	• Employee receives award • Price to acquire award is set on grant date (can be nil) • No initial payment by employee to receive award	• Employee enrolls in the plan prior to the start of the "offer period" • Employee indicates the amount to contribute prior to start of offering period
Vest	• The date on which restrictions are lifted • Employee may exercise after this date	• N/A
Exercise/ Purchase	• The date on which employee exercises right to purchase • Generally , considered the taxable moment	• The date at the end of the offer period on which shares are purchased • Shares are generally purchased at a discount • Taxation occurs on the purchase date on the discount (unless tax qualified ESPP)

Common Equity Award Types

	Restricted Stock (RSA)	Restricted Stock Units (RSUs)
Definition	• An award of shares that is not fully transferable until certain conditions have been met.	• A promise that the employee will receive a certain amount/value of shares at a certain point in time, often the only conditions on the award is that the employee remains employed.
Grant/ Offer	• Employee receives award of shares to which they are the beneficial owner • Employees receive RSA at a nominal or no cost • If employee receives "ownership rights" (i.e., dividends, right to vote) at grant, taxation may arise at grant in several countries	• Employee receives award • Typically employee receives RSUs at no cost • Given the employee is granted a "unit" of shares, no ownership rights will arise
Vest	• The date on which restrictions are lifted and employee becomes entitles to receives shares • Commonly the point of taxation (unless employee was entitled to "ownership rights" at grant)	• The date on which restrictions are lifted and employee is entitled to receive shares • Generally the point of taxation

Tax Treatment -Types of Tax

Income Tax	• Tax paid on general income • The individual's tax rate depends on annual gross income • Due at the point of taxation (i.e., vesting or exercise)
Social Tax	• Contributions to social security, Medicare, disability, or other social programs. Varies by country. • Either a flat rate with no threshold or subject to a maximum annual contribution income threshold • Due at the point of taxation (i.e., vesting or exercise)
Capital Gains Tax	• Paid on capital income from the sale of assets • Either a flat rate or marginal rate and can change based on how long you hold your shares, annual income, etc. • Due at sale

Amount to be taxed

SO / ESPP

Spread* at Exercise/Purchase	Gain at Sale
Subject to income/social taxes	Subject to capital gains tax

RSA / RSUs

FMV at Vesting	Gain at Sale
Subject to income/social taxes	Subject to capital gains tax

***Difference between the Fair Market Value ("FMV") of the shares at exercise/purchase and the exercise/purchase price.**

Global Issues

- Differences in timing of taxation / calculation of taxable amount
  - Some countries make the tax point of options the date of vest, for example in Kenya or potentially Belgium.
  - If employee receives “ownership rights” (i.e., dividends, right to vote) at grant of RSAs, taxation may arise at grant in several countries
  - In some countries, elections can be made to change the tax point of the award to the date of grant, for example in the US (s83(b)) or in the UK (s431 election).
  - Special Valuation Rules
    - Italy (Normal Value), India (Category 1 Merchant Banker), Malaysia (High/Low Average)

Global Mobility

- If the individual moves countries during the life of the award, the majority of those countries will seek to tax part of the income
- Many countries will only look to tax the income over the grant to vest period of the award, therefore, if an employee moves to a country after the award had vested, that country will not tax
- Some countries look to tax the award over the entire grant to exercise period, also sourcing often depends on the applicable tax treaties
- Tax approved plans may have tax benefits in one country, but it unlikely that they will have any tax benefits in another if an individual is mobile

Withholding

Overview
• When the employer pays basic salary, taxes are typically withheld automatically and reflected in the employee's paycheck
• Similarly, equity granted in local countries may also be subject to tax that must be withheld
• Withholding will be required at the point of taxation (i.e., typically vesting or exercise, depending on the award type)
• Withholding can occur in several ways: • Local payroll withholding: Employee receives all shares, payroll withholds taxes from basic salary • Sell to cover: Broker will sell enough shares to cover taxes and send to local subsidiary for remittance, employee receives the remaining shares • Net-share withholding: Taxes are determined before point of taxation, parent holds back enough shares to cover taxes, employee only receives remaining shares, parent remits money to pay taxes to local entity for remittance [Note accounting considerations with net-share withholding]
• Withholding requirements vary by country, award type, and the chargeback process

Reporting

Overview
• After the employer withholds taxes, they are required to remit and report them to the tax authorities
• Additionally, employees are required to report the income received from equity and the taxes that have been paid via their personal tax returns
• Reporting requirements vary by country and may occur annually, monthly, or upon grant. Some countries may have special reporting requirements for equity income.
• For example, in the US: • Employers must report taxes withheld on equity vested or exercised each quarter in Form 941 • Employers must report income to employees and tax authorities on Form W-2 annually • Employees must report income annually on Form 1040 by April 15th

Withholding Rates – Possible Approaches

Blended rate

- Look at employee population in each country holistically and determine blend based on salary levels

Majority rate

- Use rate that a majority of the population in each country is at based on salary levels

Max-marginal rate

- Use highest marginal/progressive tax rate in each country
- More flexibility due to recent changes in accounting rules (net-settle)

Minimum Rate

- Use lowest marginal/progressive tax rate in each country
- Primarily used before the changes in the accounting rules

Actual rate

- Withhold at each employee's actual tax rate as provided by local payroll

Possible Approaches – Flat withholding rates per country

Maximum Marginal Rate

- **Pros**
  - Easiest to administer – just one rate per country
  - Ensures compliance with local withholding rules
- **Cons**
  - Employees likely to complain they are being over withheld if their actual rate is less than maximum marginal
  - More shares are sold therefore forfeiting potential appreciation of shares
  - Potential legal issues
  - Potential for employee questions regarding rate used
  - Disconnect between intent/philosophy of Plan and outcome
  - Employees get cash back for amounts over-withheld

Variations

- **Majority rate**
  - Easy to administer
  - Might end up being maximum rate
  - Rate applies tov majority of population – less instances of over or under-withholding
- **Blended rate**
  - Similar to majority rate however calculates essentially a weighted average based on # of employees in each rate band.
  - Amounts of over or under-withheld will generally be less requiring smaller true-up
  - Will likely need a true-up in all cases

Possible Approaches – Actual Rates

Pros

- Most accurate withholding, little to no true-up required
- Correct number of shares sold or withheld from employees
- No legal issues resulting from employees selling more shares then necessary
- Pure equity plan
- Potential for fewer questions from employees regarding withholding amounts

Cons

- Administrative challenges
- Feeds from local payroll into broker might not be possible
- Need to ensure recharge positions considered
- Need to establish process for terminated employees who may no longer be on payroll
- If not done correctly, possible under-withholding - need process to collect additional amounts from employees
- Can only withhold or sell whole shares - will always be a true-up.

Takeaway – if company can do it, and can do it correctly, actual rates are best!

Withholding Rate Objectives / Considerations

Local compliance

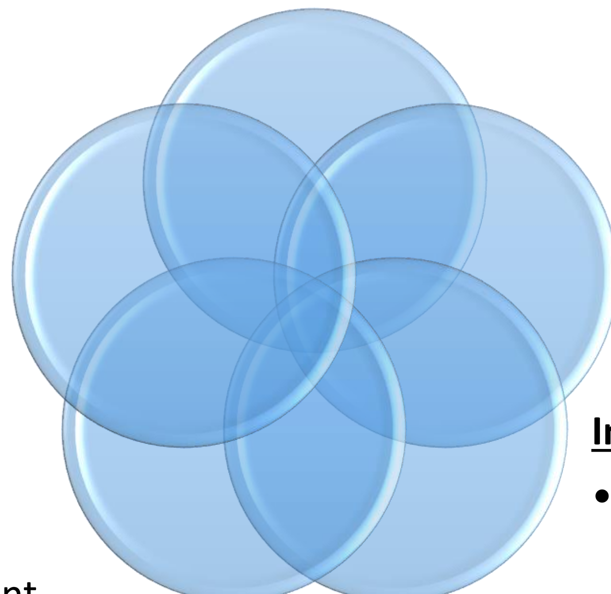
- Ensure withholding occurring where required by local law

HR: alignment with Plan

- Equity award vs cash

Administrative process

- Burden on HR/payroll stakeholders depending on rate approach



Legal

- Employee consent to withholding

Impact to employee

- Number of shares withheld or sold to cover tax liability
- True-up (if required)

Overall Framework For Determining Withholding Rate

Countries	How many countries? Is withholding required?	Depends? (chargeback, award type, etc.)	Rates (flat rate, statutory rate, marginal/progressive rates)	
Population	Equity offered to highly compensated or senior-level employees?	Is the population broad based (most if not all employees receive some form of equity)?		
Awards	NQSO – Commonly cashless sell all so no issues with withholding at max	ESPP – Commonly withholding via cash through local payroll	RSU – Common to withhold shares to cover taxes ("net-settle") or sell shares on the market ("sell to cover").	
Objectives	Impact to employee	Administrative burden	Local compliance	Legal / HR
Special Cases	Mobile Population – local transfer or tax equalized?	U.S. top executives		

Mobile Employees – Trailing Liabilities

What is a trailing liability?

- A tax liability generated by equity income earned in a particular country (or countries) but recognized after departure from that country (or countries)
- Example 1:
  - Expatriate is a US Citizen
  - RSUs granted and vested (in part) while living/working in Canada
  - RSUs fully vested/released while living/working in US
  - Canada Treatment: Withhold and report on Canadian source income
  - US Treatment: Withhold and report on 100% of the income less amount subject to foreign withholding (i.e., Canadian source)

Corporate Tax Deductions and Recharges

Corporate Tax Deductibility

Securing a corporate tax deduction – US

- IRC §83 provides a compensation deduction to the ultimate employer
- US corporations may obtain a tax deduction for the compensation element recognized by US employees
- No corporate income tax deduction is allowed under US tax laws for equity transferred to employees of foreign subsidiary

Corporate Tax Deductibility

Securing a corporate tax deduction – US

- Exception, ‘check the box’ entities which are treated as a branch of a US Company
- Instead, US Parent Company is deemed to contribute cash (in the form of a capital contribution) to foreign subsidiary
- Foreign subsidiary is deemed to use that cash to buy shares from the parent
- Foreign subsidiary is deemed to transfer those shares to employee for services
  - Deduction in foreign subsidiary

Corporate Tax Deductibility

Securing a corporate tax deduction – Foreign

- Deduction only available at foreign subsidiary level if permitted under foreign laws
- With exception of the UK, most foreign jurisdictions require that an economic cost be incurred in order to secure a corporate deduction
- To satisfy this "cost" requirement, parent can establish process to charge the subsidiary for the value of the equity delivered to their employees ("recharge agreement")

- Payment as a result of that process creates a local economic cost
- Lower corporate taxes in the local jurisdiction
- Tax-free repatriation of cash

Corporate Tax Deductibility

Factors to consider in the recharge determination

- Is a corporate tax deduction available?
- Is foreign subsidiary profitable or expected to be profitable?
- Is cash repatriation from subsidiary to parent desired?
- Are there any corporate cost-sharing arrangements?
- How does a recharge impact the employer's social tax liability on the awards?
- How does a recharge affect the withholding and reporting requirements imposed upon the employer?
- How does a recharge impact employee's income and social tax liability or timing on the awards?
- Are there any other considerations (e.g., labor law, foreign exchange control)?

Mechanics of a Chargeback

Parent company grants awards

Local employees receive awards	Local subsidiary not involved in Plan operation but may be asked to provide grant recommendations

Parent company charges back costs to local entity

Parent company implements chargeback arrangement and establishes agreement with local entity that it will bear the related costs	At the time of vesting/exercise, parent company will invoice local entity for the cost of the awards made to its employees

Local subsidiary bears award costs

The agreement and invoice generates an 'expense' in local entity's statutory accounts that triggers a local corporate tax deduction	In some countries, a chargeback arrangement triggers additional taxes, withholding and reporting requirements.

Objectives of a Chargeback

- Secures a corporate tax deduction in the right place
- Ensures the right entity is bearing the costs
- Forces local entities and employees into compliance in non-US locations
- Reduces effective global tax rate
- Repatriates cash tax free

Chargeback considerations

Employer compliance – Local employees

- May change the timing or character of the income
- Potential increase in taxes due
  - Brazil
  - Indonesia
- May create a direct link between the equity award and the Foreign Subsidiary resulting in acquired rights and other labor law complications
- No deduction may be allowed
  - Canada
  - Netherlands

Chargeback considerations

Employer compliance – Local employees

• While reporting and withholding is required in most countries, the addition of a chargeback may trigger these requirements in some jurisdictions

- Mexico
- Belgium
- Thailand
- Colombia
- Poland
- Czech Republic
- Greece

Chargeback considerations

Mexico

- **Social Tax with a Chargeback**
  Employee and employer social taxes will be imposed to the extent the employee's normal income does not exceed the monthly wage cap.

- **Other Taxes with a Chargeback**
  The employer is required to pay a local payroll tax. The rate varies depending upon the state in which the employer is located.

Securities / Regulatory Issues

Securities Laws

- The offer of shares to employees may trigger certain filing requirements if the offer is considered a "public offer" of shares
- This can be expensive and onerous unless exemptions apply
- Many countries establish threshold limits on the number of offerees and the value of shares being offered. If these thresholds are not exceeded the offer is exempt from filings;
- Others specifically exclude employee share plans from securities filings requirements
- Others require filings to be made even where an exemption is available (Australia and New Zealand).

Foreign Exchange Issues

In some countries, the authorities impose restrictions on the flow of currency in and out of the country for monitoring purposes. Examples are in:

- Brazil
- China
- Russia
- Pakistan

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Thank You!