Share Plan Lawyers Group: Global Share Plans- Issues To Consider Before Implementation

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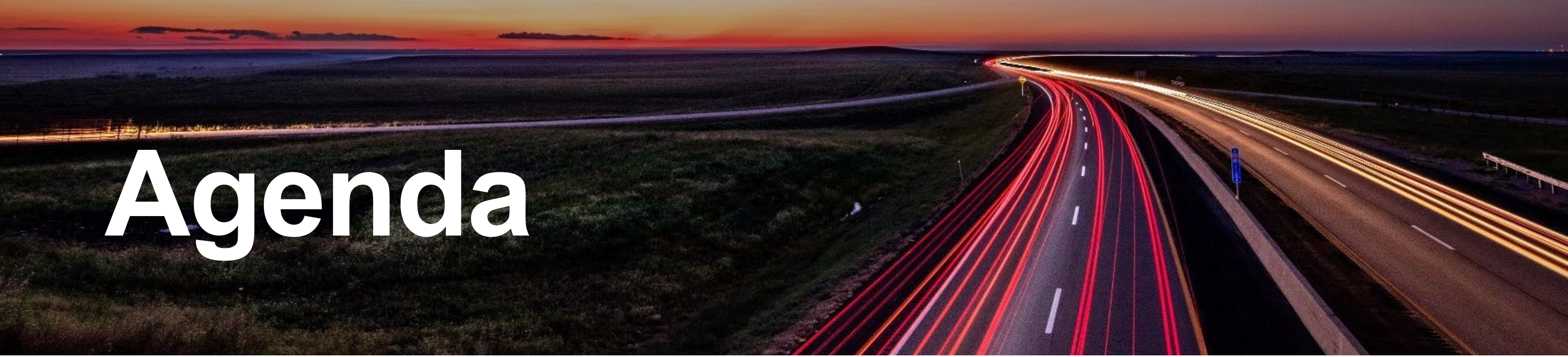


Agenda

1. Key issues to focus on
2. Brexit and data protection
3. Global developments: snapshot
4. Corporate tax focus
5. Which Macron? A focus on launching share plans in France (including updates)
6. Questions & Answers

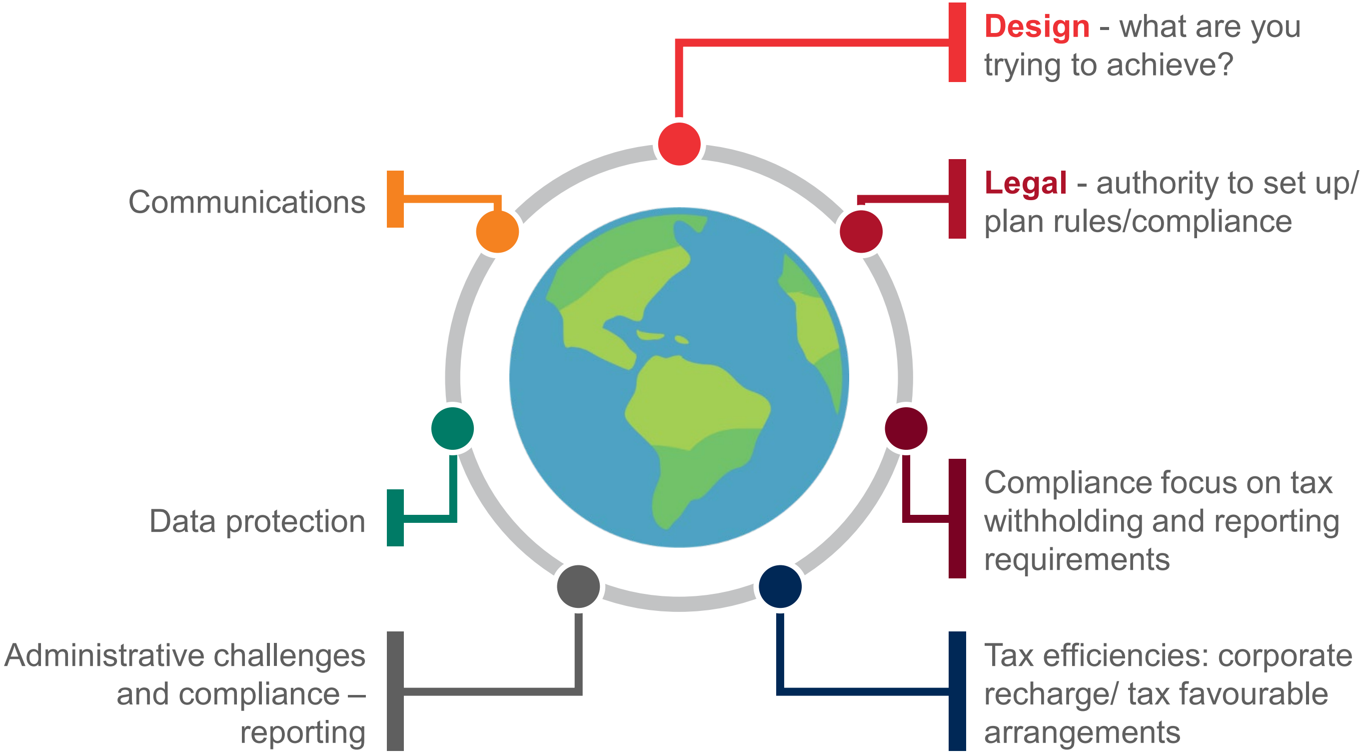
01 Key issues to focus on

Global share plan update | Key issues to focus on

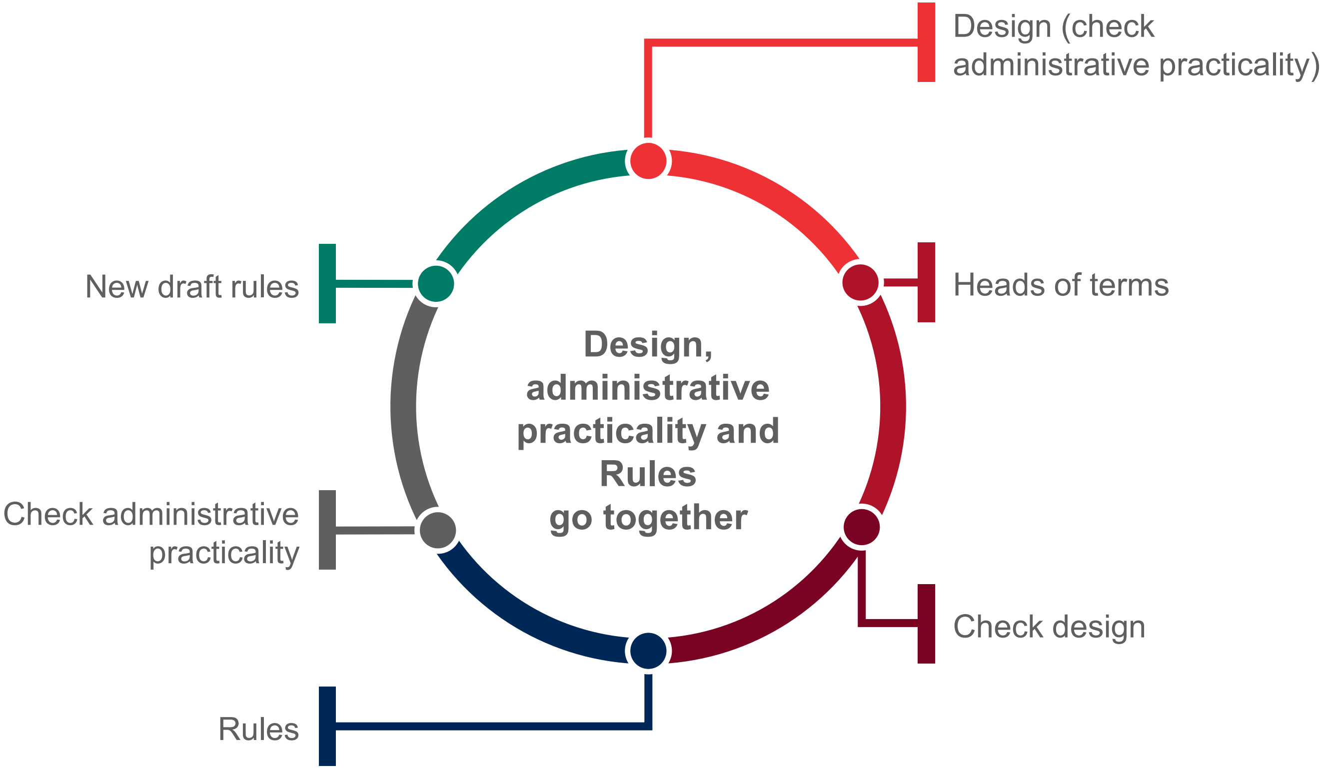
- Interest in global share plan launches remains strong
- Focus on administrative efficiency
- Compliance focus on tax withholding and reporting requirements
- Tax efficiencies: corporate recharge/ tax favourable arrangements
- Securities laws and exchange control compliance
- Data protection
- Role of local coordinators in securing compliance

Key issues to focus on

Global Share Plan Best Practice



Design, Administrative Practicality and Rules go Together



Some Potential "Quick Wins"

All Employee Plan Design

1 **Use a simple structure on a global basis, with limited country-specific exceptions**

- Make the plan design straight-forward to understand and administer
- A cash alternative where essential/ Remove purchase element to limit securities filings

2 **Be clear if a tax favourable regime is worth going for**

- UK All Employee Plan – is it better to launch an International Plan based on UK standard SAYE plans or a Share Incentive Plan or go for a simpler alternative?
- Adopt a US ESPP or keep a similar plan? See below

3 **Standardised global documentation; online access**

- Plan Rules and Award Documentation- standard terms
- Employee rights risks – different position across jurisdictions but address risk with single set of harmonized disclaimer wording

4 **Standardised grant dates, rather than one-offs**

- Minimise one off grants (e.g., for new joiners)
- Avoid frequent vesting dates (e.g., every month or quarter)

Some Potential “Quick Wins”

All Employee Share Purchase Plan Design

1

Limit employee flexibility

- e.g., changing amount of contributions; coming into and out of schemes
- Treatment of leavers

2

Local currency

- Contribution limits and savings
- Savings arrangements

3

Dividends

- Reinvest dividends into plan shares, rather than pay out in cash

4

Tax withholding

- Withhold taxes from shares, **rather than from deduction from salary or employee payment**
- Standard withholding processes and provisions

Key issues to focus on

Tax and Social Security

WITHHOLDING AND REPORTING

1. An important area of exposure for companies
2. Starts with plan documents
3. Active auditing of share plans in many countries
4. Penalties for non-compliance
5. Prepare for these obligations well before the first taxable event (ideally before grant)
6. Worth obtaining local advice

Key issues to focus on

Tax and Social Security

TAX ADVANTAGED PLANS

- Many countries offer tax perks where plans comply with certain conditions (some simple, some onerous), for example, UK, US, France, Spain and Singapore to name a few.
- Can be expensive and administratively burdensome
- Risk of disqualifying awards due to non-compliance and missed tax withholding
- Consider benefits v costs:
  - How many employees would benefit?
  - Can the company devote resources to maintaining this?

02 Brexit and data protection

United Kingdom

Brexit impact

Background

- UK has been negotiating exit from the EU (Brexit) for several years
- Prior to Brexit, UK had to implement various EU Directives and apply rules under EU Regulations
  - EU prospectus rules (as discussed above)
  - EU privacy rules
  - EU social security regulations

Update

- Brexit occurred on January 31, 2020
- Transitional arrangement with EU to continue to apply EU rules until December 31, 2020
- Even after transition arrangement ends, exemptions from prospectus requirement should remain in effect (employee share plan, small offering, small value exemptions)
- After transitional arrangement ends, UK will be viewed as "third country" for purposes of EU privacy regulations – see discussion below
- After transitional arrangement ends, employees transferring between EU/UK may be subject to double social security charges

Brexit - Key Points

Agreement with the EU still not reached

UK companies can still launch share plans into the EU

Impact on data transfers

Social security contributions

Effect on Administrators

Be prepared- even if no deal

European Union

ECJ invalidates EU-US Privacy Shield

Background

- Companies may collect, process and transfer employees' personal data to administer participation in the share-based incentive programs only if valid justification exists
- Previously, in connection with the cross-border transfer of data to USA, companies could rely on the EU-US Privacy Shield Framework

Update

- On July 16, 2020, the European Court of Justice ("ECJ") issued a ruling invalidating the adequacy of data protection in the United States and the Privacy Shield
- Companies relying on the Privacy Shield in connection with the cross-border transfer of personal data will need to find a new compliance method since July 15, 2020 with no grace period
- Reliance on Standard Contractual Clauses is still possible. However, companies should assess whether the clauses are sufficient to protect personal data transfers in instances where the law of the third country allows its public authorities to access such information

Data Protection after Brexit - Key Points

- Agreement with the EU still not reached
- UK companies are likely to be in the same position as US companies
- No finding of adequacy
- Use of Standard Contractual Clauses?
- UK GDPR
- Consent?
- Effect on Administrators
- Be prepared- even if no deal

03 Global developments

Jurisdictions

- Canada
- China
- European Union
- Russia
- Sweden

Canada

Proposed limitation on stock option deduction

Background

- Beneficial tax treatment currently available for stock options if underlying shares are "prescribed shares"
  - Only 50% of spread at exercise subject to income tax (may differ in Quebec for Quebec provincial taxes)

Update

- Proposed elimination of beneficial tax treatment on stock option gains in excess of CAD 200,000 annual cap (per employee) for grants made by "large, long-established, mature firms"
- CAD 200,000 cap calculated based on FMV of underlying shares at grant
- Cap should apply on prospective basis to options granted after proposal implemented into law
- One benefit: corporate tax deduction would be available for option gains not subject to preferential tax treatment
- Originally intended to come into force January 1, 2020, but delayed

Canada

Proposed limitation on stock option deduction

Action Items

- Determine if option grants would exceed annual cap
- Monitor developments

Canada

New case law on termination of vesting for equity awards

Update

- Recent judicial decision (*O'Reilly v. Imax Corporation*) held former employee wrongfully terminated and awarded terminated employee 24 months' worth of unpaid compensation, including amounts from forfeited equity awards that would have vested during that time
- In its decision, court indicated that the plans (and presumably award agreements) did not unambiguously establish when termination would occur for purposes of awards and interpreted ambiguity in employee's favor
- Highlights importance of defining "termination" when drafting award agreements to avoid uncertainty with respect to treatment of awards during a notice or garden leave period
- However, in an even more recent case, where appropriate language was included in the award documentation (*Battiston v. Microsoft*), the decision focused on whether the termination provisions are "harsh and oppressive" and the required amount of notice to participants regarding such provisions
- Potential application of provincial Employment Standards Act requirements

Canada

New case law on termination of vesting for equity awards

Action Items

- Review and refine definition of “termination” in plan documents/award agreements, as necessary
- Monitor further case developments and appeals
- Evaluate potential exposures for long service employees.

China

Updates on SAFE requirements

Background

- Under Circular 7, non-PRC public companies must seek approval from State Administration of Foreign Exchange ("SAFE") for share-settled equity awards granted to "domestic individuals" working in China, followed by ongoing reporting obligations
- Filing in province where issuing company has legal subsidiary
- All funds related to awards must be remitted out of/into China through dedicated account
- Company must undertake to immediately repatriate all proceeds to China
- Non-PRC private companies are not authorized to grant equity awards in China

China

Updates on SAFE requirements

Updates

- In Beijing:
  - New application requirements
  - Beijing SAFE requested companies complete questionnaire to assess impact of trade dispute
- Shanghai SAFE more closely scrutinizing re-registration and quota applications
  - Amounts reported as remitted must match amounts reported on quarterly reports
  - Full quota may not be approved due to amounts remitted in prior years
- Banks more closely scrutinizing remittances
  - May flag employees not included on employee list submitted to SAFE
  - If approval received in Shanghai, may refuse to accept proceeds pertaining to share sales occurring > six (6) months after termination of employment
- Shanghai and Beijing SAFE reject registration of pre-IPO plans

China

Updates on SAFE requirements

Action Items

- Review data before re-registration to ensure it accurately reflects vesting, quota and remittance data reconciled with quarterly reports and bank records
- If approval received in Shanghai:
  - Submit re-registration applications early (typically they will accept this starting in early October)
  - Ensure process is in place for selling shares and repatriating proceeds within six (6) months after termination of employment
- Update employee lists (requires amended registration application) to avoid new employees' funds being held up by banks
- Monitor impact of China-US trade dispute

European Union

Updates on EU prospectus directive / regulation

Background

- Public offerings of securities in EU / EEA (mainly share purchase plans) were subject to EU Prospectus Directive
  - Required filing of EU-compliant prospectus, unless exemption or exclusion applied
- Available exemptions / exclusions:
  - EUR 5 million exclusion
  - 150-person exemption
  - Employee share plan exemption
    - "Information Document" must be distributed to employees - but no prospectus filing
    - Available only for companies incorporated / headquartered in EU / EEA or listed on EU / EEA exchange

European Union

Employee share exemption from EU prospectus regulation

Action Items

- For offers made in reliance on employee share plan exemption from prospectus requirements, prepare/distribute Information Document to eligible employees (verify country-specific requirements)
- Country-specific considerations related to the Information Document
  - Separate Information Document required for Poland, valid for 12 months, and must be translated into Polish
  - Translation in Germany is recommended, unless employee population is sufficiently fluent in English
- Some regulators continue to require securities filings, even if relying on an exemption from the prospectus filing requirement
  - Pre-offer reports are required in Austria, Croatia, Greece, and Portugal
  - Post-offer reports are required in Hungary, Italy*, Poland, and Portugal

Russia

Foreign account reporting requirements

Background

- Employees who are Russian currency residents must file both (i) notifications on the opening, closing or change of details of foreign bank accounts, and (ii) annual cash flow reports on foreign bank accounts, regarding the beginning and ending balances and the transactions conducted during the year

Update

- As of January 1, 2020, reporting requirements expanded to foreign brokerage accounts opened in connection with the implementation of equity programs
- An exemption from reporting requirements could be available if the turnover or balance in the account is low and certain other conditions are met – but bank/brokerage accounts opened in the US are not eligible for exemption

Russia

Repatriation requirements

Background

- Previously, employees could receive funds directly into foreign accounts in OECD (Organisation for Economic Co-operation and Development) or FATF (Financial Action Task Force) countries without having to repatriate them to a Russian bank, provided funds were from the sale of securities listed on the Russian stock exchange or foreign stock exchanges specified by Russian federal law (e.g., NYSE and Nasdaq)

Update

- Effective December 2, 2019 (with retrospective effect to January 1, 2018), exemption from repatriation requirement applies to a foreign <u>bank</u> account only if account is in an EAEU (Eurasian Economic Union) member country or a country that supports the automatic exchange of financial information including under the common reporting standard (CRS) with the Russian Federation
  - Because US is not an EAEU member country and does not have an automatic exchange agreement with Russian Federation, Russian-based employees may not directly transfer funds into a foreign bank account in the US and must initially credit funds to a Russian bank account
- In contrast, under a directive effective April 17, 2020, repatriation requirements relaxed for foreign <u>brokerage</u> accounts
  - Employees generally may receive funds related to shares (e.g., cash dividends, sale proceeds, etc.) directly into a foreign brokerage account in the US (or other foreign country)

Russia

Foreign account reporting requirements & repatriation requirements

Action Items

- As potential penalties for failure to comply are significant, consider notifying participants of foreign account reporting and repatriation requirements
- Update tax supplements, as necessary

Sweden

Tax withholding challenges

Background

- Equity award income taxed as employment income and subject to employer tax withholding obligation
    - Technically, withholding from salary required
    - Further, prohibited from withholding tax in excess of employee's monthly gross salary
    - Most companies ignored and used net share delivery/sell-to-cover withholding method

Update

- Due to new PAYE reporting requirements, Swedish Tax Authority (“STA”) has more visibility into taxes withheld on equity award income
- If tax withheld exceeds employee's monthly gross salary, flags to STA that tax not withheld from salary
- STA auditing companies for non-compliance with withholding obligations

Sweden

Tax withholding challenges

Action Items

- Consult Swedish payroll to determine exposure
- At least going forward, consider changes to withholding process (unless already withholding from salary)
    - Withhold only from salary, up to employee's monthly gross salary, and employee responsible for remaining tax (if any)
    - Withhold from salary, up to employee's monthly gross salary, and withhold/sell shares to cover any remaining tax due (can be remitted to employee or directly to STA)
    - Withhold using net share issuance, but bifurcate reporting of settlement of an award
        - Report only the net shares issued as income/benefit-in-kind
        - Report the amount remitted as tax withholding as a separate “cash share related incentive” (evaluate accounting implications)
- Add tax withholding provision to terms for Sweden, if needed

04 Corporate tax focus

United Kingdom

HMRC Corporate Tax Deduction Attack? New reporting obligation for net share withholding

Background

- Companies must file annual share plan return, reporting all grants and taxable events during prior tax year

Update

- Beginning with 2019-2020 share plan return which was due in July 2020, companies must report if using net share withholding method
  - Report net shares delivered to employees
  - Report value of shares withheld to cover taxes
- HMRC will likely use the information to reduce corporate tax deduction for share-based awards by value of shares withheld
- Consider use of Sell to Cover
- Recharge arrangements?

United Kingdom

New reporting obligation for net share withholding

Action Items

- Address additional reporting if using net share withholding method
- Be prepared to reduce corporate tax deduction amount if relying on statutory corporate deduction
  - Can continue to claim deduction for withheld shares if value charged to UK employer pursuant to written reimbursement agreement

Corporation Tax Deduction

1 Can the local employer receive an automatic statutory deduction?

- No

2 Can the local employer receive a deduction if they reimburse the parent?

- No

3 Are there any specific requirements in order to get a deduction?

- If the settlement is in cash, a tax deduction may be available. However, the tax deduction does not apply with respect to employees earning annual wages over set limits

4 Does it impact the employee tax treatment?

- No

Corporation Tax Deduction

1 Can the local employer receive an automatic statutory deduction?

- No

2 Can the local employer receive a deduction if they reimburse the parent?

- Yes

3 Are there any specific requirements in order to get a deduction?

- Local tax deduction generally available if reimbursement is made or not.
- A recharge agreement is advisable, but according to the latest criteria of our General Directorate of Taxes in a 2018 binding ruling and our GAAP, not essential.
- Based on Supreme Court rulings, what seems to be an essential condition is that the Spanish subsidiary is formally aware of the share plan and is a signing party to the relevant agreements.
- Quantum of the tax deduction: FMV of the shares at grant or at vesting?
- Director´s deferred share compensation: strict compliance with corporate regulations to avoid that the Spanish Tax Authorities challenge the tax deduction

4 Does it impact the employee tax treatment?

- No

05

Which Macron? A focus on launching share plans in France (including updates)

French-qualified vs. Non-qualified RSUs and SOs

Employer costs

Non Qualified RSUs and SO	Qualified RSUs Pre-Macron	Qualified RSUs Macron I	Qualified RSUs Macron II	Qualified RSUs Macron III	Qualified SO
	At the rate of 30%	At the rate of 20%	At the rate of 30%	At the rate of 20%	At the rate of 30%
At a rate up to 46% (same as for salary) Based on the Vesting Gain, i.e. fair market value of the shares at delivery date Due at **delivery of shares**	Based on the fair market value of the underlying shares at grant date or IFRS value Due at the **grant** of the awards Opportunity to claim employer contribution on forfeited awards	Based on the Vesting Gain, i.e. fair market value of the shares at delivery date Due at the delivery of shares			Based on IFRS value **or** 25% of the fair market value of the underlying shares at grant date Due at the grant of the awards Opportunity to claim employer contribution on forfeited awards.

French-qualified vs. Non-qualified RSUs

Employee Costs

	NQ RSUs	"2012" Regime	MACRON I	MACRON II		MACRON III	
				< 300,000 €	> 300,000 €	< 300,000 €	> 300,000 €
Income tax	Progressive rate up to 45%	Progressive rate up to 45%	Progressive rate up to 45% Application of rebate depending on the holding period ▪ 50% : 2 years ▪ 65% : 8 years	Progressive rate up to 45% Application of rebate depending on the holding period ▪ 50% : 2 years ▪ 65% : 8 years	Progressive rate up to 45%	Progressive rate up to 45% Automatic 50% rebate (regardless of the holding period)	Progressive rate up to 45%
Social taxes or contributions	Up to approx. 23% of which 2.9% is non-tax deductible	9.7% of which approx. 6.8% is tax deductible + 10% specific social contribution	17.2% on entire gain of which 6.8% is partially or totally tax deductible (depending on holding period)	17.2% on entire gain of which 6.8% is partially or totally tax deductible (depending on holding period)	9.7% of which approx. 6.8% is tax deductible (depending on holding period) + 10% specific social contribution	17.2% on entire gain of which 3.4% is tax deductible	9.7% of which approx. 6.8% is tax deductible + 10% specific social contribution
Overall taxation	Approx. up to 59.45% Taxable event at delivery of shares.	Up to 61.64% Taxable event at sale	Depending on the holding period: up to ▪ max 59.14% ▪ min 31.915% **Taxable event at sale**	Depending on the holding period: up to ▪ max 59.14% ▪ min 31.915% **Taxable event at sale**	Up to 61.64% **Taxable event at sale**	Up to 38.17% **Taxable event at sale**	Up to 61.64% **Taxable event at sale**

French-qualified vs. Non-qualified SO

Employee Costs

	Non-Qualified SO	Qualified SO
Income tax	Progressive rate up to 45% Taxed during the *year of the exercise* of the SO ⇨ Cash issues: how to finance the tax due upon exercise?	Progressive rate up to 45% Taxed during the *year of sale* of the underlying shares
Social taxes or contributions	Up to approx. 23% of which 2.9% is non-tax deductible	9.7% of which approx. 6.8% is tax deductible + 10% specific social contribution
Overall taxation	Approx. up to 59.45%	Up to 61.64%

France

Biggest challenges in the past 12 months

Closed Periods

Recent legislative changes on the definition of the applicable periods

- Qualified RSUs: underlying shares cannot be sold within specific time periods
- Qualified SO: options cannot be granted within specific time periods

Employer-specific social security contribution claims

Employer contribution paid at the time of the grant of SO and RSU ("Pre-regime Macron") can be claimed for forfeited SO and RSUs

Tax and social audits

Scrutiny in relation to the practice of the employer in terms of reporting obligations, social security contributions, with the risk of challenging the French-qualified status of the RSU and/or SO

France

Several withholding issues in practice arise, not addressed by French tax code or administrative guidelines:

Withholding must be performed by the debtor of the sums (i.e., granting company) even if located abroad

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Rates of withholding:
"sell to cover" or
"net settlement" issues

Withholding tax and internationally mobile employees: how is the gain sourced?

- Foreign-source income that gives rise, pursuant to an international tax treaty, to a tax credit equal to the French tax corresponding to such income is excluded from the scope of the withholding tax
- "Expatriate" and "Impatriate" tax regimes: employees are exempt of tax on part of their remuneration, including non-qualified gains

⇨ Adjustment of the withholding tax basis the month of vesting or exercise?

Questions

Baker McKenzie.

bakermckenzie.com