

Global Equity Services

Clients and Friends Newsletter

Global

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THE TRENDS**

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Recent Developments for the Fourth Quarter 2009

This letter is from the Global Equity Services ("GES") group in San Francisco, Chicago and New York. Attorneys in the GES practice group work extensively with multinational employers to design, implement, and maintain equity-based compensation programs, including stock option, stock appreciation rights, restricted stock, restricted stock unit and stock purchase plans for their employees, consultants and directors. Within this context, we provide advice regarding US and non-US tax, securities, labor, exchange control, data privacy and other legal requirements. We design equity-based compensation programs to take into account a client's overall international tax structure and its accounting requirements. We also offer sophisticated and experienced perspectives on option repricing/exchange programs and ways to preserve the equity incentives in transactions such as spin-offs, mergers and acquisitions. In addition to legal services, we deliver project management services and prepare employee communications. To complement our equity-based compensation practice, we furnish guidance in connection with global and domestic benefit plans to document fiduciary decisions, compare benefit programs and attain compliance. This letter summarizes developments around the world that affect global stock plans and that, for the most part, occurred between October and December 2009. In some cases, we expand on topics mentioned in previous updates.

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Fourth Quarter 2009 — The Trends

The new decade brings much of the same in equity compensation, but a few new challenges as well.

We were unable to convince the Australian government through our comments (thanks to those clients who joined our submission) to drop the adverse, tax-at-vest approach to stock options, so we are now helping clients modify their award strategy in Australia to mitigate the adverse tax results there. We are also preparing revised tax summaries for employees and for Australian offer documents.

We have been busy with several clients who are “redomesticating” (*i.e.*, moving their corporate domicile from Bermuda, Cayman or Netherlands Antilles to France, Ireland, Switzerland, UK or other European locations). For the most part, these companies continue to have their shares publicly traded here in the US throughout the move. The redomestication requires considerable attention to the company’s outstanding and future equity awards, and our GES team has worked closely with these companies and our vast international tax network to achieve the desired results. If you find yourself faced with one of these transactions, please start planning early because the amount of effort it takes to move the sponsorship of the existing equity and other benefit plans to the new corporate entity as well as assuming all of the outstanding awards is considerable. Further, the company’s ability to grant certain types of awards following the redomestication, such as RSUs where no consideration is paid to receive the shares, may be limited depending upon the new country where the company is domiciled.

We are also working closely with many companies to review their ESPP documents and ESPP procedures to reflect the final Section 6039 and 423 Regulations (as you may know, we have been closely involved in the regulations process, including providing comments and appearing at the public hearings). At this stage, we have developed a strategy for insuring that ESPPs are not only compliant with these new regulations, but also have the maximum flexibility to accommodate international employees and various corporate structures.

Finally we continue to focus on state-of-the-art international compliance, assisting our clients in not only designing cost-effective strategies for global grants, but also putting in place plan and award documentation to optimize legal and tax compliance globally.

AUSTRALIA

[Passage of Employee Share Scheme Tax Legislation](#)

As reported in the first, second and third quarter 2009 Clients & Friends newsletters, amendments to the Australian tax laws governing the taxation of stock options, RSUs and ESPPs were first introduced in the 2009/2010 Australian Federal Budget (the “Budget”).

After a lengthy review process, the amendments to the tax laws became law¹ on December 14, 2009. Notably, the amendments to the tax laws were passed without further modification and apply to stock options, RSUs and ESPP purchase rights granted both on or after July 1, 2009. The new tax laws also apply with respect to reporting and valuation requirements for awards granted prior to this date. As we have previously noted, these rules have a significant negative impact on stock options (taxation at vesting), so we recommend companies evaluate in particular the continued grant of stock options in Australia. For a description of the new laws, please see our prior client alerts [Australian Employee Share Scheme Legislation Introduced into Parliament](#) and [Australian Senate Passes Employee Share Scheme Tax Legislation](#).

As this newsletter goes to press, the Board of Taxation has just issued new regulations regarding the valuation methodology for income under stock options, RSUs and ESPPs. We are currently reviewing the new regulations and will issue a separate client alert in the next few days. Upon a first quick review, it appears it will still be necessary to use the statutory formula to value unlisted rights, such as options, which would likely result in some taxable value even for most underwater options. For a more detailed discussion of the new regulations, please see our Sydney office's [Client Alert](#). Companies will need to follow the developments in this area closely, so they can accurately prepare the first employer reports under the new laws, which are due to employees by July 14 and to the tax authorities by August 14. The reporting will need to be completed in a statement on a prescribed form (which has yet to be published), but not on the employees' pay slips.

At this time, companies should evaluate their Australian grant practices and modify any Australian Offer Documents and/or employee information supplements to include a description of the modified tax treatment of stock options, RSUs and ESPP purchase rights. Revised Offer Documents will need to be lodged with the Australian Securities and Investments Commission (or "ASIC") promptly upon the next grant in Australia. Please contact your GES attorney for additional details.

CHINA

[Update on Exchange Control Requirements Applicable to Cash-Settled Awards](#)

As reported in our first, second and third quarter 2008 Clients & Friends newsletters, the Central Bank and State Administration of Foreign Exchange (the "Central SAFE") issued an internal circular to the various local SAFEs on April 6, 2007, entitled "Operational Guidelines on Foreign Exchange Administration Concerning Domestic Individuals Participating in Stock Purchase Plans and Stock Option Plans of Overseas Listed Companies ("Hui Zong Fa [2007] No. 78" ("Circular 78"), under which SAFE approval is required for both ESPPs and for stock option plans (including those limited to cashless exercise). Although RSUs are not expressly mentioned in Circular 78, approval is also required for

¹ The legislation that was enacted which contains the new employee share scheme rules are the *Income Tax (TFN Withholding Tax (ESS)) Act 2009 (Cth)* and the *Tax Laws Amendment (2009 Budget Measures No. 2) Act 2009 (Cth)*.

RSUs where no funds are remitted out of China and employees simply receive the proceeds back into China from the sale of the shares. We offer the following update regarding Circular 78 issues related to cash-settled awards in China:

As reported in our third quarter 2008 Clients & Friends newsletter, Shanghai SAFE had taken the view that where a stock award (such as an RSU or a SAR) is settled in cash, SAFE approval is not necessary. However, in more recent conversations with officials at various SAFE offices, our PRC colleagues were informed that SAFE officials now take the view that cash-settled RSUs and SARs are indeed subject to exchange control approval because the amount of cash payment refers to the stock price. Further, Beijing and Shanghai SAFE offices have been reviewing and approving exchange control applications for equity award plans that cover cash-settled RSUs. Therefore, it appears that local SAFE offices are now following Central SAFE's position that cash-settled awards are subject to Circular 78 and thus require SAFE approval.

We should note that in our experience, both Central SAFE and local SAFEs seem to change their views/positions from time to time and are not always consistent among themselves. We will continue to monitor the position of SAFE officials, particularly at local SAFE offices other than Beijing and Shanghai. If you are interested in considering whether to grant cash-settled awards in China, please contact your GES attorney.

DENMARK

Taxation of Time-Vested RSUs Clarified

Guidelines published by the Danish tax authorities in December 2009 seem to provide greater certainty with respect to the time of taxation of time-vested RSUs. To date, RSUs have not been specifically addressed under Danish tax law but, based on case law, the tax authorities have sought to tax them at the time the employee obtains an "unconditional right" to the RSUs. In most cases, this has been interpreted to occur at vesting. However, there is a risk that RSUs subject to time-based vesting may be taxed at grant, although this risk is relatively low for RSUs that are forfeited in the event of the employee's death. To further reduce the risk of tax at grant, we have recommended granting RSUs subject to performance-based vesting.

The recently published guidelines seem to provide greater certainty with respect to when employees will be considered to have obtained an "unconditional right" to RSUs (and are therefore subject to tax). Under the guidelines, it appears that tax should be due at vesting only if (i) vesting is conditioned upon continued employment (which is typically the case for most companies), and (ii) the vesting period is three years or more. If the vesting period is less than three years, it is unclear if taxation can be postponed until vesting (at least in the absence of performance vesting conditions). Under a conservative approach, to ensure tax at vesting, it may still be advisable to impose performance vesting conditions on RSUs granted in Denmark (in addition to the conditions set forth in Items (i) and (ii) above).

There are also labor law risks associated with granting RSUs (and other equity awards) in Denmark. For RSUs (and other stock awards, not including restricted stock) granted to

employees after July 1, 2004, the Stock Option Act permits employees involuntarily terminated for *any* reason, except for breach of the employment contract (*i.e.*, serious misconduct), to retain all outstanding grants, whether vested or unvested, until the expiration date of the award, regardless of language in the plan or other grant documents to the contrary. (Please note that an argument that the employee should not be permitted to retain outstanding grants on the basis of poor performance or that he or she failed to meet performance expectations is highly unlikely to succeed in the Danish labor courts.) Employees may also be entitled to at least a pro-rata portion of future grants they would likely have received in the year of termination. If the employee voluntarily terminates employment, he/she is not entitled to any unvested awards, nor can he or she retain vested awards until the expiration date.

Please let your GES attorney know if you would like more information regarding the taxation of RSUs or the application of the Stock Option Act in Denmark.

ESTONIA

Possible Changes to Taxation of Equity Awards Granted by Foreign Issuer

The Ministry of Finance has introduced a draft amendment to the Estonian income tax act that would affect the taxation of employee equity awards (*e.g.*, stock options, RSUs, rights to purchase shares under an ESPP) granted by a non-resident company.

At present, income from equity awards granted by a local Estonian employer is considered a fringe benefit and the employer must pay income tax and social taxes on such income. In contrast, income from equity awards granted by a non-resident company (*e.g.*, a US company that grants equity awards to employees of its subsidiary in Estonia) is not considered a fringe benefit, provided that the local Estonian employer is not charged for the cost of the awards. In this case the employee must pay the applicable tax on the income from such awards.

Under the proposed legislation, income from equity awards granted by a non-resident company will also be characterized as a fringe benefit so that the local employer must pay income tax and social taxes on such income.

The taxable event for equity awards would stay the same under the draft legislation so that it occurs when the grant recipient receives a non-forfeitable and appraisable benefit (usually, exercise for options, vesting for RSUs and purchase for ESPP).

The draft amendment has not yet been approved by the government and submitted to the Parliament. Several organizations (such as the Estonian Employers Confederation and the Estonian Chamber of Commerce and Industry) have requested that the Ministry of Finance open a discussion about the proposed changes to the law, so it is not certain whether the amendment will become law. If the amendment does become law, it is anticipated it would become effective January 1, 2011, although it is not clear at this point whether it would affect outstanding awards or only awards granted on or after such date. Watch for information about this development in future newsletters or feel free to contact your usual

GES attorney if your company is considering granting equity awards in Estonia and needs to know whether or not the amendment has become law.

FRANCE

Recent Labor Court Decisions Involving Equity and Benefits

There have been a few cases decided in French courts recently that may have an impact on employee equity awards granted in France.

In one case a French court ruled that a company must communicate to each employee the decision to grant options. Otherwise, the court decided, the employee will not have been informed of the starting point of the exercise period, leading to the conclusion that the exercise period has not begun. A notice of grant should suffice for the communication; therefore, we believe most companies will not have any problem complying with this requirement.

A second line of cases, although not specifically related to equity awards, has been decided by the French Supreme Court in relation to discrimination. In these cases, the French Supreme Court decided that, when only a part of a company's workforce receives a benefit, it may be necessary to show that the benefit was not provided on a discriminatory basis, but instead was made on objective (and non-discriminatory) grounds, with justification as to why only a part of the company's personnel was eligible for the benefit. If no objective grounds are set forth, non-eligible employees may be able to sue and receive damages amounting to the benefit and, if the case calls for it, potential criminal sanctions both for the company and its corporate representatives. Because these cases did not address equity grants, and in particular equity grants provided to employees of a French subsidiary, it is unclear as to how, or whether, these cases would apply to equity grants by US multinationals. It would appear at this stage that discretionary grants to key executives or employees of the French subsidiary can be successfully defended; however, these cases do indicate a troublesome trend in French labor decisions that companies will have to closely monitor because of their potential impact on selective equity grants in France.

Another trend in French labor court cases (although not all of these cases have been confirmed by the French Supreme Court) is that it is problematic to treat employees differently based on the nature of their termination, unless such disparate treatment is based on objective criteria. French courts construe "objective criteria" in a restrictive manner, but the condition of continued employment for the grant/vesting/exercise of employee equity awards should be acceptable under current law.

Finally, a French Supreme Court decision now makes it clear that it is problematic to penalize employees by requiring forfeiture of previously vested awards even in the case where an employee is terminated for gross misconduct, which is roughly equivalent to "for cause." In this case, the court determined that such forfeiture was a prohibited financial penalty and the employee was entitled to damages.

Please contact your GES attorney if you would like additional information on any of these cases.

Penalties for Late Payment of AMF Fees

We have been advised that the Autorité des marchés financiers ("AMF") is issuing penalties for late payment of AMF filing fees. Clients who either filed a French prospectus before the implementation of the EU Prospectus Directive or who filed an EU prospectus in France are subject to AMF filing fees. The minimum filing fee rate per prospectus is €1,000, unless the value of the shares purchased during the prospectus period was in excess of €6,666,666.

HUNGARY

Solidarity Tax Abolished

In our second quarter 2006 Clients & Friends newsletter, we noted that as of January 1, 2007, in addition to personal income tax, individuals would be subject to a solidarity tax on the amount of their aggregate income that exceeded a certain threshold, including equity income. This solidarity tax was abolished effective as of January 1, 2010. If you have included information about the solidarity tax in employee communications, you should remove that information when you are updating such communications.

INDIA

Liberalization of Repatriation Requirements

On January 15, 2010, the Reserve Bank of India issued a notification liberalizing repatriation requirements for non-Indians resident in India. Pursuant to the notification, non-Indians resident in India may open and maintain a foreign currency account with a bank outside India and deposit all of their salary in this account, as well as any proceeds resulting from equity awards (provided any income tax due on the salary/equity income has been paid). Previously, such residents could remit only an amount not exceeding 75% of their salary into foreign bank accounts.

New Guidance on Valuation of Equity Awards

As you may have seen in our December 23, 2009 client alert, the Government of India issued guidance on the valuation of equity awards (for Indian tax purposes) on December 18, 2009. As you may recall, the June 6, 2009 Indian budget announced the elimination of the fringe benefit tax (FBT) applicable to employee equity awards. Thus, employees are (again) subject to income tax on their equity income at exercise (options), vesting (RSUs) or purchase (ESPP), and the employer has a withholding obligation with regard to the income tax. Although the elimination of the FBT is retroactive to April 1, 2009, the Indian government had not issued guidance on how the fair market value of the shares should be calculated for purposes of determining the taxable amount at exercise/vesting/purchase.

Unfortunately, under the new guidance, companies are not free to use their share trading price unless the company is listed on a "recognized" stock exchange (i.e., shares registered under the Indian Securities Contract (Regulation) Act). Companies whose shares are not

traded on a "recognized" exchange (which will be most, if not all, U.S. issuers) will have to hire an Indian merchant bank to determine the value of their shares on any relevant date. In particular, the guidance reads: the "fair market value ... on the [relevant] date shall be such value as determined by a merchant banker on the specified date."

Accordingly, the valuation rules which applied during the FBT regime will apply, including the need to engage an Indian merchant bank for valuation purposes. Even with a cashless exercise of an option, it appears that the need for a merchant bank valuation is not avoided, presenting the possibility of the employee having income on the option exercise based on the merchant bank valuation for the shares for that day and a simultaneous capital gain or loss on the sale transaction if the sale is at a different price than the valuation.

If an employer has used a different method of valuation since the April 1, 2009 elimination of the FBT, amended reports would be required, unless perhaps a merchant bank valuation can be obtained to support the value previously reported. Please contact your GES attorney to obtain more information on how to best proceed in this situation.

ISRAEL

Israeli Tax Authority Issues Section 102 Trustee Plan Guidance

The Israeli Tax Authority (the "ITA") has recently issued several *unofficial* emails setting forth the ITA's view of the issues affecting awards granted under a Section 102 trustee plan in Israel. In particular, please be aware of the following:

(1) *Approval Required for Supervisory Trustee Arrangement for Trustee Awards:* As in the past, options, RSUs and/or purchase rights granted under a trustee plan intended to comply with the requirements for favorable tax treatment under Section 102 of the Income Tax Ordinance and shares acquired under these plans must be deposited with a trustee for a lock-up period. (The length of the lock-up period varies from 12 to 24 months from the grant date according to the tax route selected.) Previously, the ITA accepted that, in most cases, awards granted by a foreign issuer and the shares acquired were not actually deposited with an Israeli trustee; instead, the awards and shares were held by the company-designated broker who ensured compliance with the lock-up period requirements with assistance from the trustee to whom the broker and/or company communicated any sales of shares. This arrangement was referred to as a "supervisory trustee" relationship and was deemed to satisfy the requirements for trustee plans.

Recently, however, the ITA has begun to insist that companies granting awards under a trustee plan that rely (or intend to rely) on a supervisory trustee arrangement obtain specific approval for such arrangement. The approval can be obtained by the trustee or the company. If your company grants awards under a trustee plan and relies on a supervisory trustee arrangement, please contact your GES attorney regarding the approval requirement.

(2) *Taxation of Dividends:* The tax rate applicable to dividends paid on shares acquired under a trustee plan prior to the expiration of the applicable lock-up period has changed, according to recent advice from the ITA. Previously, such dividends were subject to tax at a

flat rate of 20%. Now, however, the ITA has insisted that dividends paid on shares acquired under a trustee plan prior to the expiration of the applicable lock-up period should be treated as gains from the sale of shares and, therefore, subject to tax at a rate of 25% (for awards granted under the "capital gains" tax route) and 46% (for awards granted under the "ordinary income" tax route). Although there is no legal basis for this change in interpretation, it is likely that trustees will (and should) begin withholding taxes on dividends at the new rates effective immediately.

This change in view should not directly impact the parent company and/or local entity as the trustee is responsible for withholding all taxes in connection with awards granted under a trustee plan. That being said, companies may want to review any tax summaries they provide to employees to ensure that this change is properly reflected.

ITALY

[Tax Authorities Issue Official Interpretation of New Guidelines Governing Reporting of Foreign Assets and Asset Transfers](#)

As many of you likely are aware, Italian tax residents must report on their annual tax returns (Form UNICO, Schedule RW), or on a special form if no tax return is due, any foreign investments or investments held outside of Italy, as well as asset transfers that, as of the calendar year-end, exceed €10,000. The Italian government recently has announced measures to step up enforcement of these asset reporting obligations, including increased penalties and guidelines for investigating the existence of such assets and asset transfers. The Italian tax authorities have issued an official interpretation regarding the penalties for reporting failures that includes a flat penalty ranging from €258 to €2,065 and an opportunity to reduce penalties that may apply to certain unreported foreign assets in 2008 by filing an amended tax return for 2008. Because this is a taxpayer (rather than employer) obligation, we recommend notifying Italian employees that there may be an opportunity to reduce penalties arising from past asset reporting failures and advising them to consult with their personal tax advisors regarding these obligations. If you have any questions, please contact your GES attorney.

[Tax Circulars Clarify Optionees' Obligation to Report Vested Options](#)

The Italian tax authorities also have clarified in two recent tax circulars that, in determining whether the €10,000 threshold for foreign assets or investments has been exceeded, Italian taxpayers must take into account any vested stock options over shares of a foreign company that taxpayers may hold. If the €10,000 threshold was exceeded as of December 31, 2009, the taxpayer must report all foreign investments or investments held outside of Italy, including the vested stock options, on his or her tax return or special reporting form, which must be filed during 2010. Because this is a taxpayer (rather than employer) obligation, we recommend notifying Italian employees that vested stock options over shares of non-Italian companies must be reported as foreign assets in Italy and advising them to consult with their personal tax advisors regarding these obligations. If you have any questions, please contact your GES attorney.

Employers May Be Able to Correct Non-payment of Social Insurance Contributions with Reduced Penalties

In early December 2009, the Budget and Economic Commission of the Italian Parliament approved an amendment to the 2010 Finance Bill that would give employers in Italy an opportunity to correct past failures to pay social insurance contributions for work periods through October 2009. Affected employers also would be able to reduce penalties to as little as 40% of what the original penalty would have been. If this amendment is included in the Finance Bill, employers must take certain affirmative steps to seek a correction, including making a formal request to the Italian social security authorities, within 30 days of the Finance Bill becoming effective. If you would like additional information regarding the possibility of correcting previous non-payment of social insurance contributions in Italy, please contact your GES attorney.

Broadening of Social Security Exemption

On December 11, 2009, the Italian Social Security Authority released Circular No. 123, which offers official guidance on Law Decree no. 112/2008 (published on June 25, 2008 and approved by the Italian Parliament on August 5, 2008). Law Decree no. 112/2008 provides that stock options exercised after June 25, 2008 are exempt from social security contributions. In Circular No. 123, the Social Security Authority clarifies that other share-based awards should also be exempt from social security contributions, provided they are not granted to the “generality of employees” in Italy (*i.e.*, only to a select number of employees in Italy).

By imposing this requirement, it appears the Social Security Authority wanted to preclude companies and employees from availing themselves of both the social security exemption and the broad-based plan exemption (pursuant to which employees may be able to exclude €2,065 per calendar year from their taxable equity income and which applies if awards are granted to the generality of employees in Italy). However, the same concern apparently did not apply to stock options which are exempt from social security contributions even if granted to the generality of employees in Italy.

Consequently, because the exemption under Circular No. 123 applies only if awards (other than options) are not granted to the generality of employees, it will not be available to most ESPPs (which are typically offered to all employees in a particular country). However, the exemption would be available to RSUs or restricted stock, provided these awards are granted only to select employees in Italy. The exemption applies to all shares issued on or after December 11, 2009, regardless of when the underlying award was granted. In addition, it may be possible to apply the exemption to shares issued between June 25, 2008 and December 11, 2009, in which case companies and employees would have to seek a refund for overpaid social security contributions in connection with taxable events that occurred during this period. Because the period of time for claiming a refund for social security overpayments may be limited, companies interested in filing such a claim with the Social Security Authority should contact their GES attorney as soon as possible.

JERSEY

[Jersey to Amend Legislation Regarding Taxation of Share Options and Share Awards](#)

Jersey is reevaluating the need to amend its Income Tax (Jersey) Law regarding the tax treatment of share options and share awards granted to employees and officers.

Currently, Jersey's legislation on this issue is complex and does not deal specifically with the taxation of equity awards, which has not only been difficult for companies operating in Jersey but has cost Jersey's Comptroller considerable time and resources to make tax determinations. The fundamental principle applied to stock option schemes at this time is that employees and officers are taxed on the market value of options at grant, rather than when the options are exercised. The global economic downturn, which resulted in a decrease in the value of many awards (and therefore a greater tax burden in relation to the actual value received for the award), has intensified Jersey's need to amend its current legislation.

Jersey's tax treatment of stock option and other equity awards applies to Jersey-resident employees and officers, as well as to individuals seconded to Jersey on short-term contracts. Amendments to current legislation will also take into account new residents and exiting residents, and whether awards are granted or issued by an overseas employing company.

We will continue to update you on any potential changes in the taxation of equity awards in Jersey. If you have any questions, please contact your GES attorney.

NEW ZEALAND

[Addition of Ireland as Specified Overseas Jurisdiction](#)

In New Zealand, the Securities Act (Overseas Employee Shares Purchase Schemes) Exemption Notice 2002 (the "Exemption Notice") exempts certain overseas issuers from the prospectus and investment statement requirements if certain conditions are met (*e.g.*, certain documents must be provided to both the employees and the Registrar of Companies). The Exemption Notice covers companies that are incorporated in specified overseas jurisdictions, including the US. Effective December 18, 2009, the Exemption Notice now also applies to companies that are incorporated in Ireland. For companies moving their headquarters to Ireland and granting equity to New Zealand employees, this change is welcomed.

Please contact your GES attorney if you have any questions relating to relying on the Exemption Notice for offers under employee stock plans in New Zealand.

PERU

[Revised Capital Gains Tax Treatment](#)

Prior to January 1, 2010, no tax was due upon the sale of shares provided that the individual had not already executed ten sales and ten purchases of shares in either domestic or foreign companies during the calendar year. However, effective January 1, 2010, any capital gain

realized from the sale of shares will be subject to income tax at a rate of 5%. This change may necessitate updating tax summaries provided to employees in Peru.

POLAND

Recent Court Rulings Indicate Taxable Event for Equity Awards May Not Be Until Sale of Shares

Two recent court rulings in Poland lend more weight to the view that stock options and RSUs should be taxed upon the sale of shares, not upon exercise and vesting (respectively). The recent court rulings that, despite the Polish tax authorities' position to the contrary, the deferral from taxation provided under Article 24.11 of the Personal Income Tax law applies to shares of both Polish and foreign companies, and applies to both newly issued and treasury shares.

In a September 15, 2009 ruling, a Polish court considered whether awards granted pursuant to a foreign company's equity plans (which included a Deferred Bonus Plan, Executive Share Option Plan and Long-Term Incentive Plan) would be taxable upon vesting/exercise or upon the subsequent sale of shares. The tax authorities had taken the position that participants earned taxable income at vesting/exercise and, because the employer bore the cost of the plans, the income should be categorized as employment income. Further, the tax authorities concluded that the Article 24.11 deferral from taxation only applied to newly issued shares of Polish companies.

The court, however, held that the income was not employment income, despite the fact that the employer bore the cost of participation in the plans, because the employer played no role in deciding who was entitled to receive awards under the plan and the rights of participants to acquire shares did not result from agreements with or actions by the employer. The court also held that the Article 24.11 deferral from taxation applied to foreign companies, as well as Polish companies, and applied to both newly issued and treasury shares. Finally, the court held that taxable income would be earned by a participant only upon the subsequent sale of shares and should, therefore, be taxed as capital gains.

In a separate case, a Polish court considered a foreign company's employee stock purchase plan, under which shares were granted for free (the "Discount Shares") to participants as a reward for purchasing shares (the "Investment Shares") under the plan. The Discount Shares could not be sold for a specified holding period. Further, if a participant held the Investment Shares for a specified period, the participant would receive additional shares (the "Additional Shares"). Affirming some of the same principles enunciated in the September 15, 2009 ruling, the court held that because participants had to acquire Investment Shares and had to refrain from selling those shares in order to receive the Discount Shares and Additional Shares, taxable income would be incurred at the subsequent sale of shares, rather than upon receipt of the Discount Shares and Additional Shares.

The tax authorities have appealed these recent court decisions and therefore the rulings are not final. Even if the decisions are upheld, they are not binding on the tax authorities and therefore may not necessarily convince the tax authorities to change their position in the near term. Polish tax authorities have, however, historically changed positions on whether stock

options and RSUs are taxable at exercise and vesting, respectively. Although the tax authorities once took the position that income from stock options and RSUs should be categorized as capital gains, the tax authorities in recent years have taken the position that such income should be treated as employment income, and therefore, taxed at vesting or exercise, as applicable.

We will continue to update you on any changes in the taxation of equity awards in Poland. If you have any questions, please contact your GES attorney.

QATAR

New Income Tax Law

On November 17, 2009, Qatar issued a new income tax law effective January 1, 2010. Implementing regulations, which should provide details on the new law, are expected to be published soon. At this time, it seems resident expatriate individuals will be subject to income tax. Residency includes expatriates who work in Qatar for more than 183 days in any 12-month period. Qatari nationals are exempt from the new income tax law.

"Taxable income" is defined as gross income derived from all transactions conducted by the taxpayer in Qatar after subtracting allowable deductions. Thus, income from employee equity awards may be included in this definition and therefore, subject to income tax in Qatar. If the local Qatari employer reimburses the non-Qatari issuer for the cost of awards and expenses the payments on its Qatari books and records, the benefit would seem to be taxable to expatriate employees resident in Qatar.

RUSSIA

Securities Regulator Expected to Issue Guidance about Equity Plans Offered by Non-Russian Issuers

We reported in our first and second quarters 2009 Clients & Friends newsletter that amendments to the Russian Securities Market Law in May 2009 affect the ability of non-Russian issuers to grant equity awards to employees in Russia. Specifically, under the amendments, it may no longer be possible to offer equity programs without filing a registration with the Russian securities regulator (the Federal Service for the Financial Markets, or "FSFM"). At the time of our previous newsletters, we reported that US and other non-Russian issuers should consider ceasing to grant equity awards, including stock options, RSUs settled in shares and ESPPs to employees in Russia until the FSFM provides more certainty about the treatment of such awards under the amendments.

Although it was expected to be issued in 2009, to date, the FSFM has not issued official guidance about the regulation of equity awards offered to Russian employees of US and other non-Russian issuers. In the summer and fall of 2009, a number of companies approached the FSFM on an informal basis to obtain certainty about whether they could offer their equity award plans in Russia. Although no official guidance was issued, some of these companies received positive oral feedback from representatives of the FSFM, including one representative who indicated that multinational companies' equity-based

compensation plans are not viewed as a pressing issue by the FSFM. Similarly, another representative of the FSFM orally indicated that the regulator is not planning to restrict grants of stock options and similar rights by foreign companies to Russian individuals where the grant is made in accordance with applicable foreign law (*e.g.*, US law), the awards are granted to a limited number of individuals in Russia in connection with their employment for a Russian entity of the company group, and the awards are non-transferable and may only be exercised abroad. This is consistent with an unofficial securities law exemption that was previously available to foreign issuers before the May 2009 amendments to the securities law.

Finally, the head of the FSFM stated publicly at an American Chamber of Commerce meeting in Moscow in December 2009 that the recent amendments to the securities law do not apply to equity awards offered by foreign issuers to their employees in Russia. In addition, he indicated that the FSFM is preparing to issue official guidance in the near future, upon which multinational companies can rely in offering their equity plans to Russian employees.

These positive oral statements from representatives of the FSFM are promising, and we are optimistic that the FSFM will issue such guidance in the near future. Many companies that have put their equity award grants on hold are anxious to start offering stock options, RSUs, ESPPs and other equity awards to employees in Russia. We should note that even if the FSFM issues guidance, the regulator does not have the power to revise the Russian Securities Market Law. Thus, whatever guidance the FSFM issues, it could take additional months or years to determine how the requirements are enforced in practice by the FSFM or the courts. In addition, equity awards may need to be appropriately structured so that they comply with any requirements imposed by the FSFM.

We are closely monitoring these developments, and our colleagues in Russia are communicating regularly with the securities regulators. We encourage you to speak to your GES attorney if you have any questions or to determine if there are any solutions that may be available for your company.

SLOVAK REPUBLIC

Slovak Income Tax Act further Amended

Pursuant to an amendment of the Slovak Income Tax Act on December 8, 2009, stock options granted on or after January 1, 2010 will be subject to tax at exercise on the difference between the exercise price and the fair market value of the shares. Previously, options were taxed at vesting.

For options that were granted before January 1, 2010, the tax treatment is not entirely clear, but it appears that the stock options will be taxed both at vesting and exercise. The taxable amount at vesting will likely be the difference between the exercise price and the fair market value of the shares at vesting, and the taxable amount at exercise will likely be the difference between the fair market value of the shares at vesting and the fair market value of the shares at exercise.

If you have any questions regarding the above, please contact your GES attorney.

SOUTH AFRICA

New Interpretation of Exchange Control Filing Obligation

South African residents may participate in offshore employee stock plans where they are required to pay for shares in an amount up to their foreign investment allowance (which is currently ZAR4,000,000). Previous exchange control rulings in South Africa provided that participation in an offshore scheme required an application to be made to the Exchange Control Department at the South African Reserve Bank (“Exchange Control”) seeking approval for that participation.

A few years ago, the Exchange Control granted a dispensation for South African residents to transfer funds in excess of the threshold amount to purchase shares so long as the shares were immediately sold and the amounts were immediately repatriated back to South Africa. Under the dispensation, where shares are offered free of charge (as with RSUs), the South African resident is lawfully allowed to hold shares up to any value and is not required to immediately repatriate sales proceeds to South Africa. “Authorized Dealers” (which are banks licensed in South Africa and which can approve exchange control applications) generally interpreted the dispensation to mean that no Exchange Control approval would be required so long as the foreign investment fell within the parameters of the dispensation.

Exchange Control has now advised Authorized Dealers that this is not a correct interpretation of the dispensation and that they still require formal applications for approval for local employees to participate in foreign employee stock plans. Technically, the party responsible for applying to Exchange Control for the approval is the employee but, practically speaking, Exchange Control accepts applications from local subsidiaries/branches on behalf of the employees. Once issued, the approval is a blanket approval for all employees and there should not generally be a requirement to file subsequent applications for approval under the same plan. Accordingly, companies offering their stock plans to employees in South Africa should file an application for formal approval to allow South African employees to participate in their employee stock plans. Approval is recommended even for mandatory cashless-exercise options, but should not be required for cash-settled awards. However, it should be noted that Authorized Dealers in South Africa are applying the rules differently and there is some confusion regarding the correct application of the rules.

The application process is fairly straightforward and we recommend that you contact your GES attorney to discuss the Exchange Control application process.

SPAIN

Recent Legislation Limits Availability of Claiming 40% Tax Exemption

As reported in our third quarter 2009 Clients & Friends newsletter, an April 30, 2009 Spanish Supreme Court decision found that employees may be eligible for the 40%

exemption, even if they have been granted options on an annual basis, provided the employee has not exercised the options on a frequent or recurrent basis (*e.g.*, annually or semi-annually). This decision would be reversed by pending legislation, the Sustainable Economy Bill of Law (the “Law”). The Law was approved by the Spanish government and is pending approval by parliament. Among other amendments to the Personal Income Tax Law, the Law would reinstate the prior requirement that, in order to benefit from the 40% exemption, options may not be granted on an annual basis. Therefore, in the case of options, the exemption will be available to an employee provided (i) the employee does not receive annual or more frequent grants, and (ii) the employee exercises his/her option more than two years after the date of grant (regardless of when the option vested). Please note that if the Law is passed without any amendments it will apply retroactively to income accrued since 2004.

In light of this pending legislation, employers may be well advised to continue to withhold tax on the full amount of the option income. Please consult your GES attorney to determine if the 40% exemption may be available for equity awards granted to employees of your Spanish subsidiaries.

SWEDEN

Tax Authorities to Treat ESPP Rights as Stock Options

In November 2009, the Swedish tax authorities released a legal position paper regarding ESPPs in which they state that they view the right to purchase shares under an ESPP as an employee stock option. The practical implication is that the rules related to stock options held by mobile employees who move to Sweden (which we reported on in our third quarter 2008 newsletter) will apply to ESPPs. Therefore, the entity that was the employer at the date of grant of the right (*i.e.*, typically, the employer on the first date of the relevant offering period) will have both the income tax withholding and reporting obligation and the employer social tax liability at the time of purchase. If the original employing entity does not have a permanent establishment in Sweden, it does not need to withhold the employee's income tax; instead the employee must pay his or her own income tax. However, the original employing entity must still pay the social tax and report the income and will need to file an application with the Swedish Tax Agency for a Swedish registration number in order to do so. Where the relevant foreign employing entity does not have a permanent establishment in Sweden, it may be possible to enter into arrangements with the employee or with a local Swedish entity to fulfill some of these obligations on behalf of the original foreign employing entity.

The tax authorities have added one caveat to this new position, which is that they would need to look at the terms of an ESPP to determine whether or not the plan constitutes an ESPP subject to this new position (or whether rights under such plan instead are characterized, as was previously the case, as a purchase of securities).

If your company (or any of its subsidiaries) has employees who will be transferring to Sweden during an ESPP offering period, you should contact your usual GES attorney to

determine whether your ESPP will be subject to this new position and, if so, what steps must be taken in order to fulfill these obligations.

UNITED KINGDOM

Reference to Exchange of Stock Options in UK Approved Plans

On October 20, 2009, the Revenue published updated guidance as to what should be included in UK approved equity plan rules regarding the exchange of options. The guidance emphasizes that references in UK-approved equity plan rules to an exchange of options being triggered by events (such as a change of control) under overseas legislation (*i.e.*, non-UK legislation) are acceptable only if the overseas legislation is “very closely comparable” to the UK legislation. The Revenue is now clearly taking a stricter view of what events may trigger an exchange of approved options. For more information please see [*Exchange of share options: Obtaining control by compromise or arrangement*](#).

Bank Payroll Tax for Equity Awards Granted by Banks and Others

A new Bank Payroll Tax is in effect for bonuses (and similar types of income) granted or paid by banks and “building societies” (including UK branches of US banks) from December 9, 2009 through April 5, 2010 (and likely will be further extended). This 50% tax, payable by an employer, generally applies to all types of income or bonuses other than normal salary. The Bank Payroll tax applies to equity awards (*i.e.*, stock options, RSUs, etc.), subject to certain limited exclusions for stock incentive plans and SAYEs, and may apply if the employee has more than £25,000 of “extra” non-salary income for the year.

To be exempt from the new Bank Payroll Tax, bonus awards would need to fall within the definition of “Excluded Remuneration”. This includes, for example, payments representing the fulfillment of contractual promises made prior to the chargeable period (even if the payment is dependent upon the individual complying with certain conditions); however, payment may not be subject to the exercise of discretion by any person.

As mentioned above, while this new tax only applies to banks and “building societies,” UK branches of US banks are subject to these rules. Foreign financial trading companies operating in the UK are also subject to the rules. Therefore, US banks and financial institutions with a UK branch should consider this new tax and have documentation reviewed before making grants or promises of equity awards in the UK.

The technical notes and draft legislation can be found by [clicking here](#).

UK Tax and National Insurance Rates

Following are the highlights of changes in the UK income tax and National Insurance Contribution (“NIC”) rates for the 2010 – 2011 UK tax year:

Income Tax

For the 2010-11 tax year:

- the maximum income tax rate is 50% (for annual income over £150,000);
- the personal allowance of £6,475 for income tax is lost where employees claim the remittance basis of taxation and is reduced when income is above £100,000 (the allowance is reduced by £1 for every £2 of income above the £100,000 limit);
- employees who bear the employer NICs receive a credit against their income tax.

National Insurance Contributions

All NIC rates will rise an additional 0.5% in April 2011 (*i.e.*, the total increase for all NIC rates is 1% rather than 0.5%) which means that, from April 2011:

- Employer NICs – 13.8% (rather than the current 12.8%)
- Employee NICs up to the Upper Earnings Limit – 12% (rather than the current 11%)
- Employee NICs over the Upper Earnings Limit – 2% (rather than the current 1%)

UNITED STATES

[Ninth Circuit Issues Order Withdrawing Xilinx Opinion in Cost Sharing Case](#)

On January 13, 2010, the US Court of Appeals for the Ninth Circuit, in a one sentence order, withdrew its opinion in which the Court had held that stock options must be included as a cost in R&D cost sharing agreements, thus potentially increasing the costs allocable to the US parent in a cost sharing agreement with its Irish subsidiary. This, in turn, would result in more ownership of the R&D being allocable to the US parent with higher attendant US taxes on the income from the intangible property.

The earlier opinion had been highly criticized as a departure from the arm's-length standard, which historically applied to intercompany pricing issues. The next step (perhaps a rehearing *en banc* or a new revised opinion) is eagerly awaited, as it will have a dramatic impact on the treatment of stock-based compensation in cost sharing and other intercompany pricing arrangements.

[IRS Announces Broad Payroll Audit Project](#)

In November 2009, the IRS announced an audit initiative to examine 6,000 companies for compliance with payroll tax obligations, including among other matters, executive compensation and fringe benefits. Worker classification issues (employee vs. independent contractor) will also be a major focus.

In light of this initiative, employers would be well advised to perform an internal assessment of their classification of workers and payroll tax processes and procedures. One particular item relating to equity plans is compliance with the next day deposit rules for certain payroll taxes in excess of \$100,000 which occur off the regular payroll cycle, such as option exercises or RSU vesting/releases.

[California Supreme Court Rejects Challenge to Voluntary Salary Deferred Equity Plan](#)

The California Labor Code contains provisions requiring the prompt payment of all earned wages and prohibits an employee from returning wages to his or her employer. A financial consultant at Citigroup sought to apply these provisions against Citigroup with respect to a voluntary employee incentive compensation plan under which employees could elect to receive a portion of their cash salary as restricted stock (at a reduced price) with a two year vesting provision. The employee, who filed a putative class action, sought to avoid forfeiture of the shares when he left before the two year vesting date.

The California Supreme Court rejected the employee's claim, holding that straight-time wages over the minimum wage are a matter of private contract between the employee and employer. Hence, the employee was free to agree to reduce his cash salary (not below minimum wage) and instead receive restricted stock subject to vesting.

Although most California practitioners believe this to be the correct result under the California Labor Code, it is helpful to have this confirmed by the California Supreme Court.

[IRS Issues Voluntary Document Correction Program under Section 409A \(Notice 2010-6\)](#)

On January 5, 2010, the IRS issued Notice 2010-6, which provides for a voluntary correction program allowing employers to self-correct certain document failures in their nonqualified deferred compensation plans subject to Section 409A of the Internal Revenue Code of 1986, as amended ("Section 409A").

As a reminder, Section 409A may apply to stock options and SARs if they are granted at a discount (*i.e.*, have an exercise price that is less than the fair market value on the date of grant) or if they otherwise have a deferral feature. RSUs may also be subject to Section 409A if the underlying shares are delivered in a year following the year in which the right to the RSUs vest (including through any early vesting provision such as a retirement-age provision). The document correction program is available to RSUs, but it is not available to noncompliant plan documents providing for stock options and SARs that are subject to Section 409A. (However, we note that operational failures (*e.g.*, administrative error resulting in using incorrect exercise price) under compliant plans providing for stock options and SARs may be eligible for correction under the correction program that the IRS previously made available in 2008 under Notice 2008-113.)

The correction program allows for the correction of certain plan document failures and provides relief from the general adverse tax consequences that would apply in the case of a Section 409A violation by reducing both the amount of income that will be taxed early and the additional tax for corrected document failures. Under generous transitional relief applicable to the document correction program, the adverse tax consequences under Section 409A may be avoided altogether in the case of certain plan document failures that are corrected before December 31, 2010.

For more information about the document correction program, please see the following [Client Alert](#) that discusses the IRS guidance.

VIETNAM

Vietnam Taxation of Equity Awards

As you may recall, Vietnam's first comprehensive Law on Personal Income Tax (the "PIT Law") went into effect on January 1, 2009, changing the progressive personal income tax brackets and changing the tax treatment for employees participating in share plans. In October 2009, Vietnam's Ministry of Finance (the "MOF") issued Official Letter 14169/BTC-TCT (the "Official Letter") to clarify the tax treatment of stock options and share bonuses ("RSUs") under the PIT Law. Although not binding, tax departments in Vietnam are likely going to follow the Official Letter until the MOF issues additional or different guidance.

Unfortunately, the Official Letter sets forth undesirable tax treatment of equity awards and also raises questions that have yet to be answered by the MOF. Pursuant to the Official Letter, income recognized from stock options and RSUs constitutes both employment income and income from a securities transfer, which are subject to tax upon the sale of shares received upon vesting or exercise. The local employer is obligated to withhold tax at the time of sale. This withholding obligation means that companies will have to track shares until sale (even for former employees) which we understand can be very burdensome. However, we note that most companies require employees to exercise options with a cashless exercise feature and force the sale of share at vesting of the RSUs, in order to facilitate compliance with the exchange control restrictions in Vietnam. Therefore, in practice, we assume that most companies will be able to satisfy their withholding obligation at exercise or vesting, as applicable (which coincides with the sale of the shares in these instances).

There are also still many unanswered questions regarding the calculation of the taxable income. According to the Official Letter, the taxable employment income is equal to the accounting entry for the award recorded by the entity paying the award. Thus, according to a strict reading of the letter, the taxable employment income would likely be the accounting expense the issuer records for the awards granted to the Vietnamese employees. This amount could be higher than the actual gain earned by the employee at exercise of options or vesting of RSUs.

Similarly, tax on a securities transfer will be imposed at 0.1% of the sale price or 20% of the gain which is described in the Official Letter as the difference between the sale price and the "non-preferential purchase price." The Official Letter does not make clear what "non-preferential purchase price" means, but some advisors also interpret this to be the accounting expense of the award. The employee must choose between being taxed at 0.1% of the sale price or 20% of the gain, and must register his or her preferred tax method in advance with the tax authorities. Regardless of the employee's election, the income is subject to a temporary withholding of 0.1% of the sale proceeds, which is reconciled at year-end.

Although the Official Letter was issued in October 2009, companies should be prepared to apply the tax treatment set forth in the Official Letter to stock option exercises and RSU vestings that occurred in 2009. Please note, however, that employers were exempted from

withholding on employment income in Vietnam through June 30, 2009. In addition, an exemption was in place for withholding on income from a securities transfer until the end of 2009.

As noted above, it is uncertain how the guidance in the Official Letter should be applied to awards granted by non-Vietnamese companies (especially with regard to the calculation of the taxable income). It is recommended that companies consider applying for a tax ruling with the MOF to clarify these issues. If you are interested in applying for a tax ruling, please contact your GES attorney.

Meanwhile, we will of course update you on any additional information or clarifications issued by the MOF. If you have any questions about the tax treatment of equity awards in Vietnam, please contact your GES attorney.

[Vietnam's Draft Decree May Prohibit Securities Offerings By Foreign Companies](#)

Vietnam's State Securities Commission ("SSC") is drafting a Decree on Private Offerings ("Draft Decree"), which provides that foreign companies that are not Vietnamese legal entities will not be permitted to offer securities – including private offerings – in Vietnam. Under the Draft Decree, any offering of shares of stock issued by foreign companies in Vietnam will not be permitted. The SSC has verbally indicated that this restriction would apply to any offering, including options restricted to a cashless exercise.

Although the Draft Decree is consistent with Directive No. 20/2008/CT-TTg issued by the Prime Minister of Vietnam on June 23, 2008, which similarly prohibits foreign companies that are not Vietnamese legal entities from offering securities in Vietnam, the Draft Decree is inconsistent with the stated position and actions of the State Bank of Vietnam ("SBV") and the Ordinance of Foreign Exchange Control and Decree No. 160 that allow indirect overseas investments.

Currently, the SBV takes the position that offering a cashless program in Vietnam is not prohibited, and continues to grant approval for foreign companies implementing cashless employee stock plans in Vietnam. Further, the Ordinance of Foreign Exchange Control and Decree No. 160 allows indirect overseas investment. The discrepancy may be a result of the differing positions between the Vietnamese authorities regarding the definition of securities offerings. It is possible a distinction will be made whereby the offering of treasury shares will be permitted and the offering of newly issued shares may not be.

We realize the Draft Decree may call into question whether you may offer your employee stock plan in Vietnam. We will continue to monitor the situation and keep you apprised of developments in Vietnam. If you have any questions about offering your employee stock plan in Vietnam, please contact your GES attorney.

For more information, please contact your GES attorney or you may contact one of the following partners in the GES group:

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