Global Equity Compensation Considerations in an Inversion Transaction

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An "inversion transaction" is a corporate restructuring under the terms of which an existing corporation moves its corporate headquarters from one country (*i.e.*, U.S.) to another, (*i.e.,* Ireland) usually by inserting into its corporate structure a new parent corporation above the existing parent company. In most instances, the corporation's shares remain listed on a recognized stock exchange throughout the restructuring. Since 2008, Baker and McKenzie has assisted over 16 corporations in various inversion transactions.

Here are the key points with respect to global equity awards that you should understand if your corporation is considering an inversion transaction:

You Are No Longer a "U.S." Corporation

Although a corporation's shares may continue to be listed on the New York Stock Exchange or another exchange throughout the inversion, the corporation's "situs" (place of incorporation) has moved. If the corporation was a U.S. corporation, it is now incorporated in a new country, and new corporate rules are likely to apply towards outstanding and new equity awards.

The new rules could require, for example, that an employee pay "par value" to receive RSU shares or that grant documents be executed by "deed" (as may be the case in the U.K. and Ireland). More importantly, these new corporate rules likely mean that the corporation's equity plan, grant agreements, grant policies, and procedures must be modified to comply with the legal requirements of the new situs In some cases, the stock administration practices may also need to be changed.

Outstanding Awards Must Be Adjusted

In most U.S. inversions, employee stock options and other awards will be adjusted and converted from a right to shares in the U.S. corporation to a right to shares in a non-U.S. corporation. This adjustment and conversion -- even if on a one-for-one basis and "tax free" from a U.S. federal income tax standpoint -- may result in a tax event for employees, or an undocumented securities offering by the non-U.S. corporation.

The corporation will need to review the laws for each country where equity awards are outstanding, to determine whether the conversion will be considered a taxable disposal of one equity right in exchange for a new equity right. If the company has any tax-qualified plans or programs in place (*e.g.,* French-qualified options, Israeli Section 102 options), the conversion may result in a taxable disposal of the existing qualified right, triggering immediate taxation absent a tax ruling or approval.

Further, the non-U.S. corporation may be seen as having "offered" a new security regardless of whether the conversion of existing equity awards into rights over the new parent corporation's shares occurs "automatically." The corporation may need to ensure that a securities exemption or registration is completed prior to the conversion.

Your Plans and Agreements Will Change

Before new equity awards can be granted by the relocated corporation, any equity incentive plans and agreements have to be approved, assumed, and adopted by the new board and possibly by shareholders in accordance with the corporate rules of the new jurisdiction.

Often companies that relocate will continue to choose, as the governing law for their equity plans, the same U.S. state law that governed the plans before the move. However, even if the same law governs, there is a new plan sponsor and certain corporate changes have taken place (*e.g.,* a corporation now offers ordinary shares, not common stock) that must be reflected in the plans. Tax-qualified plans also may need to be "re-approved," and recharge agreements for the costs of equity awards, re-negotiated and re-executed, with the new parent corporation (assuming that the recharge of costs remains tax beneficial following the move).

Mobility Issues Just Got Worse

The taxation of equity awards for mobile employees is a difficult issue for any multinational corporation. When a corporation moves its headquarters to a new country, it is likely that its board of directors and executives, as well as rank-and-file employees, will be doing business in both countries, which may trigger a tax liability in more than one jurisdiction. The directors of the corporation may now be subject to tax in the location where the company is headquartered, even if they do not step foot in the country - due to their services for a corporation registered in that country.

It may be possible for a corporation to negotiate an agreement with the tax authorities for the allocation of equity income between countries for directors/key executives, and to communicate the tax implications of the move to directors/employees well in advance of the inversion for tax planning purposes.

Compliance Begins Again for "New" Stock Plans

Once a corporation moves to a new corporate headquarters and its stock plans are re-adopted so that new grants can be made, the corporation will need to consider its global compliance for stock plans anew. Where previously regulators may not have had the corporation on their radar screen, they may now be aware of the corporation's business operations in a country and the scope of its share plan offerings because the inversion transaction has been covered in the local press.

In some jurisdictions, the inverted corporation must file a new securities filing for the offer of its shares to employees, or seek new exchange control permits or approvals (for example, an approval from China's State Administration of Foreign Exchange for a non-U.S. public company to offer its shares to PRC nationals may need to be renewed for the "new" corporation). Some regulators will not require a full new registration if the corporation's share plans have not changed significantly as a result of the inversion; however, as noted above, sometimes the move will require material changes to the equity incentive plan to comply with new corporate rules, so plan changes have to be considered first and time allotted to manage compliance issues thereafter. If the corporation intends to grant equity awards at the time of the conversion, or shortly thereafter, it must plan ahead to complete these tasks.

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Baker & McKenzie has helped many corporations work through the issues, manage expectations and control costs and exposure risks arising from inversion transactions. We recommend that our clients speak to other corporations who have gone through inversions to see how they have handled the changes and we like to put them in touch with each other. As with any corporate restructuring, careful planning and clear communications with directors and employees is essential.

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