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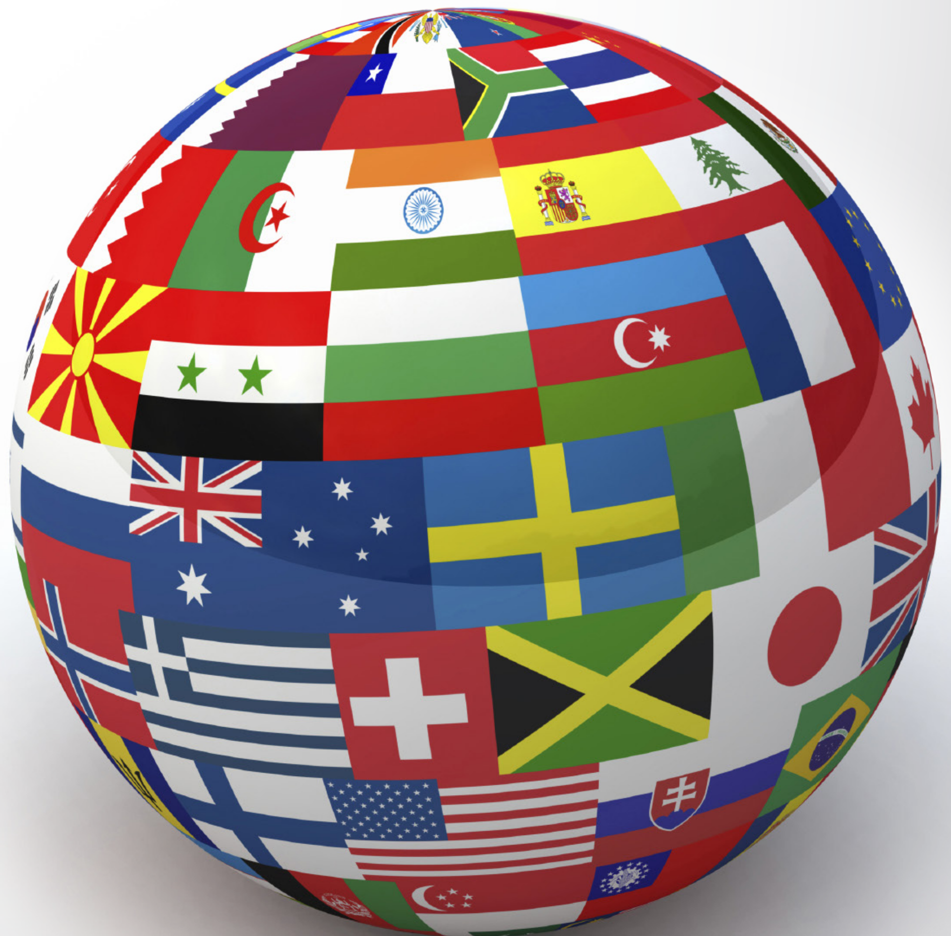
CLIENTS & FRIENDS NEWSLETTER

July 2016



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Please visit our Global Equity Services upcoming events page for a full list of our upcoming events, speaking engagements and webinars.

The Global Equity Equation Blog

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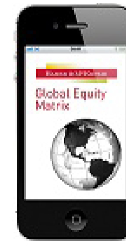

Available for download on your iPhone, iPad or Android smartphone

New Publication Available For Download

The Global Employer Magazine - 2015 Review and 2016 Preview

In this issue of the Global Employer Magazine we cover some of the most important developments that took place around the world in 2015 and set out recommended actions on how you should respond. Click here to download.

Practice Group Update

GES Implements New Practice Management Software Tool

In an effort to more efficiently provide our clients with the highest quality of legal services, the Global Equity Services (GES) practice recently implemented a law practice management software tool. GES has partnered with Clio, a cloud-based law practice management software solution with maintains bank-grade data security, to establish a system to organize and track GES projects on a per client/matter/country basis. We expect this tool to allow us to be more efficient and save costs for our clients.

Clients have the opportunity to collaborate with GES attorneys via Clio's client portal, Clio Connect. Clio Connect provides a shared calendar, shared task list and document repository, which is presented in a simple user interface.

Please reach out to a GES attorney if you would like to use Clio Connect on your next GES project.

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Australia

Changes to Australian Share Plan Reports

As we reported in our fourth quarter 2015 newsletter, the Australian Tax Office ("ATO") announced some fundamental changes to the Employee Share Scheme reporting process, including the manner in which the reports can be lodged and the content of the reports.

In conjunction with these changes and as a means for assisting companies complete their reporting obligations as quickly and painlessly as possible, we have developed software to meet the ATO's new Share Plan Reporting requirements and can assist companies throughout the new electronic filing process by providing both full-service support or, if preferred, lodgment services only.

For information about these services and pricing, please see our brochure here. For specific questions regarding the Australian Share Plan reporting rules and related procedures, please see our recent blog post here and please contact your GES attorney.

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China

Preferential Tax Treatment Extended to More Companies

In late 2015, the Ministry of Finance and the State Administration of Taxation (the "SAT") extended certain tax incentives nation-wide effective January 1, 2016 pursuant to Notice 116. Such tax incentives apply to stock awards, but likely not other stock-based awards such as options, RSUs or ESPP. Previously, these tax incentives were available only to companies in the national independent innovation demonstration zones.

Among the available tax incentives, preferential tax treatment now is available to all "high-new-technology enterprises" ("HNTEs") in China. The preferential tax treatment allows employees of HNTEs to evenly recognize equity compensation income over multiple months in calculating the individual income tax attributable to such income in the same manner as provided under Notice 35. However, unlike Notice 35, HNTEs do not need to be a listed company, but instead, they must meet certain requirements and obtain recognition as an HNTE in China with the government accreditation office. Also, it is important to note that share awards made to all employees of an HNTE are ineligible for the preferential tax treatment under Circular 116.

Beyond the preferential tax treatment extended to HNTEs, the Hainan Provincial Tax Bureau also extended certain tax incentives to employees of unlisted companies in the Hainan Province pursuant to Circular 1151. Circular 1151 provides the same tax incentives as Circular 35 (e.g., employees are allowed to evenly recognize equity compensation income over multiple months in calculating the individual income tax). The preferential tax treatment applies to stock options, and likely also to RSUs. Unfortunately, it is unavailable to companies outside the Hainan Province.

For information about whether any of these new tax incentives are available for equity awards granted to employees of your local operations in China, please contact your GES attorney.

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Denmark

New Tax Preferential Treatment for Equity Compensation Awards

As we reported in our fourth quarter 2015 newsletter, the Danish Parliament adopted new Section 7P of the Danish Tax Assessment Act to provide tax preferential treatment for certain share-based payments to Danish employees effective July 1, 2016. Under the new legislation, shares acquired pursuant to equity compensation awards (up to 10% of the affected employee's annual salary) meeting certain requirements will not be subject to taxation until the shares are subsequently sold, at which time the amounts will be taxable as capital gains rather than as employment income. In brief, the requirements under the new Section 7P regime include:

- the employee and the employer must conclude an agreement that the new rules will apply at the time when the award agreement originally is granted;
- the value of the equity award may not exceed 10% of the employee's annual salary at the time of entering into the agreement;
- the equity award must be paid by the employer company or a group company;
- the equity award must be settled in shares, etc. in the employer company or a group company;
- the shares may not belong to a particular share class;
- equity awards must be non-transferable; and
- equity awards must entitle the employee (or the grantor) to acquire (or supply) shares.

As a tradeoff for the tax preferential treatment, companies granting equity compensation awards under the new Section 7P regime will be unable to claim a local tax deduction for such costs. However, companies also will avoid the payroll costs associated with the equity awards (on the basis that the taxable income realized at sale will be classified as capital gains income rather than employment income).

For additional information about whether the grant of equity compensation awards to employees under the new Section 7P regime makes sense for your company, please contact your GES attorney.

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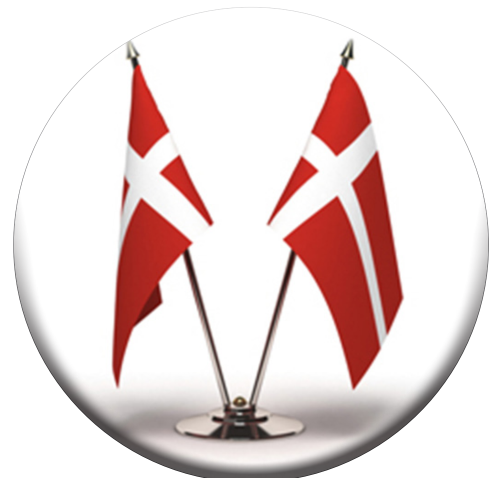

European Union

Brexit Impact on Global Share/Incentive Plans

On June 23, 2016, voters in the United Kingdom cast a historic referendum vote to exit the European Union. The reverberations of the "Brexit" vote have been significant in the global financial markets and the political landscape in Europe, and the British government likely will formally commence the withdrawal process shortly, at which time exit negotiations will start at various levels of the European Union.

For companies granting equity compensation awards under employee share and other incentive plans in the United Kingdom and elsewhere in Europe, the United Kingdom's Brexit vote has no immediate effect on such offerings but raises many significant issues and questions that multinational companies will face as the terms of the United Kingdom's withdrawal from the European Union are negotiated over the coming years.

For some preliminary thoughts and comments on these issues and what they may mean to your company's use of equity compensation in the United Kingdom and the rest of Europe in the future, please see our recent alert and Firm's Brexit resource page and contact your GES attorney.

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Korea

New Income Tax Withholding Obligations for Foreign Assignees

Under a new tax law, effective from July 1, 2016, Korean entities that pay a service fee to a foreign parent corporation will need to withhold income tax on employment income received by foreign assignees in certain situations, even where the employment costs are not borne by the Korean entity. Although the details surrounding the new law are unsettled, it applies to Korean companies operating in certain industries (e.g., air transport, construction, and professional, scientific, or engineering service) and likely will apply to equity compensation awards granted to foreign assignees.

Please contact your GES attorney for additional information about whether the new tax law will apply to your company and whether any adjustment to current tax withholding and reporting practices are warranted.

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Luxembourg

New Employer Tax Reporting Requirement for Equity Compensation Plans

On December 28, 2015, the Luxembourg tax authorities released Circular L.I.R. n°104/2bis which imposed a new tax reporting requirement, effective January 1, 2016, on employers in Luxembourg whose employees receive stock options and other equity compensation awards.

In brief, employers must provide the local tax office to which they report ("Bureau RTS") with a copy of the applicable equity compensation plan(s) and a list of beneficiaries (e.g., award recipients or, in the case of an employee stock purchase plan, eligible employees) at least two (2) months prior to the date the equity compensation plan is first offered to employees in Luxembourg (or as soon as possible for outstanding awards granted prior to January 1, 2016).

Although the Circular specifically only references stock option plans, the Luxembourg tax authorities informally have stated that the new tax reporting obligation applies to all equity compensation awards.

For additional information about the new tax reporting requirement, please see our February 2016 client alert and contact your GES attorney.

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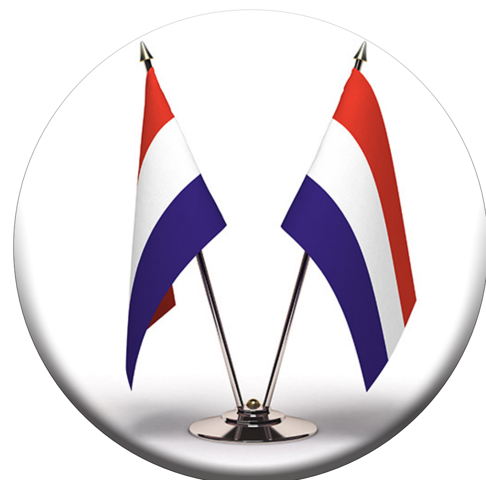

Philippines

Philippine SEC Eliminates Notice Obligations for Exempt Transactions

In late 2015, the Philippines Securities and Exchange Commission ("SEC") issued Amended Implementing Rules and Regulations of the Securities Regulation Code ("2015 IRR") which effectively eliminated the requirement for issuers to submit a Notice of Exemption (via Form 10.1) for equity compensation grants to less than 19 employees in the Philippines within a 12 month period.

Previously, issuers could either file a Notice of Exemption or a Confirmation of Exemption but in releasing the 2015 IRR, the Philippine SEC eliminated all references to a Notice of Exemption (except for commercial papers) and only retained discussions on obtaining a Confirmation of Exemption.

Subsequent to the issuance of the 2015 IRR, the Commissioner of the Philippine SEC unofficially clarified the regulatory body's intent to eliminate the Notice of Exemption filing requirement (given that the 2015 IRR did not expressly state that issuers were not required to submit a Notice of Exemption) and proposed to issue a written circular to memorialize this clarification.

Because the Philippine SEC has not yet issued the circular reflecting the clarification, companies intending to refrain from submitting a Notice of Exemption on the basis of the 2015 IRR and the Commissioner's unofficial comments should contact your GES with any questions regarding the potential risks.

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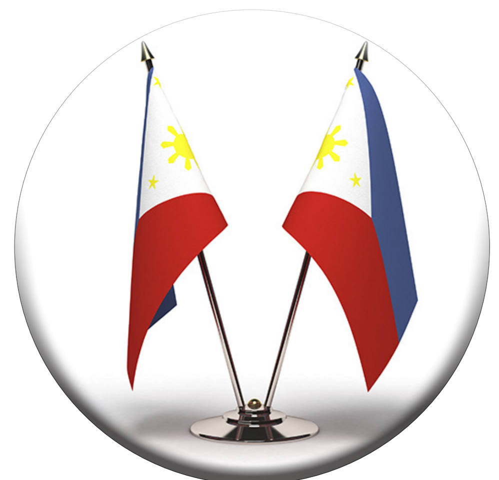

Romania

Tax Withholding and Reporting Obligations for Non-Exempt Equity Awards Clarified

As we reported in our fourth quarter 2015 newsletter, Romania adopted a new tax exemption for the grant of equity compensation awards that allows award recipients to avoid paying income taxes and social security contributions on the taxable income realized from the award and eliminates any income tax and social security contribution withholding obligations on the part of the local employer in Romania.

In conjunction with various questions raised about the treatment of equity awards which do not qualify for the exemption, our colleagues in Romania confirmed that in the case of non-exempt awards where the local employer in Romania does not bear the cost of such awards (via a reimbursement arrangement), the employee personally is responsible for reporting the taxable income realized from the equity award and paying the income tax and social security contributions (including the employer portion of social security contributions).

To mitigate the burden of having the employee pay the employer portion of the social security contributions, the local employer can agree to pay such amount on the employee's behalf but the employer's payment will trigger additional taxable income to the employee (which in turn will trigger income tax and social security contributions). As such, the only way the local employer in Romania could pay the employer portion of the social security contribution on behalf of the employee on a tax-neutral basis is via a tax gross-up.

For additional information on the tax withholding and reporting obligations associated with non-exempt equity awards in Romania, please contact your GES attorney.

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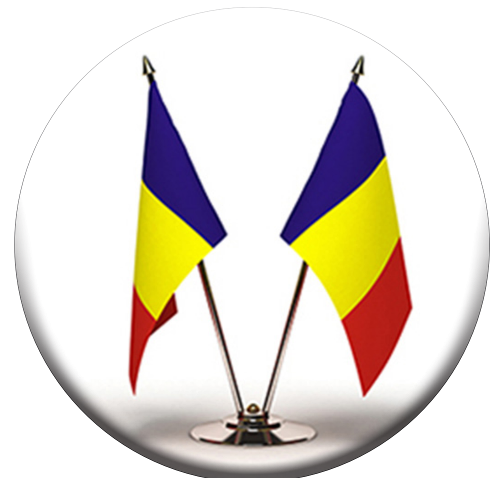

Turkey

New Legislation Clarifies Taxable Events for Equity Awards

Pursuant to the new Income Tax Law that is expected to be enacted soon, stock options will be treated as taxable salary income on the date of exercise on the option spread (that is, the difference between the fair market value of the shares issued at exercise and the exercise price) and RSUs will be treated as taxable salary income on the date of vesting on the fair market value of the shares issued in settlement of the RSUs.

Previously, Turkey lacked specific legislation governing the tax treatment of equity compensation awards granted by a foreign parent corporation to employees of a Turkish subsidiary, and many companies and advisors adopted the view that the shares acquired pursuant to equity compensation awards were not taxable until the shares subsequently were sold (provided that the Turkish subsidiary did not bear the cost of such awards via a reimbursement arrangement with the foreign parent corporation).

Under the proposed Income Tax Law, equity compensation awards would continue to avoid social insurance contributions and the local subsidiary in Turkey would not be required to withhold income taxes or report the taxable income realized by award recipients so long as the Turkish subsidiary does not bear the cost of such awards. Instead, the award recipients personally would be responsible for declaring the taxable income realized from the equity compensation award and paying the applicable income taxes to the Turkish tax authorities.

Turkey Adopts New Data Privacy Law

Effective April 2, 2016, Turkey adopted the Law on the Protection of Personal Data ("Personal Data Law") to harmonize Turkish data protection rules with the European Union.

The Personal Data Law is modeled after EU Data Protection Directive 95/46/EC and sets forth a general framework that addresses, in part,

- individual privacy rights,
- adequate disclosure and informed, affirmative consent by residents in Turkey,
- security and other data protection measures, and
- administrative fines and criminal sanctions (including prison sentences under the Turkish Criminal Code) for the unlawful collection, processing and transmission of personal data.

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The Personal Data Law provides for a transition period for businesses to bring their data privacy functions in Turkey into compliance with the new rules, and the Turkish Data Protection Authority will adopt implementing regulations during the coming year.

For more information about the Personal Data Law and what it will mean to your company's operations in Turkey, please see our Istanbul office's recent client alert and contact your GES attorney.

United Kingdom

HMRC Seeks Taxpayer Input on Whether to Retain the Formal NIC Election Process

HMRC recently commenced a consultation procedure on whether to discontinue the practice of formally approving joint elections whereby companies granting equity compensation awards to employees in the United Kingdom are allowed to transfer the employer portion of National Insurance Contributions ("NICs") to award recipients. Companies and award recipients would continue to be able to transfer employer NICs by written agreement (typically as part of the equity compensation award agreement itself), but formal joint NIC elections approved by HMRC would be eliminated as a cost-savings measure (given the labor-intensive nature of the approval process). The purpose of the consultation procedure is to determine whether any accounting or other benefits would justify retaining the formal HMRC approval process.

By way of background, companies and equity compensation award recipients can transfer responsibility for employer NICs in one of two ways. If the employer NICs are transferred to the award recipient by agreement, the company effectively is entitled to repayment of the employer NICs from the award recipient but remains ultimately liable to HMRC if the award recipient fails to pay such amounts.

By contrast, if the employer NICs are transferred to the award recipient by means of a formal joint election approved by HMRC, sole responsibility for paying the employer NICs is transferred from the company to the award recipient and as a result, the company is no longer responsible for the payment of the employer NICs if the employee fails to pay them. For this reason, most companies have preferred to transfer the employer NICs by way of a formal joint election approved by HMRC.

Additional information on the consultation procedure can be found online here and companies can submit comments to HMRC via email at shareschemes@hmrc.gsi.gov.uk until July 13, 2016.

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United States

New Financial Accounting Standards Board (FASB) Rules on Stock Withholding

On March 30, 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-09, which amends the rules for the accounting of stock compensation under FASB ASC Topic 718.

Among the new standards is a rule that that will allow companies to withhold shares to satisfy tax withholding obligations for stock-based awards at a rate higher than the minimum statutory tax rate without causing the awards to be subject to liability accounting treatment.

Current Stock Withholding Rules

Prior to the new standards, withholding of shares to cover tax withholding obligations at a rate above the minimum statutory tax rate generally resulted in liability accounting, which is less favorable than the "equity" treatment that would otherwise generally apply.

In the U.S., for federal tax purposes, to the extent an employee had supplemental wages for the year of $1 million or less, this meant that companies withheld a number of shares based on the 25% supplemental wage rate, which was often less than the employee's effective tax rate.

Outside of the U.S., because a concept similar to the supplemental rate does not generally exist, companies often had to withhold at an individual's actual tax rate (a significant administrative endeavor) or otherwise agree on a suitable withholding rate with their accountants.

New Stock Withholding Rules

The new standard allows companies to withhold shares at a rate of up to the maximum statutory rate in the applicable jurisdiction without subjecting the award to liability accounting. In theory, this allows U.S. withholding at a rate of up to 39.6% federal, plus state and local taxes. However, as a practical matter, based on current U.S. tax rules, withholding must be calculated using either the supplemental wage rate or a withholding rate based on the employee's current Form W-4 filing.

In addition, although an employee can file a revised Form W 4 prior to an equity award taxable event claiming a different number of exemptions or specifying a dollar amount to be withheld, the IRS rules do not allow an employee to specify an exact tax rate. Further, if the employee wants to go back to his/her "normal" withholding rate for the next salary payment, the employee has to provide a new Form W-4 prior to the next payment date.

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Due to the administrative challenges arising from the increased processing of Form W-4s that would be created by allowing employees to file revised Form W-4s in order to increase the rate of withholding on their equity compensation awards, the liberalization introduced by the new accounting standard will primarily be beneficial for withholding on awards granted to employees in Non-U.S. jurisdictions, where withholding at the maximum applicable rate should not trigger the same tax issues as apply in the U.S.

Additional Considerations

Companies wishing to withhold shares at a rate that is higher than the minimum statutory rate in light of the new standard should consider whether their equity plans or award agreements require amendment to authorize the higher withholding rate. Companies will also need to consider whether any required plan amendment would require shareholder approval under the Nasdaq or NYSE stock exchange rules.

In addition, companies will need to weigh the cost and cash flow implications of withholding shares using a higher tax rate because the company will need to generate the cash for the tax withholding that is required to be remitted to the applicable tax authorities.

Effective Dates

For public companies, the new standards are effective for annual reporting periods beginning after December 15, 2016, and interim periods within those annual periods. For nonpublic companies, the new rules are effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods. Early adoption of the new standards is permitted, but companies must adopt all of the new rules under ASU 2016-09 in the same period.

IRS Issues New Proposed 409A Rules

On June 21, 2016, the IRS issued proposed regulations to clarify or modify various aspects of the current Code Section 409A ("409A") regulations that were issued in final form in 2007. The proposed regulations cover numerous topics but do not introduce any seismic changes in the deferred compensation landscape.

However, they do address a number of equity compensation issues that are worthy of note, including the following:

- **Flexibility for Payment Timing upon Death.** Under current 409A regulations, death is a "permissible payment event" for awards subject to 409A (e.g., RSUs with a retirement-vesting feature), and the payment would generally be treated as being made on the date of death if it is made within a relatively limited period following the date of death, unless a specified year after death is designated under the plan terms as the payment period.

  Yet, despite the administrative challenges of making a payment at the time of death (e.g., identifying and verifying beneficiaries, completing probate or taking such other steps as may be required by applicable estate laws), the final regulations did not provide any special dispensation from the general time period in which the payment is required to be made following an employee's death. In a helpful change, the proposed rules allow for an amount that becomes payable upon death to be paid at any time between the date of death and December 31 of the calendar year following the year in which the death occurs, regardless of the payment period set forth in the plan or award agreement.

In addition, a plan may allow a beneficiary to select the payment date within this period.

The plan may be silent on the payment period following death, and a plan or agreement amendment is not required to be amended to rely on the new payment period. However, to the extent a company wishes to amend the terms of an outstanding award for purposes of contractual clarity, it is free to do so without violating rules that generally prohibit amendments to the time of payment under an outstanding award that is subject to 409A.

It is not clear under the proposed rules whether the new flexibility applies to payments of amounts under awards that are exempt from 409A (e.g., RSUs designed to pay out immediately upon vesting and within the "short-term deferral period" discussed below). This is something we hope will be clarified by the final regulations.

- **Additional Exception to Short-Term Deferral Rule.** Under the short-term deferral rule, an award such as an RSU is exempt from 409A if it is settled within 2.5 months following the end of the later of the employer or employee's tax year in which the award vests (i.e., by March 15 if employee and employer are both calendar year taxpayers).

  Current rules provide certain narrow exceptions that will allow for payment after this short-term deferral period without violating 409A. The proposed rules create an additional exception, which is available if the issuer reasonably anticipates that making the payment would violate "Federal securities laws or other applicable law," provided that the payment is made as soon as practicable once the risk of such violation no longer applies. The change mirrors a similar exception that applies to awards subject to 409A under current rules. The new rule could prove helpful in circumstances where securities or other laws require a deferral of payment under an outstanding equity or cash incentive award (e.g., rules requiring mandatory deferrals of compensation at certain financial institutions) or prevent the legal issuance of shares due to lack of registration or other required approval.

  Given the breadth of its wording, the exception could even prove helpful in a situation where a company is unable to timely deliver shares to a U.S. taxpayer employee working outside the U.S. due to its need to complete a local securities or exchange control filing or otherwise obtain local governmental approval.

- **Permissible Delayed Cash-Out of Options and SARs in Connection with Transactions.** Under the current 409A regulations, deferred compensation subject to 409A that is tied to the value of the employer's stock can generally be paid on the same schedule and terms that the transaction consideration is paid to shareholders in connection with a change in control.

  For example, this is helpful where part of the purchase price due to shareholders of an acquired company in a change of control is deferred pursuant to an earn-out provision or is subject to an indemnification hold-back, as it allows for treatment of acquired company equity award holders in a manner consistent with that of acquired company shareholders. The proposed rules confirm that the ability to delay payment in certain change of control transactions applies to the payment of stock options (including incentive stock options) and stock appreciation rights that are "cashed out" in connection with a transaction.

  However, the proposed regulations do not address the conversion of such stock rights into another form of compensation such as cash or RSUs that vest or are paid over the original vesting schedule – a practice that is not uncommon.

- **Transfer of Unvested Restricted Stock as Payment of Deferred Compensation.** Grants of restricted stock awards are generally exempt from 409A. However, the proposed regulations clarify that the grant of unvested restricted stock to satisfy a deferred compensation obligation (e.g., a deferral of a cash bonus) will not be respected as a 409A-compliant payment of the deferred amount unless the employee makes a Code Section 83(b) election to be taxed on the restricted stock at grant or the grant is made in accordance with 409A's subsequent deferral election rules.
- **Grants to Prospective Employees.** Due to the definition of "eligible issuer of service recipient stock" under the current 409A regulations, stock options or stock appreciation rights granted to prospective employees that are effective prior to commencement of employment would not be exempt from 409A. The proposed 409A amendments modify this definition, with the result that it will be possible to grant stock options or appreciation rights that are exempt from 409A to individuals before they commence employment, provided that it is reasonably anticipated that the individual will begin providing services, and the individual actually does begin providing services, within 12 months after the date of grant.

  Although the prevalence of stock options has decreased in recent years, many companies continue to grant options to executives and other senior employees and this new ability to grant 409A-exempt stock options to prospective employees may help with executive or other new hire negotiations.

  That said, many plans preclude the grant of equity awards unless the individual is an employee or other service provider on the date of the grant, and therefore, the plan terms will need to be reviewed before making any grants to take advantage of this relaxed rule.

The proposed rules are subject to comment for 90 days following their publication in the Federal Register (i.e., until September 20, 2016). Taxpayers may rely on the proposed rules before they are published as final regulations, and the IRS will not assert positions contrary to those set forth in the proposed regulations - at least until final regulations are published.

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