Global Equity Services

CLIENTS & FRIENDS NEWSLETTER

October 2016

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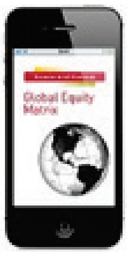

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Belgium

Tightening View of Belgian Social Security Administration with Respect to Equity Awards

Belgian social security contributions are generally due on remuneration income, including income from equity awards, where the cost of the remuneration is "borne" by the local employer.

In a recent case, the Belgian Social Security Administration took the position that the remuneration was "borne" by the local Belgian employer simply due to the fact that the local Belgian employer made (non-binding) recommendations as to who should receive certain awards and for how many shares.

Our Brussels office considers this position to be very questionable and lacking legal grounds, but there is a risk that the Belgian social security administration will continue to take this position and may request information on the decision-making process related to equity awards.

We recommend that companies review their grant processes and reconsider any involvement by the Belgian entity in the decision-making process, to avoid any risk that social security contributions could become due on equity award income.

Please contact your Global Equity Services attorney to discuss the issue in more detail.

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Bulgaria

Withholding, Reporting and Social Tax Obligations on Equity Award Income Clarified in Bulgaria

Recent opinion letters issued by the Bulgarian tax authorities have clarified the income tax withholding and reporting and social tax obligations for stock option and restricted stock unit ("RSU") income in Bulgaria.

For option income, no income tax withholding or reporting obligations or social taxes will be due, provided the local entity does not reimburse the foreign parent company for the cost of the awards.

In contrast, shares issued at vesting of RSUs qualify as "employment income" subject to social taxes, even if the RSUs are granted by a foreign company and the local employer does not reimburse the company for the cost of the awards.

Further, the recent opinion letters indicate that the local employer is not obligated to pay any portion of the social taxes due on RSU income if:

- the RSUs are granted by a foreign company, and
- the local employer does not bear the cost of the awards.

This means that, for RSUs granted by a foreign company, the employee would be obligated to pay both the employee's and employer's portion of social taxes unless the local employer reimburses the foreign company for the cost of the RSUs (in which case the employer becomes responsible for paying the employer portion).

Although the opinion letters are only binding on the companies for which they were issued, these letters suggest the tax authorities may follow the same approach for other RSU programs.

Fortunately, the practical impact of the social tax obligations for RSUs may be minimal given that the social security and health insurance contributions in Bulgaria are subject to relatively low monthly income ceilings. This means that many employees likely will have already exceeded the monthly contribution ceiling with their other compensation and will not have to pay social taxes on RSU income.

Please contact your GES attorney for additional information about the impact of these changes on your company's income tax and social tax withholding and reporting practices.

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Costa Rica

Social Insurance Contributions No Longer Due on Equity Award Income in Costa Rica

Due to a lack of regulation, the social insurance contribution obligations for equity award income in Costa Rica have been subject to frequent change.

In the past few years, it has been advisable for companies to take a conservative approach and pay/withhold employer and employee social insurance contributions on equity award income regardless of whether the local entity reimbursed the foreign parent company for the cost of the awards. This approach is consistent with the tax authorities' position on withholding and reporting obligations for income tax.

Recently, however, the Costa Rican Social Security Agency ("CRSS") has taken the position that social insurance contributions are not due on equity award income where the local entity is not taking a corporate tax deduction for the cost of the awards.

In light of this change, companies may wish to reevaluate their social insurance withholding and payment practices for equity award income keeping in mind that the CRSS has yet to issue any official guidance on this issue and may change it position at any time.

Please contact your GES attorney for additional information about whether any adjustments to social tax practices are warranted.

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European Union

EU Market Abuse Regulation

The EU Market Abuse Regulation (the "MAR") came into force on July 3, 2016, replacing the previous Market Abuse Directive with immediate effect. As Regulation, MAR applies directly to all EEA/EU Member States largely without the need for implementing legislation (as opposed to a Directive). As the previous Market Abuse Directive, the MAR fights insider dealing, unlawful disclosure of inside information and market manipulation but with stricter procedural regulations (e.g., prescribed format of insider list, filing deadlines reduced), and an expanded scope of securities transactions required to be reported. Also the MAR introduces new "Closed Periods" (i.e., mandatory blackout periods) for Directors and Officers.

For US publicly traded companies subject to the MAR, and subject to limited exceptions, there is a 30-day closed period prior to the announcement of the annual report and the quarterly reports.

Issuers (not) listed in Europe

A distinction must be made between general MAR obligations (the prohibition of insider trading and market manipulation) and specific issuer obligations, such as the obligation to publish inside information or to maintain insider lists or for directors and officers to be subject to reporting obligations for their trading and certain black-out periods ("Directors Dealings").

The insider trading and market manipulation prohibitions of the MAR apply to all companies listed on an exchange in the EU (e.g., London Stock Exchange, Euronext Paris, Frankfurt Stock Exchange), regardless of whether the companies voluntarily list their shares in the EU or are traded by a broker (consent of the issuer is not required) on the Open Market. This may be come relevant, e.g., in case of offering of an ESPP in the EU/EEA. As a result, by engaging in insider trading or market manipulation, employees of companies not listed on a European Stock Exchange but with its shares traded on over the counter stock exchange segments by the broker, would violate not only U.S., but also the MAR. The MAR rules are not identical in all aspects with U.S. law and in some ways may be stricter.

Issuer obligations will apply to issuers listed on a regulated market (the standard and prime segments on European stock exchanges) and to exchange regulated segments (which qualify as a Multilateral Trading Facility) such as AIM in London or the Entry Standard in Frankfurt (e.g. the German Open Market (Freiverkehr) segments are not affected by the issuer obligations, i.e. the provisions of MAR dealing with disclosure of insider information, insider lists and directors and officers dealings will not apply if these issuers have not consented to the trading of the shares on such MTFs).

Next Steps

Companies listed in the EU/EEA or being subject to Open Market trading (e.g., because of the offering of an ESPP in the EU/EEA) should ensure that existing internal policies, procedures and templates are compliant with the new MAR requirements and inform certain key management accordingly.

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EU General Data Protection Regulation

The new EU data protection framework entered into force on May 25, 2016 and will apply from May 25, 2018, which means organizations have two years from now to comply with the new rules.

The new framework, the General Data Protection Regulation ("Regulation") will replace the current Data Protection Directive and applies directly to all EU/EEA Member States, without the need to implement the rules into local law (as it would be the case with a Directive). The Regulation concerns all processing of personal data of organizations with or without an EU presence but who target EU individuals.

Issuers (and their subsidiaries) who process personal data of EU individuals should review their data protection policies and equity plan documentation (in particular any consent forms) to make sure they are in compliance once the Regulation applies as of May 2018.

What's New

The most significant changes from an equity awards perspective are as follows:

- The Regulation applies to processing operations which involve EU individuals, regardless of whether the data controller or processor is based in the EU.
- The rules for obtaining valid consent of the individual to move data outside the EU are now tighter; existing consents may still work, provided they meet the new conditions.
- The rights of individuals have been bolstered: individuals may require the data controller to erase their personal data without undue delay, e.g., in case they withdraw consent. This would entail an obligation of the data controller to inform third parties (e.g, service providers) to erase the data of the individual.
- The new accountability principle makes data controllers responsible to be in a position to demonstrate compliance.
- In line with this new principle, data controllers and data processors have to develop or update their internal breach notification procedures; the notification of the Data Protection Authorities ("DPA") in case of data infringement within 72 hours of awareness is compulsory.
- The requirement to notify or seek approval from the DPA was removed in many circumstances and the data controllers will have to evaluate if they want to consult the DPA in advance of the processing.
- Non-compliance can lead to fines of up to the higher of 4% of annual worldwide turnover or EUR 20 million.

In the world of equity awards, it is essential to make sure that, for data transfers from the EU to the US, there is a legitimate basis. Although this is not a new concern and we have been advising on the importance of valid consents or other grounds for a transfer for many years, in light of the potential fines non-compliance could be quite painful. The two-year transition period to ensure compliance should be used wisely.

Please contact your GES attorneys to determine if any changes to your current processes are recommended.

France

Loi Macron Further Clarified in New Tax Guidelines

On June 14, 2016, the French Tax Administration issued guidelines commenting on various changes to the qualified RSU regime under Loi Macron. We have previously reported on the new qualified Macron regime in a client alert and blog post.

The guidelines confirm that the plan under which qualified RSUs under Loi Macron can be granted must have been approved by the company's shareholders after August 7, 2015 (the date on which Loi Macron was published), unless shareholders generally do not have to approve the equity plan under which RSUs are granted under the law applicable to the issuing company.

To meet this requirement, companies can seek shareholder approval either for the entire equity plan or for the French sub-plan under which the qualified RSUs are to be granted. If approval is sought for the entire plan, it is not strictly necessary that the approval be sought only to grant qualified RSUs under Loi Macron.

In other words, if companies have obtained shareholder approval for their plan after August 7, 2015 for other reasons (e.g., to increase the share reserve), this should enable them to grant qualified RSUs under Loi Macron under the plan.

However, we recommend that, if US companies are seeking shareholder approval, they include a reference to Loi Macron (and the fact that they intend to grant qualified RSUs under Loi Macron) in the proxy disclosure.

Income Tax Withholding May Become Required Starting With Calendar Year 2018

Currently, French employers are not required to withhold income tax on employment income, including income from equity awards. Instead, French tax payers are required to pay income tax due when they file their tax return for the year in which the income was recognized.

The draft Finance Act contains provisions creating an obligation for the employer to withhold personal income on employment income, starting with calendar year 2018.

It is anticipated that this obligation would also cover income recognized from non-qualified equity awards (whether granted by a French or non-French company), while qualified awards would remain exempt from withholding.

We will continue to monitor the progress of this proposal.

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Sweden

Proposal for Tax-Qualified Option Regime in Sweden

The Swedish government is considering the introduction of a tax-qualified option regime. Under the proposal, qualified stock options would not be subject to income tax at exercise. Instead, the options would be subject to the capital gains tax regime and would be taxed only at sale on the difference between the sale proceeds and the exercise price (at a rate of 25% or 30%).

By contrast, currently, options are taxed at exercise on the spread (i.e., difference between the fair market value of the shares at exercise and the exercise price) at the same rate which applies to employment income, which can be up to approximately 55%. Only any additional gain (i.e., difference between the sale proceeds and the fair market value of the shares at exercise) is taxed under the capital gains tax regime.

Under the current proposal, the tax-qualified option regime would be available only to companies:

- with less than 50 employees (likely total, not only in Sweden),
- with net annual sales of less than SEK 80 million (approx. USD10 million), and
- being incorporated for less than 7 years.

Also, the proposal excludes companies in certain industries. As such, the proposal has been heavily criticized for being too narrow and there are efforts underway to expand the regime to more companies.

On the other hand, other groups (e.g., the Swedish Tax Agency) recommend rejecting the proposal altogether, claiming a loss of taxes as a result and marking the proposal as being contradictory to the dualistic tax system.

The tax-qualified option regime – if adopted – is expected to take effect from January 1, 2018, at the earliest.

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United States

IRS Eliminates Requirement to Include 83(b) Election with Annual Tax Return

In July 2016, the Internal Revenue Service (IRS) issued final regulations eliminating the requirement for taxpayers making an "83(b) election" to enclose a copy of the election with their annual tax return.

Pursuant to Section 83(b) of the Code, a taxpayer who receives a transfer of property under an unvested award subject to Code Section 83, such as a restricted stock award, may elect to be taxed on receipt of the relevant property (i.e., stock) instead of on the vesting date by filing an election with the IRS no later than 30 days after the grant date.

Before the change in the regulations, a copy of the 83(b) election had to be enclosed with the taxpayer's annual tax return, which meant that the return could not be filed electronically. Thus, the elimination of the tax return requirement is intended to encourage taxpayers to electronically file their annual tax return. **The change applies to property transferred on or after January 1, 2015.**

Note that the 83(b) election must still be filed with the IRS no later than 30 days after the date the property is transferred. In addition, as before, an employee making an 83(b) election is required to file a copy of the election with his or her employer, to enable the employer to fulfill its tax withholding and reporting obligations.

Companies should review their plan prospectuses and other employee communications to ensure that they are updated to the extent necessary to reflect this change in the tax filing requirements for awards subject to Code Section 83.

Shareholders Challenging Section 16 Exemption Availability Where Net Share Tax Withholding is Elective

Several companies have received letters from the plaintiff's bar seeking to recover "short-swing profits" from Section 16 officers where an officer has elected to exercise a right, or the company has exercised its discretion, authorized under the terms of an equity award agreement, to have shares withheld by the company to satisfy tax withholding obligations within six months of a purchase of shares by the officer that is not exempt from Section 16 short-swing profit liability rules.

Background

Under Section 16(b) of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act"), any "profit" realized by a Section 16 officer arising from the "acquisition" (purchase) of company shares that is not exempt from these rules within six months of a non-exempt "disposition" (sale) of shares must be disgorged to the company. The withholding of shares to satisfy tax withholding obligations arising under a Section 16 officer's equity award agreement is considered a disposition of securities by the Section 16 officer to the issuer.

However, the disposition will be exempt from Section 16(b) pursuant to Rule 16b-3(e) if the terms of the net share withholding are approved by the board or by a compensation committee meeting the requirements of Section 16.

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Section 16 Claims

The plaintiff shareholder claims are based on a Compensation and Disclosure Interpretation ("CDI") in which the SEC Staff has taken the position that a tax withholding right that is subject to company management's discretion would require specific approval of the individual transaction in order for the Rule 16b-3(e) exemption to be available (perhaps based on the theory that company management's discretion means that the board or committee delegated to management the decision whether to approve withholding, rather than making the decision itself).

Therefore, according to this guidance, if the terms of the agreement provide for withholding of shares to satisfy tax withholding obligations, but also authorize the company to select a different method of tax withholding, the net share withholding would not be considered an exempt transaction.

Companies have also received demands from plaintiff shareholders claiming that Rule 16b-3(e) exempts net share withholding only if it is "automatic," and does not exempt an elective withholding, where the Section 16 officer could have elected to use a different method to satisfy tax withholding obligations on his or her equity award.
The plaintiff shareholders are basing this position primarily on the SEC Staff CDI described above.

However, the better interpretation of this CDI is that specific approval by the board/committee would be required only where company management has been given discretion, rather than where the Section 16 officer is given discretion to elect net share withholding as the method to be used to satisfy tax withholding obligations.

In light of the potential claims in this area, companies that have not already done so may wish to consider revising the tax withholding provisions in their equity award terms to follow the SEC Staff interpretation and eliminate company management's discretion to deny net share withholding for Section 16 officers that has been approved by the compensation committee/board (or impose strict guidelines on the company's discretion). Companies may also need to weigh whether to also eliminate any discretionary authority on part of Section 16 officers to determine the method of tax withholding.

NYSE Issues Guidance Confirming that Equity Plan Amendments to Allow Maximum Tax Withholding Do Not Require Shareholder Approval

The New York Stock Exchange (NYSE) has issued guidance clarifying that an amendment to an equity compensation plan, which previously allowed shares to be withheld to satisfy tax withholding obligations calculated based on the minimum statutory rate, to provide that the tax withholding obligations may be calculated based on the participant's maximum tax rate will not require shareholder approval.

Background

As discussed in our last Clients & Friends newsletter, the FASB recently amended the accounting rules to allow companies to withhold shares to satisfy tax withholding obligations calculated using the highest rate in a participant's jurisdiction without incurring liability accounting treatment.

Previously, share withholding to satisfy tax withholding obligation was required to be calculated using the minimum statutory rate to avoid liability accounting treatment. As a result, most equity compensation plans required that share withholding to satisfy tax withholding obligations be calculated using the minimum statutory rate.

In light of the changes to the accounting rules, companies considered amending their plans to allow share withholding at the maximum rate. However, both the NYSE and NASDAQ stock exchange rules were silent on whether such an amendment would give rise to shareholder approval.

NYSE Guidance

The NYSE issued revised FAQs confirming that an amendment to an equity compensation plan authorizing share withholding to satisfy tax withholding obligations to be calculated at the participant's maximum tax rate (instead of the minimum statutory tax rate) would not be considered a material amendment that would give rise to shareholder approval. The NYSE guidance confirms that this type of amendment would not require shareholder approval even where the withheld shares are recycled under the terms of the plan (i.e., are issuable pursuant to future awards).

Additional Considerations

While the change to the accounting rules allows share withholding to be calculated based on the highest tax rate in a participant's jurisdiction, the relief provided under the NYSE guidance is limited to the participant's highest tax rate.

Therefore, to the extent a company desires to withhold at the highest tax rate in a jurisdiction where a participant is located (particularly in non-US jurisdictions, where this approach may be easier to administer), it may be necessary to seek additional guidance from the NYSE on whether withholding at the highest rate in a given jurisdiction would also not give rise to shareholder approval.

Based on informal conversations with the NASDAQ staff, we understand that the NASDAQ is likely to take a consistent position with the NYSE and is anticipated to issue guidance imminently on this topic in the form of FAQs.

Proposed Dodd-Frank Rules Regulating Incentive Compensation at Certain Financial Institutions

In April 2016, six federal agencies regulating the financial sector (the "Agencies") issued proposed rules under Section 956 of the Dodd-Frank Act, superseding the initially proposed rules issued in April 2011.

The proposed rules introduce extensive requirements to implement Section 956's mandate of prohibiting incentive-based compensation that is excessive or encourages inappropriate risks that could lead to material financial loss.

It widely considered that the rules foreshadow more broad-based reforms; thus, the scope of the new rules should be of interest to public companies outside the financial sector, as well as fundamentally important to those within it.

Covered Institutions

The rules apply to all financial institutions with assets of $1.0 billion or more, but create three levels of covered institutions based on asset size, with the most onerous requirements applicable to those at Level 1 and Level 2, with respectively, assets of $250 billion or more and assets of between $50 billion and $250 billion.

Incentive-based Compensation

The regulated "incentive-based compensation" includes variable compensation, fees or benefits that serve as an incentive or reward for performance, and excludes compensation provided solely for continued employment such as salary, or time-based equity awards.

Requirements Applicable to all Covered Institutions

All covered institutions are subject to the general prohibition on excessive compensation and the rules set out a range of factors the Agencies will consider in evaluating whether compensation is excessive, including the total compensation provided to covered persons versus other persons with comparable expertise and the financial condition of the financial institution.

All institutions are required to include appropriate risk-balancing features in their incentive compensation arrangements, including the use of both financial and non-financial measures of performance and downward adjustment of amounts awarded to reflect actual losses, inappropriate risks or compliance deficiencies.

Appropriate oversight of incentive compensation arrangements by the board of directors or compensation committee and compliance with certain disclosure and record-keeping requirements is also necessary for all covered institutions.

Additional Requirements for Level 1 and 2

The most prescriptive requirements, and those having the greatest impact on the design and terms of equity and other incentive arrangements, apply to Level 1 and 2 institutions.

For incentive-based compensation granted to "senior executive officers" ("SEOs") (defined to include a group typically broader than a covered institution's Section 16 officer group) and "significant risk takers" ("SRTs"), identified based on having at least one-third of their total compensation in the form of incentive-based compensation and either being among the highest paid covered persons in the consolidated organization (top 5% for Level 1 and top 2% for Level 2 institutions) or being in a position to commit or expose 0.5% or more of a covered institution's capital, the proposed rules require the following:

- Mandatory Deferrals: After the end of a performance period, mandatory deferral periods of up to four years are required for between 40% and 60% of incentive-based compensation, depending on whether the institution is Level 1 or 2, whether the individual is an SEO or SRT and whether the performance period was more or less than three years. The maximum four-year deferral of 60% of incentive-based compensation applies where an SEO at a Level 1 institution earns incentive-based compensation in a performance period of less than three years.
- Vesting During Deferral Period: Compensation is considered "unvested" during the deferral period, in that it may be forfeited in specified circumstances relating to failures in risk management or controls, poor financial performance caused by deviation from risk parameters, non-compliance with laws or standards and inappropriate risk-taking. Vesting may occur no faster than on an annual pro-rata basis. Importantly, the proposed rules do not require continued employment or achievement of performance goals during the deferral period; thus, the compensation will generally not be unvested from a tax perspective, with the result that the deferral arrangements will need to be structured to comply with Code Section 409A.
- Acceleration of Vesting: Permitted only upon death or disability. As the deferral arrangements will generally be subject to 409A, to make payment early, a disability would need to be a 409A disability.
- Clawback: Applies for seven years after the end of the deferral period if the covered institution determines that an SEO or SRT engaged in (i) misconduct that resulted in significant financial or reputational harm to the covered institution, (ii) fraud, or (iii) intentional misrepresentation of information used to determine the SEO's or SRT's incentive-based compensation.
- Leverage Limitation: Maximum of 125% of target for SEOs and 150% for SRTs.
- Performance Design: Goals based on relative performance are not permitted unless combined with absolute performance measures.
- Stock Option Limit: Options and SARs may count for only up to 15% of incentive compensation used to determine the minimum deferral amount.

Since the financial crisis in 2008, many financial institutions have already dramatically revised their compensation structures to build in downward adjustment provisions, clawbacks and other risk-mitigation strategies.

However, the prescriptive nature of the rules will require an even deeper focus on the structure, design and governance of all types of incentive compensation arrangements, from annual bonuses to long-term equity and cash-based incentive awards.

Performance plans and award agreements will need to be revised to reflect the new requirements, particularly for Level 1 and 2 institutions which must incorporate the new deferral, forfeiture, downward adjustment and clawback provisions into their award terms.

A vast number of comments were submitted on the proposed rules during the comment period which ended on July 22, 2016, so the precise scope of the final rules remains to be seen. The requirements will not take effect until the first calendar quarter that begins at least 540 days after the final rules are published in the Federal Register.

Any incentive-based compensation plan with a performance period that begins before such date would not be required to comply with the requirements of the proposed rules.

Vietnam

Vietnam Clarifies Process for Obtaining Approval Under New Exchange Control Regime

As previously reported in our client alert, the State Bank of Vietnam ("SBV") issued Circular 10/2016/TT-NHNN ("Circular 10") which provides guidance on the requirement to obtain SBV approval for share plans offered to Vietnamese employees of affiliates of foreign parent companies in Vietnam.

On August 13, 2016, Circular 10 went into effect. However, the text of Circular 10 does not directly address some important practical considerations for companies currently offering, or considering offering, equity awards in Vietnam.

Baker & McKenzie was able to discuss some of these issues on an informal basis with a responsible official at the SBV. The SBV official offered several clarifications but companies may want to seek an official dispatch from the SBV confirming the informal guidance below.

Companies that obtained SBV approval before the implementation of Circular 10:

- Should not be required to seek new SBV approval provided that they continue to offer equity awards under the same plan and do not allow employees to hold shares.
- Will be required to seek new SBV approval if they would like to implement an ESPP (or any other new plan) and/or will allow Vietnamese employees to hold shares.
- Will be required to open a Vietnamese bank account to transfer equity award proceeds into and out of Vietnam. Companies with an existing approval will need to present such approval to open the Vietnamese bank account.
- Will be required to submit a quarterly report on a prescribed form which includes details of the equity-related proceeds transferred into or out of Vietnam.

Companies seeking new SBV approval will need to provide:

- A written registration application on a prescribed form.
- Documents proving the legal status of the foreign issuer which will need to be notarized, legalized, consularized and then translated into Vietnamese.
- Notarized documents proving the legal status of the Vietnamese entities.
- Vietnamese translations of the plan and applicable award agreements.
- List of Vietnamese employees participating in the plan.Companies can avoid obtaining SBV approval by offering cash awards or awards settled in cash (provided shares are never issued) paid through local payroll.

It also appears that (i) Circular 10 should not apply to foreign nationals working in Vietnam and (ii) it may be possible to submit a single application package for all Vietnamese entities offering equity awards However, companies should obtain an official dispatch from the SBV to clarify these issues.

If you have questions about the impact of Circular 10 on your company's equity plans, please contact your Global Equity Services attorney.

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