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Global Equity Services

# CLIENTS & FRIENDS

Quarterly Newsletter | June 2017

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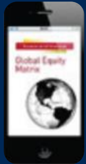

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# Australia

## Australian Share Plan Reporting: We Can Help

### Key takeaway

The deadlines for the Australian Share Plan Reports are approaching: the Employee Share Scheme Statements must be distributed to employees by July 14, 2017 and the Annual Report must be filed with the Australian Tax Office (ATO) by August 14, 2017.

### We Can Help

Our Global Equity Services Practice can provide full-service support, including:

- Calculations of the taxable amount, including mobile employees;
- Produce Employee Share Scheme Statements for distribution to employees;
- Produce the ATO Annual Report and lodge with the ATO;
- Prepare standard communication to employees explaining ESS Statement; and
- Prepare individual calculation spreadsheet for each employee.

*If your company prefers lodgement service only, we can:*

- Provide an ESS Reporting Spreadsheet for you to populate;
- Produce ESS Statements for distribution to employees; and
- Produce the ATO Annual Report and lodge with the ATO.

For more information on our services and pricing, see our Australian Share Plan Reporting brochure.

For specific questions regarding the Australian Share Plan reporting process, please contact your GES attorney.

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# Belgium

## Belgium Expands Scope of Stock Exchange Tax

The Belgium Stock Exchange Tax was expanded effective January 1, 2017. Under the expanded regime, the tax also applies to share disposals and purchases for consideration carried out by intermediaries located outside of Belgium where the order for the transaction is given, directly or indirectly, by a Belgian resident individual or entity to a foreign intermediary. The tax previously applied only if the transaction was carried out by an intermediary located in Belgium.

Although there is no direct guidance from the Belgian authorities on how the changes affect employee stock plans, some of the transactions made pursuant to such plans may now be considered subject to the tax. In particular, the sale of shares acquired under a stock plan will be subject to the tax if it is executed by a non-Belgian broker. By contrast, the issuance of shares at vesting of RSUs is not subject to the tax as employees do not pay any consideration to acquire the shares. Similarly, if option exercises and ESPP purchases are satisfied by transferring newly issued shares to the employees, the tax should not apply.

At the sale of shares, the tax is levied on the total sale proceeds (not only the gain). The current rate is 0.27%, but the tax is capped at €1,600 of taxes due per transaction.

Non-Belgian brokers or intermediaries can appoint a fiscal representative in Belgium to report the transaction, withhold the tax and remit it to the Belgian tax authorities. Absent this appointment, the individual taxpayer is responsible for reporting and paying the tax due directly to the Belgian tax authorities.

Under transitional rules (i) transactions taking place from January through March where no Belgian withholding representative is appointed and (ii) transactions taking place in January through April where a Belgian withholding representative is appointed must be reported and the applicable tax paid by June 30, 2017. After the transition period, transactions where no Belgian withholding representative is appointed must be reported and the applicable tax paid by the end of the second month following the month in which the transaction takes place.

The tax return on which the transaction has to be reported cannot be filed electronically. The paper form can be found here and further instructions are included here.

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# Canada

## Quebec Stock Option Deduction Increased to 50% for Large Companies

Provided certain conditions are met, employees may exclude 50% of the spread at option exercise for both federal and provincial tax purposes. However, in Quebec, the deduction has historically been limited to 25% for Quebec provincial tax purposes. Pursuant to recent changes, the 25% deduction has been increased to 50% provided

1. The options were granted after February 21, 2017,
2. The shares are listed on a recognized stock exchange,
3. The individual is an employee of a company with a Quebec payroll of at least $10 million per year at the time the option grant was made, and (4) the general requirements of the tax deduction are met.

We recommend assessing whether your employees qualify for the increased deduction and, if so, whether the tax withholding rate for employees in Quebec should be adjusted accordingly.

## Local Tax Deduction Now Available for Time-based or Performance-based RSUs in Canada

In the past, the Canada Revenue Agency (CRA) generally has not allowed a local tax deduction for the cost of share-settled equity awards (although it may have been possible to take a deduction under very narrow circumstances where the issuer had complete discretion (*i.e.*, it did not have any legal obligation) to decide whether shares would be issued to a grantee). However, based on a technical interpretation released by the CRA on April 12, 2017, the CRA appears to have updated its position for share plans such that a company should be entitled to a tax deduction for the cost of the awards if:

- it awards share-based compensation to an employee;
- it retains the discretion to determine whether the award will be settled in cash or previously unissued or treasury shares;
- it does not commit to delivering the shares at any time before settlement;
- it actually delivers shares; and
- where the award is granted by a non-Canadian parent company, the Canadian entity reimburses the parent for the cost of the award.

Although the interpretation is not law, but simply a non-binding clarification by the CRA, we believe that most companies may now be able to obtain a tax deduction in Canada for (time-based or performance-based) RSUs. By contrast, it would be more difficult to structure an option or purchase rights granted under an ESPP as being able to be settled in cash or shares. In either case, companies would need to confirm with their accountants whether retaining the discretion to settle the award in cash or shares will subject the award to liability accounting, *i.e.*, mark-to-market accounting (rather than (fixed) equity accounting).

In addition, it is important to note that, if the award can be settled in cash or shares, it will be subject to the salary deferral rules in Canada. These rules provide that any portion of an award that is settled more than three years after the end of the year in which the services were rendered (for which the award is granted) is subject to tax at grant. Companies will need to review their vesting schedules to determine if they will be subject to the salary deferral rules and, potentially, adjust their vesting schedule to avoid taxation at grant.

Similarly, if companies tried to structure an option such that it can be settled in cash or shares (to enable a tax deduction), this discretion will eliminate the ability to rely on the 50% tax deduction that generally is available for stock options.

If you are interested in pursuing a tax deduction for your awards in Canada, please contact your GES attorney to discuss next steps.

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# Colombia

## Tax Deduction for Equity Awards Without Recharge Arrangement

Historically, a corporate tax deduction for the cost of equity awards granted to employees in Colombia by a non-Colombian parent company was available to the Colombian employer only if the Colombian employing entity reimbursed the parent company for the cost of the equity awards. If reimbursement took place, it triggered a tax withholding and reporting obligation for the Colombian employing entity (which did not exist absent reimbursement).

On December 29, 2016, the Colombian Congress enacted Law 1819 of 2016, reforming the Colombian tax code. Among other changes, effective for the tax year beginning on January 1, 2017, a corporate tax deduction is now available regardless of whether the Colombian employing entity reimburses the foreign parent company for the cost of the equity awards.

By contrast, it is our position that the changes did not affect the Colombian employing entity's tax withholding and reporting obligations. This means tax withholding and reporting continue to be required only if the Colombian employing entity reimburses the foreign parent company for the equity awards.

For additional guidance on how to claim a corporate tax deduction in Colombia, please contact your GES attorney.

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# European Union

## New EU Prospectus Regulation to Replace the EU Prospectus Directive

As reported previously, the relevant EU authorities decided at the end of 2016 that a new EU Prospectus Regulation will replace the EU Prospective Directive. According to the updated timeline circulated by the International Capital Market Association (ICMA), the new EU Prospective Regulation is expected to be published in June 2017. The new EU Prospectus Regulation becomes operative 24 months after its publication, which means that the new regime is expected to apply as of June 2019.

In light of the new timeline, the EU Prospectus Regulation should result in the following consequences for issuers who currently have to file an EU prospectus for share-based offerings to employees in Europe:

- Issuers who file their EU prospectus in the first half of the calendar year will need to continue to file EU prospectuses for 2017, 2018 and 2019
- Issuers who file their EU prospectus in the second half of the calendar year will need to continue to file EU prospectuses for 2017 and 2018.

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# France

## Employer Social Tax Refunds Possible for Forfeited French-qualified RSUs

### Key takeaway

French employers may be able to claim a refund for employer social insurance contributions paid upon grant of French-qualified RSUs that are subsequently forfeited.

### Summary

In a decision dated April 28, 2017, the French Constitutional Court ruled that employers can claim a refund of the employer social insurance contribution paid upon grant of French-qualified RSUs if the RSUs are subsequently forfeited. In reaching its decision, the court reasoned that the law cannot require an employer to pay tax on remuneration that is not actually paid.

This is potentially good news for companies that granted French-qualified RSUs under the pre-Macron regime, which required the payment of a non-refundable employer social insurance contribution of 30% at grant (due on the value of the shares underlying the RSUs at grant or the IFRS value of the awards, at the election of the employer).Such companies may now have a right to claim a refund of the previously-paid contributions if the French-qualified RSUs are subsequently forfeited and the underlying shares are not issued to the French employees. The right to a refund arises when the French-qualified RSUs are forfeited. However, it is likely that the refund can be claimed only if the contributions were paid within the last three years.

The decision does, on its face, not apply to employer social insurance contributions paid upon grant of French-qualified options. It is not certain if another court decision is necessary before companies can claim refunds for such contributions or if the French social security authorities will consider refund claims without a court decision.

We recommend that companies that have granted French-qualified RSUs under the pre-Macron regime or French-qualified options review their forfeiture records to determine whether they have a possible claim for refund.

Please contact your Global Equity Services attorney with any questions related to the availability of and timing of claiming a refund.

We want to thank our colleagues in Paris for their assistance with this alert.

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# Japan

## Potential Changes to Japanese Securities Filing Obligations

The Japanese Financial Services Agency (FSA) recently concluded that a company's offer of RSUs to its Japanese employees was a securities offering, notwithstanding the fact that the RSUs were granted by a foreign parent company (not the local employer) and the employees did not pay cash consideration to receive the RSUs or the underlying shares. The FSA required the company (a US multinational) to make securities disclosures in relation to its grant of RSUs.

This is a departure from the position previously taken by the FSA which indicated that awards and/or shares granted at no consideration would not be considered securities offerings for purposes of the Japanese securities filing requirements (unlike grants of options or the offering of an ESPP which are subject to the securities filing requirements in Japan, unless an exemption applies).

It should be noted that the FSA has not made a formal announcement that RSUs are considered securities offerings nor have they provided any guidance on when a grant of RSUs must be included in a securities disclosure.

Notwithstanding, based on the guidance provided by the FSA to the company described above, we believe it is prudent to assume that a grant of RSUs that is made "in parallel" with a grant of stock options or the offer of an ESPP will need to be disclosed in any securities filings that has to be completed for the options or ESPP. The FSA has not defined what would constitute "in parallel" but we believe it is reasonable to assume that a parallel offering does not occur where the grant of the RSUs is communicated more than two weeks before or after the grant of the options or the offer of the ESPP (as applicable).

As there is no official guidance from the FSA, this position is still subject to change. However, at this time, we are recommending companies take a conservative approach going forward and include RSUs in any securities filings made for options or an ESPP if the grants are communicated within two weeks of a grant of stock options or the offer of an ESPP. We will continue to provide updates as we obtain more information on this new development.

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# Philippines

## Philippines SEC Adopts New Policy Requiring All Companies to Obtain a Securities Exemption for Share-Settled Awards

In our July 2016 Client & Friends Newsletter, we reported that the Philippines Securities and Exchange Commission (SEC) issued Amended Implementing Rules and Regulations of the Securities Regulation Code (SRC) which eliminated the requirement for issuers to submit a Notice of Exemption (via Form 10.1) for share-settled equity award grants to less than 20 employees in the Philippines within a 12 month period. By contrast, grants to more than 20 employees within a 12-month period continue to require a confirmation of exemption filing under Section 10.2 of the SRC.

However, based on a conference with the Director of the Markets and Securities Regulation Department ("MSRD") on 2 February 2017, the SEC *en banc* has adopted a new policy requiring all foreign companies issuing shares pursuant to an employee share plan to obtain a confirmation of exemption under Section 10.2 of the SRC. This means that issuances of shares pursuant to an employee share plan will no longer be considered as an exempt transaction under Section 10.1 of the SRC, even if there are fewer than 20 offerees in the Philippines within a 12-month period. According to the Director of the MSRD, the rationale for this new policy is that the SEC wants to review the implementation of all plans in the Philippines, in order protect the interest of the employees in the Philippines.

The Director of the MSRD mentioned that the SEC will implement this new policy immediately, pending issuance of a memorandum circular. However, there is no requirement that the SEC publish any formal guidance to effectuate their policy. Therefore, under a conservative approach, companies should assume that the new policy is now in effect and grant equity awards to employees in the Philippines only if a confirmation of exemption has been obtained from the SEC.

We continue to take the position that the grant of cash-settled awards is not considered a securities offering in the Philippines and, hence, does not require an exemption.

If you are offering share-settled awards to employees in the Philippines and have not previously obtained an exemption under Section 10.2 of the SRC, please contact your GES attorney for additional guidance.


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# Romania

## Private Companies Benefit From Expansion of Definition of Stock Option Plan

Effective January 1, 2017, Romanian legislation expanded the definition of "stock option plan" to include equity awards settled with shares not listed on a stock exchange. This change in Romanian law allows equity awards offered by private companies to benefit from preferential tax treatment in Romania, provided certain other conditions are met. Shares offered under equity plans that meet the definition of "stock option plan" are exempt from tax until the sale of the underlying shares.

By way of background, Romania introduced changes to its tax laws starting January 1, 2016 which allow equity awards to qualify for preferential tax treatment, provided the equity awards are settled in shares and are granted under a plan that meets the definition of a "stock option plan."

Originally, equity awards had to satisfy three conditions to meet the definition of a "stock option plan.":

1. First, the equity awards can only be granted to employees or directors of the issuer or its affiliates.
2. Second, there must be a minimum period of one year between grant and vesting of the equity award.
3. Third, only shares listed on a regulated trading market or alternative trading system could fall under the definition of a "stock option plan."

With the changes to Romanian legislation effective January 1, 2017, the third requirement no longer applies. Accordingly, private companies who grant share-settled equity awards in Romania now may benefit from the tax exemption under a "stock option plan," provided the minimum vesting period and employee/director grant requirements are met.

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# United Kingdom

## HMRC Confirms No Grossing Up Tax Charge Applies on PAYE Defaults Where Enforceable Indemnification Provisions in Place

Tax withholding in the UK takes place through the Pay-As-You-Earn (PAYE) system. The local subsidiary must calculate and pay to Her Majesty's Revenue & Customs (HMRC) the tax liability arising upon the applicable taxable event within 14 days after the end of the tax month during which the taxable event takes place (or within 17 days after the end of the tax month during which the taxable event takes place if paying electronically).

The local subsidiary is required to pay the tax on behalf of the employees to HMRC by the relevant payment date irrespective of whether it has collected the tax from the employees by that date (and may become liable to pay penalties and interest with respect to any late payment to HMRC). Within 90 days after the end of the tax year in which the applicable taxable event occurs, the local subsidiary must recover the tax from the employees. If the employee does not reimburse the local subsidiary for the income tax paid on his or her behalf by this due date, the employee is deemed to have received a benefit equal to the amount of tax not recovered. This results in an additional tax and NICs charge to the employee on the amount of tax that was not recovered, regardless of whether the employee subsequently reimburses the local subsidiary. The employee then has to account to the HMRC directly with respect to the income tax due on this additional benefit under the self assessment regime, while the local subsidiary must withhold employee NICs and pay employer NICs on the deemed benefit. This is considered a grossing up tax charge as it is essentially a tax on a tax charge.

HMRC has now indicated that the grossing up tax charge can be avoided provided there is an enforceable contractual agreement pursuant to which the employee indemnifies the employer or issuer for the income tax due. It is possible to include this obligation in the award agreement. Accordingly, we recommend updating award agreements to include language that reflects HMRC's recent guidance.

If you have any questions or would like assistance with updating your award agreements for the UK, please contact your GES attorney.

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For more information on the annual share plan return process, please see our May 2017 client alert.

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## Are You Ready for This Year's UK Annual Share Plan Reporting?

Annual share plan returns must be filed with the UK tax authorities (Her Majesty's Revenue & Customs or "HMRC") in relation to equity awards in the UK on or before July 6 following the end of each UK tax year, which runs from April 6 to April 5. The returns for this year will not be staggered and companies are encouraged to submit their returns as early as possible.

# Ukraine

## Ukraine Loosens Licensing Restriction on Shares Acquired for No Consideration

On February 23, 2017, the National Bank of Ukraine issued Decree No. 14 which changed the definition of "placement" for purposes of determining whether a placement license is required for the holding of shares outside of Ukraine.

Ukrainian residents (excluding private entrepreneurs) no longer must obtain a placement license to hold shares of a foreign company outside of Ukraine, provided that no payment is made from Ukraine to acquire the shares. Accordingly, for shares that are acquired for free (such as shares at vesting of RSUs), a placement license will no longer be required.

For more information on the licensing restriction please see our April 2017 client alert.

Please contact your GES attorney if you would like to explore granting share-settled awards to employees in Ukraine under the relaxed rules.

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# United States

## First Court Dismissal of Shareholder's Section 16 "Short-Swing Profits" Claim Alleging Discretionary Share Withholding

Over the past two quarters, we have reported on claims filed in federal court by plaintiff shareholders seeking to recover "short-swing profits" from Section 16 officers by matching an allegedly discretionary (non-exempt) withholding of equity award shares from a Section 16 officer that occurred within six months of an acquisition (such as a purchase) of shares by such officer that was non-exempt under Section 16(b) of the Exchange Act.

Although in each case the withholding of shares was authorized by the issuer's board or compensation committee-approved award agreement and therefore should be exempt from Section 16(b) under Rule 16b-3(e), the shareholder has argued that a share withholding transaction is so exempt only if the authorized withholding occurs automatically in accordance with the Board or Compensation Committee approval and without any ability on the part of the Section 16 officer or the company to determine that an alternative method may be used to satisfy tax withholding obligations.

In what appears to be the first ruling on the issue, on April 26 2017, the US district court for the Southern District of Texas dismissed the shareholder's claim in its entirety. See *J.D. Jordan v. Robert Flexton, et al*., No. 4:16-CV-03316 (S.D. Tex. filed November 9, 2016). In this case, the plaintiff shareholder's claim centered around share withholding transactions that occurred pursuant to the terms of a compensation committee-approved RSU agreement that required the defendant Section 16 officers to satisfy their tax withholding obligations by delivering cash to the company, but if they failed to do so, the company was authorized to either withhold from cash or stock otherwise payable to the officers, including shares deliverable under the RSU.

The plaintiff claimed that the withholding in shares was non-exempt both because (i) the officers had discretion to pay their taxes in either cash or in shares, which demonstrated their ability to take advantage of their inside information, and (ii) the company had discretion as to whether to withhold in shares or from cash compensation - which the plaintiff asserted would mean that the withholding was not "automatic" as required by the SEC in Compensation and Disclosure Interpretation 123.16 relating to Rule 16b-3, issued in 2007.

In dismissing the plaintiff's claim, the court stated simply that "the transactions in question are compensation related and are designed to be exempt under Section 16b-3(e) of the Securities Exchange Act of 1934." Although the court did not provide further analysis of the basis for its decision, it has clearly rejected the arguments on

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which these plaintiff shareholder claims are based and it is to be hoped that it will be persuasive for the courts considering the other pending cases.

Until such other cases are decided, it remains advisable to limit the use of discretion around share withholding in equity award agreements with Section 16 officers, particularly discretion on the part of the company in view of the existing SEC guidance on this point.

## SEC Amends Settlement Cycle Rule from T+3 to T+2

Stepping into line with the EU and much of the Asia/Pacific, effective September 5, 2017, broker-dealers in the U.S., Canada and Mexico will be required to settle most securities transactions, including those under equity compensation plans, within two business days after the trade date ("T+2"), a shortening of the current settlement cycle of T+3. The effectiveness of the change to the settlement rule is subject to regulatory support and completion of industry-wide testing in the second and third quarters of 2017. In adopting the amended Settlement Cycle Rule on March 22, 2017 (Rule 15c6-1(a) under the Securities Exchange Act of 1934), the SEC stated that the amendment is designed to increase efficiency and reduce risk for market participants.

The shortened settlement cycle will have an immediate effect on equity plan transactions that involve a sale on the market, including "same-day-sale" and "sell-to-cover" option exercises (or "cashless" exercises). Companies need to be prepared to administer these transactions in one day less, including calculating the amount of withholding taxes and delivering shares to the broker in time to enable the broker to deliver the net shares or cash proceeds to the participant by the second business day after the exercise date.

For US plan participants, where withholding will typically be done using the flat supplemental withholding rate, the reduced settlement period may not cause a significant administrative burden. However, bear in mind the IRS's next day deposit rule, which requires the deposit of employment taxes with the IRS within one business day when an employer accumulates $100,000 or more of employment taxes at any one point. The IRS issued a Field Directive in 2003 which considers timely a deposit of taxes relating to a broker-assisted cashless option exercise if the deposit is made within one day of the settlement of the transaction, i.e., by T+4 under the existing Settlement Cycle Rule.

Although the IRS has not yet issued any guidance on the rule change, with the implementation of the new T+2 settlement rule, the next day deposit rule will likely mean a corresponding reduction of the deposit deadline for taxes relating to such exercises to T+3 (assuming $100,000 of accumulated employment taxes).

Companies with a large number of non-US equity plan participants or mobile participants who have worked in several countries and/or states during the life of the award may face additional challenges in implementing the shortened settlement

period, given the potential difficulty with quickly calculating withholding taxes when non-US and/or multi-jurisdictional tax rules and rates have to be considered.

To facilitate compliance, it may be worth moving to maximum rate or other single flat rate withholding per non-US jurisdiction; many companies already do this or are considering it, particularly with the effectiveness of Accounting Standards Update 2016-09, allowing for withholding in shares at maximum rates without triggering liability accounting. Also, now is the time to engage with any tax advisors assisting with mobile employees to confirm they can deliver their calculations of taxes due on multi-jurisdictional transactions within 24 hours of a transaction. Finally, plan prospectuses or other employee communications that discuss the settlement period for market transactions should be reviewed and updated to reflect the new rule.

## House of Representatives Passes Increase to the Dollar Threshold for Additional Disclosure Under Rule 701

The House of Representatives recently passed the Encouraging Employee Ownership Act of 2017. If enacted, this legislation would increase the value of securities a company that is not subject to US public reporting requirements could provide to its employees and other service providers pursuant to a compensatory benefit plan without having to provide additional disclosure, including financial information, to award recipients.

Many companies that are not subject to the periodic reporting requirements under Section 12 of the Exchange Act, such as US private companies and non-US public and private companies that are not publicly traded in the US, rely on Rule 701 of the Securities Act of 1933 when offering equity awards to employees under a compensatory benefit plan (or arrangement). Although the 701 exemption is self-executing, it has several requirements, including that the following information must be provided to award recipients if the aggregate value of securities "sold" in reliance on Rule 701 during any consecutive 12-month period exceeds $5 million:

- A summary of the material terms of the plan;
- Information about the risks of investing in the securities sold pursuant to the plan; and
- Certain financial statements, prepared in compliance with U.S. GAAP (or prepared in compliance with IFRS in the case of foreign private issuers) or reconciled to U.S. GAAP, including a current balance sheet and statements of income, cash flows and stockholders' equity for each of the two fiscal years preceding the date of the balance sheet and for any interim period.

The financial statements must be prepared no more than 180 days before the offering or sale of securities, which may be burdensome for companies that prepare these materials less frequently or that are sensitive about providing the company's financial information. Due to these disclosure obligations, private companies often

seek alternative exemptions to Rule 701 or scale back their offerings if they anticipate having offerings greater than $5 million in a 12-month period.

The Encouraging Employee Ownership Act of 2017 would raise the 12-month sales limit from $5 million to $10 million (indexed for inflation), with those in favor saying that it is meant to encourage small business growth. The House of Representatives passed the bill with bipartisan support with a final vote of 331 yeas and 87 nays. Similar legislation has been introduced in the Senate.

We will keep you apprised of further developments.

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