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## Global Equity Plan Development and Implementation

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This practice note provides legal guidance for practitioners whose U.S. corporate clients are developing equity-based compensation plans for granting equity awards to employees both within and outside the United States. The practice note describes the tax and regulatory issues to be considered when developing a global equity plan, includes practical tips to avoid some of the common traps into which U.S. practitioners fall, and identifies best practices for administering awards under global plans. Finally, it provides guidance on preparing the necessary documentation for international equity awards.

The keys to developing global equity plans are preparation, flexibility, and vigilance. A company that is considering offering equity to employees outside the United States should allow plenty of time to review the relevant tax and regulatory implications for each jurisdiction. As a preliminary matter, this review should form the basis of a cost-benefit analysis before a final decision is made to grant equity awards in a particular country. Global equity plan sponsors should be prepared to amend an existing plan being relied on for non-U.S. grants and customize the design of any award agreements as needed. Early planning is critical since implementation timelines can be delayed if securities, exchange control, or other filing is required prior to making award grants. Companies also need to be vigilant after rolling out the plan because the applicable tax, securities, and exchange control rules change often (and sometimes retroactively). As a best practice, advise global equity plan sponsors to conduct tax and regulatory compliance reviews on an annual or more frequent basis.

This practice note is organized in the following topics:

- Drafting Tips for Global Equity Plans
- Preliminary Considerations for Implementing Global Equity Plans
- Employment Law and Data Privacy Issues
- Drafting Award Agreements for Non-U.S. Recipients

For background information on equity plans generally, see [Designing a Public Company Equity Compensation Plan](#) and [Drafting a Private Company Equity Compensation Plan](#).

### Drafting Tips for Global Equity Plans

As noted above, one of the keys to successfully implementing a global equity plan is flexibility in plan drafting. This section discusses design considerations when drafting an omnibus equity incentive plan that will be implemented on a global basis. An omnibus plan is a plan that permits the grant of a variety of different types of equity award, including stock options that may be qualified as incentive stock options for U.S. tax purposes under I.R.C. § 422 (ISOs) as well as non-qualified stock options and other awards.

In many ways, drafting an equity incentive plan for global use is not much different from drafting a plan for use solely in the United States. For example, the plan should be drafted with enough flexibility to minimize the need to go back to the plan administrator (typically, the company's compensation committee or board of directors)—and in some cases to shareholders—to amend the plan to address changes in laws or in the company's grant practices. However, there are some specific considerations, discussed below, that apply when a plan is intended for use on a global basis.

### ***Scope of Plan – Eligible Entities***

First and foremost, you should ensure that the issuer company's equity plan permits the offering of awards to employees of its subsidiaries and related entities located outside of the United States, and is not limited to granting awards to employees of the "Company," which is typically defined to include only the issuer or plan sponsor. You should review references to the company throughout the plan to determine whether expansion to include subsidiaries and/or affiliates is warranted in a particular context. You should also pay attention to the plan's definitions of "subsidiary" and "affiliate." Although from a non-U.S. perspective, it is often desirable to have broad ability to grant awards to employees, directors, or consultants of various types of entities around the world, you should bear in mind that:

- To the extent that a company wants the ability to grant ISOs, the eligible employer entities must be parent or subsidiary corporations within the meaning of I.R.C. § 424(e) and (f), respectively.
- To the extent that non-qualified options and stock appreciation rights (SARs) are intended to be exempt from I.R.C. § 409A, the employer entity of a grant recipient must generally be a controlled direct or indirect subsidiary of the issuer company. 26 C.F.R. § 1.409A-1(b)(5)(iii)(E).
- For public companies wishing to make offers and sales of securities in reliance on a [Form S-8](#) registration statement filed with the Securities and Exchange Commission (SEC), the employer entity must be a direct or indirect controlling parent or controlled subsidiary of the issuer.

Therefore, the plan should be drafted to reflect these statutory and regulatory limitations, to the extent applicable.

### ***Plan Purpose***

To minimize employment law litigation risks (discussed further below, under Employment Law and Data Privacy Issues), ensure that any clause setting out the purpose of the plan does not imply that the plan is intended to reward employees for past contributions or provide increased compensation. This type of language may be used by plaintiff employees to support entitlement and vested rights claims in non-U.S. courts.

### ***Authorization of Non-U.S. Terms and Sub-plans***

To facilitate the offering of the plan on a global basis, the plan should include a provision that specifically authorizes the plan administrator to vary the terms and conditions of awards under the plan and/or adopt sub-plans to the plan as necessary or advisable to comply with the laws and business practices of foreign jurisdictions, allow for the grant of non-U.S. tax-qualified awards, or otherwise enable the plan to achieve its purpose when offered outside of the United States.

To give the plan administrator maximum flexibility, this non-U.S. awards provision should supersede other provisions of the plan, except for (1) the maximum number of shares subject to the plan or particular awards thereunder and (2) the plan term (if any). Among other things, this will give the plan administrator freedom to deviate from U.S.-centric provisions of the plan that do not work well for, or are inconsistent with the legal requirements for, non-U.S. offerings. For example, a definition of "retirement" based on age and/or years of service could pose age discrimination claim risks when used for awards to employees in the European Union (EU), and a definition of "disability" that refers to the Internal Revenue Code does not precisely mirror the criteria required to be used under foreign tax-qualified plans, such as in France.

### ***Compliance with Laws***

Throughout the plan, ensure that any references to complying with applicable laws and/or obtaining required regulatory approvals as a condition to the issuance of shares appropriately encompass the laws of foreign jurisdictions, as well as U.S. state, federal, and local laws. The laws of foreign jurisdictions relevant to the offering of equity securities to employees change fairly rapidly—and sometimes retroactively—such that it is not uncommon that an issuer may find itself unable to legally or practically issue shares subject to outstanding awards due to filing or other obligations that arise after the date of grant.

To protect the company from liability in these scenarios, the equity plan should not only state that awards and issuances of shares are subject to compliance with all applicable U.S. and non-U.S. laws and requirements, but also that the company has no liability for any failure to issue shares as a result of its inability or impracticability to obtain or maintain any necessary approvals under U.S. or non-U.S. laws. In practice, it is also often helpful if the company has express authority to cancel awards in these circumstances. Note, however, that to avoid potential adverse accounting treatment, any discretion to cancel awards should be limited and narrowly tailored.

## **Taxes and Withholding**

U.S. equity plans typically include a brief provision authorizing the company to withhold taxes, including by withholding in shares issuable pursuant to an award. Such withholding provisions often limit share withholding to the amount determined using the “minimum statutory withholding rate,” as was required to avoid liability accounting treatment of awards under U.S. accounting rules prior to recent modifications. Current rules allow for withholding in shares at up to the maximum applicable rate in a participant’s jurisdiction (for more information on this change, see [Financial Accounting Standards Board \(FASB\) Accounting Standards Update, Compensation—Stock Compensation \(Topic 718\), No. 2016-09](#) (March 2016)).

When plans are being offered globally, it is important to ensure that the withholding provision authorizes withholding of all applicable taxes, social contributions (i.e., employee contributions to governmental social insurance programs), and other applicable payroll levies under U.S. and foreign laws through a non-exclusive variety of withholding methods, such as selling a participant’s shares, withholding from salary or other compensation, and withholding in shares. Flexibility in withholding methods is key because not all withholding methods will work in all countries. For example, there are potential tax issues with withholding in shares in several countries, including the United Kingdom, where the shares withheld for purposes of covering the taxes likely will not benefit from a statutory tax deduction that is otherwise available to the local employer entity for stock-settled awards granted to its employees, including grants made by a parent company. In addition, be careful not to mandate how the fair market value of shares will be determined for tax withholding or reporting purposes (including by reference to the plan’s definition of fair market value) because some countries have prescribed definitions of fair market value that must be used for tax purposes.

Finally, a longstanding issue with share withholding under U.S. equity plans is that there is no concept of a minimum statutory withholding rate outside the United States. Such language can make it difficult to implement the withholding provision, at least where the plan does not provide the plan administrator sufficient flexibility to interpret and apply any minimum rate provision in a manner that will allow for an effective withholding in non-U.S. jurisdictions. Following the recent changes to the U.S. accounting rules, you should consider amending any plan references to withholding in shares at the minimum statutory rate to allow for withholding at up to the maximum applicable rate in a participant’s jurisdiction because this type of flexibility can greatly facilitate the use of share withholding on a global basis.

For public companies, guidance under both the New York Stock Exchange (NYSE) and the Nasdaq Stock Market listing rules confirms that a plan amendment to increase the rate at which shares may be withheld for taxes is not a material amendment triggering shareholder approval. See [NYSE Listed Company Manual Rule 303A-08](#) and [NYSE Frequently Asked Questions on Equity Compensation Plans](#) (Aug. 18, 2016), FAQ C-1; and [Nasdaq Listing Rule 5635\(c\)](#) and [Nasdaq Listing Center Reference Library, Shareholder Approval - Equity Compensation Plans, Frequently Asked Questions](#), Identification Number 1269 (Oct. 19, 2016).

Note, however, that in its Frequently Asked Questions regarding its 2017 policies on evaluating stock plan proposals, Institutional Shareholder Services (ISS) stated that it negatively views a plan amendment that increases the tax withholding rate in an equity plan that contains a “liberal share recycling” feature, whereby the shares withheld for taxes would be added back to the pool of shares available for new awards. See [ISS, Americas Proxy Voting Guidelines Updates: 2017 Benchmark Policy Recommendations](#) (Nov. 21, 2016) and [ISS, U.S. Equity Compensation Plans: Frequently Asked Questions](#) (Dec. 16, 2016), FAQ 32. Although it is unclear under ISS’s policy whether including an increased share withholding provision in a plan with a liberal recycling feature could result in an overall negative recommendation from ISS on the plan, in view of the risk that it may contribute to a negative recommendation and the fact that such a plan amendment may be adopted without shareholder approval under the stock exchange rules, companies should consider adopting the change outside of an equity plan proposal that is being presented to shareholders for approval.

## **Beneficiary Designations**

Leaving aside whether permitting beneficiary designations is a good practice for U.S. plan participants, determining the validity of a beneficiary designation for non-U.S. participants presents unique challenges. Some countries require that the designation be notarized or witnessed (similar to a will in the United States) and any designations not meeting these requirements will be deemed invalid. Other countries have rules requiring that a percentage of the decedent’s assets pass to the surviving spouse, children, or other specified heirs. A beneficiary designation to anyone other than these specified heirs will be subject to challenge in such countries. If the company issues the shares to a designated beneficiary who is not legally entitled to receive them, the rightful heir may seek compensation from the company.

The easy fix is to add some qualifying language to the plan that provides that beneficiary designations are allowed if permitted by the plan administrator. Such language gives the company the flexibility to decide not to allow beneficiary designations for non-U.S. participants or to permit beneficiary designations if the company is satisfied that the designation complies with local rules. Note, however, that verifying such compliance could be a costly and burdensome undertaking.

## ***Amendment Authority***

Many U.S. equity plans allow the plan administrator to amend the plan (or awards granted thereunder) at any time, provided that the amendment may not adversely impact outstanding awards without a participant's consent. When a plan is being offered globally, any such limitation on the amendment authority should also specifically allow for any amendments that are necessary or advisable to comply with applicable laws in a relevant jurisdiction. Such blanket amendment authority for legal compliance may prove useful to the company in the event of unanticipated and possibly retroactive changes in the laws in the jurisdictions in which awards have been granted.

## ***Special Considerations for Global Employee Stock Purchase Plans***

Many U.S. companies (generally, public companies) offer broad-based employee stock purchase plans (ESPPs) that are intended to qualify for tax-favored status in the United States under I.R.C. § 423. These plans not only offer preferential tax treatment for the employees over non-qualified options, but also may be offered with a discounted purchase price (as low as 85% of the lesser of the fair market value of the shares as of the grant date or the exercise date). For further background on these plans, see [Developing Qualified Employee Stock Purchase Plans](#).

Like omnibus equity incentive plans, such qualified ESPPs require a thorough review in order to ensure a successful roll out to non-U.S. employees, and the key drafting consideration is to give the plan administrator broad discretion to modify the terms and conditions of the offering if necessary or desirable to accommodate foreign laws. This is somewhat complicated by the requirements for qualified ESPPs. Therefore, in addition to the considerations outlined above for equity incentive plans, companies offering a global ESPP should consider the following points:

### ***Eligibility Exclusions***

Under I.R.C. § 423, a qualified ESPP must be offered to all employees of the participating entities, subject to certain permitted exclusions. Among the permissible excludable employees are those who work fewer than 20 hours per week or five months per year. Many U.S. companies adopt this permitted exclusion as an eligibility condition under their ESPP. However, such an eligibility condition would need to be amended before the company could offer the ESPP to employees of its EU subsidiaries because the exclusion of part-time and fixed-term employees would violate EU discrimination laws designed to protect such employees.

### ***Separate Offerings***

The regulations under I.R.C. § 423 allow a company to designate separate subsidiary corporations (as defined in I.R.C. § 424(f)) as participating in separate offerings under a qualified ESPP. 72 Fed. Reg. 59,074, 59,075 (Nov. 17, 2009). Moreover, the requirement that all plan participants have equal rights and privileges under the plan is met as long as employees within each separate offering have such equal rights, including with respect to the employees eligible to participate in a particular offering. This means that a company can designate foreign subsidiaries as participating in separate offerings from U.S. subsidiaries and then can adopt different plan terms and eligibility requirements for employees within such separate offerings, as necessary or desirable to accommodate foreign laws or practices. See 26 C.F.R. §§ 1.423-2(e)(6), Example 8 and 1.423-2(f)(7), Example 5. For example, a company could allow for the offer of the ESPP to all part-time and full-time employees of its EU subsidiary corporations while continuing to exclude part-time employees of the company and its U.S. subsidiaries. Separate offerings may also be helpful for different U.S. offerings where variations in terms are desirable between domestic subsidiaries. Separate offerings also prevent certain plan failures occurring in one offering from tainting the tax-qualified status of options granted under other offerings. In this regard, it is advisable to include a provision in the ESPP authorizing separate offerings and specifying the non-exhaustive variety of ways in which the plan administrator may modify the general plan terms within such separate offerings, as necessary or desirable to address foreign law requirements.

### **Limited Exceptions for Non-U.S. Law Compliance**

There are limited exceptions to the eligibility and equal rights and privileges requirements of the regulations under I.R.C. § 423 relating to non-U.S. compliance considerations.

Specifically, an employee who is citizen or resident of a non-U.S. jurisdiction may be excluded from a qualified ESPP offering even if not in one of the permitted exclusion categories if the grant of an option to such employee is prohibited by the laws of the non-U.S. jurisdiction. 26 C.F.R. § 1.423-2(e)(3)(1).

Further, if any benefit under a qualified ESPP offering would violate the laws of a non-U.S. jurisdiction if provided to citizens or residents of that jurisdiction, then the offering may provide for different rights regarding that benefit, to the extent necessary to comply with foreign law, provided that such rights are less favorable than those provided under the same offering to employees

resident in the United States. 26 C.F.R. § 1.423-2(f)(4). This is a narrow exception to the equal rights requirement for a single offering that could theoretically be used instead of structuring two separate offerings as described above. In practice, however, the exception is rarely useful because modifications to the terms of an ESPP offering that are required to comply with non-U.S. laws usually result in terms that are more favorable to non-U.S. participants, not less favorable (e.g., inclusion of part-time employees in order to satisfy EU requirements).

#### *Non-qualified Options*

Since non-U.S. taxpayers outside the United States will not realize any tax benefit from participating in a U.S. tax-qualified ESPP, a U.S. company should consider modifying its ESPP to allow for the grant of options to employees outside the United States under separate offerings that do not comply with I.R.C. § 423 and are not tax qualified under U.S. laws. The ability to make non-qualified offerings can be particularly useful when a company's corporate structure includes branch or representative offices or "check-the-box" entities that are disregarded for federal tax purposes. This is because employees of branch offices, representative offices, and disregarded check-the-box entities are deemed employees of the applicable direct parent corporation and therefore cannot be excluded from the ESPP if employees of the parent are eligible to participate, regardless of the difficulty of offering the ESPP in the jurisdictions in which the branch, representative, or disregarded entity are resident (assuming the offering is not prohibited by foreign law).

For example, assume a U.S. plan sponsor wishes to offer its ESPP to employees of its subsidiary in Taiwan but does not wish that subsidiary's branch office in China to participate due to an onerous exchange control filing that would be required by the Chinese authorities. This design will not work under a qualified ESPP because the employees of the Chinese entity are deemed employees of the Taiwanese corporation and, under I.R.C. § 423, may not be excluded from the ESPP or treated differently from the Taiwanese employees. The separate offerings rule will not solve this problem because separate offerings within a single corporation (i.e., the Taiwanese subsidiary) are not permitted. And the exception for non-U.S. law compliance is not applicable because the offering is not prohibited under Chinese law; it is merely subject to an additional filing requirement. However, if the ESPP allows for the grant of non-qualified options, the U.S. company could designate the Taiwanese subsidiary as participating in a separate, non-qualified offering and then exclude employees of the Chinese entity from participating.

Another potential benefit of permitting non-qualified offerings is that it would be possible to offer the ESPP to employees of entities that do not meet the definition of "parent" or subsidiary of the issuer under I.R.C. § 424(e) and (f), respectively. Importantly, however, you should bear in mind that this type of expansion of the entities eligible to participate in the ESPP may require shareholder approval under applicable stock exchange rules.

#### Special Considerations for Section 16 Officers

If any officers of the company subject to Section 16 of the Securities Exchange Act of 1934 (Exchange Act)—so-called Section 16 officers—participate in an ESPP outside the United States, you should bear in mind that transactions under a non-qualified ESPP offering will not be automatically exempt from the reporting requirements under Section 16(a) of the Exchange Act or the short-swing profit rules under Section 16(b), as is the case for transactions under a qualified ESPP. However, if the particular non-qualified offering in which a Section 16 officer participates meets the definition of a Stock Purchase Plan in Exchange Act Rule 16b-3(b)(5) (17 C.F.R. § 240.16b-3(b)(5)), then transactions under such offering should qualify for the same treatment under Exchange Act Section 16(a) and (b) as a qualified ESPP plan (i.e., no reporting requirements or short-swing liability considerations). Exchange Act Rules 16a-3(f) and 16b-3(c) (17 C.F.R. §§ 240.16a-3(f)(1)(i)(B), 240.16b-3(c)). To qualify as a Stock Purchase Plan, the offering must satisfy either:

- Two of the rules for qualified ESPPs: exclusion of 5% owners and the equal rights and privileges rule) –or–
- The non-discrimination requirements for qualified retirement plans under I.R.C. § 410 17 C.F.R. § 240.16b-3(b)(5).

#### **Preliminary Considerations for Implementing Global Equity Plans**

A diligent review of applicable country laws and tax obligations in advance of commencing an international plan offering is essential. It is important that you advise on the potential costs to the company and, in some cases, the local employer. Since this analysis may affect plan design, implementation timing, the types of equity awards that will be offered in a particular jurisdiction, or even if grants can practicably be made in a particular country, you should engage in this review in the planning stages. The following sections address the primary considerations for this review.

## **Securities Law Compliance**

Under Section 5 of the Securities Act of 1933 (Securities Act), U.S. companies offering equity securities to employees and other eligible service providers must ensure that a registration statement covering the securities has been filed with the SEC or that an exemption from registration is available. Typically, U.S. public companies who are subject to reporting requirements under the Exchange Act will file a [Form S-8](#) registration statement covering the shares to be offered under their equity incentive plans, and U.S. private companies will rely on Rule 701 under the Securities Act (17 C.F.R. § 230.701). In addition, private companies will need to comply with any U.S. state securities law registration or exemption requirements in order to offer their equity plans within the United States.

As you might expect, it is not sufficient to focus solely on the U.S. securities law issues when granting awards to employees outside the United States. It is also necessary to consider whether offering equity to employees will be considered a securities offering in the countries where the company would like to grant and conduct a cost-benefit analysis of any applicable compliance obligations before deciding to move forward in a particular country.

Some key considerations and factors impacting the securities law requirements are set forth below.

- **Type of award.** In many countries, the determination of whether a company needs to complete a registration, furnish a prospectus, or meet other securities law requirements depends on the type of award being offered (e.g., stock options, restricted stock units, or options under an ESPP). Stock options or ESPP options, where the employees have to pay an exercise price or purchase price to buy the shares and make an investment decision as to when to exercise such right, or whether to participate in the plan, are more likely to be subject to compliance requirements under non-U.S. securities laws. In contrast, restricted stock units or similar awards, where the employee pays no cash consideration to receive the award or the shares and makes no investment decision, are frequently not considered securities in non-U.S. jurisdictions.
- **Size or value of offering.** The number of employees to whom awards are being offered and/or the value of the offering is another key determinant of securities law compliance requirements. Many jurisdictions have small offering exemptions, whereby the offering of securities to fewer than a specified number of individuals or with an aggregate value below a certain threshold will not trigger securities law compliance requirements. For example, within the EU, an offering to fewer than 150 employees or with an aggregate value of less than €5,000,000 in a 12-month period is generally not subject to any prospectus requirement under the EU Prospectus Directive. See [Directive 2003/71/EC of the European Parliament](#).
- **Manner of settlement.** The manner of settlement of an equity award may also affect securities law obligations. It may be possible to avoid a securities filing requirement by cash settling an award (e.g., in the Philippines) or restricting the method of exercise of a stock option to a cashless sell-all, a sell-to-cover, or net-exercise method. If the employee elects to do a cashless sell-all exercise, the employee instructs a broker to sell the shares issued upon option exercise, to use the sale proceeds to pay the option exercise price plus service fees and any applicable withholding taxes, and to remit the balance to the employee in cash. If the employee elects to do a sell-to-cover exercise, the employee instructs the broker to sell enough shares to cover the option exercise price plus service fees and applicable taxes, and to purchase company stock in the name of the employee with the balance. In a net exercise, the company holds back a sufficient number of shares to cover the exercise price and applicable taxes and issues the net shares to the employee. In each case, the employees are not putting personal funds at risk. For example, in Italy, imposing a cashless exercise requirement for options allows a company to make an offering without engaging a licensed Italian financial intermediary. In Indonesia, companies can offer cashless exercise options to more than 100 employees with a value in excess of IDR 1 billion without doing a prospectus filing.
- **Class of offeree.** Exemptions to certain securities registration, prospectus, or licensing requirements are available in many countries for securities offerings that are limited to employees only (e.g., in Malaysia and Thailand). The issuing company should review the availability of such employee exemptions and determine whether they are self-executing, require a notice, filing, or other approval from the relevant securities authority, and/or require the issuer to provide certain information to employees. The issuing company also should confirm any ongoing obligations it may have to be able to continue to rely on such exemption for subsequent offerings.

## *Impact of Securities Law Compliance*

Although many companies have long-established grant practices and wish to offer awards uniformly on a global basis, the ability to avoid a costly and/or onerous securities filing in a particular country by offering restricted stock units instead of options or an ESPP, by modifying the manner of settlement of awards, or by limiting the number of non-U.S. offerees, often provides sufficient motive for a company to deviate from its standard policy.

However, in case a company is not willing or able to adapt its grant practices or plans and an exemption from registration or prospectus requirements is not available, it is important to review the securities law requirements in each jurisdiction in which awards may be offered at least three to six months in advance of an offering date so as to leave sufficient time to complete any filings that may be required.

### ***Exchange Control Compliance***

A number of countries outside the United States have exchange control laws that regulate the flow of funds to and from such countries, restrict their residents from purchasing foreign currency (e.g., U.S. dollars), or investing in foreign shares. Some countries require repatriation of share sale proceeds or cash dividends. In some cases, it is possible to avoid having to complete an exchange control filing or registration by modifying the award design so that there is no outflow of currency and/or ability to hold shares (e.g., by restricting an option to a cashless sell-all exercise (as described above under “Manner of settlement” in the securities law compliance discussion), or by cash-settling awards or forcing the sale of shares immediately at vesting.

Such modifications will not always work to avoid exchange control requirements. There are several countries in which companies must complete an exchange control registration in order to offer equity plans to employees in such countries. For example, a U.S. multinational company wishing to offer equity awards to Chinese national employees of its subsidiaries in China is required to register its equity plan with the State Administration of Foreign Exchange (SAFE), open a dedicated foreign exchange account through which all funds related to the plan will flow, and ensure the repatriation of all equity plan proceeds to its employees.

In 2016, Vietnam adopted a similar exchange control registration requirement that is largely based on the China SAFE model, but has the added complexity of requiring each Vietnamese employer entity to register with the State Bank of Vietnam and establish a dedicated foreign exchange account through which all funds related to the equity plan must flow. The registration and approval processes can take many months to complete so it is important to consider and review any such restrictions sufficiently in advance of granting equity awards.

### ***Taxation of Equity Awards***

U.S. companies granting equity to employees of their non-U.S. subsidiaries need to consider the tax and social insurance implications of such awards for the employer subsidiary and for its employees.

#### ***Employee Tax Effects***

The tax treatment of equity awards in many countries is generally aligned with that in the United States. For example, non-qualified options are taxed on the difference between the value of the shares and the exercise price paid (the spread) at the time of exercise, and restricted stock units are taxed on the fair market value of the shares issued to the employee. However, this is not the case in all countries or for all award types. Certain differences to the United States in terms of the timing of taxation and the calculation or characterization of equity award income, as well as factors affecting the taxation of equity awards, are summarized below.

- **Timing of taxation.** Two notable exceptions to the typical U.S. timing of taxation relate to options under a qualified ESPP and restricted stock awards:
  - In the case of a qualified ESPP, the tax-favored treatment that U.S. employees enjoy under I.R.C. § 423 does not apply outside the United States. As noted above, qualified ESPP options typically are offered at a discount of up to 15% of the underlying share value at the beginning or end of an offering period. Most countries will tax employees on the discount at the time of purchase.
  - In the case of restricted stock, most countries take the position that employees are taxed on the fair market value of the restricted shares at grant, rather than at vesting (when there is no longer a risk of forfeiture) as in the United States, under I.R.C. § 83. Taxation at grant, when the employee does not freely own the shares, detracts from the incentive nature of the award, especially when the employee may not be able to obtain a refund of taxes paid if he or she terminates employment before the restrictions on the shares lapse. Restricted stock also presents difficulties in countries where the employer has a withholding obligation at grant because unvested shares may not be withheld or sold to cover the withholding taxes and the employer may need to withhold such amounts from the employee’s salary or require employees to pay the applicable amounts out of pocket. For these reasons, U.S. companies are usually well advised to avoid granting restricted stock to employees outside the United States.

There are a number of other country-specific variations in the timing of taxation of equity awards. For example:

- In Israel, ordinary income taxation of employee equity awards generally does not occur until the employee sells the acquired shares, rather than at the time of exercise, purchase, or vesting.
- In Chile, effective as of January 1, 2017, stock options are taxed at vesting (rather than exercise).
- In Australia, although options and restricted stock units granted on or after July 1, 2015 are generally subject to tax at exercise or vesting, respectively, an earlier tax event may occur at termination of employment if an employee holds vested awards that are not subject to forfeiture. In addition, if an employee sells the shares acquired from an equity award within 30 days of the original taxable event (i.e., within 30 days of exercise/vesting/purchase, as applicable), the taxable event in Australia is deferred until sale of shares and the taxable amount is based on the sale proceeds, less any consideration paid by the employee.
- **Calculation of taxable amount.** Several countries have rules that specify how shares should be valued for tax purposes. For example, in India, companies must engage a licensed merchant bank to calculate the fair market value of the company's shares for tax purposes. The merchant banks often determine fair market value by reference to the average of the high and low prices on the relevant date, which may not reflect the valuation methodology generally used by the company to calculate tax liabilities (in some cases, there may be room to negotiate with the merchant bank to use the company's plan definition of fair market value). Under Malaysian tax laws, fair market value is defined as the average of the high and low trading price on the relevant date, and under Italian law, a 30-day trailing average price is used to determine the fair market value for tax purposes.
- **Manner of settlement.** Settlement of an award in cash, rather than in stock, may change the income tax and/or social contributions obligations. For example, no social insurance contributions are due on stock-settled awards in Hong Kong or Singapore, but social contributions will apply (subject to certain monthly ceilings) to cash-settled awards paid through local payroll.
- **Type of award.** The type of award (e.g., option versus restricted stock unit) may impact the tax treatment in certain cases. For example, stock options are taxed only at sale in Brazil, provided that the Brazilian employer does not reimburse the issuer company for the option and the options are not otherwise considered part of local compensation. Whereas restricted stock units are taxed at vesting regardless of these factors (with any subsequent gain being subject to capital gains tax at sale, subject to a significant monthly exemption).
- **Tax-qualified regimes.** In some countries, there are tax-favored regimes that make one award type more attractive from a tax and/or social insurance perspective. For example, in Canada, stock options can qualify for a 50% tax exemption on the spread at exercise provided certain requirements are met. In France and Israel, it is possible to grant tax-qualified options or restricted stock units that can result in income tax savings for employees as well as employer social insurance contribution savings. Similar tax-qualified programs are also available for stock options and ESPPs in the United Kingdom. Such regimes typically require modifications to the terms and conditions of the awards and/or the adoption of sub-plans in order to qualify for the specific income tax and/or social insurance contribution treatment. Companies that are considering modifying their standard awards to take advantage of tax-qualified regimes should first conduct a cost-benefit analysis because such regimes may entail ongoing costs that might ultimately make such regimes less attractive to the issuer (e.g., trustee fees in Israel). In any event, it will be necessary to ensure continued compliance, and companies should factor in the legal and administrative costs arising out of the need to monitor the relevant laws and make any necessary modifications to the awards, sub-plans, or administrative procedures to reflect changes to the relevant tax regimes (a particularly significant issue in countries like France where changes have been frequent).

In view of the above considerations, companies granting awards outside the United States should be open to varying their normal grant practices to avoid granting an award type that may not be tax beneficial to the employee.

#### *Company/Employer Tax Obligations*

The issuing company or employer may be required to withhold and/or report income taxes and social insurance contributions on the equity award income to the tax and/or social insurance authorities. Some of the key considerations relating to employer obligations are outlined below:

- **Responsible party.** In most countries where a withholding and/or reporting obligation exists, it is the local employer's responsibility. There are a few countries where the issuing company is responsible for the withholding and/or reporting (e.g., Canada and the U.K.), although the local employer usually will be able to satisfy the requirements on behalf of the issuing company.

- **Reimbursement by local employer.** If the local country employer bears the cost of the awards granted to its employees by reimbursing the issuer company for such costs, it may have a significant impact on the income tax and/or social insurance contribution treatment of the award, as well as on whether the employer has a tax withholding or reporting obligation. There are numerous countries in which the presence of such a reimbursement arrangement will trigger income tax and/or social insurance contribution withholding, reporting, or payment obligations that would not otherwise apply (e.g., Mexico, South Korea, and Thailand). Reimbursement arrangements are often highly beneficial to U.S. issuers, helping them to secure local tax deductions for the equity award compensation expense borne by local employer entities, thereby reducing their global tax expense, and enabling them to repatriate cash to the United States on a tax-free basis under I.R.C. § 1032. However, the impact of such arrangements on the taxation of awards must be considered, as well as their appropriateness in view of existing cost sharing and transfer pricing arrangements between the U.S. issuer and its non-U.S. subsidiaries.
- **Local employer involvement.** There are a number of countries where the involvement of the local employer in the administration of the equity plan—and/or referencing equity awards in local employment agreements, offer letters, or other materials—may trigger an employer withholding, reporting, and/or social insurance contribution obligation where one would not otherwise exist. The general theory is that this type of employer involvement converts the awards into local employment compensation. Triggering a tax withholding and/or reporting obligation may not necessarily have a significant impact on the issuing company or the employer, but triggering a social insurance contribution obligation could. Unlike the United States, where the employer-paid portion of social security is relatively low and the largest portion of social security is subject to an annual wage ceiling, social insurance contributions in many countries are quite high and sometimes uncapped. For example, the employer social insurance contribution in Belgium is approximately 30% (uncapped), but is arguably not payable on equity awards granted by a foreign issuer, provided that the local employer is not involved in the administration of the awards or equity plan.
- **Potentially high employer social insurance contribution obligations.** There are several countries in which equity awards are subject to high employer social insurance contribution obligations regardless of local employer involvement. For example, in Argentina, the employer social insurance contribution is approximately 27%, payable on all types of income and with no ceiling. Similarly, in Sweden, the employer social insurance contribution is approximately 32%, payable on all wages and with no ceiling. Companies considering granting equity outside of the United States should be aware of this liability, which may cause them to grant to a limited number of employees or reduce grant sizes. Another method a company may use to help control award costs, and make the expense more predictable, is to design the award so as to cap the amount of share appreciation the recipient may benefit from.

One of the primary areas of potential exposure in offering a global equity plan arises out of non-compliance with local country tax obligations. Therefore, companies offering equity globally should make it a priority to stay abreast of applicable tax rules, ideally by reviewing tax law changes on at least an annual basis.

### **Employment Law and Data Privacy Issues**

In addition to the securities, exchange control, and tax laws that directly affect global equity plans described in the previous section, there are other non-U.S. laws that have implications for companies implementing and administering such plans.

### **Employment Rights**

Employees outside the United States generally have greater employment protections than U.S. employees. For example, the concept of “at-will” employment does not exist, and most employees are employed via contract. As such, the employer may not be able to modify the terms of employment without obtaining the employee’s consent and employees who are terminated involuntarily may be entitled to statutory severance or termination indemnities.

If equity awards are deemed part of local compensation, employees may claim that the awards constitute vested rights or entitlements of employment. In other words, employees may claim that the equity awards form part of their salary, and that their right to future grants has therefore vested and cannot be eliminated without their consent. To mitigate these types of vested rights or entitlement claims, you should advise the U.S. company to keep equity awards separate from local salary and other benefits provided by the local, non-U.S. employer by not referencing equity awards or plans in the local employer’s offer letters, contracts, employer handbooks, or any other documents related to employment.

Keeping equity awards separate from the local employment relationship can be significantly beneficial to companies by helping them to:

- Preserve the U.S. issuer company's right to discontinue the grant of future equity awards and/or reduce their size by avoiding successful vested rights claims by employees
- Avoid having to include the value of equity awards in local salary for purposes of calculating employment-related benefits, including vacation pay and severance or other end-of-service payments
- Allow the U.S. issuer company to enforce the forfeiture and other provisions in its award agreements without regard to local employment law requirements
- Avoid works council consultation obligations (that may generally apply when making changes to employment benefits) for purposes of adopting, modifying, or terminating a global equity plan or the awards granted thereunder

Limiting the local employer's involvement to the maximum extent practicable puts the company in a better position to argue that the awards are discretionary benefits provided by the U.S. issuer company and not by the local employer, which will in many cases help to successfully defend against vested right and similar employment law claims and have the other benefits noted above.

#### **Data Privacy Laws**

EU countries (and, increasingly, other countries) have adopted data privacy laws that restrict the collection, processing, and/or transfer of personal data. Personal data is generally any data that can be used to identify an individual, such as the person's name, address, telephone number, or e-mail address. Among other things, the EU Data Protection Directive ([Directive 95/46/EC](#)) prohibits the transfer of personal data to countries whose laws are not considered to provide adequate protection of personal data (including the United States), unless certain procedural safeguards are met. Such transfer restrictions can hamper the ability to administer global equity plans.

U.S. multinational companies wishing to offer global equity plans often have existing processes in place for handling their non-U.S. employees' personal data to comply with privacy laws, especially where the company has a global human resources platform. Where such processes are not in place or do not adequately cover the types of data needed for equity plan participation, companies need to review their data privacy processes when implementing global equity plans to ensure that they have complied with the necessary steps to receive the personal data required to administer and maintain the plan. Such steps may include obtaining the employee's consent in writing, possibly in local language, in order to be able to transfer the relevant data to the United States.

#### **Drafting Award Agreements for Non-U.S. Recipients**

In drafting award agreements for non-U.S. award recipients, companies should focus on adding provisions that give contractual protections to the company on a variety of issues that are common from country to country, and should also ensure that the award agreements provide sufficient flexibility for dealing with constantly changing laws and rules.

It is not uncommon for companies to use forms of award agreements designed for U.S. employees when granting awards to employees outside the United States. However, such U.S.-centric agreements are often inadequate to address non-U.S. tax and regulatory requirements or the entitlement and joint employer risks that may arise when a U.S. parent company offers awards to employees of non-U.S. subsidiaries. To address these issues, a U.S. company offering awards internationally should adopt a separate, customized form of agreement with country-specific provisions for each international jurisdiction included in an appendix thereto or adopt a global form of agreement for use both within and outside the United States that encompasses all the necessary terms and provisions. There are pros and cons to either approach, and the ultimate decision as to the appropriate form usually comes down to company preference in view of the demographics of its equity-eligible population and, sometimes, stock plan broker limitations.

Whether an issuer decides to use a jurisdictional or global form of award agreement, the agreement should contain the following:

- **Entitlement risk mitigation language** whereby the grantee acknowledges, *inter alia*, the discretionary nature of the awards, that the awards are separate from the local employment relationship, and that the grantee has no entitlement to future grants or benefits in lieu of equity awards. See Appendix: Model Clauses for International Award Agreements for an example.
- **Broad withholding language** to enable the issuer and/or the employer to withhold using a variety of methods (e.g., from the proceeds of the sale of shares, employees' salaries or other compensation, and shares to be issued upon exercise/vesting of an award), as certain methods may not be permissible or may potentially create issues in certain countries. See Appendix: Model Clauses for International Award Agreements for an example.

Note that it is usually appropriate to carve out any Section 16 officer awards from discretionary application of withholding methods that include withholding in shares, so as to avoid any potential loss of the Exchange Act Rule 16b-3(e) exemption from short-swing profit liability that applies when withholding in shares is approved by the issuer's board of directors or compensation committee.

- **Securities law disclaimers** (where applicable) to facilitate the issuer's ability to rely on an exemption to prospectus, registration, and/or filing requirements in certain countries, similar to the Rule 701 employee share plan exemption under the Exchange Act.
- **A data privacy consent or notice** to authorize the processing, transfer, and collection of the grantee's personal data in connection with administration of the equity plan. Such consent or notice should be as explicit as possible regarding the intended use for the data and disclose all intended recipients.
- **Governing law and venue provisions** that specify a U.S. state governing law and a designated venue for disputes. In many cases, a foreign court may choose not to respect a venue provision and will permit an employee to bring a claim in the jurisdiction where the employee lives or works. In such circumstances, the venue provision may serve only as a deterrent to the employee in bringing a claim in the first place. In situations where a court permits such a claim, many courts will respect the governing law provision and solicit expert testimony and case law from the applicable U.S. state in order to help the court decide the dispute. Regardless of whether these provisions will be enforceable in a particular jurisdiction, they also may help to bolster the position that the equity plan is a discretionary benefit offered by the U.S. issuer and not a term of employment provided by the local employer.

Companies may also want to consider including certain employee-friendly information in the agreements, or in country-specific appendices thereto, to notify employees of about how participating in the plan will affect them (e.g., regarding exchange control, or foreign asset/account requirements or other obligations they may have in connection with the equity awards). Such notifications inform employees of obligations that they are solely responsible for, but may otherwise overlook, especially where the only foreign shares employees own are shares received under the U.S. issuer's equity plans. In addition, such notifications may protect the company if an employee incurs a fine for non-compliance with an exchange control or other law and makes an unfounded claim against the company for indemnification. The company can point to such notifications as an additional defense against such a claim.

A standard U.S. form of agreement that has not been modified for international use may contain provisions that create issues if used outside the United States. One example, as noted above under Drafting Tips for Global Equity Plans is beneficiary designation language, which may potentially expose the company to liability if the company acts in accordance with a beneficiary designation that is later determined invalid under local law. Another example is award agreements that permit employees to defer settlement of an award (albeit in compliance with the nonqualified deferred compensation rules under I.R.C. § 409A). Such deferral provisions can create problems where such deferrals do not operate to defer the timing of taxation in the non-U.S. jurisdiction, so the employee is taxed on compensation that is not yet paid. Also, U.S. retirement-vesting provisions that affect the recipient's rights under the award (e.g., an accelerated vesting provision based on meeting an age-plus-service threshold) may violate age discrimination rules in the EU and certain other countries that are intended to protect both younger and older workers.

## **Appendix: Model Clauses for International Award Agreements**

Following are sample clauses for equity award agreements intended to provide contractual protections to the company that take into account non-U.S. employment law and tax considerations, and to permit highly flexible withholding alternatives, including at the company's discretion.

### ***No Implied Rights Clause (Option Award)***

**No implied rights.** In accepting the Option, Participant acknowledges, understands, and agrees that:

1. The Plan is established voluntarily by the Company, it is discretionary in nature and it may be amended, altered, or discontinued by the Company at any time, to the extent permitted by the Plan.
2. The grant of the Option is voluntary and occasional and does not create any contractual or other right to receive future grants of Options, or benefits in lieu of Options, even if Options have been granted in the past.
3. All decisions with respect to future Option grants, if any, will be at the sole discretion of the Company.
4. Participant is voluntarily participating in the Plan.
5. The Option and the shares subject to the Option are not intended to replace any pension rights or compensation.

6. The Option and the shares subject to the Option, and the income and value of same, are not part of normal or expected compensation or salary for any purpose, including, but not limited to, calculating any severance, resignation, termination, redundancy, dismissal, end of service payments, bonuses, long-service awards, pension or retirement or welfare benefits, or similar payments.
7. The future value of the underlying shares is unknown, indeterminable, and cannot be predicted with certainty; if the shares subject to the Option do not increase in value, the Option will have no value; if participant exercises the Option and acquires shares, the value of such shares may increase or decrease, even below the exercise price.
8. For purposes of the Option, Participant's employment or other service relationship will be considered terminated as of the date Participant is no longer actively providing services to the Company or one of its affiliates (regardless of the reason for such termination and whether or not later found to be invalid or in breach of employment laws in the jurisdiction where Participant is employed or the terms of Participant's employment agreement, if any) and, unless otherwise expressly provided in this Award Agreement or determined by the Company, Participant's right to vest in the Option under the Plan, if any, will terminate as of such date and will not be extended by any notice period (e.g., Participant's period of active service would not include any contractual notice period or any period of "garden leave" or similar period mandated under employment laws in the jurisdiction where Participant is employed or the terms of Participant's employment agreement, if any); furthermore, in the event of termination of Participant's employment or other service relationship (regardless of the reason for such termination and whether or not later found to be invalid or in breach of employment laws in the jurisdiction where Participant is employed or the terms of Participant's employment agreement, if any), Participant's right to exercise the Option after termination of employment, if any, will be measured with reference to such date and will not be extended by any notice period; the committee shall have the exclusive discretion to determine when Participant is no longer actively providing services for purposes of the Option (including whether Participant may still be considered to be providing services while on a leave of absence).
9. Neither the Company nor the Participant's employer nor any affiliate will be liable for any foreign exchange rate fluctuation between Participant's local currency and the U.S. Dollar that may affect the value of the Option or of any amounts due to Participant pursuant to the exercise of the Option or the subsequent sale of any shares acquired upon exercise.

#### ***Tax Matters and Withholding Clauses (Option Award)***

**Tax matters.** Participant acknowledges that, regardless of any action taken by the Company or, if different, Participant's employer (the "Employer"), the ultimate liability for all income tax, social insurance, payroll tax, fringe benefits tax, payment on account or other tax-related items related to Participant's participation in the Plan and legally applicable to Participant ("Tax-Related Items") is and remains Participant's responsibility and may exceed the amount actually withheld by the Company or the Employer. Participant further acknowledges that the Company and the Employer (1) make no representations or undertakings regarding the treatment of any Tax-Related Items in connection with any aspect of the Option; and (2) do not commit to and are under no obligation to structure the terms of the grant or any aspect of the Option to reduce or eliminate Participant's liability for Tax-Related Items or achieve any particular tax result. Further, if Participant is subject to Tax-Related Items in more than one jurisdiction, Participant acknowledges that the Company and/or the Employer (or former employer, as applicable) may be required to withhold or account for Tax-Related Items in more than one jurisdiction.

**Withholding.** Prior to any relevant taxable or tax withholding event, as applicable, Participant will make adequate arrangements satisfactory to the company and/or the Employer to satisfy all Tax-Related Items. In this regard, Participant authorizes the company and/or the Employer, or their respective agents, at their discretion, to satisfy the obligations with regard to all Tax-Related Items by one or a combination of the following:

- Withholding from Participant's wages or other cash compensation paid to Participant by the Company and/or the Employer
- Withholding from proceeds of the sale of shares acquired upon exercise of the Option, either through a voluntary sale or through a mandatory sale arranged by the Company (on Participant's behalf pursuant to this authorization without further consent)
- Requiring Participant to tender a cash payment to the company or an affiliate in the amount of the Tax-Related Items –and/or–
- Withholding in shares to be issued upon exercise of the Option

provided, however, that if Participant is a Section 16 officer of the company under the U.S. Securities Exchange Act of 1934 ("Exchange Act"), then the Committee (as constituted to satisfy Rule 16b-3 of the Exchange Act) will determine the method of withholding from alternatives (1)–(4) above and, if the Committee does not exercise its discretion prior to the applicable withholding event, then Participant will be entitled to elect the method of withholding from alternatives (1)–(4) above.

Depending on the withholding method, the company may withhold for Tax-Related Items by considering applicable minimum statutory withholding amounts or other applicable withholding rates, including maximum applicable rates, in which case Participant will receive a refund of any overwithheld amount in cash and will have no entitlement to the equivalent amount in shares. The company may refuse to honor the exercise of the Option or refuse to issue or deliver the shares or the proceeds of the sale of shares, if Participant fails to comply with his or her obligations in connection with the Tax-Related Items.

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