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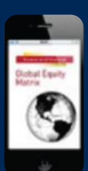

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In this issue

A Fond Farewell to our Global Equity Services Practice Group Chair: Valerie H. Diamond

As most of you know, our esteemed colleague Valerie H. Diamond will retire from Baker McKenzie effective July 5, 2018 following a 25 year career with Baker McKenzie. Valerie has served as the chair of Baker McKenzie's Global Equity Services Practice Group for the last ten years and garnered many accolades over the course of her professional life. She was described by *Chambers USA* as a "Leader in the Field" and the "go-to attorney for large corporations in the US." She was honored as an exceptional contributor to the industry by the National Association of Stock Plan Professionals, as a Top Woman Attorney and Top Rated Employee Benefits Lawyer in Northern California by *Super Lawyers*, and she has been recognized as a "Leading Lawyer" in Employee Benefits & Executive Compensation by Chambers USA from 2016 – 2018. But, more importantly, Valerie has been an exceptional colleague and a wonderful leader who has consistently elevated our practice with her innovative spirit and her dedication to the team.

Thank you, Valerie, for all you have done for the Global Equity Services Group and best wishes for your retirement.

Australia

Australian Share Plan Reporting: We Can Help

The deadlines for the Australian Share Plan Reports are approaching: the Employee Share Scheme Statements must be distributed to employees by July 16, 2018 and the Annual Report must be filed with the Australian Tax Office (ATO) by August 14, 2018.

To learn more, please read our May 2018 client alert.

Belgium

New Securities Account Tax

Effective January 1, 2018, a tax of 0.15% of the total value of securities held in a securities account is due if the average annual value of such securities is at least €500,000.00. The tax is due if the securities are held by:

- Belgian tax resident individuals in a securities account with a Belgian or foreign financial institution
- Non-resident individuals in a securities account with a Belgian financial institution

The brokerage account tax applies to shares acquired pursuant to an equity award, but not to unvested and/or unexercised equity awards. For shares maintained in a securities account maintained by a Belgian financial institution, it is the financial institution's responsibility to report and levy the tax. For shares held in a foreign securities account (e.g., a US brokerage account), the Belgian resident will be solely responsible for reporting and paying the tax due.

Canada

Termination Clauses in Award Agreements for Canadian Employees

Please contact your Global Equity Services attorney to ensure your award agreement includes the appropriate language.

Two recent Court of Appeal decisions have provided some insight into the differing approaches that Canadian courts may take on the enforceability of contractual termination clauses. By way of background, under Canadian law, a contractual termination clause can be used to limit an employee's entitlement to "reasonable notice of termination" under the common law. During the "reasonable notice period," which can be quite lengthy, an employee is entitled to receive all of the compensation and benefits that he or she would have received if he or she had been working. Therefore, an award agreement which provides that an employee's right to vest in the award will cease when the employee no longer actively provides services, regardless of any common law notice period, was generally thought to be enforceable under Canadian law. Note that different rules may apply in the civil law jurisdiction of Quebec, where judges have the authority to ignore termination clauses that they consider to be unfair to an employee, even if the contractual language is clear and otherwise enforceable.

Early in 2018, the Ontario Court of Appeal held that termination clauses do not need to contain specific language to oust the common law, as long as the "intention to displace an employee's common law notice rights can be readily gleaned from the language agreed to by the parties." However, the Alberta Court of Appeal recently held that a termination clause must include explicit language to oust an employee's common law rights.

The conflicting Ontario and Alberta Courts of Appeal decisions introduce some uncertainty when drafting termination clauses. Although the Ontario case seems to indicate that termination clauses may be enforceable even if they do not specifically refer to an employee's common law rights, we recommend that companies include language that is clear, unequivocal and does not allow for multiple interpretations. This comports with the conventional view that Canadian courts will interpret employment agreements in an employee-friendly manner. As a result, it is advisable to include a specific termination clause for Canadian employees (e.g., in a Canada appendix to the award agreement) that makes it clear that an award will stop vesting upon the earlier of (i) the employee receiving notice of termination, (ii) the employee providing notice of resignation from his or her employment, and (iii) the employee ceasing to provide active services, notwithstanding any common law or statutory notice period under Canadian law. In light of evolving judicial decisions regarding termination clauses and employee entitlements, companies should also include a "saving" provision in any Canada appendix, which clearly indicates that limitations on vesting will be subject to any requirements explicitly prescribed by applicable legislation.

Denmark

Update to Section 7P Regime

As reported in our July 2016 Clients & Friends newsletter, under the favorable tax regime introduced by Section 7P of the Danish Tax Assessment Act, an employee can defer tax due on equity awards until the underlying shares are sold, at which time the entire gain is taxed as capital gain (rather than employment income).

Until January 1, 2018, the preferential treatment under the Section 7P regime was limited to shares with a value not exceeding 10% of the employee's annual salary (provided the other conditions of the Section 7P regime were met).

Effective January 1, 2018, the Danish Ministry of Taxation increased the threshold from 10% to 20%, provided at least 80% of the Danish employees are offered participation in the plan. It is permissible to exclude the following employees when calculating the 80% requirement:

- Employees with an employment period of less than three (3) years
- Employees with less than 8 working hours per week
- Managers that participate in another incentive program/plan of the company

If the 80% requirement is not met, the 10% threshold remains applicable.

New Reporting Requirements Effective January 1, 2019

Effective January 1, 2019, the local employer in Denmark is required to report on an annual basis the issuance of shares pursuant to equity awards to the Danish tax authorities through the electronic system "eKapital AKSA." The report is due by January 20th of the year following the year in which the employee acquired the shares. The report will need to include:

- Name of the issuer
- Number of shares acquired
- Date of acquisition
- Acquisition price (if any)

Note that similar reporting requirements already apply to any awards granted under the Section 7P regime.

European Union

Update on EUR 5 Million Exclusion from Prospectus Requirement

As reported in our March 2018 Clients and Friends newsletter, the exclusion from the prospectus requirements for EU/EEA offerings with a value of less than EUR 5 million during any 12 month period will change effective July 21, 2018 such that the exclusion is available only for EU/EEA offerings with a value of less than EUR 1 million during any 12-month period. Each EU/EEA country has the discretion to raise the threshold for the exclusion to up to EUR 8 million.

We are aware that the Netherlands has increased the exclusion threshold from EUR 1 million back to EUR 5 million. In order to rely on the EUR 5 million exclusion, however, it is now necessary to distribute an Information Document alongside with other offer materials to the employees and the Dutch Authority to the Financial Markets (*Autoriteit Financiële Markten*, "AFM") prior to making the offer.

Further, we understand both Denmark and Ireland have announced their intent to increase the threshold to EUR 8 million in the coming months, and the UK recently introduced legislation aimed at achieving the same goal. We are not aware of the regulators in other countries having made any decisions or announcements, but remain hopeful that most, if not all, EU countries will increase the threshold at least back to EUR 5 million.

If you are offering a share plan in the EU in reliance on the EUR 5 million exclusion, please check with your Global Equity Services attorney to ensure the exclusion is still viable for future offerings.

Israel

Israeli Supreme Court Rules Stock-Based Compensation to be Included in Cost Base Under Cost-Plus Arrangements

In a ruling handed down in late April 2018, the Israeli Supreme Court sided with the Israel Tax Authority (ITA) and upheld two decisions of the lower District Court in the Kontera Technologies Ltd. and Finisar Israel Ltd. cases, resulting in a potentially increased tax burden for Israeli subsidiaries of multinational companies offering share-based awards to Israeli employees.

For more information on how your company may be impacted by the recent decision, please read our May 2018 client alert and our June 2018 blog post.

Saudi Arabia

New Securities Rules for Employee Equity Award Offerings

On December 27, 2017, the "Rules on the Offer of Securities and Continuing Obligations" ("OSCOs") were published replacing the former Offer of Securities Regulations. Under the OSCOs, which became effective in Saudi Arabia on April 1, 2018, the offer of equity awards or shares to employees is now considered an "Exempt Offer" rather than a "Private Placement." As a result, the securities filing requirements that previously applied have changed significantly. Specifically:

(i) Equity award or share offers to employees no longer need to be made through an Authorized Person. Previously, an offer of equity awards or shares to an employee could only be conducted through an Authorized Person (i.e., a firm licensed to engage in securities business in Saudi Arabia).

(ii) A pre-offer filing is no longer required. Previously, the Authorized Person had to submit a pre-offer notification to the Capital Market Authority ("CMA") ten business days prior to the offer of equity awards or shares to employees.

(iii) A post-offer notification is no longer required. Previously, the Authorized Person was required to provide a list of all employees who acquired shares, including details of the total proceeds of the offer, within ten days of the conclusion of the offer to the CMA.

Instead, under the OSCOs, issuers are required to submit quarterly reports to the CMA. While official guidance from the CMA has not been issued, it is expected that the issuer can submit the quarterly report on its own without the assistance of an Authorized Person. The information required in these notifications will likely include:

(i) the number and categories of the offerees (but not specific names)

(ii) amount paid per share

(iii) date of commencement and completion of the offering (i.e., the date of grant and the term of the award and/or vesting schedule)

(iv) the size of the offering (i.e., total number of shares issued)

The quarterly notifications will need to be submitted after the end of each calendar quarter (March 31, June 30, October 31 and December 31). Once again, the CMA has not issued official guidance, but the CMA has indicated that quarterly notifications should be filed within a "reasonable" time after the end of each calendar quarter. However, the CMA did indicate that one month after the end of a calendar quarter would not be considered reasonable; therefore, quarterly notifications will likely be due within one to two weeks following the end of a calendar quarter.

If your company is granting equity awards or shares to employees in Saudi Arabia, please contact your Global Equity Services attorney to ensure a timely quarterly report is filed for the current quarter.

The first quarterly notification to the CMA will be due for the second calendar quarter ending June 30, 2018. Filings are required to be made electronically through a CMA designated portal, which is not yet available. Until the portal is available, we expect that quarterly reports can be sent by email to the CMA.

Sweden

New Tax-Advantaged Option Regime

As of January 1, 2018, small companies and start-ups in Sweden have the ability to grant tax-advantaged employee share options. The main purpose of the new regime is to make it more attractive for employees to join start-ups by deferring tax due on stock options to the time of sale of the underlying shares. At sale, any gain is taxed only at the (lower) capital gains tax and not subject to employment income tax and social insurance contributions.

The favorable tax treatment will be available only to employees of companies with 50 employees or less, revenue of SEK 80 million (approx. USD 9.9 million) or less and which have been in business for less than ten years.

Further, the new rules are not available to banks and financial companies, insurance companies and real estate companies. There are also restrictions regarding the vesting schedule and exercise period, the total value of all options and of each employee's options granted and the option holder's working hours and salary.

Accordingly, because of the requirements that have to be met, we anticipate the new rules will have limited applicability.

Switzerland

Tax Ruling Required for Equity Awards in the Canton of Vaud

As some of you may remember, it typically used to be necessary to submit tax ruling requests confirming the tax treatment of equity awards in Switzerland. Effective January 1, 2013, a federal tax law clarified that tax was due only when shares subject to an award were issued (i.e., at exercise for options, vesting for RSUs and purchase for ESPP). After this clarification, companies generally stopped filing ruling requests.

However, we recently learned that tax officials in the canton of Vaud still deem it necessary to confirm the tax treatment of equity awards through a tax ruling. The good news is that, whereas previously companies were required to file an official ruling request with a comprehensive description of the facts and requested tax assessment, the tax officials in Vaud may now accept a short ruling request via email where equity awards with standard provisions are being granted. The responsible tax official will provide the tax assessment as a response to the ruling request which will outline the employer's and employee's responsibilities in connection with the equity awards.

For additional information on seeking a tax ruling in connection with equity awards in Vaud, please contact your Global Equity Services attorney.

United Kingdom

Tax-Advantaged Options Must be Granted by Deed

As noted in our March 2018 Clients & Friends Newsletter, Her Majesty's Revenue & Customs ("HMRC") recently commented that tax-advantaged stock options granted under a Company Share Option Plan ("CSOP") should be granted by way of deed. HMRC emphasized that it may view a CSOP whose rules do not provide for grants by way of deed as a serious error (which could result in the options failing to qualify for tax-advantaged treatment).

In light of HMRC's comment, companies seeking to grant tax-advantaged options under a CSOP may need to change the mechanism by which the grants are made. A deed can be an internal document (not shared with the employees), but it must list all of the material terms of the grants (i.e., name of employee, number of shares subject to option, vesting schedule and exercise price) and be executed by individuals with the requisite authority under the company's corporate governance structure. This deed could be prepared simultaneously with the grant resolutions and approved by the Board or Compensation Committee. However, we understand that it can be challenging for companies to have employee-specific grant information available on the date of grant. In this case, it may be necessary to approve the deed subsequently by way of a new resolution (or unanimous written consent), but this approach is not free from risk, as HMRC may take the position that the exercise price has to be set as of the date of the deed (not the original grant resolution).

If you are granting tax-advantaged options under a CSOP, please contact your Global Equity Services attorney for additional details on how to grant the options by way of a deed.

Court of Appeal Holds Retirement Vesting Provision Objectively Justified

In the UK (and generally throughout the EU), direct and indirect age discrimination is prohibited, unless the discrimination can be objectively justified. In the context of equity awards, this prohibition may capture termination provisions which confer benefits on retiring employees of certain ages which are not available to younger employees. For example, a provision allowing continued vesting after retirement for employees who meet both age and service-based criteria risks being deemed unlawful as discriminating against younger employees who meet only the service-based criterion. Until recently, neither this risk of age discrimination nor the exception for objective justification had been tested for equity awards in a published EU court decision.

In *AirProducts v. Cockram*, the UK Court of Appeal upheld a lower court's ruling that a termination provision allowing certain retiring employees to retain unvested awards if they left after attaining the company's customary retirement age of 55 was lawful under UK law. The court found that the retirement treatment was lawful because it was objectively justified as a proportionate means of achieving a legitimate aim, as it encouraged retention and also created opportunities for younger employees.

This decision is good news, but companies should continue to exercise caution for several reasons. First, this decision was rendered on a set of facts specific to one company and still can be appealed. Also, this decision is binding only in the UK. The decision may be persuasive elsewhere in the EU, but anti-discrimination risks in other EU jurisdictions remain. Therefore, we recommend that companies seeking to offer (or continue offering) beneficial treatment for equity awards in the UK and EU based on age-related criteria carefully consider whether the intended treatment can be objectively justified within the framework of proportionality and legitimate aims established by *AirProducts v. Cockram*.

United States

Pennsylvania's New Non-Resident Withholding and Reporting Requirements For Non-Employee Compensation

In October 2017, Pennsylvania Governor Tom Wolf approved Act 43 of 2017 (Act 43). Act 43 requires anyone who makes a payment of Pennsylvania source "non-employee compensation" or business income to a non-resident, which is reported on a Form 1099-MISC, to withhold Pennsylvania income tax (currently 3.07%) from such payment. For this purpose:

- "Pennsylvania-source income" is compensation for services performed within Pennsylvania. Compensation for a non-resident's services performed outside of Pennsylvania is not taxable even if the payment is made from within Pennsylvania or if the employer is a Pennsylvania resident.
- "Non-employee compensation" is compensation paid to someone who is not an employee for services provided in the ordinary course of a trade or business and includes payments to independent contractors, consultants and directors.

Withholding is optional for payors paying less than $5,000 annually. However, if it is not certain whether the total amount of payments to be made to a nonresident non-employee in a year will exceed $5,000, the DOR has encouraged businesses to withhold and remit income tax from all payments made, so as to reduce the risk of noncompliance and related penalties.

The effective date of Act 43 was originally January 1, 2018, but the DOR has issued guidance that no assessment for failure to withhold will be applied for a period ending prior to July 1, 2018. However, the DOR expects payors to file the related Form 1099-MISC with the DOR timely in January 2019.

Additionally, the DOR's guidance states that even if a non-employee lives in a state with withholding tax reciprocity with Pennsylvania, such reciprocity applies only to W-2 based employee compensation and does not apply to Pennsylvania-source income being reported on a Form 1099-MISC.

Companies making payments of Pennsylvania-source cash or equity compensation to directors, consultants or other non-employees who are nonresidents of Pennsylvania should be prepared to withhold Pennsylvania income tax by no later than July 1, 2018 and to file a copy of the relevant Form 1099-MISC with the DOR in January 2019.

Rule 701 Enhanced Disclosure Threshold to Increase from $5 million to $10 million

On May 24, 2018, the President signed the Economic Growth, Regulatory Relief, and Consumer Protection Act into law (the Act). Although the Act is primarily aimed at rolling back certain banking regulations under the Dodd-Frank Act, the Act also directs the Securities and Exchange Committee (SEC) to increase the "sales" or stock value threshold from aggregate sales of $5 million to $10 million that triggers enhanced disclosure where a company grants stock-based based awards to employees (or other service providers) in reliance on Rule 701 of the Securities Act of 1933, as amended (the Securities Act). Rule 701 provides an exemption from the registration requirements of the Securities Act.

Many companies that are not subject to the periodic reporting requirements under Section 12 of the Securities Exchange Act of 1934, as amended (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 when offering equity awards to employees under a compensatory benefit plan (or arrangement). Although the Rule 701 exemption is self-executing, it imposes 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
- Certain financial statements, prepared in compliance with US GAAP (or prepared in compliance with IFRS in the case of foreign private issuers) or reconciled to US 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.

Under Section 507 of the Act, the SEC must by July 23, 2018 amend Rule 701 to increase from $5 million to $10 million the 12-month stock value "sales" threshold that would give rise to the enhanced disclosure obligations described above. The enhanced disclosure threshold is required to be indexed for inflation every 5 years (and rounded to the nearest $1 million). The increased enhanced disclosure threshold should be a welcome relief to US private companies and non-US private and publicly traded companies that are not subject to the reporting requirements of the Exchange Act. Companies relying upon Rule 701 should continue to monitor their compliance with the $5 million disclosure requirements until the SEC has issued guidance regarding the effectiveness of the Rule 701 amendment.

Courts Continue to Reject Shareholder Challenges of Allegedly Discretionary Share Withholding for Section 16 Insiders

Over the past two years, plaintiff shareholders have brought numerous suits in federal courts alleging that company or insider discretion around share withholding on equity awards negates the approval of such withholding by the Board or Compensation Committee and means that the withholding is not exempt under the short-swing profit rules of Section 16(b) of the Exchange Act. So far, these claims have not been successful, bringing some comfort to companies whose equity award agreements permit the company, or a Section 16 officer or director, to elect to satisfy withholding taxes in shares or by another method. However, most of the cases have been dismissed on procedural grounds, so we continue to wait for definitive judicial guidance on the merits of these claims.

As a recent update, in March 2018, the Fifth Circuit affirmed the lower court decision that we discussed in a prior post. (See *Jordan v. Flexton*, 5th Cir., Case No. 17-20346.) The lower court had held that withholding shares from a duly approved equity award to cover taxes was an exempt transaction, not matchable against a non-exempt purchase of shares within six months, and therefore not subject to short-swing profit disgorgement, because such a transaction is compensatory in nature and designed to be exempt - even though under the award terms the company and the Section 16 officer could have chosen to pay taxes differently. Although it affirmed the lower court's decision, the Fifth Circuit did not discuss the merits of the plaintiff's "discretionary" share withholding argument because it was not properly raised in his opening brief. This is unfortunate because it would have been helpful for precedential purposes to have the Fifth Circuit's analysis (and hopefully, its rejection) of this argument.

Additionally, federal district courts in Delaware, Ohio and California have recently tossed similar suits brought by a non-attorney plaintiff attempting to represent himself (see *Olagues v. Remondi*, Del. Dist. Ct, C.A.-No. 17-1004-LPS), *Olaques v. Timken* (N.D. Ohio, Case No. 5:15CV1870), and *Olagues v. Ravich*, C.D. California, Case No. CV 17-938-DMG). Because such shareholder derivative lawsuits are representative lawsuits brought on behalf of a corporation and a corporation cannot represent itself in court, the courts determined that the suits must be brought by a shareholder represented by legal counsel. Accordingly, these cases were dismissed on procedural grounds and the courts did not reach the merits of the claims. As such, the cases do not provide further insight into how the courts will analyze the question of whether company or insider discretion around share withholding results in a non-exempt withholding of shares. Therefore, although there is reason for optimism regarding the likely outcome of future similar suits, companies should continue to be cautious about the level of such discretion contained in their equity award agreements.

Potential Impact of California's Dynamex Decision on ESPP and other Non-Discretionary Plans

In a recent California Supreme Court decision, *Dynamex Operations West Inc. v. The Superior Court of Los Angeles County*, the court abandoned a flexible multifactor classification standard used to determine whether workers in California are classified as independent contractors or employees and adopted an "ABC" test that presumes workers are employees and places the burden on companies to prove their workers in California are independent contractors. Although the *Dynamex* holding is limited to the classification of employees for purposes of applying California's wage orders, which impose obligations on employers relating to minimum wages, maximum hours, and basic working conditions, independent contractors who are reclassified as employees could attempt to rely on the decision as a basis to make a claim, on a retroactive basis to the date they commenced providing services to the company, for compensation or benefits to which employees are entitled, including participation in non-discretionary equity compensation plans.

In light of the *Dynamex* decision, companies who have service providers in California should review the terms of their plan documents to confirm that they include protective language stating that plan eligibility will not be extended retroactively to individuals who are initially hired as independent contractors even if a court or administrative agency later determined they are employees. If a company's plans do not contain this protective language, depending on the type of plan, a company should consider whether it may be prudent to amend the terms governing eligibility to include this language. This consideration may be particularly relevant for companies sponsoring non-discretionary plans, such as employee stock purchase plans intended to qualify under Section 423 of the Internal Revenue Code, where eligibility is determined based on the existence of an employer-employee relationship.

SEC Provides Updated Guidance on Proxy Disclosures for Compensation Plan Proposals

On May 11th, the staff of the SEC's Division of Corporation Finance issued 45 Compliance and Disclosure Interpretations (CDIs)[1], replacing previously published telephone interpretations on proxy rules and Schedule 14A. Most of the updates are non-substantive, as noted by the SEC, and therefore the updates are

[1] Link to https://www.sec.gov/corpfin/proxy-rules-schedules-14a-14c-cdi.

primarily helpful for consolidating the relevant guidance in one place. Twelve of the CDIs relate to Item 10 of Schedule 14A, which sets forth the disclosure rules when a compensation plan is submitted to shareholders for approval, but only the following interpretation, CDI 161.03, is identified as a substantive change:

> **Question**: If a registrant is required to disclose the New Plan Benefits Table called for under Item 10(a)(2) of Schedule 14A, should it list in the table all of the individuals and groups for which award and benefit information is required, even if the amount to be reported is "0"?
>
> **Answer**: Yes. Alternatively, the registrant can choose to identify any individual or group for which the award and benefit information to be reported is "0" through narrative disclosure that accompanies the New Plan Benefits Table. [May 11, 2018]

As background, the "New Plan Benefits" table is required to be included in a proxy proposal for shareholder approval of a compensation plan when either:

- awards have been made under the plan that are contingent on shareholder approval
- the plan has set benefits or amounts, such that the benefits or amounts that will be issued under the plan are determinable (e.g., formulaic director award plans)

The table requires disclosure of such determinable awards granted or to be granted to (i) the issuer's CEO, (ii) each of the named executive officers, (iii) the executive group, (iv) the non-executive director group, and (v) the non-executive employee group.

Practically speaking, the change set out in CDI 161.03 is not that substantive. The only difference between the new CDI and the SEC's prior telephone interpretation is that the new CDI confirms that it's acceptable to provide information on individuals or groups who did not receive contingent grants or will not otherwise receive determinable awards in a narrative along with the table, rather than in the table itself.

At the same time, it is instructive to see that even in view of its Disclosure Effectiveness Initiative, the SEC remains focused on the New Plan Benefits table. No fewer than seven out of the twelve CDIs on Item 10 relate to the table. Therefore, although past disclosures in this area have tended to take a variety of approaches, companies required to disclose a New Plan Benefits table in the future will no doubt want to adhere closely to the new CDIs in their compensation plan proposals.

For more information

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