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Global Equity Services

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Quarterly Newsletter | February 2019

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In this issue

Australia

Proposed Changes to Securities Law Exemptions for Private Companies

Currently, private companies wishing to offer equity awards to employees in Australia have limited exemptions from the securities law requirements available to them. The Australian government has proposed to simplify and extend one of the current exemption regimes to allow offers with a value of AUD 10,000 per employee in any 12-month period (up from the existing limit of AUD 5,000), allow contribution plans (e.g., employee stock purchase plans) and relax the requirements around public disclosure of commercially sensitive financial information. We are continuing monitor this development.

We thank Madeline MacIntosh and Ben McLaughlin from our Sydney office for their contribution to this new development.

Belgium

Further Information on Income Tax Withholding and Reporting Obligations for Equity Awards

As reported in our October 2018 Clients & Friends Newsletter, the Belgian government proposed new legislation that was intended to introduce (i) a general income tax reporting obligation, and (ii) a general income tax withholding (and reporting) obligation with respect to equity awards granted by a foreign parent company, regardless of any facts and circumstances such as whether there is a recharge arrangement in place or whether the Belgian employer is involved in such awards. Due to the resignation of the Belgian government in December 2018, the legislation was not approved before the end of 2018. However, it was subsequently approved in 2019 and these obligations were introduced, albeit on a different timeline than previously expected.

Please see our Client Alert, dated February 1, 2019 for an update on the relevant timing for the introduction of the reporting and withholding obligations in Belgium.

China

Significant Amendment of Individual Income Tax Law

China amended its Individual Income Tax (IIT) Law on August 31, 2018. Some changes, such as the adjustment to the tax brackets and standard deductions applicable to salaries and wages and operating income, took effect as of October 1, 2018. Some changes took effect as of January 1, 2019, including (among others):

- Adjustment to the income categories and the creation of a comprehensive income category;
- Introduction of the "accumulative advance withholding method" by employers for PRC tax residents and annual tax filing requirements for residents if the withholding amount differs from their tax liability;
- Reduction in the time presence threshold from a "full year" to 183 days for a non-domiciliary to constitute a Chinese tax resident.

It was not clear under the amended laws whether the preferential tax treatment under Notice 35 would still apply to equity awards. However, on December 27, 2018, the Ministry of Finance and the State Administration of Taxation jointly issued Notice 164 clarifying this and other points.

Impact of Notice 164 on Equity Awards

According to Notice 164, resident taxpayers may separate their qualified equity incentive income derived from listed company plans from other comprehensive income for tax calculation purposes. This policy will be effective for the years 2019 to 2021. During this period, qualified equity incentive income derived by resident taxpayers within the same tax year should be aggregated and subject to IIT at the annual tax rates. As compared to the previous tax calculation method under Cai Shui [2005] No. 35 ("Notice 35"), which allows taxpayers to spread the equity incentive income over prescribed months (capped at 12 months) to determine the applicable monthly tax rate, the tax calculation method under Notice 164 is generally more favorable for taxpayers due to the application of annual tax rates.

Future rules will be issued to specify the tax treatment for qualified equity incentive income from January 1, 2022.

As of January 1, 2019, there are no specific rules addressing the tax treatment of equity incentive income derived by non-resident taxpayers. It remains to be seen whether non-resident taxpayers may receive any preferential tax treatment on equity incentive income under the new IIT regime.

Impact of Notice 164 on Annual Bonuses

Previously, both resident and non-resident taxpayers were entitled to the preferential tax treatment for annual bonuses under Article 2 of Guo Shui Fa [2005] No. 9. ("Notice 9"). Under Notice 9, an annual bonus can be divided by 12 to determine the applicable tax rate and quick calculation deduction.

Notice 164 repealed Article 2 of Notice 9, but continues to provide preferential tax treatment for annual bonuses derived by resident taxpayers for the calendar years 2019 to 2021. Under Notice 164, resident taxpayers may choose to (i) continue to enjoy the existing preferential tax treatment by treating the annual bonus as separate income from their comprehensive income, and dividing the annual bonus by 12 to determine the applicable tax rate and quick calculation; or (ii) include the annual bonus in their comprehensive income for tax calculation purposes. The latter method may benefit those tax residents who derive a relatively low amount of other comprehensive income and therefore are able to enjoy a lower annual tax rate.

Annual bonuses derived by resident taxpayers should be aggregated with other comprehensive income for tax calculation purposes starting from January 1, 2022.

Notably, there are no specific rules addressing the tax treatment of annual bonuses derived by non-resident taxpayers. It is currently unclear whether non-resident taxpayers may receive any tax preferential treatment on annual bonuses.

Denmark

Additional Information on Stock Option Act Changes

In our October 2018 Clients & Friends Newsletter, we reported on a draft bill that would amend the Danish Stock Option Act to eliminate the requirement for "good leavers" to retain equity awards and receive a pro-rata award after termination of employment. The bill was adopted by the Danish Parliament in December 2018 and is effective for relevant grants made on or after January 1, 2019. However, it is currently unclear whether or not grants need to be made under a plan or program that has been established on or after January 1, 2019 to be able to rely on the amended rules or if it is sufficient that the grants themselves are approved on or after this date. In any case, when a company makes grants that are governed by the amended Danish Stock Option Act, the Employer Statement - which provides information to employees about the Stock Option Act - still needs to be provided to employees but it will need to reflect the amended rules.

Please contact your Global Equity Services attorney if you need help in determining whether your company can rely on the amended rules for grants made after January 1, 2019 and/or if you need assistance with revising your company's Employer Statement.

European Union

Update on EUR 5 Million Exclusion from Prospectus Requirement

If your company has been relying on the EUR 5 million exclusion to offer a share plan in the EU/EEA, please check with your Global Equity Services attorney to understand the current thresholds in your various countries.

As reported in our March 2018 and June/July 2018 Clients and Friends Newsletters, the exclusion from the prospectus requirements for the offering of securities where the consideration paid for the securities is less than EUR 5 million in the European Union ("EU") / European Economic Area ("EAA") during any 12-month period changed effective July 21, 2018. As of such date, the exclusion is available for the offering of securities where the consideration paid for the securities is less than EUR 1 million throughout the EU / EEA during any 12-month period. However, each EU/EEA country has the discretion to raise the threshold for the exclusion to up to EUR 8 million. We have been monitoring this in each of the EU/EEA countries.

Belgium - Belgium increased the threshold for the exclusion to up to EUR 5 million. However, an offering of securities where the consideration paid for the securities is between EUR 1 million and EUR 5 million in the EU / EEA during any 12-month period may require a Belgian 'information note' (i.e., a disclosure document but not as cumbersome as a full prospectus). An exemption from the 'information note' requirement may be available for certain issuers.

France - France increased the threshold for the exclusion to up to EUR 8 million. However, to rely on this exclusion, the issuer will need to prepare a disclosure document for potential investors. This document does not need to be approved by the French securities regulator (the AMF) but it does need to be submitted to the AMF along with any promotional documents.

Germany - Germany increased the threshold for the exclusion to up to EUR 8 million. In addition, the new exclusion is not limited to offerings by financial institutions as was previously the case. Therefore, any company with an offering within this limit can now rely on this exclusion in Germany.

Ireland - Ireland increased the threshold for the exclusion to up to EUR 5 million.

Poland - Unlike most of the other EU jurisdictions, this exclusion in Poland is not self-executing except for offers where the consideration paid for the securities (throughout the EU) during a 12 month period does not exceed EUR 100,000.

For offerings where the consideration paid for the securities (throughout the EU) during a 12-month period exceeds EUR 100,000 but is less than EUR 1 million, the issuer must prepare an "Information Memorandum" which includes (among other things) basic information on the issuer and the terms and conditions of the offer and publicly disclose this Information Memorandum.

For offerings where the consideration paid for the securities (throughout the EU) during a 12-month period exceeds EUR 1 million but is less than EUR 2.5 million, the issuer must prepare a more complex and detailed form of Information Memorandum, which must be translated into Polish and be publicly disclosed. Moreover, this Information Memorandum is valid for only 12 months and issuers relying on this exemption must appoint an "offering agent" (i.e., broker or other investment firm) through which to make the offer.

UK - The UK has enacted new legislation which includes an exclusion from the prospectus requirements for offerings with a value of up to EUR 8 million throughout the EU/EEA over a 12-month period. When considering the value of the shares offered over the preceding 12 months, it is only necessary to include offers that relied on this exclusion. Offers made in reliance on other exemptions or exclusions (such as the exemption for offers to fewer than 150 employees in any EU/EEA country) can be disregarded for purposes of the EUR 8 million exclusion. Therefore, to the extent an issuer offers shares under an ESPP to fewer than 150 employees in any other EU/EEA country, the value of any such shares would not count against the EUR 8 million limit when calculating this for UK purposes.

Depending on the terms of the UK's exit from the EU, which is scheduled to occur on March 29, 2019, this exclusion may or may not continue to apply in this manner.

India

Proposed Data Privacy Law Changes

A draft data protection bill was released in India on July 27, 2018. The bill appears to be modeled after the EU General Data Protection Regulation. For example, the following provisions are included in the bill: •Strengthening of notice and consent requirements

- Establishment of a dedicated Data Protection Authority
- Specific requirements for cross-border data transfers
- Potential penalties for violating the new law are fines of up to INR 150 million or 4% of total worldwide turnover in the previous financial year (whichever is greater).

It is not clear when the amended law may be final and what impact it will have on equity awards offered by a multinational company to employees in India.

Israel

Notice from Tax Authority to Certain Companies Asking for Restated Tax Returns

If your company has granted equity awards under the capital gains track trustee regime that vest based on an exit event or upon the achievement of other performance criteria, you should check with your Global Equity Services attorney to assess the impact of this circular on such awards.

We previously reported (in our May 2018 Client Alert and June 2018 blog post) on a ruling of the Israeli Supreme Court in the *Kontera* and *Finisar* cases which resulted in a potentially increased tax burden for Israeli subsidiaries of multinational companies offering share-based awards to Israeli employees.

The Israeli Income Tax Authority ("ITA") subsequently issued a public notice discussing these decisions and affirming the ITA's position that equity compensation accounting charges should be included in the cost basis of Israeli employers who charge affiliated companies for their services under a "cost plus" arrangement. The notice called on companies who did not include equity compensation in their cost basis in years prior to the court decisions to file restated tax returns which reflect the recent verdicts. This is an unprecedented request and there is a question of whether there is a legal basis for the ITA to require such actions. Nonetheless, companies with cost plus arrangements with Israeli subsidiaries should review the notice and discuss this matter with their advisor, as the disclosure may be advantageous in reducing the risk of penalties and transfer pricing adjustments.

Tax Circular Impacting Capital Gains Track Trustee Awards with Certain Vesting Criteria

On December 5, 2018, the Israeli Tax Authority ("ITA") published Circular 18/2018 which set forth (and, in some cases, reiterated) the ITA's position on whether and how equity awards that vest based on certain criteria can benefit from the capital gains track trustee regime.

- Equity awards that vest solely on an "exit" event (such as a sale of the company or an initial public offering of a company's shares) are not eligible for the beneficial tax treatment under the capital gains track trustee regime. The ITA has provided a 180-day period (i.e., until June 3, 2019) during which companies can amend such awards to remove the exit event vesting condition and restart the two-year holding period with the trustee, in which case the awards will be eligible for the beneficial tax treatment. A notice to the ITA is also required.
- Equity awards that vest based on performance criteria must (i) state the maximum number of shares issuable under the award at the time of grant, and (ii) the performance criteria must be based on objective financial milestones to benefit from the beneficial tax treatment under the capital gains track trustee regime.

Netherlands

Changes to Ex-Pat Tax-Favored Regime

Prior to 2019, certain ex-patriates were able to receive 30% of their wages (including income from equity awards) tax-free for **up to 8 years**, pursuant to a special ruling from the Dutch tax authorities for foreigners. As of January 1, 2019, the maximum term of this 30% tax-free regime is **5 years**.

For 30% facilities that were granted prior to 2019, transitional rules have been introduced as follows:

Original end date	Revised end date
In 2019 or 2020	Unchanged
In 2021, 2022 or 2023	December 31, 2020
In 2024 or later	3 years less than original end date

If your company had obtained such a ruling for ex-patriate employees in the Netherlands, please see the October 2018 alert from our Amsterdam office for further information and guidance on how to proceed.

We thank Don-Tobias Jol from our Amsterdam office for his contribution to this new development.

New Zealand

Proposed Data Privacy Law Changes

A bill to reform the New Zealand Privacy Act was introduced in Parliament on March 20, 2018. Key proposed changes include: mandatory reporting of privacy breaches, potential issuance of compliance notices by the Privacy Commissioner and strengthening cross-border data flow protection. The changes and the consequences of non-compliance are not nearly as significant as changes in other jurisdictions (e.g., the EU with the introduction of the General Data Protection Regulation in 2018), but it is evidence of a trend toward more data protection that we are observing in many countries. It is not clear when the amended law may be final and what impact it will have on equity awards offered by a multinational company to employees in New Zealand.

Change to Local Tax Deduction Requirements

Previously, for a local employer in New Zealand to take a corporate tax deduction with respect to equity award income recognized by its employees from an award granted by the employer's foreign parent company, the local employer was required to pay for the cost of the award, e.g., by entering into a recharge arrangement with the parent company. As of September 29, 2018, under section DV 27 of the Income Tax Act, New Zealand employers are entitled to a deduction, as of right, of an amount equal to an employee's equity award income under an employee share scheme at the time that the employee derives the income. The shares do not need to be issued or paid for by the New Zealand employer.

Puerto Rico

Change in Securities Law Exemption Requirements

In a September 2018 meeting, officials of the Office of the Commissioner of Financial Institutions ("OCFI") stated that the current position of the OCFI is that if a company intends to rely on the exemption from the registration and disclosure requirements for offers related to shares listed on the NYSE or Nasdaq (or certain other exchanges), a petition of exemption should be filed with the OCFI. Previously, the exemption for offers over shares listed on the NYSE and NASDAQ (and certain other exchanges) was considered to be self-executing. If required, the petition consists of a short letter describing the issuer and the offer, copies of the grant documentation and a small filing fee.

Companies offering equity awards in Puerto Rico should speak to their Global Equity Services attorney about whether they should file a petition for exemption.

United States

Change to 401(k) Rules Alters Six-Month Suspension under ESPP

The IRS recently proposed regulations related to hardship distributions from 401(k) plans that impact employee stock purchase plan ("ESPP") administration. Currently, if an employee takes a hardship distribution from a 401(k) plan that follows certain safe harbor rules, the employee is required to suspend contributions to other employer plans, including an ESPP, for a period of six months. Under the proposed regulations, such six-month elective suspension cannot be applied for 401(k) plan years commencing after January 1, 2020. During plan year 2019 (i.e., on or after January 1, 2019 for calendar year plans), plan sponsors may choose to retain or eliminate the six-month suspension following hardship distributions. In addition, plan sponsors could choose to eliminate the six-month suspension for hardship distributions taken in 2018.

Under the proposed regulations, 401(k) plans that follow the safe harbor will need to be amended to address this change, as well as certain other changes that do not impact ESPPs. Pursuant to the preamble to the proposed regulations, individually designed 401(k) plans should have until the end of the second calendar year that begins after the issuance of the relevant "Required Amendment List" to adopt the amendments. For now, 401(k) plans are required to have operational compliance only.

If an ESPP hardwires the 401(k) hardship distribution suspension rule into the ESPP plan document, the ESPP, as well as any plan prospectus or other ancillary documentation, should be amended to eliminate the suspension for ESPP contributions by the start of the 2020 401(k) plan year or, if sooner, the date the plan sponsor elects to eliminate the six-month contribution suspension.

ISS Updated Equity Compensation Plan and Compensation Policies for 2019

In December 2018, Institutional Shareholder Services ("ISS") issued its updated US Compensation Policies and Equity Compensation Plans FAQs for 2019. Some notable changes are introduced, as outlined below.

Equity Compensation Plans FAQs

For companies seeking shareholder approval of a new or amended equity plan on or after February 1, 2019, the updated policies leave the general equity plan scorecard ("EPSC") methodology framework intact, but made the following noteworthy changes.

- **CIC Vesting Factor**. The change in control (CIC) vesting factor has been revised to provide full EPSC points if the company's plan discloses the CIC vesting treatment for both time-based and performance-based awards, regardless of the actual substantive vesting treatment that the company elects to apply. However, if the plan is silent on the vesting treatment or if the plan provides the company with discretion to determine the vesting treatment, the company will not be allocated any points. Under the pre-2019 ISS policies, companies were allocated points for this factor if equity awards did not vest automatically upon a CIC unless the awards were not assumed or, in the case of performance awards, the equity awards vested pro-rata based on the actual performance attainment level and/or the time elapsed in the performance period as of the date of the CIC.

  Historically, many companies elected to forego the points attributable to the CIC vesting factor preferring to retain discretion and flexibility to determine the CIC vesting treatment at the time of a CIC, so the change to this factor may not influence a company's decision on whether to comply with this policy.

- **Excessive Share Capital Dilution**. An additional negative overriding factor has been added for the S&P 500 and Russell 3000 EPSC models that will be triggered when the company's equity compensation program is estimated to dilute shareholders' holdings by more than 20% (for the S&P 500 model) or 25% (for the Russell 3000 model). Note that this policy appears to focus on share capital dilution rather than voting power dilution. As a negative overriding factor, it may result in an "against" recommendation from ISS on an equity plan proposal regardless of the EPSC score.

- **162(m)-Related Plan Amendments**. Many companies have been awaiting ISS's view on plan amendments to reflect the elimination of the "performance-based compensation" exception to the USD 1 million limit on the deductibility of compensation paid to public company "covered employees" under Code Section 162(m). As most have anticipated, ISS's policies for 2019 confirm that ISS will not look favorably on plan amendments that remove good governance provisions, such as individual award limits. Eliminating such provisions will not result in a reduction of points under the EPSC, but doing so may be considered a problematic pay practice that could influence ISS's recommendation with respect to a company's say-on-pay vote or under ISS's executive pay evaluation policy (as noted below under the Compensation Policy updates). However, ISS has no issue with removal of general references to 162(m) qualification, including the metrics to be used in performance awards.

- **Plan Duration Factor**. Recognizing that companies will no longer need to bring their equity plans to shareholders every five years for Code Section 162(m) purposes, the updated EPSC places increased weight on the estimated plan duration factor in an effort to encourage plan resubmission to shareholders more often than stock exchanges require. The factor itself - under which full points are awarded for a plan with an estimated duration (based on three-year average burn rate) of five years or less, half points are awarded if the estimated duration is between five and six years and no points are awarded if it exceeds six years - is not changed.

General US Compensation Policies

The following updates to ISS's general compensation policies are of particular note for shareholder meetings on or after February 1, 2019.

- **Problematic "Good Reason" Provisions**. ISS has expanded its list of problematic pay practices that are most likely to result in an adverse say-on-pay vote recommendation to include problematic "Good Reason" termination definitions that present windfall severance risks, such as definitions triggered by potential performance failures, e.g., a company bankruptcy or delisting. However, the updated policy notes that Good Reason severance provisions relating to a successor's failure to assume a specific agreement will no longer trigger the problematic pay practices policy.
- **162(m) Compensation Design Changes**. Although not included among the practices "most likely" to trigger an adverse say-on-pay vote recommendation, ISS has identified a "shift away from performance-based compensation to discretionary or fixed pay elements, including changes made in light of the removal of 162(m) deductions, as a problematic pay practice (which could also negatively impact ISS's recommendation under its executive pay evaluation policy).
- **Suspension of Adverse Director Compensation Recommendation Policy**. ISS will delay until 2020 the policy it introduced for the 2018 proxy season providing for a potential adverse recommendation for the board committee responsible for approving or setting non-employee director compensation where there is an established pattern of excessive pay levels without a compelling rationale or other mitigating factors. In addition, ISS has revised and provided additional transparency on its methodology for identifying companies with non-employee director compensation that would result in a negative recommendation. In this regard, the policy states that pay outliers will be those with individual non-employee director pay figures above the top 2-3% of all comparable directors. After this quantitative review, ISS will review the quality of the company's disclosure regarding its non-employee director compensation to determine if its concerns are mitigated, based on disclosure of a compelling rationale for the level of director compensation. The policy also recognizes that additional fees are often legitimately paid to directors serving in chairperson or lead director roles by comparing such directors to others serving in similar roles.

- **Smaller Reporting Company Compensation Disclosures**. In reaction to the SEC's recent change to the definition of "smaller reporting companies," which expands the number of such companies, ISS states that it is unlikely to support a say-on-pay proposal for such companies if they scale back their compensation disclosure to the point where it does not enable investors to make an informed vote (notwithstanding that reduced disclosure is permitted under SEC rules). Glass Lewis previously announced a similar policy for 2019.
- **Front-Loaded Grants**. ISS states that it is unlikely to support grants that cover more than four years (i.e., the grant year plus three future years) and requires firm commitments not to grant additional awards over the covered period. Glass Lewis has also expressed an intent to scrutinize front-loaded grants in its 2019 policy.

Glass Lewis 2019 Policy Guidelines

Glass Lewis has updated its proxy voting policies for 2019, which include the following changes addressing executive compensation:

- **Excise tax gross-ups**. Glass Lewis will consider recommending against the compensation committee chair (or the entire compensation committee) and/or a company's say-on-pay proposal where new excise tax gross-ups related to change in control payments under Code Section 4999 are included in executive employment agreements, especially where the company previously committed to not provide such entitlements in the future.
- **Contractual payments and arrangements**. Glass Lewis clarified the circumstances that may contribute to a negative recommendation on the say-on-pay proposal, and will consider US market practice, size, and design of entitlements when evaluating sign-on bonuses and severance arrangements. Some factors that may result in a negative recommendation include excessive sign-on awards or severance and multi-year guaranteed bonuses.
- **Executive compensation disclosure for smaller reporting companies**. In reaction to the SEC's recent change to the definition of "smaller reporting companies," which expands the number of such companies, Glass Lewis will consider recommending against compensation committee members of smaller reporting companies where materially decreased compensation discussion and analysis (CD&A) disclosure substantially impacts shareholders' ability to make an informed assessment of the company's executive compensation practices.
- **Grants of front-loaded awards**. Glass Lewis added a new policy on front-loaded awards pursuant to which it will analyze the size of the award on an annualized basis (rather than the entire sum) and may compare the annualized amount to the practices of a company's peer using benchmarking data. If a company breaks its commitment not to grant additional awards during a

specified period following the grant of front-loaded awards, Glass Lewis could recommend against the company's pay program.

- **Recoupment provisions ("clawbacks")**. In evaluating a company's general compensation program, Glass Lewis may negatively weigh clawback policies that simply satisfy minimum legal requirements.
- **162(m) Amendments**. Glass Lewis states that it does not generally view amendments to equity plans and changes to compensation programs in response to the elimination of tax deductions under 162(m) as problematic. However, Glass Lewis qualifies this, stating that this "specifically holds true if such modifications contribute to the maintenance of a sound performance-based compensation program."

IRS Guidance on Deferral for Private Company Awards

On December 7th, the IRS issued Notice 2018-97 to provide initial guidance on the new private company income inclusion deferral regime enacted under Code Section 83(i) as part of the 2017 Tax Cuts and Jobs Act ("Section 83(i)"). Under the deferral regime, eligible employees of eligible privately-held companies may elect to defer payment of federal income taxes due on exercise of stock options or settlement of restricted stock units ("RSUs") for up to five years from when the employee's right to the stock is vested (i.e., generally, option exercise or RSU vesting), as described in our December 2017 alert.

In Notice 2018-97, the IRS provides guidance on the following aspects of Section 83(i):

1. **The 80% Employee Coverage Requirement -** Section 83(i) is available only where options or RSUs are granted under a written plan to not less than 80% of all employees who provide services in the United States, with the same rights and privileges. The Notice clarifies that to meet the 80% coverage requirement with respect to a calendar year, an eligible corporation must have granted options or RSUs (or both) to 80% of its employees *in such calendar year* (not counting employees who are ineligible for the deferral, such as the CEO, CFO or four highest compensated officers). Awards granted in prior years may not be taken into account in determining whether the 80% requirement is met. Further, the 80% test is calculated based on the total number of individuals employed at *any time* during the applicable year, as well as the total number of employees receiving awards during the year, regardless of whether the employees were employed at the beginning or end of the calendar year.
2. **Tax Withholding on Deferred Income -** Withholding of income tax on awards subject to deferral under Section 83(i) is required at the end of the permitted deferral period, based on the taxable amount (and share value) as of the option exercise date or RSU settlement date. Withholding must be applied at the

maximum rate in effect (currently, 37%). The Notice states that the IRS expects that proposed regulations on Section 83(i) will require that such withholding be applied without reference to (i) any payment of regular wages, (ii) an employee's Form W-4 or request for additional withholding or (iii) the withholding method used by the employer.

Additionally, in order to facilitate collection of such withholding tax, potentially years after the issuance of shares to the employee, the Notice requires employees to agree that their deferred stock will be held in an escrow arrangement until the withholding obligations are satisfied, and specifies that such obligations may be satisfied by withholding from the shares of stock held in escrow. Although an escrow arrangement may help with compliance with the withholding obligations, it will be of limited practical utility if the share value has decreased between the option exercise or RSU settlement and the end of the deferral period, such that the value of the shares held in escrow may be insufficient to cover the withholding tax liability.

3. **Employers' Ability to Opt Out of the Regime** - A recurring question since the enactment of Section 83(i) is whether employers can avoid application of the regime entirely, given its withholding complexities and administrative burdens, noting also that penalties apply where an employer fails to notify employees that their equity awards qualify for deferral. Fortunately, the Notice confirms that employers may preclude their employees from making Section 83(i) elections by declining to establish the required escrow arrangement. Companies may also avoid the application of Section 83(i) by providing in the terms of the options or RSUs that no election under Section 83(i) will be available with respect to the shares issued upon the exercise of options or settlement of RSUs.

The terms of Notice 2018-97 will be incorporated into future regulations and will apply to any taxable year ending on or after December 7, 2018. Future guidance may be forthcoming pursuant to comments that the IRS was accepting through February 5, 2019.

For more information

Narendra Acharya
Chicago
narendra.acharya
@bakermckenzie.com

Nicole Calabro
San Francisco
nicole.calabro
@bakermckenzie.com

Denise Glagau
San Francisco
denise.glagau
@bakermckenzie.com

Sinead Kelly
San Francisco
sinead.kelly
@bakermckenzie.com

Barbara Klementz
San Francisco
barbara.klementz
@bakermckenzie.com

Lindsay Minnis
New York
lindsay.minnis
@bakermckenzie.com

Aimee Soodan
Chicago
aimee.soodan
@bakermckenzie.com

Brian Wydajewski
Chicago
brian.wydajewski
@bakermckenzie.com

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Baker & McKenzie LLP

300 East Randolph Street, Suite 5000
Chicago, IL 60601
United States

Tel: +1 312 861 8000
Fax: +1 312 861 2899

www.bakermckenzie.com