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Global Reward Update – Wrap Up

December 2023

As we approach the festive season and the end of the year, we wanted to summarise some key developments we have seen impacting global incentive plans since our last update. Some are an update on information provided in previous Global Reward Updates (GRUs) and others are new developments.

We hope this summary is useful, and if you have any questions, please do get in touch with your usual Deloitte contact or any of the Incentives partners listed on the final page.

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Global tax & legal updates

Brazil: Proposed taxation of foreign share disposals

It is proposed that, as of 1st January 2024, individuals resident in Brazil will need to declare income obtained from foreign capital investments separately from other income and capital gains. This includes not only financial income obtained from investments, but also the sale of shares listed outside of Brazil.

Taxation of foreign exchange currency fluctuation and income received from entities outside of Brazil (so called "controlled entities") are also being discussed in the Brazilian Senate.

If such rules are approved, individuals would need to report and pay taxes through their annual tax return and no longer through the monthly self-assessment process that is currently in place. Additionally, the current exemption limit (for proceeds up to BRL 35k per month) will cease. Offsetting losses would also be possible under the proposed changes.

Once details of these changes have been finalised, employers should consider updating any employee guidance.

We will keep this under review and will provide any necessary updates.

Canada: Additional beneficial ownership reporting requirements for Trusts

As mentioned in previous Global Wrap Ups, the implementation of additional reporting requirements applicable to Canadian trusts and to non-resident trusts that are deemed to be residents of Canada (under section 94 of the Income Tax Act), had been delayed until the end of 2023 (here is a link). It has now been confirmed that the new requirements will apply for all trust tax years ending after 30th December 2023. For most Canadian trusts, this means the reporting requirements will be in effect for the tax year ending December 31, 2023 with the first trust returns due on March 30, 2024.

Historically, trusts have always been required to file an annual income tax return, although there have been several statutory and administrative exceptions that removed the requirement for trusts to file. Under this new legislation, many trusts which are not currently filing income tax returns will need to file annual T3 income tax returns, as this reporting is now needed for both resident and non-resident trusts deemed to be Canadian under the non-resident trust rules.

This new legislation also introduces new disclosure requirements. Relevant trusts will now need to file a Schedule 15 (Beneficial ownership information of a trust) alongside their annual T3 income tax return. Where trusts have already been filing T3 returns, the new legislation will mean enhanced disclosure requirements in respect of every settlor, trustee, and beneficiary (this includes both resident and non-resident beneficiaries of Canada).

Canada: Additional beneficial ownership reporting requirements for Trusts (continued)

The exceptions to the new trust reporting rules of new subsection 150(1.2) of the Income Tax Act are quite narrow and trustees should not assume that their trusts meet the exclusion criteria. A trust that meets one of the exceptions listed in paragraphs 150(1.2)(a) to (n) will not be required to provide in their T3 returns the additional information set out in new section 204.2 of the Regulations with respect to the trustee, beneficiaries, and the settlor. It is important to keep in mind that, the fact that a trust earns no income and has no activity does not automatically exempt it from having to file a return.

We recommend employers impacted by these changes continue to gather the requisite information ahead of the deadline. Penalties may be levied for late filing, incomplete, or inaccurate reporting.

Please contact us if you would like our assistance considering how these additional reporting requirements impact your obligations in operating a trust. We are able to assist you in navigating the rules and planning for an efficient information-gathering process.

Canada: Introduction of Employee Ownership Trusts

As discussed in our Global Wrap Up in August 2023 (here is the link), a new type of entity, the Employee Ownership Trust (EOT), is being introduced to facilitate the sale of a controlling interest in a qualifying business from its business owners to a trust for the benefit of its employees as a group (similarly to an “Employee Stock Ownership Plan” in the US or an EOT in the UK).

An amendment was made to this proposal in the 2023 Fall Economic Statement on 21 November 2023, by allowing an exemption of capital gains on the first $10 million realised on the sale of a business to an Employee Ownership Trust, subject to certain restrictions. It remains to be seen how this enhanced capital gains exemption would intersect with the alternative minimum tax, which includes a minimum amount of income on the realisation of certain other capital gains subject to exemptions.

This exemption would be in effect for the 2024, 2025, and 2026 years. We expect further details to be provided in the coming months.

We will keep this under review and publish further updates in due course.

China: Extension of preferential tax policies

As discussed in our Global Wrap Up in April 2023 (here is the link), China's Ministry of Finance and State Taxation Administration issued Bulletin No. 25 of 2023, which further extends the preferential individual income tax treatment for equity incentive plans offered by listed companies. The policy, which was set to expire on 31 December 2023, has been extended to 31 December 2027.

The preferential treatment applies to equity incentive plan compensation (e.g., stock options, stock appreciation rights, restricted shares) offered by listed companies to resident individuals based on their employment. Such compensation is taxed separately from the individual's other comprehensive income. Affected taxpayers generally benefit from this separate taxing method since the IIT burden on such compensation may be lower as compared to including it in comprehensive income.

As part of the preferential tax treatment, bonuses can also be taxed separately at the rate applicable to the income corresponding to the annual bonus divided by 12, instead of being included in comprehensive income.

Please contact us if you would like more information about whether your plans could benefit from this preferential tax treatment, or if you would like assistance with the relevant reporting obligations in China.

Czech Republic: Proposed tax point deferral for employee share plans

The Czech authorities are proposing amendments to the taxation of employee share plans that may defer the tax point to when employees sell the relevant shares. If adopted by Parliament, the amendment would take effect from 1 January 2024.

The new regime is designed to delay the taxation of shares acquired through an employee stock ownership plan (ESOP), which is a term used in the Czech Republic to describe employee share plans such as RSU’s and Stock Options.

The amendment will apply to situations where an employee acquires stock in the employer's business corporation, a parent or subsidiary, or a capital-related entity, or an option to acquire such stock.

The taxation point will depend on various factors such as termination of employment, employer liquidation, employee or employer tax residence changes, transfer/transmission of stock/option, exercise of option, exchange of stock, or the expiration of ten years from the acquisition date.

We will keep this under review and will provide any necessary updates.

Finland: Clarifications of eligibility requirements for ESI regime

In 2021 a new incentive regime in Finland was introduced, known as the employee share issue ("ESI") regime. This applies to shares issued directly to employees of non-listed companies located in the EEA. Our previous update on the introduction of ESI and summary of the qualifying conditions can be found here.

On 28 June 2023, the Finnish Supreme Administrative Court issued two rulings that provide clarification for certain qualifying conditions applicable to the ESI regime. This relates to the allocation of shares to certain sub-sets of employees that must be predicated on 'objective and common' criteria.

The new rulings provide additional certainty on the 'majority of employees' condition of the regimes and the metrics that can be used to allocate shares to participating employees. Ultimately, for the allocation of shares in the context of ESIs, the rulings verified the following:

- Variation in share allocation between employees or groups of employees is permitted
- Allocation in shares based on the value of an employee's work contribution is permitted
- Calculating the value of an employee's work contribution may be determined using metrics other than salary
- The employer can exercise discretion in determining the factors that impact the value of an employee's work contribution, if the criteria applied are objective and
    a) the employer does not discriminate against any particular employee / group, and
    b) no employee / group receives a nominal number of shares

Allowing this flexibility in the application of the 'majority of employees' condition is likely to increase the popularity and usability of ESI, rendering this relatively new incentive scheme a desirable method of attracting and retaining employees in young private companies.

These court decisions strengthen our current approach and are in line with what we see in practice. Please contact us if you would like any further information about the ESI regime.

Germany: The Future Financing Act

As discussed in our Global Wrap Up in August 2023 (here is a link), there were several proposed changes to the legislation, these have now been finalised and will be implemented from 1 January 2024.

The details of each of these updates are summarised in the August 2023 Global Wrap Up (see above link). Any material changes to the original proposals are outlined below.

Proposed increase to annual tax-exempt amount:
The annual tax-exempt amount will increase from €1,440 to €2,000 per calendar year, rather than the €5,000 that was originally proposed.

Proposed flat rate of income tax on ERS:
This proposal has been removed and any income arising on the acquisition of employment-related securities (ERS) will continue to be taxed at the employee's marginal rate of tax (which is up to 45%).

Proposed tax point deferral for private companies:
Increasing the employee limit, to include companies employing fewer than 1,000 employees (original proposal increased the limit to 500 employees).

The tax point has been updated so that the payment of tax is deferred until the earlier of:

- the point of sale
- 15 years from the date of acquisition (20 years was originally proposed); and
- termination of employment. However, where the employer voluntarily assumes liability for the employee's income tax and agrees to recover the liability through withholding, the income tax will only be due on a sale of shares or termination of employment.

Please contact us if you would like to discuss how this may impact the operation of your plan.

Germany: 1/5 rule no longer to be considered within the withholding process

Currently the 1/5 rule can be applied to income earned over more than one year at the withholding stage. As a result of this method, the income tax payable on the taxable amount will be five times the tax payable on one-fifth of the taxable amount. The intention of this method is to ease the effects of the progressive tax rate system in Germany. This method is generally beneficial for employees who are not already paying tax at the highest marginal rate.

As of 1 January 2024, this method can no longer be considered by the employer within the withholding process. However, individuals can apply for this rule via their personal income tax return.

We recommend employers consider updates to their withholding processes and any employee communications, to consider these updates.

Ireland: Amendments to the KEEP Scheme

The Irish Minister of Finance has commenced four amendments to the Key Employee Engagement Programme (KEEP) scheme. The KEEP scheme is a tax-advantageous share-option incentive arrangement for start-ups and small and medium-sized enterprises (SMEs), which was introduced in 2018.

These amendments are welcome improvements to the scheme, which have been introduced to react to criticism of the current scheme design. We discussed some of the criticism and proposed amendments in our Global Wrap Up in December 2022 (here is the link).

The amendments are effective from 20th November 2023 and include the following:

1. Extension of the KEEP scheme to the end of 2025;
2. Allowing shares that are originally acquired from a KEEP option and are subsequently redeemed, repaid or purchased by the company (i.e. a buy-back of the shares) to qualify for KEEP, in certain circumstances;
3. Increasing the limit for the total market value issued but unexercised qualifying share options for qualifying companies, and qualifying holding companies, from €3 million to €6 million; and
4. Changes to the types of shares that qualify for KEEP from new ordinary fully paid up shares to ordinary fully paid up shares, so that existing shares a company holds can qualify.

Please let us know if you would like assistance considering whether your plans satisfy the relevant conditions or if you are designing a new qualifying plan.

Italy: New special expat regime

Currently there is a 'special expat regime' that allows individuals who transfer tax residency to Italy to exempt part of their Italian sourced income (including salary and share plan income) from income and local tax withholdings, subject to conditions. Depending on the applicable regime, the Italian sourced portion of the income can be reduced by up to 90%, for both income and local tax withholding purposes. The regime lasts for 5 years and may be extended for an additional 5 years.

It is proposed that employees or self-employed persons who transfer their tax residence to Italy will have a new special regime (50% exemption) starting on 1 January 2024 for up to 5 years, with no extensions.

A cap of €600,000 will be introduced on the income that can benefit from tax relief. There will also be some new requirements to be met to be eligible for this new special regime, such as:

- high qualification or specialisation;
- absence of tax residence in Italy in the three tax periods prior to obtaining residency;
- maintenance of tax residence in Italy for the next five years while benefiting from the regime. If this is not the case, the individual will have to reimburse the benefit received (plus penalties and interests);
- it is not possible to apply the regime in cases where a transfer is made between companies in the same international group.

These changes have not yet been finalised. We hope for clarification on whether individuals who register in the Italian records as resident before 31 December 2023, would continue under the old version of the regime.

We will keep this under review and will provide any necessary updates.

Netherlands: Scaling back of the 30% ruling

As discussed in our Global Wrap Up Update in December 2022 (here is a link), the Dutch government have confirmed that the 30% ruling will be capped at €233,000, which is the 'WNT norm' for 2024.

As previously mentioned, employees to whom the 30% facility applies in the last payroll period of 2022, the cap on the 30% facility base will be applicable from 1 January 2026, if they remain employed by the same withholding agent, or when they switched to a new employer within a period of three months (where conditions are met).

Netherlands: Scaling back of the 30% ruling (continued)

An amendment of the 30%-ruling was passed on October 26, 2023, bringing significant changes to this tax benefit for employees and their employers. These amendments include:

1. A gradual reduction of the 30% ruling over a 5 year period, divided into three 20 month periods starting on 1 January 2024:
    - Initial 20 months: During the first 20 months, the maximum reimbursement will remain at 30%.
    - Subsequent 20 months: In the following 20 months, the maximum reimbursement drops to 20%.
    - Final 20 months: For the last 20 months, the maximum reimbursement further decreases to 10%.

If the ruling has a shorter duration than 60 months, the same percentages and periods apply until the end of the term.

There will be a transition period for employees who were already benefitting from the 30%-ruling in December 2023. These existing cases will continue to be governed by the existing legislation (including the wage cap). If an employee qualifies as an "incoming employee" after an interruption exceeding three month, the rule for the transitional period is no longer applicable.

2. The abolition of the option for partial non-resident tax liability (which is available to employees with a 30% ruling in effect), which would be effective from 1 January 2025. A transitional rule will be applicable, where employees already benefitting from the 30%-ruling in December 2023, can still make use of the partial non-resident taxpayer status until the end of 2026.

These changes are subject to final approval and this is anticipated in December 2023. We recommend immediate attention is taken by relevant employers to:

- update employee communications,
- considering timings of any new 30% ruling applications,
- planning for adjustments in your compliance and payroll processes.

Please contact us if you would like our assistance in considering any of the above.

Netherlands: Introduction of a Conditional Withholding Tax

On 1 January 2021, Netherlands introduced a Conditional Withholding Tax (CWHT) on interest and royalty payments (The Withholding Tax Act 2021). This Act has now been amended and extended to cover dividends.

As of 1 January 2024, a CWHT tax of 25.8% will apply on dividend payments to companies residing in certain blacklisted jurisdictions ("Low Taxed Jurisdictions") and in certain abusive cases, on receiving companies who are not resident in a Low Taxed Jurisdiction.

This newly introduced CWHT may also apply to dividend distributions that are currently exempt from Dutch dividend withholding tax ("Regular Dividend WHT") under the domestic exemption. Starting 1 January 2024, the CWHT will apply separately from the Regular Dividend WHT and will need to be tested for each dividend payment to a non-Dutch resident company.

Please let us know if you'd like to have a more in-depth discussion, or have any questions, especially if you have plans for making a distribution in 2024.

Nigeria: Introduction of capital gains relief

The Nigerian government has signed the Finance Bill 2023 into law which, along with other updates, has introduced two capital gains tax reliefs. On 6 July 2023, President Bola Ahmed Tinubu signed the Finance Act (Effective Date Variation) Order 2023 which varied the effective date of the Act, FA23 from 1 May 2023 to 1 September 2023.

The laws have been amended to allow capital losses arising from a chargeable disposal to be offset against capital gains arising from the disposal of the same type of asset. Where capital losses exceed the current year capital gains, any remaining capital losses may be carried forward to offset against future capital gains arising from the same type of asset for a maximum period of five years. After five years, the loss will be deemed to have lapsed.

Rollover relief has also been made available for the sales of shares in order to defer any capital gain. To qualify for the rollover relief, proceeds from the sale of shares should be invested to acquire eligible shares in the same Nigerian company or shares in other Nigerian companies within the same year of assessment.

We recommend employers consider updating any employee communications to consider these updates.

Slovakia: Changes to taxation of unlisted securities

On 28 June 2023, the Slovak Parliament approved key amendments to the Slovak Income Tax Act. no 595/2003 Coll that will come into force on 1 January 2024. These changes have been further clarified in Information Guide 20/DZPaU/2023/I issued by the Slovak tax authorities.

Firstly, a tax exemption has been introduced for non-monetary income received from employee share plans. The exemption would apply where:

- the employee's shares are not tradeable on the regulated market,
- the employer has not paid any dividends since the company's registration, and
- these are satisfied through to the end of the tax year during which the shares were acquired by the relevant employee.

Secondly, the new law changes the calculation of capital gains when selling unlisted shares. With effect from 1 January 2024, the capital gain will be calculated as the nominal value of the security upon maturity, less the original acquisition price. Where the shares are redeemed prior to maturity, this is calculated as the buyback price less the acquisition price. Up to 31 December 2023, the equivalent capital gain is calculated as the difference between the nominal value of the security upon its maturity and the original issue price. Therefore, the change in the deemed "cost" of the asset could ultimately change the capital gain on which income tax is payable (e.g. where there is a difference in the original acquisition price and the original issue price).

Thirdly, the changes introduce an individual tax exemption from capital gains arising from the sale of unlisted securities, provided the relevant securities/share certificates were owned by the taxpayer for more than three years. Please note that this exemption will not apply where these shares were used as business assets of the taxpayer. Where the exemption is not available, the capital gain will be subject to income tax (there is no separate capital gains tax in Slovakia).

Please let us know if you require any further information on these changes or require assistance with assessing how these impact your incentive plans.

United Kingdom: Vermillion court case ruling on employment related securities

The Supreme Court has recently handed down judgment in the much-anticipated case of *HMRC v Vermilion Holdings Limited.* After debating in the lower courts, the Supreme Court has ruled unanimously in favour of HM Revenue & Customs (HMRC).

The case considered whether a share option granted to a managing director should be treated as an employment-related securities option, and subject to income tax on exercise.

United Kingdom: Vermillion court case ruling on employment related securities (continued)

In particular, the judgment focussed on the application of section 471 of the Income Tax (Earnings and Pensions) Act 2003. This section addresses whether an option should be treated as employment-related. Firstly, it considers whether the option was made available "by reason of employment" and secondly, if the option was made available by the employer. While the first part requires a causal link between the employment and the options, and involves difficult judgment calls, the second avoids this by providing a "bright line rule". If the option is made available by the employer, section 471 deems it to be employment related.

It was found as a matter of fact that the option was not granted by reason of employment. Unfortunately for the option holder, the Supreme Court ruled that this had no bearing; the second part applied, therefore the reason for the grant was irrelevant, and the option was deemed to be employment-related.

The Court did accept one minor qualification to the deeming rule. If the rule results in an outcome that is "unjust, absurd or anomalous", it may not apply. But on the facts the Court held that was not the case.

Impact

It is now clear that if an option is made available by an employer then it is deemed to be employment related, whatever the surrounding facts, except in the most unusual circumstances.

In short, you only need to consider the reason for the grant if it is made available by someone other than the employer.

By extension, the same is true for a direct award of shares. Section 421B, which deals with an acquisition of shares, is substantially the same as section 471.

We recommend any employers that have relied on earlier decisions in the case and taken a position that an option or award of shares was not employment-related, should revisit this.

Going forwards the working assumption should be that where an employer grants an option or provides shares to a current employee or director, it is deemed to be employment-related and therefore within the scope of income tax and potentially PAYE and NIC.

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