

## Global Equity News

Winter/Spring 2010 Edition



### Welcome

Welcome to the inaugural edition of Global Equity News!

We have designed this publication to share specific and timely topics, new developments affecting equity award programs, as well as to provide you with an overview of some of the more significant tax and regulatory efforts adopted by governments around the world. For your convenience, we have also included a summary of the country-specific updates our group has released over the past six months.

This edition covers a range of topical issues that companies need to stay on top of, from the heightened need to address mobile employees to an update on the complex 457A rules and the new Section 6039 reporting requirements in the United States.

In addition, we have highlighted certain equity award trends we are seeing in the United Kingdom, and we will share trends from other countries in subsequent issues.

In order to help keep you abreast of the broader changes taking place in the world of equity compensation, we plan to issue this publication every six months, and of course we will continue to issue our Global Rewards Updates in the meantime.

We hope this publication will serve as a useful resource to you and your organization and, as always, we welcome your feedback.

Best Regards,

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### Issues impacting mobile employees

Despite tough economic times, and companies looking to cut costs, recent surveys continue to report an upward trend in the prevalence of international assignments and relocations. At the same time, tax authorities around the world are becoming increasingly interested in mobile employees participating in equity incentive and deferred bonus programs, due to the significant values that have been provided under these plans in the past and the fact that such values are expected to continue into the future. Consequently, we are seeing more and more companies evaluating their policies and processes for effectiveness and compliance with regulatory requirements.

The approaches taken to implementing equity incentive and deferred bonus programs depend upon the size and complexity of the company, its administrative capabilities, and the size of its mobile workforce. Companies' policies toward mobile employees and award programs, however, must address the applicable regulatory regime in their specific jurisdictions.

That said, technology platforms, which can enable companies to implement effective withholding and reporting processes on equity compensation in various countries, are becoming more affordable. Therefore, these systems applications are becoming an option available to all, rather than just the largest multinationals, going forward.

Sourcing of income for deferred bonus plans raises its own special challenges as it is possible, depending on the taxing jurisdiction, that different tax positions may be appropriate. For example, payments may be sourced 100% to the original bonus year, apportioned over the vesting period or apportioned over the bonus year, plus vesting period. The most appropriate position will depend upon the terms of the particular plan and the taxing jurisdiction.

Finally, as a consequence of such reviews, companies may find that they are operating inconsistently across plans and often between different elements of remuneration. We see this particularly in connection with tax equalization policies and in a number of cases this has resulted in the company wanting to review its whole expatriate management approach and policy.

### Equity award trends in the United Kingdom

The challenging economic environment and varying degrees of regulatory intervention in the area of compensation and tax policy have had a significant impact in the UK and we expect to see further changes emerging in the coming months.

This is impacting the design of employee share plans, and key themes emerging include a revival in broad based plans and an increased focus on bonus deferrals into equity.

### Broad-based plans

Over the past 12 to 18 months, we have witnessed a reengagement with broad-based arrangements, particularly share purchase plans.

Whilst little has been published as to why this is the case, a combination of internal and external factors are creating a catalyst for change and creating an environment where commercially these plans make sense. Perceived low share prices, a need to retain and motivate good people, and wanting to bring employees together with a common purpose, i.e. corporate glue, are key drivers. Moreover, in an environment where increasing cash compensation remains a real difficulty, broad based plans are a means of remaining competitive and can be a very efficient way of rewarding people (for both the corporate and the individual).



It is interesting to note that already 65% of Financial Times Stock Exchange Index (FTSE) 100 companies have a Share Incentive Plan (the UK tax approved share purchase plan) in place. Although not all are fully operational, we are seeing a reengagement with these plans and are anticipating that this number will grow. Additionally, an increasing number of companies are considering rolling out these plans on a global basis.

This style of plan typically allows employees to purchase shares out of gross income worth up to £1,500 per annum, with the possibility of receiving matching shares (usually a 1:1 ratio). The UK also allows for free shares to be awarded, within fairly modest limits. Currently, they appear to be perceived as having an advantage over an option type arrangement in that the employee is committing something into the plan i.e., they have "skin in the game."

Broad-based option plans also remain popular within the UK (for example 79% of the FTSE 100 operate with a Savings-Related Share Option Scheme). However, companies are currently looking more to share purchase type arrangements due to the extra commitment required from employees.

Going forward, it will be interesting to see whether this trend is mirrored by companies in the U.S., where a similar legislative framework exists for Employee Stock Purchase Plans ("Section 423 Plans").

### **Bonus deferrals**

As a result of increased regulatory and public/shareholder pressure, sitting alongside the G20's stated commitment to improving international compensation standards, more companies are introducing or extending bonus deferral arrangements. The immediate impact is being seen within the financial services industry; however, we anticipate that there will be a corresponding trend emerging amongst companies generally.

Typically when a threshold bonus value is reached for a particular year, a proportion of the bonus above this amount will be deferred into an award of shares. These shares will vest over a period of years in the future, sometimes based on additional performance conditions, as well as continued employment.

In the UK, such arrangements can be structured to be taxed at the point of deferral/award or when the shares are ultimately delivered without restriction to the individuals. Historically, the preferred tax point has been at the end of the vesting period when the shares are released without restrictions, and this is generally possible to replicate globally.

However, in an environment where tax rates are increasing, companies are facing the challenge of trying to balance the desire to accelerate income to mitigate individual tax outcomes with maintaining the integrity of a deferral arrangement. In the UK, this can be achieved; however, difficulties can arise when trying to replicate this globally.

### United States: Internal Revenue Code Section 457A

If you have employees overseas who received deferred compensation benefits in 2009, they could be subject to immediate income taxation on those benefits for 2009, even if they will not receive those benefits for a number of years. Furthermore, in some circumstances, an additional 20% tax could be imposed on those benefits. Why? Because in October of 2008, Internal Revenue Code (IRC) Section 457A was enacted.

IRC 457A taxes deferred compensation for employees' services to entities in so-called "tax indifferent" jurisdictions, including for example, Bermuda, the Netherlands Antilles, and much of the Middle East. The provisions of the section and its related notice, however, include language which can cause an entity located in any country in the world to be treated as "tax indifferent" for this purpose.

Generally, IRC 457A requires an employee's deferred compensation to be included in income once any service-based vesting conditions are satisfied, whether or not the employee has actually received the income. For this purpose, deferred compensation means any arrangement or agreement that provides for the deferral of compensation. However, some equity-based compensation, as well as amounts payable not later than 12 months after the end of the taxable year in which such amounts vest, are not treated as deferred compensation for this purpose. In addition, if the amount of deferred compensation cannot be determined at the time of vesting (e.g., because the amount is based on the company's financial performance criteria), there is no income at vesting, but once the amount is determinable, the amount is taxable and subject to an additional 20% tax.

These rules apply to corporations and partnerships, and to both private and public companies. Although originally targeted at offshore hedge funds, as written, IRC 457A has a much broader application, applying to the deferred compensation plans of many multinational corporations.

Affected companies should review their plans immediately. IRC 457A applies to deferred compensation attributable to services performed after December 31, 2008. Deferred compensation amounts attributable to pre-2008 services are covered under a grandfather rule (IRC 457A income inclusion can be delayed on these amounts until 2017); and plans can be amended to address the grandfather rule until December 31, 2011.

Regardless of what companies decide regarding amounts not vested at December 31, 2008, it is now more important than ever to track employee services performed in tax indifferent jurisdictions separately to determine proper income inclusion, or amend relevant plans, with respect to these deferred amounts.

### United States: IRC Section 6039 ISO and ESPP reporting

On November 16, 2009, the U.S. Treasury Department issued final regulations relating to the return and information statement requirements under IRC Section 6039, which as amended, imposes return and information statement reporting requirements on any corporation that transfers stock pursuant to the exercise of an Incentive Stock Option (ISO) or an option under an Employee Stock Purchase Plan (ESPP). These returns and statements are due by January 31 of the calendar year following the calendar year in which the transfer occurred. Although the return requirement has been waived for 2009 (returns for 2010 transfers will be due January 31, 2011), information statements for 2009 transfers must be furnished to employees by January 31, 2010. The final regulations are effective January 1, 2010.



The final regulations specify the information that must be included on the return and information statements for ISOs and ESPPs. With respect to ESPPs, the regulations provide that the reporting requirements apply to both qualifying and disqualifying dispositions. The reporting requirements will apply to ESPPs where the employee's exercise price is less than 100% of the value of the stock on the date of grant, as well as those offerings where the employee's exercise price is not fixed and determinable on the date of grant.

In addition, the following changes should be noted:

- **Transfer of Legal Title** – The final regulations provide that when shares acquired under an ESPP are directly deposited to an employee's brokerage account, the first transfer of legal title occurs when the shares are transferred to the broker or financial institution immediately following the exercise of the option. A transfer of legal title does not occur if a corporation issues stock directly to the employee or registers the shares in the employee's name on its books. In this situation, the corporation's reporting obligations would not be triggered until the first transfer of legal title, such as when the employee sells the stock or the stock is transferred to the employee's brokerage account.
- **Nonresident Alien Exception** – The final regulations provide exceptions to the return requirements with respect to a transfer pursuant to an ISO exercise or the first transfer of legal title of shares under ESPP (i) to a nonresident alien, and (ii) to whom the corporation is not required to provide a Form W-2 for any calendar year during the period beginning with the first day of the calendar year in which the option was granted and ending on the last day of the calendar year in which the ISO is exercised or the employee is first transferred the legal title of the acquired shares. The corporation would remain obligated to provide an information statement to the nonresident alien.

The final regulations may be relied upon for 2009 transfers. As a result, companies should review these rules to determine whether the changes will affect their reporting obligations with respect to ISO and ESPP transfers and ensure they are in compliance.



#### **NASPP/Deloitte Tax LLP international and domestic stock plan design and administration surveys**

The 2008 International Stock Plan Design and Administration Survey, comprised primarily of U.S.-based companies and cosponsored by the National Association of Stock Plan Professionals (NASPP) and Deloitte takes an in-depth look at the design and administration of equity award programs available to employees around the world. Since its inception in 2004, the survey has highlighted equity award practices that can serve as a valuable commodity for industry competitors, and the 2008 survey is no exception. In addition to collecting information regarding the various types of awards offered, the survey provides separate subsections addressing plan design and operational issues unique to the European Union and 14 individual countries. Please contact your local Deloitte office to receive a copy of the survey.

Separately, the development process for the International Survey's counterpart, the Domestic Stock Plan Administration and Design Survey, is now underway. The domestic survey addresses equity award programs available to employees in the United States and is scheduled to be released by September 1, 2010.

### Global rewards updates

Throughout the year, our practice distributes Global Rewards Updates (GRUs), which highlight regulatory changes from around the world that impact equity award programs. Provided below is a title listing of all GRUs that have been released in the past six months. For convenience, our GRUs are also distributed through Deloitte's biweekly release of Global Insight, posted on certain industry Websites, and housed on [www.deloitte.com](http://www.deloitte.com) in the Tax publications section. If you are not currently subscribed to Global Insight, please visit [www.deloitte.com/us/subscriptions](http://www.deloitte.com/us/subscriptions).



#### Global rewards updates – December 2009

- **People's Republic of China:** Individual Income Tax Treatment of Share-Based Compensation Clarified
- **Australia:** Employee Share Plan Bills Passed
- **United States of America:** New Supplemental Wage Withholding Rates in New York
- **European Union:** Additional Changes Proposed Regarding Relaxation of European Union Prospectus Directive (EUPD) Requirements
- **India:** India Tribunal Rules Indian Company Cannot Deduct Stock Option Expense
- **Russia:** Long Term Incentive Plans: Federal Financial Markets Service Clarifies the May 2009 Changes to Securities Market Legislation

#### Global rewards updates – November 2009

- **United States of America:** New Income Tax and Withholding Rates Imposed in California, New York, and New Jersey
- **European Union:** Revised Relation of EUPD Requirements

#### Global rewards updates – October 2009

- **Portugal:** New Legislation Eliminates Social Security Tax on Share-Based Awards
- **European Union:** Proposed Relaxation of EUPD Requirements
- **Australia:** Draft Transitional Guidelines on Employee Share Plans Released
- **Japan:** Former Senior Executive Accused of Evading Japanese Income Tax on Stock Option Gains

#### Global rewards updates – September 2009

- **Ireland:** Commission on Taxation Issues Recommendations on Irish Tax System — Proposed Changes to Taxation of Equity Awards
- **Spain:** Spanish Supreme Court Overrides Personal Income Tax Regulation Concerning Stock Option Gains

#### Global rewards updates – August 2009

- **Australia:** Exposure Draft Released Addressing Final Proposed Changes to Employee Share Plans
- **India:** The Finance Act 2009 Receives Final Approval — Fringe Benefit Tax (FBT) Abolished and Income Taxation on Equity Awards Reinstated

#### Global rewards updates – July 2009

- **Belgium:** Administrative Circular Issued on Stock Option Plan Extension — Extending the Term of Underwater Options
- **Russia:** Longer Term Incentive Plans: Impact of Changes to the Russian Securities Market Legislation
- **Australia:** Employee Share Plans — Final Proposed Changes
- **India:** India's Budget to Potentially Abolish FBT on Equity Awards

### Contact us

Global equity programs form the foundation of most global compensation initiatives. These programs link executive and employee pay to shareholder value creation and, for most organizations, are the most longstanding borderless rewards program.

We can help companies explore tax efficient equity programs that focus on providing more reward at a lower net cost, create the administrative processes necessary to enable efficient flows of data, shares, and funds, and facilitate payroll tax compliance, as well as create the strategies and materials required to train plan administrators and educate program participants. Whether you are in the early planning stages of introducing a global equity incentive program or already operate programs in several countries, Deloitte stands ready to assist at any stage of the global equity lifecycle.

Feel free to contact one of our U.S. or U.K. Global Equity Practice Leaders or Your Local Deloitte Global Rewards Representative.

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