global peRSpectives

A QUARTERLY LOOK AT INCENTIVE AND COMPENSATION ISSUES AROUND THE WORLD –
FALL 2011, Vol. I, No. 1

IN THIS ISSUE:

Contributors to this Issue

Sophie Borenstein
Partner
Paris
+33 1 44 34 80 82
sborenstein@reedsmith.com

Jeremy Glover
Partner
London
+44 (0)20 3116 3629
jglover@reedsmith.com

Jacqui Hatfield
Partner
London
+44 (0)20 3116 2971
jhatfield@reedsmith.com

John D. Martini
Partner
Philadelphia
+1 215 241 7908
jmartini@reedsmith.com

Craig P. Tanner
Partner
San Francisco
+1 415 659 4734
ctanner@reedsmith.com

ReedSmith

WELCOME TO THE FIRST ISSUE OF 'GLOBAL PERSPECTIVES'

Welcome to the first of our Reed Smith Global Equity Compensation Newsletters. This is just one of our new ways of keeping clients informed of the latest issues in global equity compensation.

Reed Smith has been in the business of advising companies on their equity compensation arrangements and stock plans for many years. Our Global Equity Compensation team operates in many jurisdictions and provides clients with joined-up advice across their countries of operation. We advise clients on the legal issues related to all types of equity programs, from regulatory compliance and labor law issues to designing local qualified and tax effective plans.

We provide both advisory and transaction services and solutions. We undertake commercial advisory work for our clients, including design, implementation and communication of plans. We also advise our clients on the relevant issues related to their mergers and acquisitions and divestitures.

Our magazine is designed to provide a flavor of some of the recent issues affecting global stock plan design, and to help explain the services that we offer our clients. In this issue, we include articles such as anti-avoidance legislation in the UK, French stock plans, and the EU Directive in respect of alternative fund management companies. Please let us know if you would like any further information on any of the topics or any other equity compensation issues.

We will be publishing further newsletters on a regular basis so please let you would like to see a particular topic covered in a future edition."

– *John D. Martini, Practice Group Leader*

RULING ADDRESSES APPLICATION OF FAVORABLE STOCK OPTION REGIME

The French tax administration on May 24 published a new tax ruling on the application of the favorable tax regime for stock options to options granted to employees of a French company by a U.S. company, holding that 76 months could be considered a reasonable limited time to apply the regime. The ruling supersedes the previous tax ruling, RES No. 2010/41, dated July 6, 2010. (For prior coverage, see *Tax Notes Int'l*, July 26, 2010, p. 246, *Doc 2010-15583*, or *2010 WTD* 136-1.)

As in the 2010 ruling, the question was whether options granted by a foreign company to the employees of its French subsidiary may benefit from the favorable tax and social contribution regime for stock options, provided by articles 80 *bis* and 163 *bis* C of the French Tax Code, when the options are granted for a 10-year period as authorized by a special meeting of shareholders (or equivalent body), assuming all the other French legal requirements are met.

Sophie Borenstein
Partner – Paris
Tax, Benefits & Wealth Planning

In the ruling, the French tax administration held that the authorization of stock options for a period of 76 months could be considered reasonable but that after that time, the favorable regime should not be applied. However, the administration added, the favorable regime could still be applied after that time if the foreign company is subject to rules that provide the same guarantees as commercial law on the shareholders' protection and on the transparency of the activity of the board of directors (or the equivalent body). Notably, this is the case for companies that are subject to the U.S. Securities Exchange Act of 1934 and whose securities are listed on the New York Stock Exchange or the NASDAQ.

Favorable Stock Option Regime

Under the favorable French tax and social contribution regime, the shares must be held by the employee for a minimum of four years (except in the case of death, disability, dismissal, or forced retirement). If the shares are held for an additional two years, the gain is subject to tax at a rate of 18 percent plus a 12.3 percent social contribution (a total of 30.3 percent) for amounts under €152,500, and at 30 percent plus the 12.3 percent social contribution (a total of 42.3 percent) for amounts above €152,500. If the shares are not held for an additional two-year period and are sold between a holding period of four and six years, the gain is taxed at a rate of 30 percent plus the 12.3 percent social contribution (a total of 42.3 percent) for amounts under €152,500, and at 41 percent plus the 12.3 percent social contribution (a total of 53.3 percent) for amounts above €152,500. The capital gain is taxed at a rate of 19 percent plus the 12.3 percent social contribution (a total of 31.3 percent).

The employer contribution applies at a flat rate of 14 percent based on either the fair value of the options, for companies applying international accounting standards, or 25 percent of the value of the underlying shares upon the grant of the options. The employee contribution applies at a rate of 8 percent of the gain arising from the exercise of the stock options.

When the favorable tax and social contribution regime cannot be applied, gains from the exercise of the options are treated as wages and are subject to the general income tax and social contribution rates, which are based on an individual's annual income.

Application of Favorable Regime

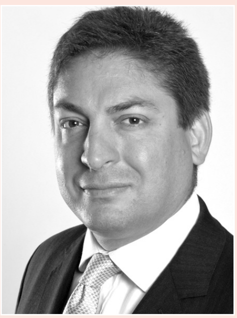
Article 80 *bis* III of the French Tax Code provides that the French stock options regime can also apply to stock options granted to employees or directors of a French company (either parent or subsidiary) whose headquarters are located

(continued on page 3, bottom)

A TOUGH NEW REGIME IN THE UK

Avoiding a 66% tax liability in the UK

The tax authorities in the UK seek, where possible, to tax as income all forms of employment reward whether provided in the form of benefits, equity or salary. The scale and complexity of anti-avoidance legislation in this area is unprecedented. At the same time, the income tax burden on employers and employees has substantially increased with an effective level of tax paid by higher earners equal to 66 percent, taking into account marginal rates, loss of personal allowances and National Insurance Contributions ("NICs"). Accordingly, any opportunity to reduce the tax burden is extremely attractive to both employer and employee.



Jeremy Glover
Partner – London
Tax, Benefits & Wealth Planning

It is possible to design share plans in the UK in an extremely tax-efficient way, but this planning needs to be done up front. Many international companies have major operations in the UK but few properly consider extending their share plans tax effectively because of misconceptions over the associated cost and complexity. Yet, there is a high cost in not doing this. Unapproved options, performance share plans and most long-term incentive plans are generally taxed on exercise/vesting with the whole of the gain made by the employee subject to income tax and NICs. For an additional rate taxpayer, this means the tax rate is 50 percent. The rate of employers' NICs is 13.8 percent and the rate of employees' NICs is 2 percent.

Companies should therefore always consider whether they should introduce share plans that have been designed to meet certain legislative requirements and, in some cases, obtain the approval of HMRC. Under an approved plan, there should normally be no charge to income tax or NICs. Instead, any gain made may be subject to capital gains tax (CGT), which may be taxed at 18 percent or 28 percent (depending on the employee's marginal rate of income tax). The effect is that it may cost an employer approximately £23,708 to provide a £10,000 net reward to an employee under an unapproved plan, but may only cost £12,195 to provide a net reward of £10,000 to an employee under an approved plan. Employees with entrepreneurs' relief may be subject to the even lower 10 percent rate of CGT. Employees may also have their annual exemption available, which may fully cover the gain made! Furthermore, the employer may be entitled to a corporate tax deduction on the gains made by the employees.

Where approved plans are inappropriate or unavailable, companies may instead want to consider creating specific arrangements that may still be tax effective. The most common arrangements are joint share ownership plans (JSOPs) or growth share plans (GSPs). These provide for the majority of any gain to be subject to CGT rather than income tax and NICs. However, unlike approved plans, the employer will not be entitled to a corporate tax deduction on gains made by the employees.

Under a JSOP, an employee will acquire an interest in shares jointly with the trustees of an employee benefit trust. Very broadly, the employee will acquire the interest to the future value in the shares; the trustees of the EBT will acquire the residual interest. The market value of the employee's interest will have some value that will be subject to income tax and NICs but this should be much lower than the value of the shares themselves. Provided that the employee and employer have entered into a joint election to be taxed on the value up front, any gain should be subject to CGT.

For unquoted companies, a similar economic and tax benefit can be achieved by establishing a GSP (essentially a new class of shares that have value on achievement of specific performance conditions or growth).

Disguised Remuneration – Anti-avoidance legislation

Tough new anti-avoidance legislation has been added as Part 7A of the Income Tax (Earnings and Pensions) Act 2003 from 6 April 2011 (with parts applying from 9 December 2010). This legislation has been introduced to allow HMRC to attack arrangements that use (EBTs) and other intermediaries to reward employees in a way that defers or avoids liability to income tax and NICs. The first draft of the legislation was extremely wide and covered most arrangements operated using EBTs. After much lobbying, we have managed to get a number of exclusions so that most forms of share scheme and long-term incentive plans are excluded. However, whilst most direct arrangements between employer or other group company and employee are excluded, companies should generally seek tax advice in respect of all of their share and cash plans. Companies should *always* seek advice when seeking to use an EBT.

Ruling Addresses Favorable Application of Stock Option Regime—continued from page 2

abroad if the granting complies with all the conditions provided by articles L 225-177 to L 225-186 of the French Commercial Code that apply to options granted by French companies.

Articles L 225-177 and L 225-179 of the French Commercial Code provide that the special meeting of shareholders may authorize the board of directors to grant options for a maximum time of 38 months. The main purpose of the limitation is to improve the transparency of shares options granting and to reinforce the control of the special meeting of shareholders on the policy of the board of directors on such granting.

The French tax administration had indicated in a tax instruction (administrative interpretation issued by the General Tax Divisions of the Ministry of Economy) dated January 5, 2009, that for options granted by foreign companies under foreign legal rules, authorization can be given for more than 38 months if the authorization is given for a specific and reasonable time.

According to the new ruling, 76 months could be considered a reasonable limited time. The ruling applies also to stock options granted before its publication date.

Reprinted with permission from Tax Notes Int'l*, June 20, 2011, p. 943.*

IT'S NEVER TOO EARLY TO START PREPARING FOR YEAR-END GLOBAL STOCK PLAN REPORTING REQUIREMENTS

The regulatory requirements for global stock plans seem to increase every year. In many countries, either the issuing company or the local subsidiary is responsible for submitting tax, securities and/or currency exchange reports annually. Below is a list of common annual reporting requirements.

Craig P. Tanner
Partner – San Francisco
Tax, Benefits & Wealth Planning

December 31

- *China – SAFE Annual Quota:* If your company has completed the registration requirements necessary to administer employee stock plans in China, the annual quota report for the upcoming year is due. The report will be filed by the designated agent for the stock plans in China.

January 15

- *Thailand – Annual Securities Report:* Annual report by companies that offer stock options to employees in Thailand is due. The companies must report option activity to the Thai SEC within 15 days of the "closing date of sale." For reporting purposes, the closing date of sale for options is the last day of each calendar year (i.e., Dec. 31) in which the stock awards vest.

January 31

- *Malaysia – Tax Report (Form BT/ESOS/2005):* Annual report of RSU share distributions, option exercises, and stock purchases that took place in the prior calendar year.
- *Philippines – Securities Report:* Annual report for companies that rely on a securities exemption under Section 10.2 of the Philippines Securities Code. (The Philippines' SEC does not specify a filing date for the report; however, we recommend that the filing be made no later than the end of January each year for the prior calendar year.)
- *United States – Tax Report:* Annual information statement report for employees with ISO exercises and/or ESPP share transfers

February 1

- *France – Annual Salary Statement (Form DADS):* Annual salary statement with information about share activity for non-qualified stock awards.
- *France – Tax-Qualified RSUs* – Vesting Report: Statement to the applicable employees and social securities authorities on vesting of tax-qualified RSUs for the prior calendar year.

February 15

- *France – Tax-Qualified Options and RSUs* – Exercise and Share Holding Report: Statement to the applicable employees and tax administration office on tax-qualified option exercise activity, and the sale or transfer of option shares in violation of the option holding period.

February 28

- *United States – Tax Report:* Information statements concerning ISPs and ESPPs on IRS Forms 3921 and 3922 due for paper filers (for electronic filers, including companies with 250 or more returns, the filing deadline is March 31).

March 31

- *Vietnam – Exchange Control Report:* Annual disclosure by companies that have obtained approval from the State Bank of Vietnam (SBV) to offer stock awards. The report should include information about (a) option exercises, (b) RSU vesting events, and (c) amounts paid to employees through the stock awards during the past fiscal year.
- *Ireland – Stock Award Activity Report:* Irish employers must file an annual report on all stock award vesting during the prior year.
- *Israel – Tax Report:* Annual report of all stock award activity. The local trustee for the stock plans may make this filing for the company.
- *United States – Tax Report:* Information statements on IRS Forms 3921 and 3922 due for electronic filers (required for companies with 250 or more returns).

FUND MANAGERS – FURTHER REGULATION ON COMPENSATION POLICIES AND PRACTICES

The European Securities and Markets Authority (ESMA) has published a consultation on proposed implementation measures for the Alternative Investment Fund Managers Directive (the Directive) that must be implemented by 22 July 2013. The Directive will include detailed provisions on compensation arrangements.

Jeremy Glover
Partner – London
Tax, Benefits & Wealth Planning

The Directive will require significant changes to the compensation policies of many fund management organisations. Whilst many such organisations are already subject to the Financial Services Authority (FSA) Remuneration Code (the Code), many others are not – e.g certain hedge funds and private equity businesses. The UK is likely to take a similar approach to implementing the Directive as it did with the Capital Requirements Directive III that gave life to the Code in the UK; it is probable that the FSA will amend the Code to implement the Directive for fund managers. However, the Code will not simply be extended to apply to these new organisations. The Directive's obligations will apply quite specifically to fund managers, and the obligations on those that are subject to the Code will increase as a result of implementation of the Directive – complying with the current Code will not be sufficient.

By way of example, the Code really only has a material impact on workers classified as Code Staff. The Directive, on the other hand, does not exempt Code Staff in the same way and will apply to risk takers who have a material impact on the risk profile of either the asset management business or of the fund itself. Also, it is unlikely that the proportionate tiered approach that applies under the Code and which relaxes the strict rules in relation to many organisations, particularly those that do not pose a large risk to the economy, will apply.

Therefore, even though the implementation date of the Directive is in 2013, organisations should start considering what this means for them now.

At the heart of the Directive requirements on compensation is the requirement that the organisation should have compensation policies and practices that promote sound and effective risk management in the context of and aligned with the risk profiles of the particular funds that it manages.

As one would expect, there are a number of specific obligations in relation to variable compensation that follow the Code to a large extent, for instance:

Jacqui Hatfield
Partner – London
Financial Industry Group

- A significant proportion should be deferred (40 percent to 60 percent as with the Code) and subject to retention periods aligned with the funds managed
- At least 50 percent should be paid in equity-linked instruments
- All variable compensation should be aligned with the wider strategy of the business

Performance assessment should be based on a multi-year framework appropriate to the life cycle of the funds managed by the organisation.

There are de minimis exemptions based on the value of assets under management for the particular manager.

It should be noted in particular that variable compensation in this context includes carried interest arrangements. Furthermore, partnerships generally are likely to be treated in the same way as corporate bodies – how this can be achieved in view of the transparent way partnerships tend to work will need to be determined.

ESMA is consulting on the level of disclosure required but proposes that disclosure as to compensation is made in relation to each fund on an aggregate basis, including more detail on compensation for senior management and those members of staff whose professional activities have a material impact on the risk profile of the relevant fund.

ReedSmith

The business of relationships.℠

reedsmith.com

NEW YORK
LONDON
HONG KONG
CHICAGO
WASHINGTON, D.C.
BEIJING
PARIS
LOS ANGELES
SAN FRANCISCO
PHILADELPHIA
SHANGHAI
PITTSBURGH
MUNICH
ABU DHABI
PRINCETON
N. VIRGINIA
WILMINGTON
SILICON VALLEY
DUBAI
CENTURY CITY
RICHMOND
GREECE
OAKLAND