JONES DAY®

Jones Day Tax Practice: Equity Incentives

The Trends

The diversification of long-term incentives ("LTIs") significantly increased over the last few years to align the interest of the issuing companies with those of a large category of beneficiaries (e.g., employees, managers, investors, sponsors). Furthermore, governance and transparency standards have risen, while PE/VC deal terms add further constraints to the design of the package. In this regard, LTIs must ensure predictable tax outcomes and legal effect and should remain deployable across various jurisdictions, in particular:

- **Transactional Dynamics (LBO/PE/VC).** Find proper balance between the value at grant, the performance conditions (including rachets), and the retention provisions (e.g., clawback, good/bad-leaver) to ensure enforceability and protect minority interests of LTIs' beneficiaries in the transactional context.
- **Carried Interest and Promote.** Structure the global economy of the deal for investors with respect to the hurdle rate, the catch-up, and the share of returns allocated to GPs and sponsors.
- **Characterization of LTIs' Gains.** Secure the tax and social treatments of the gains for employees and managers (employment revenue vs. capital gains) and minimize the risk of recharacterization in disguised remuneration.
- **Regulatory Divergence and Mobility.** Compliance with tax-favored regimes enacted by several countries for LTIs—each with distinct payroll and social security, securities law, and privacy rules—and monitoring mobile workforces (e.g., withholding and reporting in multiple jurisdictions).
- **Management of Minority Shareholders.** Find a balance between minority investors' interests and the need for the controlling shareholder to manage minority participations in a coordinated way (e.g., through pooling vehicles).

How We Can Help

We work with all categories of beneficiaries—employees, management, sponsors/GPs, LPs, issuing companies—to design, document, and implement compliant, tax-efficient incentives across various jurisdictions. We advise both the issuing companies and beneficiaries at all stages of the LTI development (e.g., grant, vesting, exit):

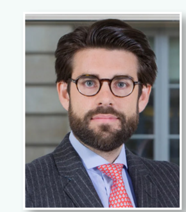
- **Issuing Companies**
  - Draft LTI plans, corporate approvals, shareholder resolutions, and works-council processes.
  - Assess the estimated tax and social costs of issuing LTIs (e.g., conduct deductibility analysis, employer contribution).
  - Perform tax and social formalities (e.g., payroll setup and cross-border withholding controls).
  - Assist in structuring the grant of LTIs in a transactional context (including setting up a pooling vehicle to ensure control over the minority investors) and support in due diligence, tax, and social audits and disputes with authorities relating to LTIs.
- **Employees and Broad-Based Beneficiaries**
  - Determine the most efficient LTIs (e.g., ESOP/RSU/VSOP) to maximize after-tax value and minimize costs for the issuing company, supported by country tax matrices and mobility playbooks.
  - Draft LTI information notice for beneficiaries and related documentation (e.g., employee information notice).
  - Prepare local filings, information reporting, and payroll instructions.
- **Management Teams, GPs, and Sponsors**
  - Negotiate the MIP (e.g., sweet equity, growth shares, warrants) with respect to the performance conditions.
  - Accompany GPs and sponsors in settling up carried interest and promote vehicles and align the return on investment on the contemplated waterfalls.
  - Advise on management incentive plans in the context of increased tax authority scrutiny, including recharacterization risks affecting carried interest and management equity.
- **Investors and LPs**
  - Review the potential dilution consequences and governance stress tests.
  - Handle side letter exchanges and post-closing monitoring (e.g., information flows, compliance calendar).

Who Will Be Impacted?

The interests of all categories of employees and of the issuing companies must be aligned to produce a virtuous circle. In particular, founders, managers, and employees must receive LTIs with predictable tax treatment, enforceable vesting terms, and transparent exit economics. Sponsors and GPs must secure carried interest and promote based on the projection of the waterfall. Issuing companies must grant scalable LTIs with calibrated dilution, compliant filings across jurisdictions, and limited tax and social leakages for both the beneficiaries and the issuing companies. Investors must benefit from governance clarity and proper disclosure concerning their investments.

Key Contacts

For further information regarding our Tax Practice, please contact your principal Firm representative or one of the lawyers listed below.



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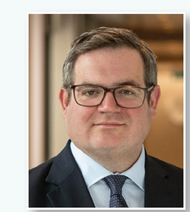

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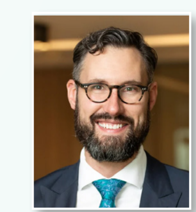

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