JONES DAY

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TAX ISSUES REGARDING INTERNATIONALLY MOBILE EMPLOYEES IN EUROPE

For businesses that employ internationally mobile employees ("IMEs"), or are considering doing so, and who provide (or who may provide) equity incentive compensation (for example, stock options and restricted stock units ("RSUs")) to their IMEs, there are many tax issues that need to be considered in order to ensure that the relevant employer complies with its tax obligations. Even within the European Union, the issues differ from jurisdiction to jurisdiction, which makes this a particular burden for employers. This *Commentary* provides an outline of the tax considerations that apply in four major EU jurisdictions (the United Kingdom, France, Italy and Germany) in respect particularly of stock option or RSU grants to IMEs, as an illustration of the issues that employers and employees must tackle.

UNITED KINGDOM

It is important to determine the appropriate tax treatment because failure to properly account for tax and social security obligations can result in the employer being liable for their employees' tax liabilities, as well as incurring significant penalties and interest. In the UK, it is the employer, in most circumstances, who is primarily liable for accounting for an employee's tax. It has been noted that HM Revenue & Customs ("HMRC," the UK tax authority) has become increasingly aware of the lack of compliance in this area.

The UK tax treatment of equity incentives provided to IMEs will depend on a number of different factors, such as the date of grant, the nature of the equity awards granted, the residency and domicile of the employee and factors relating to the employee's movement and employment.

EMPLOYEES COMING TO THE UK

Generally, stock options granted to employees outside the UK will be exempt from UK tax when the equity awards are exercised after arrival in the UK, provided that the employee is not aware of his/her move to the UK at the time of grant and the grant was not made in respect of UK duties. If the employee is aware of his/her move to the UK, or receives the equity awards during a temporary assignment

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outside the UK, then, broadly, UK tax will be payable on the gain proportionate to the work done in the UK during the period from grant to the vesting of the option.

In respect of the tax treatment of RSUs and other conditional share awards, current HMRC practice is that the tax treatment will depend on whether the equity award constitutes an option for UK tax purposes. Where the equity awards granted are treated as options, any gain should be taxed on a proportionate basis. Where the equity awards granted do not constitute options, any gain is likely to be taxed on the same basis as a cash bonus, in which case the whole gain may be liable to UK tax, subject to the availability of any reliefs.

EMPLOYEES LEAVING THE UK

Where the employee is UK resident at the time of the award but leaves the UK prior to exercise or vesting, UK income tax will be payable on exercise or vesting regardless of whether the employee remains UK resident. However, the gain subject to UK tax may be reduced under the remittance basis rules (which can apply to individuals who are not domiciled in the UK for tax purposes) or under an applicable double tax treaty. (The remittance basis means that, broadly, only income remitted to the UK is subject to UK taxation.)

As is the case for employees coming to the UK, the tax treatment of equity awards made to individuals who are not UK resident (but working in the UK at the time of grant) will depend on whether the awards constitute options for UK tax purposes, as well as the time of exercise or vesting.

Options exercised up to the end of the UK tax year of departure from the UK are generally subject to tax on the gain that is proportionate to the work done in the UK, whilst options exercised after the end of the UK tax year of departure will generally be exempt from UK tax. Of course, in practice, it may be difficult for the UK employer to ensure compliance with its obligations in respect of an employee who is no longer in the UK.

Where the equity awards granted do not constitute an option, any gain may be taxed as a cash bonus and potentially the whole gain will be subject to tax, subject to the availability of any reliefs.

It is important to note that additional rules apply to determine the tax treatment for awards made before 6 April 2008, when the tax rules on residence changed.

NON-UK DOMICILED EMPLOYEES

Employees resident but not domiciled in the UK may be subject to taxation on the remittance basis. Such individuals may be entitled to an exemption from UK income tax where some of the gain on exercise or vesting of the award is attributable to employment services performed outside the UK. The amount taxable in the UK is determined in accordance with a statutory formula and is subject to various conditions which broadly exempt a proportion of income or gain that relates to time spent outside the UK. In accordance with the remittance basis of taxation, this exemption will be lost if the income from the award is brought back into the UK, which includes using the income to pay UK debts. HMRC also considers shares in a UK company to be remitted when the income arises from those shares on the basis that they are UK assets and are therefore "used in the UK by and for the benefit of the employee".

Subject to the employee's country of residence and the existence of any double tax treaties between the employee's country of residence and the UK, relief may be available under a double tax treaty or under UK law.

FRANCE

Under French domestic rules, gains derived from the exercise of stock options or grant of RSUs are treated as employment income. As a consequence, they fall within the territorial scope of French income taxation if the beneficiary is a French tax resident or if the non-resident beneficiary performs the corresponding professional duties in France.

The French Tax Administration ("FTA") follows OECD principles in determining the territorial source of such gains in situations where the beneficiary moves his/her tax residence between different countries. Gains fall within the scope of French income taxation to the extent that the professional duties of the beneficiary were performed in France during the period that is rewarded by the grant of stock options or RSUs ("Reference Period").

REFERENCE PERIOD

Stock Options. In order to determine the part of the gain falling within the scope of French income taxation, the IME's employers must determine on a case-by-case basis (i) whether the grant constitutes reward for the beneficiary's performance before or after the date of grant in each case, and (ii) the relevant period of employment that is so rewarded.

The FTA takes the view that stock option grants are generally aimed at rewarding future performance. The Reference Period is therefore the period between the date of grant of the stock options and the date on which they vest (i.e. the date on which the right to exercise the options becomes certain because all conditions are met). For instance, where options can be exercised only after four years provided that the beneficiary is still an employee on that date, the Reference Period will be the four-year period between grant and vesting dates.

If the case-by-case analysis determines that the stock option grants are a reward for past employment, the FTA considers that the Reference Period begins and ends on the date of grant and that the gain is therefore French-source for the entire amount if the employee is performing his/her duties in France at that time, irrespective of the fact that he/she may have worked abroad in the past.

RSUs. For RSUs, two periods must be distinguished:

1. The vesting period ("*période d'acquisition*"): the employee becomes owner of free shares after a vesting period of two years; and
2. The holding period ("*période de conservation*"): the employee can dispose entirely of his/her free shares after a subsequent two-year holding period following the two-year vesting period.

In order to be qualified RSUs, the employee has to satisfy the requirements for both periods.

The Reference Period for RSUs is the period between the date of grant of the RSUs and the date on which the employee's right to receive the free shares finally vests.

In standard situations, where the shares are issued and attributed after two years provided that the beneficiary is still an employee, the Reference Period is therefore the two-year period between the date of grant and actual issue and attribution of the shares. The subsequent two-year compulsory holding period is generally not included in the Reference Period.

By contrast, if the actual issue and attribution of shares is not subject to any condition other than the expiration of the statutory two-year period from the date of grant of the RSUs, the Reference Period is considered to begin and end on the date of grant, and the gain is considered French-source if the employee performs his/her duties in France on that date, notwithstanding the fact that the shares will be actually issued only two years later (and must be held for an additional two-year period).

Since the French tax treatment of the acquisition gain is the same for qualified and non-qualified RSUs, the main benefit of qualified RSUs is that no social security contributions are due from the employer and the employee. If the shares are sold before the expiry of the two-year vesting period, the acquisition gain will bear the employer's and employee's social security contributions, but if the employee satisfies the vesting period requirement, the acquisition gain will bear social security charges at a reduced rate.

WITHHOLDING TAX ON FRENCH-SOURCE GAINS DERIVED BY NON-RESIDENT TAXPAYERS

French-source gains realised by non-resident taxpayers deriving from any sort of employee shareholding plans are subject to withholding tax under the French Tax Code.

If the employee performed his/her duties both in France and abroad over that period, the gain is considered French-source in proportion to the number of days that the activity was performed in France during the Reference Period.

The withholding tax rate and tax events mirror those for income tax on the relevant gain, depending on the magnitude of the gain, the holding period and the nature of the options and RSUs (whether qualified or not).

EXIT TAX APPLYING TO CAPITAL GAINS ON SHARES HELD BY INDIVIDUALS WHEN MOVING THEIR TAX DOMICILE OUTSIDE FRANCE

Individuals who move their tax domicile outside France are subject to tax ("Exit Tax") on unrealised capital gains on certain shareholdings and securities. Although the Exit Tax applies to all individuals who move their tax domicile outside France, individuals moving for professional reasons outside the EU to a country that has concluded a treaty with France that provides for cooperation in relation to tax administration should benefit from a stay of payment of the Exit Tax.

The FTA considers that (unrealised) gains from the exercise of stock options or from the grant of RSUs are outside the scope of the Exit Tax. However, unrealised gains on shares held after the exercise of stock options or the vesting of RSUs will fall within the scope of the Exit Tax.

ITALY

As a general rule, the Italian tax regime for equity incentives granted to employees depends on the type of award (option, RSU, restricted stock, etc.) and the terms (vesting period, transferability, etc.) of such awards. Indeed, under certain circumstances, stock awards are exempted in Italy from tax and/or social security contributions.

For IMEs, there are a number of factors (including the individual's tax residence, the date of grant and the date of exercise, etc.) that employers must take into account in order to determine their tax and social security contributions obligations (e.g., in relation to withholding) in respect of equity incentives.

Italian tax resident individuals are subject to personal income tax on their worldwide income, while non-Italian residents are subject to personal income tax on Italian-source income only. Pursuant to the Italian Tax Code, an individual is considered to be resident in Italy, for income tax purposes, whenever, for more than 183 days in a tax year, he/she (i) is registered in the Italian civil registry of the resident population, (ii) is domiciled in Italy, or (iii) is resident in Italy (i.e., his/her primary residence).

For Italian tax residents, any employment income received, including income from equity incentives, must, in principle, be included in their overall taxable income. As mentioned above, individuals who are not tax resident in Italy are subject to personal income tax on their Italian-source income only. In particular, income from employment performed in Italy by non-Italian residents is subject to taxation in Italy.

Cross-border situations may trigger potential double taxation, although relief may be available under a double tax treaty. Under the OECD Model Tax Convention, employment income is generally taxable only in the employee's state of residence unless the income is derived from work performed in the state of source. Even in the case of work performed abroad, employment income can be taxed only in the state of residence if (i) the employee spends in the source state a period not exceeding a total of 183 days in a 12-month period, (ii) the remuneration is paid by (or on behalf of) an employer who is not a resident of the source state, and (iii) the remuneration is not borne by a permanent establishment of the employer's company located in the source state.

It is necessary, therefore, to assess on a case-by-case basis whether or not an individual is tax resident in Italy.

If an individual is deemed tax resident in Italy, the equity award (depending on its type and features) would generally, on grant, be subject to taxation and social security contributions in Italy even if related to work performed abroad. Should the employment income deriving from the equity awards be taxed also in the source state, a tax credit for taxes paid in the source state may be available under Italian tax law.

If an individual is not deemed tax resident in Italy, taxes may be not be levied in Italy in connection with equity awards granted in relation to work performed in Italy, provided that none of the requirements set out in the OECD Model Tax Convention (set out above) are fulfilled.

GERMANY

A German employer is liable for an employee's tax on employment income if the tax is not properly deducted from salary and remitted to the appropriate tax office. In addition, the managing director of a company may be held personally liable for taxes which should have been withheld. Therefore, it is important for an employer to know about the tax treatment of equity awards including the time when the relevant tax is due.

The German tax treatment of equity incentive awards provided to IMEs will depend on the type of incentive and on the circumstances under which they are granted.

According to the German Tax Authority, equity awards constitute an actual benefit only if they are transferrable or are exercised. Consequently, equity awards which are not freely transferrable and may not be exercised for a certain period do not constitute a benefit and, therefore, are not regarded as taxable income.

Equity awards such as stock options may be regarded as being transferrable if (i) they are listed on a stock exchange, or (ii) the terms of the stock option agreement permit the employee to freely transfer the options. RSUs are typically not freely transferrable.

German fiscal courts have held that an employee receives a taxable benefit only at the time the benefit has an economic value to the employee, which is typically the date of exercise (in the case of an option) or the date of payment (in the case of an RSU). At this date, the employee may receive stock or a cash equivalent. The grant of stock options or RSUs or similar equity awards as such do not create a benefit since it is not certain the equity awards will ever be exercised or converted into cash.

EMPLOYEES WORKING AND RESIDENT IN GERMANY

As set out above, stock options are generally taxable at the time of exercise. The tax is based on the amount of the benefit to the employee and is calculated by reference to the difference between market value of the stock on the date of exercise and the exercise or strike price. The same treatment applies to RSUs.

In many cases, IMEs receive equity awards from the ultimate parent and the local employer may not necessarily know the amount of stock options held by an employee or the amount of the taxable benefit on exercise. In such cases, the employee is obliged to inform the employer when the stock options are exercised and the amount of the taxable benefit to enable the employer to make the appropriate wage tax deductions. If the employee does not comply with his/her obligation to provide details to the employer, the employer may not be held liable for tax which should have been withheld or may, in certain circumstances, be able to claim a refund from the employee.

EMPLOYEES LEAVING GERMANY

If the IME moves from Germany to another country between the time of grant and the exercise of the award, Germany claims the right to tax the portion of the benefit which relates to the time the employee has been resident in Germany. This may in particular circumstances result in double taxation or no taxation at all, although taxing rights in relation to a benefit are likely to be governed by an applicable double taxation treaty.

EMPLOYEES COMING TO GERMANY

The same principles apply if an IME who holds equity awards moves to Germany and exercises them when resident in Germany. Again, the German Tax Authority will claim a portion of the benefit. However, the non-taxable portion of the benefit the employee receives will be included in the calculation of the applicable personal individual tax rate.

FINAL WORD OF WARNING

It almost goes without saying that the complex nature of the tax rules relating to IMEs in different EU jurisdictions means that it is critical that the facts and circumstances of each case are analysed to determine the correct and current tax treatment. The consequences of failing to do so properly should not be underestimated.

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