

Global Equity Plans

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This Note addresses the major legal and other issues that US multinational companies should consider before granting equity awards outside of the US including taxation, social insurance, withholding and reporting, securities law compliance, exchange control requirements, data privacy laws, restrictions on payroll deductions and employee communications. This Note also provides practical tips to aid in implementing a global equity plan.

Many multinational companies can become intimidated by the prospect of implementing an equity plan outside of the US for the first time.

This Note discusses the major legal and other issues that US multinational companies should consider before granting equity awards outside of the US, including:

- Securities law compliance.
- Taxation.
- Withholding and reporting.
- Social insurance.
- Exchange control requirements.
- Data privacy laws.
- Restrictions on payroll deductions.
- Plan document requirements.

This Note also provides practical tips for implementing a global equity plan.

STEPS TO IMPLEMENTATION

When implementing an equity plan outside of the US, the most successful companies often use cross-functional teams to analyze the relevant issues and make necessary decisions before the first grant or offer occurs. Because the issues vary, the equity plan team must include members of the company's legal, tax, accounting, treasury, human resources and equity plan administration departments, with all or some working directly with outside counsel. Additional insight is also occasionally required from employment and auditing colleagues on discrete issues, such as leave of absence and award expensing issues.

After establishing the work team, the first steps toward implementing a global equity plan are to determine:

- The countries where awards will be offered.
- The different types of awards to be granted in those countries. Most companies prefer to offer similar awards worldwide, where feasible, for the sake of consistency and for the ease of administration.

Stock options and restricted stock units (RSUs) are the most common types of awards granted outside of the US, primarily because they are the most well-known and understood by local employees. Performance awards, which have become more popular in the US in recent years, are gradually being granted more frequently outside of the US, although they raise additional concerns internationally.

Most companies also generally limit their international awards to employees and do not include consultants. While international offers to consultants are feasible in most countries, they can raise different compliance issues, for example, if a securities exemption is limited to employees.

The equity plan team should undertake a review of applicable considerations country-by-country as they relate to the types of equity awards the company desires to grant. Once completed, this review will provide a framework for discussion about:

- The locations where the plan can be easily implemented.



- The locations where the process may be more challenging due to onerous or expensive filing requirements.
- The locations which may be better served by cash bonus or other alternative awards because implementation is impossible or impractical (for example, Vietnam).

PRACTICE TIP

In those countries where implementation is cumbersome, consider granting alternative award types (for example, RSUs instead of stock options), which can reduce the cost of compliance. RSUs can eliminate securities and exchange control compliance costs. In addition, if there are only a few potential grantees, companies should weigh the cost of compliance in those countries against the ultimate value of the award to those employees. Maintaining flexibility at this stage can greatly reduce the cost and difficulty of global implementation.

After finalizing the countries and award types, the next step is to prepare any securities, tax or other filings needed to be made before the grant date. The length of time it takes to obtain approval of these filings varies. For example, establishing a tax-qualified plan in the UK often takes 3 to 6 months. Many companies:

- Use a chart or spreadsheet to keep track of the status of any filings required.
- Engage in weekly status calls with outside advisors as a way to monitor progress and quickly address any issues that may arise.

The entire equity plan team should be made aware of any issues that are identified because an issue in one area may have ramifications for another team member. For example, decisions made by members of the legal or tax department may have a significant impact on and potentially complicate the administrative process for the members of the equity plan administration team.

COMPLIANCE WITH SECURITIES LAWS

Compliance with local securities laws is often the first hurdle that companies face when offering equity awards to international employees. In the US, public companies generally register the shares for their equity plans on a Form S-8. This allows employee equity plans to be registered with minimal effort and cost. Unfortunately, outside of the US, a simplified registration process specifically for employee equity plans is rare. Many countries do not have legislation that expressly provides an exemption for these types of employee programs.

Therefore, when a securities registration filing is triggered, usually because the number of offerees or amount of the offer exceeds stated thresholds, the filing is larger and more cumbersome than the Form S-8 filing in the US. In other countries, self-executing exemptions are available provided that the grantees receive specific disclosure information.

However, many countries have *de minimis* thresholds, whereby no securities filing is required if certain thresholds are not exceeded with respect to either:

- The number of grantees.

- The dollar value of the securities offered.

For example, companies granting stock options to employees in Israel are exempt from filing a registration statement in Israel if there are fewer than 35 grantees involved. In Japan, securities registration filings are exceedingly burdensome not only because of the information that must be included in the filings, but also because of the on-going supplemental filing requirements. However, if the number of grantees or the yen value of the stock options falls below a certain threshold, then the offer of stock options or stock purchase rights to employees in Japan is exempt from registration.

PRACTICE TIP

Six to eight weeks before the grant date, companies should review their grantee headcounts and award sizes in each country to determine whether they need to make any securities filings or deliver any disclosure documents to grantees.

A company can also eliminate the need for a securities filing if it can retain flexibility in the types of awards offered to employees. For example, in Japan, RSUs, unlike stock options, are not subject to Japanese registration requirements because the employee does not pay for the underlying shares. In Japan, RSUs are generally characterized as a gift to the employee rather than as an offer of securities subject to registration obligations. Restricted stock is generally treated the same for securities law purposes, but is often taxed at grant outside of the US even if a restriction on sale applies. For this reason, restricted stock is fairly uncommon outside of the US.

PRACTICE TIP

Consider granting cash-settled awards (for example, cash-settled RSUs or stock appreciation rights) instead of stock-settled awards as a way to avoid securities filings in certain countries. However, cash-settled awards, especially if they are tied to performance metrics, may raise other legal compliance or tax concerns.

For example, performance metrics can lead to an award being considered a derivative, which often requires substantial securities law compliance. Companies should not, therefore, assume that cash-settled awards will automatically reduce or eliminate compliance obligations and should always vet cash-settled awards as carefully as stock-settled awards.

EMPLOYEE TAXATION OF EQUITY AWARDS

Employee taxation is an important consideration when offering equity awards to employees in other countries. Companies should focus on these two tax issues:

- Whether any tax-qualified programs are available that may result in favorable taxation for the employee.
- Whether the international employee will experience negative tax treatment in the employee's country.

Most companies that grant equity internationally are familiar with the tax-favored treatment that applies to incentive stock options and *Internal Revenue Code Section 423* plans. While these rules do not apply to grantees subject to tax outside of the US, other countries, such as the UK, have their own tax-qualified programs. Even though a company may ultimately decide that the tax savings are not

worth the initial or ongoing cost to administer a tax favorable plan, companies should at least investigate these programs before making awards in these countries. Many tax favorable regimes require companies to take specific actions or have certain documents in place before the grant is made for the beneficial tax treatment to apply.

PRACTICE TIP

One of the keys to offering a successful international program is to consider the local tax treatment for grantees and capitalize on opportunities for favorable tax treatment. Although the types of requirements for qualified awards vary from country to country and run the gamut from the adoption of a sub-plan to setting the exercise price at a certain value, it is common for favorable tax regimes to require grantees to hold the shares for a certain number of years after the award vests or is exercised. These periods typically range from one to three years for the most favorable tax treatment.

Multinational companies should also determine whether a grant will result in negative tax treatment in the country where the employee resides. Negative treatment typically means that the employee is taxed before exercise, for stock options, or at the time of grant, for restricted stock or RSUs. Fortunately, over the last ten years, most countries have moved to fairly standard stock option tax treatment, which means that the employee is taxed on the excess of the fair market value of the shares on the date of exercise over the amount paid by the employee to exercise the options (the exercise price).

The tax laws in Belgium are one example of an exception to this general rule. In Belgium, employees are subject to tax on stock options 60 days after the grant date if the stock options are "accepted" (that is, the employee agrees to the terms of the stock option grant) during this 60-day window. The taxable amount is generally equal to 20% of the value of the underlying shares, but can be reduced to 10% if the employee does not dispose of the shares for three years and other requirements are met. Most employees view this tax treatment as unfavorable because they must pay tax on a stock option that they may never be able to exercise. For those employees who can afford to pay the tax up front, however, the tax treatment can be extremely favorable.

Due to the negative publicity surrounding this method of taxation, Belgium now allows grantees to choose when they want to be taxed on the award. Most companies provide grantees the opportunity to accept the options 60 or more days after the date they are granted so that they are taxed on the spread at exercise rather than on the value of the underlying shares at grant. Even though this alternative creates increased taxation, it postpones the taxable event to a time when the grantee is certain to receive value from the award.

Australia is another country where companies can trigger unfavorable tax results for their employees if the local laws are not considered prior to making the equity award grant due to the relatively recent adoption of deferred compensation legislation under Australian tax law.

PRACTICE TIP

Companies must consider the local tax consequences of international equity awards before the grant or offering. A program which results in unfavorable tax consequences for an employee can turn what is supposed to be a positive benefit for employees into a detriment.

EMPLOYER WITHHOLDING AND REPORTING

The tax withholding and reporting aspects of equity awards are equally vital for companies to understand before granting equity overseas because a failure to withhold or report properly can result in serious adverse consequences for a company. Some companies that have granted international equity awards and incorrectly withheld or failed to timely withhold have been subject to enforcement proceedings.

One of the main concerns companies have with the withholding and reporting aspects of equity awards is how to handle withholding when an equity award of significant value is exercised or vests. The most convenient method of withholding tax liability on the award is to:

- Add the value of the equity award to the employee's compensation.
- Withhold the taxes due from the employee's salary on the next applicable payroll date.

However, the tax on equity awards can dwarf an employee's monthly salary, thereby exceeding the salary payable to the employee.

Withholding the entire taxable amount can lead to employment law concerns because many countries have salary floors that must be paid each month. Therefore, practically speaking, most companies find that, for restricted stock and RSUs, at least, it is easier to meet their withholding obligations by withholding shares to cover taxes or instituting a forced sale of shares. When using these methods, however, companies should be aware of any accounting consequences and should carefully vet these issues with their internal accounting team before proceeding.

PRACTICE TIP

Companies should include withholding provisions in their equity plans and award agreements that enable them to utilize a variety of withholding methods. Adopting a flexible approach rather than a "one size fits all" approach can avoid local problems with administering the program.

For additional information on withholding provisions in equity plans and award agreements, see *Practice Note, Drafting an Equity Incentive Plan for a Public Company: Tax Withholding Methods* (<http://us.practicallaw.com/0-509-2202#a485252>).

SOCIAL INSURANCE ISSUES

Due to differences in entitlement policies and philosophies, social insurance regimes outside of the US differ greatly from the US social security system. The applicable tax rates for social insurance in other countries are often extremely high when compared with the US. These rates also typically include both employer and employee contributions. Because many companies grant equity awards to preserve cash on hand, employer contributions for social insurance purposes can actually defeat the purpose of leaving cash in the company's coffers.

PRACTICE TIP

Companies should always consider the social insurance costs of an award and factor them into the overall cost of the award delivered to the employee. Companies should also consider qualified programs, which can reduce the amount of social insurance payable, especially in France and the UK. Companies must also look at the actual benefit received by the employee after income taxes and social insurance costs are factored in to determine if equity awards are delivering the intended benefit.

EXCHANGE CONTROL LAWS

The equity plan team must take into account each country's exchange control laws, which can impact a global equity program in a number of ways.

CROSS-BORDER CURRENCY FLOW

The first consideration relates to cross-border currency flow when international employees must send US dollars to the US parent company to exercise their stock options and acquire the underlying shares.

In several countries, there are restrictions and limitations placed on individuals regarding their:

- Access to US dollars.
- Transfer of funds outside of their home country.

These restrictions can be absolute, meaning that fund transfers are strictly prohibited (for example, in Vietnam, no money can be sent outside the country for employee stock option exercises). They may also take the form of threshold limitations, where employees can only transfer a specified amount of funds in a given timeframe (for example, in South Africa, employees have investment allowances for external transactions). These limitations can impact the ability of global employees to fully realize the benefits of an equity incentive program.

Fortunately there are a number of ways to eliminate the concern about restrictions on the flow of cross-border funds. One alternative is to offer RSUs, restricted stock or PSUs to employees rather than stock options, so that there is no outflow of currency, although restricted stock and PSUs raise other issues as discussed above.

Another alternative, if the company prefers to offer stock options, is to require employees to exercise their options using a cashless exercise method. Under a cashless exercise program, employees are not required to send any money to exercise their stock options. Instead the equity plan broker:

- Sells the shares the employee is entitled to receive at exercise (from its own account).
- Provides a portion of the proceeds to the company to pay the exercise price.
- Remits the remainder to the employee (less any fees and taxes owed).

The company then gives the shares from the exercise to the equity plan broker to replenish its account.

REPATRIATION OF FUNDS

The second exchange control concern is whether any requirements apply once the employee has sold the shares obtained from the equity award. Many countries mandate that employees repatriate the proceeds from the sale of the shares. India and China are two examples of countries that have repatriation requirements, which prohibit the employee from keeping their sale proceeds offshore. Often the exchange control issues that arise with the repatriation of funds are less problematic than those relating to the transfer of funds outside of the employee's country, primarily because most countries with exchange controls prefer to receive hard currency.

PRACTICE TIP

Consider mandating cashless exercises for employees in those countries where the outflow of currency is problematic. Most international employees will use a cashless exercise regardless when exercising their stock options.

DATA PRIVACY LAWS

With the advent of the internet and the widespread use of computers to conduct business around the world, data privacy has become a major concern. As a result, many governments have passed legislation that attempts to protect individuals' personal data. Because equity award programs require the transfer of employee data between entities in different countries, companies must administer their programs in compliance with local data privacy rules.

In particular, employees must be aware of:

- Where and to whom their personal data is being sent.
- What precautions are being taken to safeguard that data.

When data must be transferred to a country where the safeguards are deemed inadequate, such as transfers from the European Union to the US, data privacy concerns are heightened.

PRACTICE TIP

While each country has different data privacy requirements, at a minimum, employees should give their consent to the transfer of their data. Companies should provide a summary of:

- Where the data will be sent.
- How the employees can access the data.
- How employees can correct the data, if necessary.

In several countries additional compliance steps may also be required, such as:

- Registering the database where the data is held.
- Obtaining approval from a government agency.

PAYROLL DEDUCTION CONSIDERATIONS

Payroll deductions raise an additional set of issues when a multinational company implements an employee stock purchase plan (ESPP) worldwide. Many countries have laws that specifically govern the use of payroll deductions in the employment context. These laws may:

- Prohibit payroll deductions outright for stock purchase plans.
- Impose requirements on how and where the contributed amounts can be held before shares are purchased under the ESPP.

For example, to participate in an ESPP in Hong Kong, where payroll deductions for purposes of participating in an equity plan are generally prohibited, employees should participate in the plan by either:

- Personal check.
- Automatic debit from their personal bank accounts.

Other countries only allow payroll deductions to occur if either:

- The employee has provided an express consent to make the applicable deduction.
- The contributions are held in a special bank account before the shares are purchased under the plan.

MEETING DOCUMENT REQUIREMENTS

Equity award programs typically involve the use of several documents that set forth the terms of the awards, such as:

- The base plan document.
- The award agreement.
- The US plan prospectus.

While the equity plan is most likely generic enough to comply with applicable laws throughout the world, the forms of award agreements often need to be modified to comply with the laws of the country where the grantee works and resides. The one size fits all approach for plan documents should not be followed when it comes to exporting equity award communications. To "internationalize" a standard, US-style award agreement, companies should consider making several changes.

ENHANCED TAX WITHHOLDING

Companies should enhance the tax withholding section of the document. Standard US agreements often do not include all of the permissible methods of withholding. For an international grant, it is advantageous to include several alternative methods for collecting withholding taxes that can accommodate procedures that may be required by local law.

For example, a company should have the authority to either:

- Withhold in shares or cash from the employee's compensation.
- Require the employee to provide a check to cover the tax withholding amount.

ADDRESSING LOCAL LABOR LAW

Multinationals should modify their grant agreements to address local labor law concerns. Labor laws in most countries outside of the US tend to be more pro-employee than what is considered the norm in the US. Therefore, certain local legal concepts must be addressed in the international version of an award agreement that would otherwise not be addressed in the agreement for US-based employees.

For example, at-will employment, which is considered to be standard in the US, is often not permitted abroad. Some period of notice or leave, or both, must typically be given before a termination of employment becomes effective. An award may continue to vest through the notice or garden leave period because the termination is not considered effective until the period ends (unlike in the US where terminations of employment are immediately effective).

Therefore, companies often include special language in grant agreements which provides that the award ceases to vest on receipt of notice of termination of employment and does not include any further notice period. Including this language prevents international employees from being treated more favorably than their US counterparts.

ADDRESSING DATA PRIVACY LAWS

To comply with data privacy laws, award agreements for international employees should include the employee's express consent to the use of the employee's data in administering the plan. Although companies often address employment-related data issues and obtain consent for the use of this data on the first day of employment, these initial consents may be too broad to constitute an informed consent. For this reason, it is common for companies to add specific data privacy language to their international award agreements.

For information on data privacy requirements in different jurisdictions, see *Data Protection multi-jurisdictional guide*.

COUNTRY-SPECIFIC INFORMATION

The final step to internationalizing an award agreement is to include any country-specific information that requires changes to certain terms of the award or notifies employees of any obligations they may have under the law regarding the award. For example, in countries with onerous exchange control requirements, companies may modify their standard form of award agreement to require a cashless exercise instead of permitting employees to exercise their stock options by a variety of methods. Agreements may also be modified to include information about tax, securities or exchange control reporting obligations.

Although virtually all companies inform employees of any variations between countries in the basic terms of the award, such as differences in vesting or exercise terms, not all companies provide their employees with details about their individual tax or other legal obligations.

Some companies prefer not to provide much detail on issues that do not require any action to be taken on the company's part. Other companies take a more paternalistic view and provide notices designed to help prevent the employees from inadvertently breaching their obligations. The latter approach reduces the risk of unintended consequences that can turn a valuable incentive into a source of resentment.

PRACTICE TIP

Award agreements for US grantees are a good base document for use internationally but should be modified to comply with local laws. In most countries, using a single award agreement with an appendix containing the data required by the individual's country can be less cumbersome administratively than having separate agreements for each country.

NEW DEVELOPMENTS AND MAINTAINING COMPLIANCE

Once initial grants or offers are made to employees worldwide, most companies are under the false impression that they can set aside any international concerns until their next grant cycle. However, because laws applicable to equity awards are always in flux, companies should not ignore international developments between grant dates. At any one time, up to ten countries may be in the process of altering the requirements that apply to global equity programs. Some of these changes may not need to be considered until the next time a grant is made. For example, a change to the thresholds for securities registration filings only needs to be calculated when new grants are made. On the other hand, certain changes require constant monitoring because they impact grants that have already been made to employees.

PRACTICE TIP

Companies should develop a process to monitor legal developments in the countries where they have granted or will be granting awards so that neither the company nor its employees are at risk of running afoul of the law or are confronted with any surprises. Companies should also consider scheduling regular, cross-functional team calls (possibly monthly or quarterly) to share any information learned and create an action plan to tackle any new issues that may arise.

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