Equity Incentive Compensation for Globally Mobile Employees

American Benefits Council

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Agenda

What is the Issue?

Employer Compliance Challenge

Addressing the Equity Mobility Question

Practical Considerations

What is the Issue?

Who/What do we mean by “mobile employee”…?

- Any employee that provides services in more than one tax jurisdiction (country, state, municipality, etc.):
  - Expatriates
  - Permanent Transfers
  - Temporary Assignees
  - Split Jurisdiction / Split Payroll Employees
  - Cross border Commuter Employees
  - Business Travelers

What is the issue?

Companies move employees across borders

Employees receive compensation that is earned over multiple years and frequently earned in more than one jurisdiction as the employee moves across borders

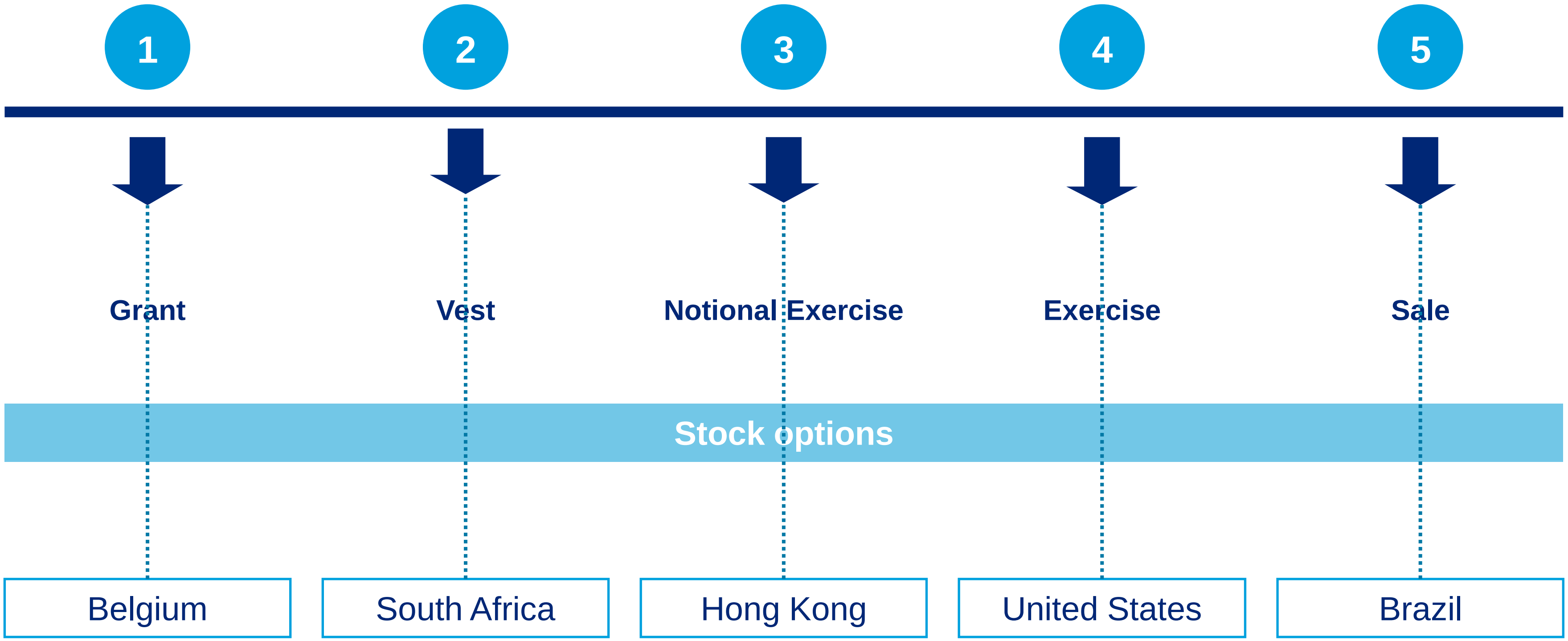
Where will the company obtain the necessary data to track its employees and ensure tax compliance?

How will this data be processed? I.e. how will withholding take place for an employee in a former location where no other wages are being reported?

What function within the organization is responsible for this process?

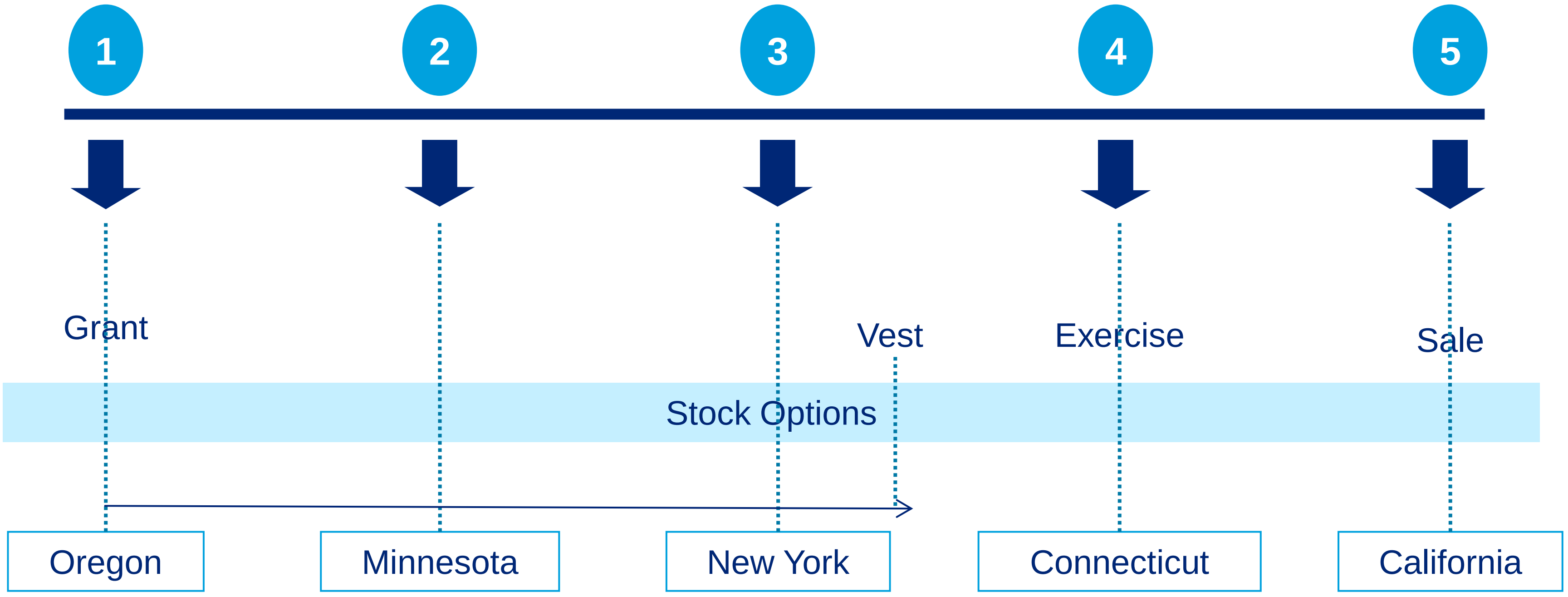
Globally mobile employees – What is an equity award trailing liability?

- An employee may be granted an equity award in one country, vest in that award in a second country, exercise in a third country, and ultimately sell the shares in a fourth country
- **There could be employer reporting and withholding as well as individual tax implications in each jurisdiction**



What is an equity award trailing liability?

- Similar issues can arise domestically between US States



Why now? Changing compliance environment

1 **Decreased revenue bases**

- Decreasing revenue bases, along with technological improvements, create enhanced capacity and more aggressive behavior by tax authorities during audits, stricter enforcement of legislation, and less leniency in the negotiation of settlements and/or assessment of penalties.
- Developed nations becoming more sophisticated in addressing and auditing taxation for ex-residents (e.g., Canada, China, Germany, UK, US)
- Decreases in company revenues result in less resources, technological and personnel, available to monitor and facilitate compliant operations.

4 **Continuously changing regulations**

- Challenge to keep current on constantly changing legislation, which increases exponentially as mobility creates need to understand interaction of regulations across jurisdictions.
- Informational filings increasingly being enacted (China, Ireland, UK)
- Departure and Exit Taxes (Hong Kong, Singapore)

2 **Public scrutiny (media and institutional shareholders)**

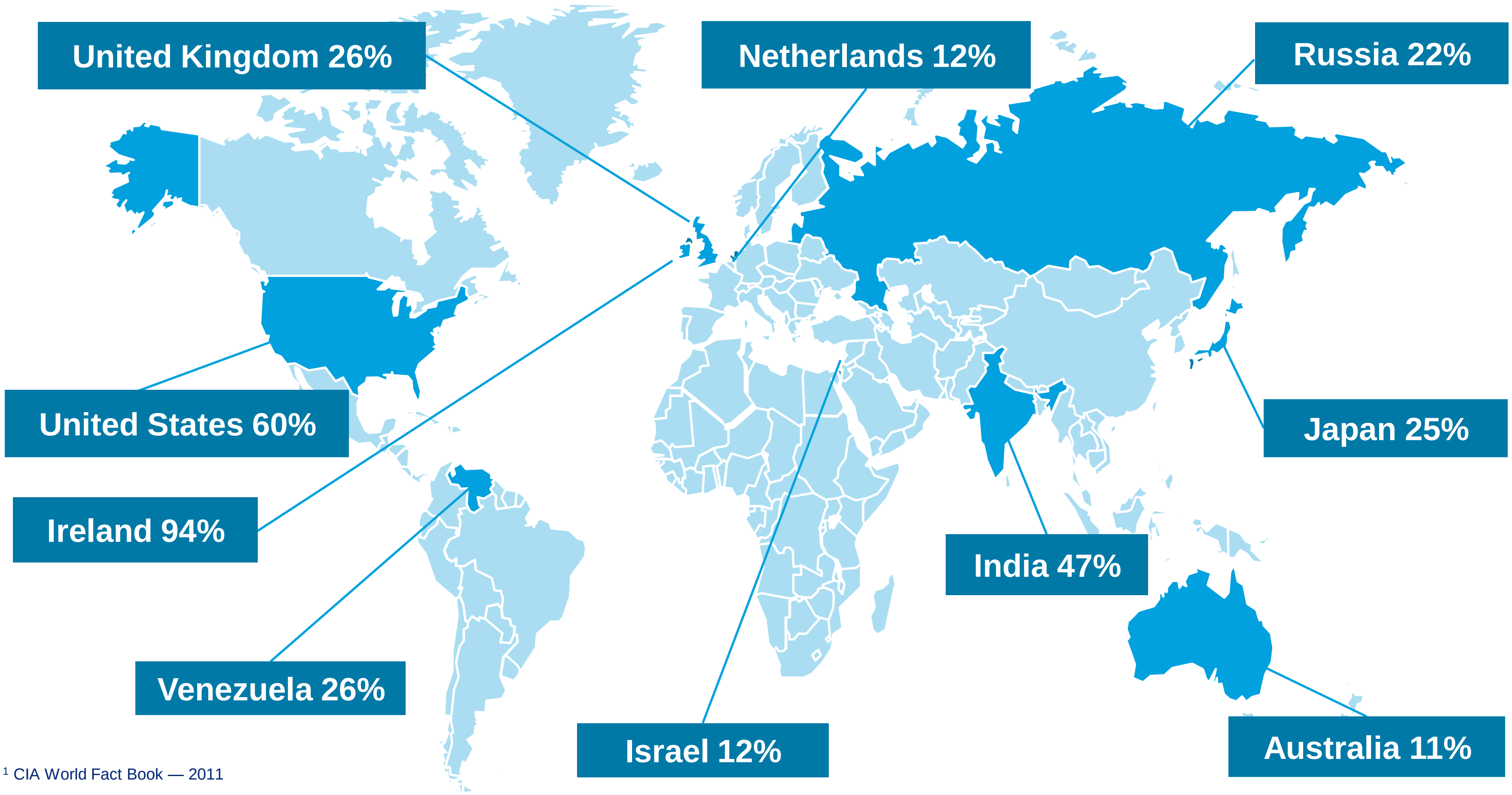
- Commercial impact of negative publicity regarding non-compliant behaviors can have greater impact than fines/penalties assessed by regulators.

3 **Management's risk tolerance**

- Changes in management accountability and disclosure requirements have changed C-suite's perspective on what constitutes acceptable risk.
- Changing demographics for mobile employees impacts areas of focus.

Why focus now?
An international perspective

There is an increasing need for governments to find new sources of revenue. According to the CIA World Fact Book[1], government spending exceeds revenues in numerous countries, including:



[1] CIA World Fact Book — 2011

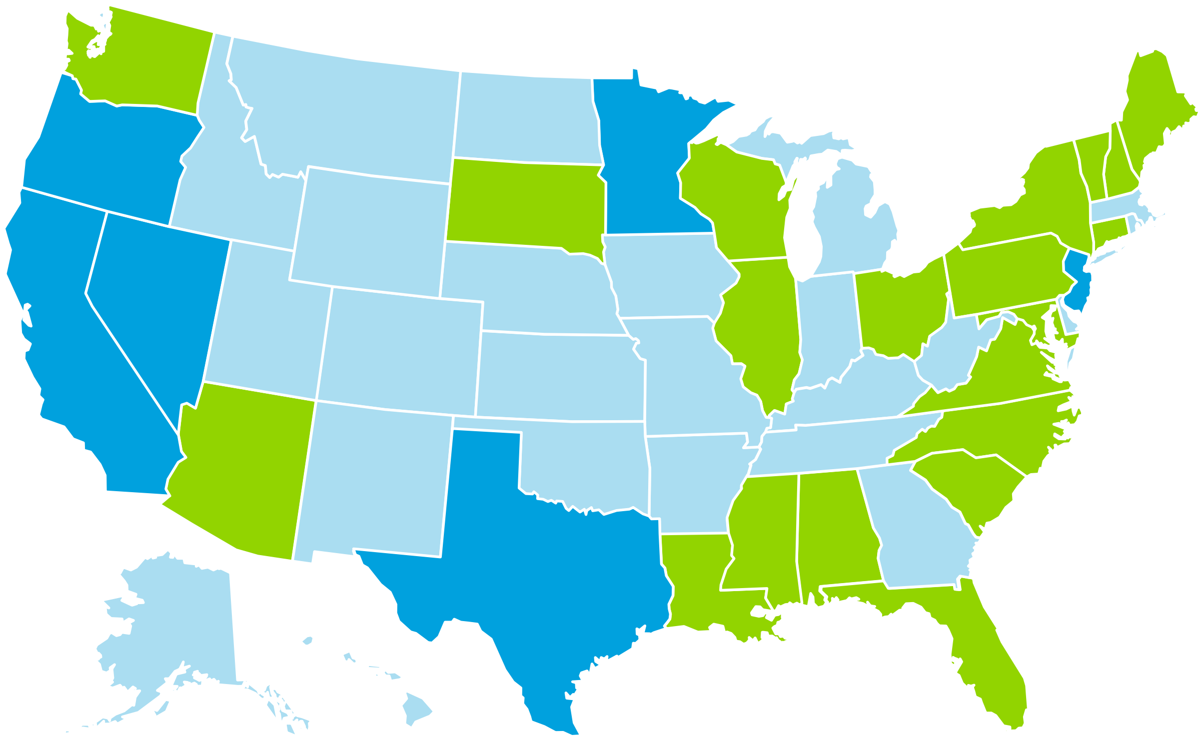
Why focus now?
A domestic perspective

The Center on Budget and Policy Priorities reported that, within the United States, 42 of the 50 state governments projected budget shortfalls for fiscal year 2012[2]

Greater than 20%

- California
- Minnesota
- Nevada
- New Jersey
- Oregon
- Texas

20 additional states greater than 11%



[2] The Center of Budget and Policy Priorities — "The State Budget Crisis and the Economy"

Cross-border compliance and equity — Tightening rules

2001	2003	2003	2005	2006–2008	2010–2011	2012
Hong Kong	**Germany**	**U.K.**	**China**	**New York/ Minnesota**	**France**	**Japan/Canada/ Ireland**
Created rules in 2001 to tax gains upon departure of expats from Hong Kong	Passed legislation in 2003 to tax gains realized by former residents	Indicated intent to tax NR gains in 2003 Form 42 added to enable tracking • Penalties charged for late submission of form • Initial penalty of £300 per reportable event; further penalties of up to £60 per day • Late or incorrect submissions affect the tax risk profile of the company	Issued Circular 35 in 2005 to enable tracking of share awards	Stuckless case, 2006 Minnesota law change, 2008	French Supreme Court rules on stock option sourcing Withholding on non-residents goes into effect	Japan: Certain Japanese branches and subsidiaries of foreign entities will be required to submit a report detailing equity compensation of resident employees Canada : Adoption of OECD grant to vest sourcing rules for stock options Ireland: Revenue confirmed “all in/all out” approach to RSU sourcing.

Global issues to consider

- Timing of taxation varies between countries:
  - Most countries tax at exercise
  - Some countries tax at grant, vest, or sale
  - Exit and trailing taxes
- Amount subject to tax varies between countries:
  - Even for those that tax at exercise, there may be differences between the statutory definition of fair market value
    - Italy — average price over the prior month
    - China/Taiwan — closing price on the date of transaction
- Company chargeback position can impact tax withholding and reporting requirements.

Global issues to consider (cont.)

- Sourcing rules vary
  - Some countries source according to location at grant (Belgium)
  - Most countries follow the OECD approach of sourcing according to location between grant and vesting (United States, Germany)
  - Some countries source based on based on location between grant and exercise (Finland, Japan)
  - Treaty may override domestic sourcing rules (UK/U.S., Canada/U.S., Japan/ U.S. treaties)
- Some countries do not source the income (Italy)
- Qualified Plans, favorable Grant Terms, and Elections
- Further complexity with social security tax
- Tax Equalization Policy

US state issues to consider

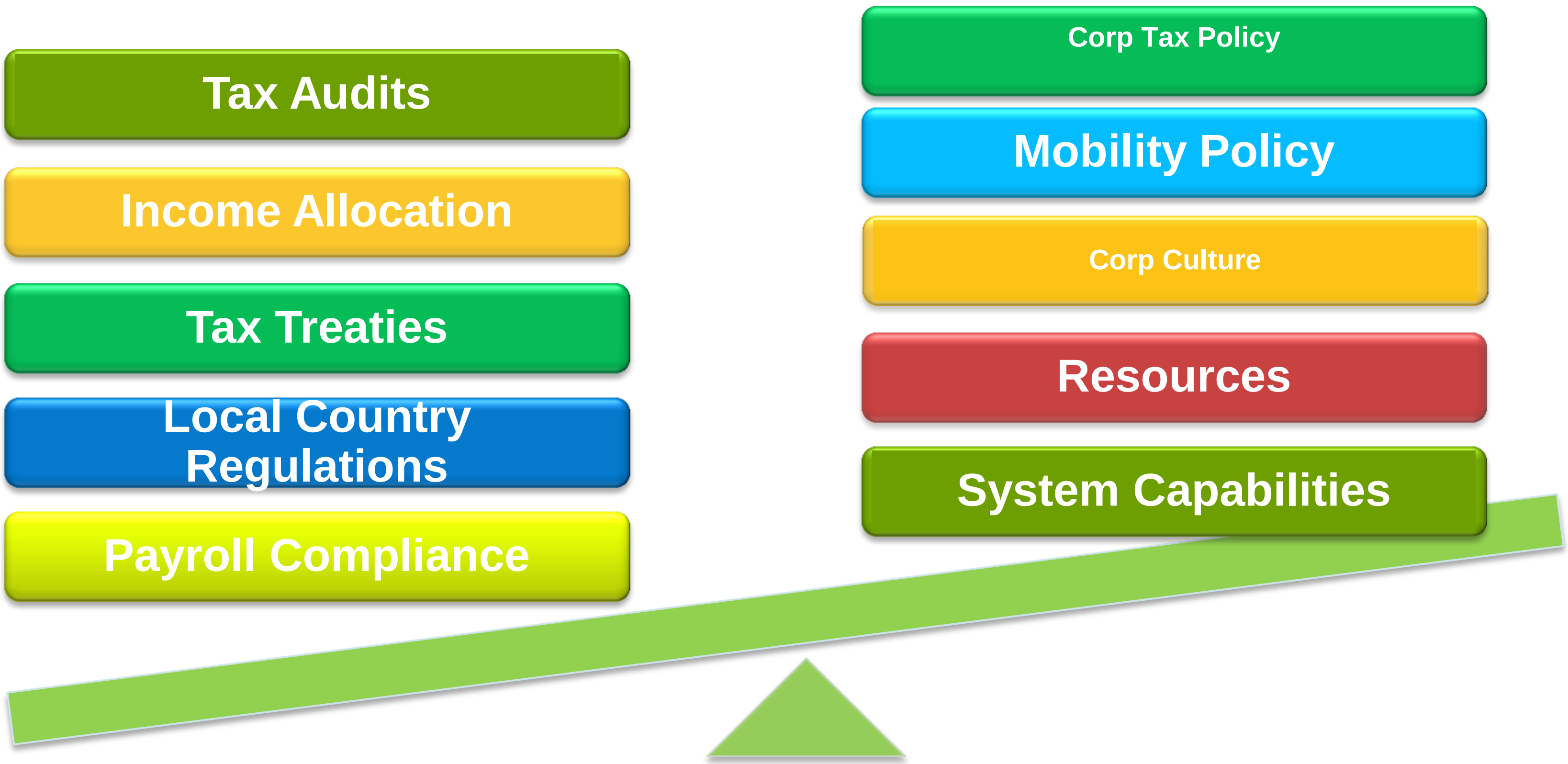
- States are enacting legislation regarding taxation for nonresidents (e.g., New York, Minnesota)
- Increased scrutiny with respect to accurate tax withholding and reporting
- Payroll tax audits, IDRs, and notices by a number of states
- Many states do not have an established de minimis reporting threshold

US state issues to consider

- States generally tax their resident on all income, regardless of its source, with some exceptions
- States tax nonresidents only on income from sources within the state
  - Which includes income from employment in the state,
  - But generally does not include income from intangible personal property (such as stock sales, i.e., capital gains tax)
- City or local tax may also be due on equity income
  - Tax treatment will differ based upon locale and how locale taxes residents and nonresidents
- Sourcing will depend on a number of factors and must be considered on a state-by-state basis
- Tax Credits and Reciprocity Agreements need to be considered

Employer Compliance Challenge

Mobility: Complex Balancing Act



Employer responsibilities

If employer reporting and/or withholding is required on equity income:

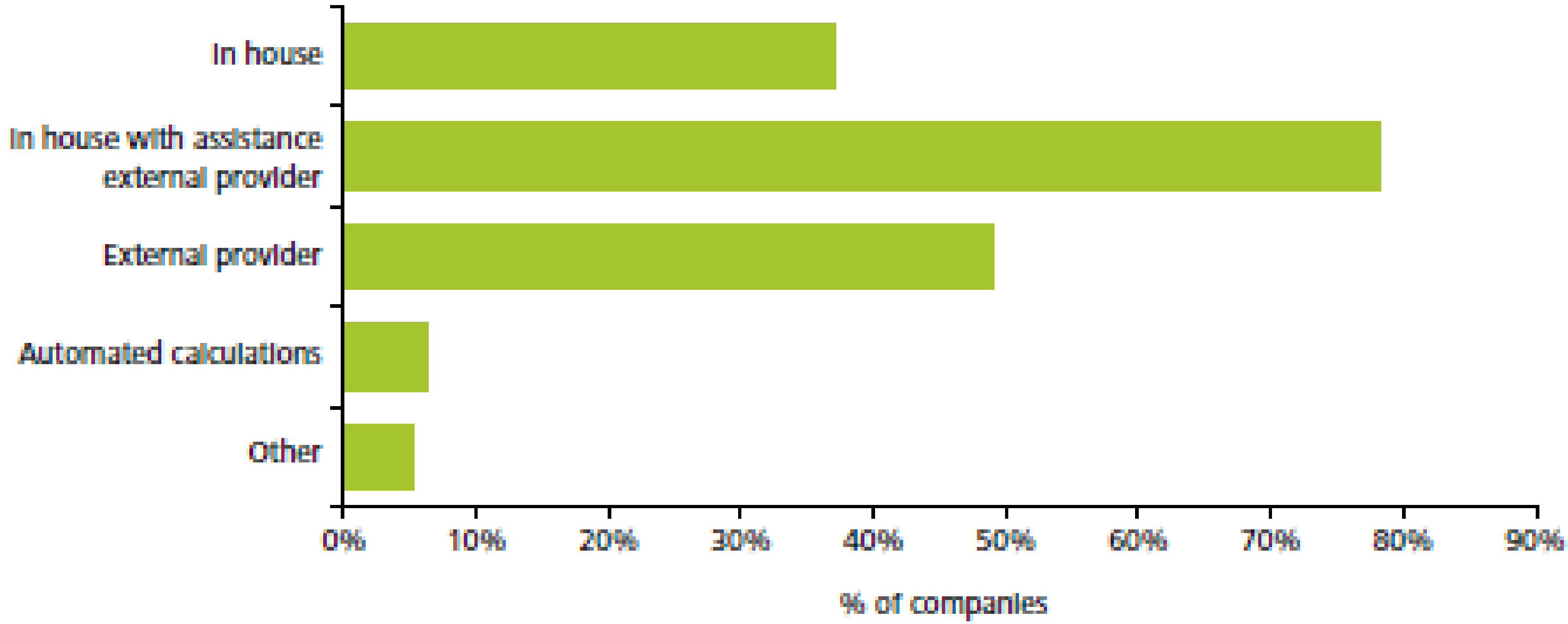
- Employer is possibly required to report and withhold in multiple jurisdictions
- What is reportable and when?
  - Award?
  - Vest?
  - Exercise?
- Determination of applicable withholding rates:
  - Review employer reporting and withholding requirements in each jurisdiction
  - Determine combined withholding rate applicable to total income (watch issues around minimum statutory withholding requirement when using net share settlement)
  - Apply withholding rate to income transaction
  - Deposit appropriate withholding with each jurisdiction (part of withholding may be hypothetical tax)
  - Ensure determined taxable income and withholding in each jurisdiction is reported locally
  - Communicate process to individual

Employer responsibilities (cont.)

- Consideration of recharge of costs (i.e., may trigger withholding and reporting obligations that do not already exist)
  - Consider whether recharge positions relating to mobile employees differ from the general corporate practices regarding recharging equity costs
- If no employer reporting and/or withholding required:
  - Employer should alert employee to individual tax obligations.
  - Employer should alert employee to individual compliance obligations.
  - Employee must report income in monthly or annual tax return filings and pay tax accordingly.
  - Employee is responsible for noncompliance penalties.
- Risk management
  - Where do you draw the line?
    - Timing-based de-minimis test
    - Income amount based de-minimis test
  - Penalties for non-compliance
  - Administrative complexities

Globally mobile employees — Withholding tax calculations

Withholding tax calculations for globally mobile employees [4]



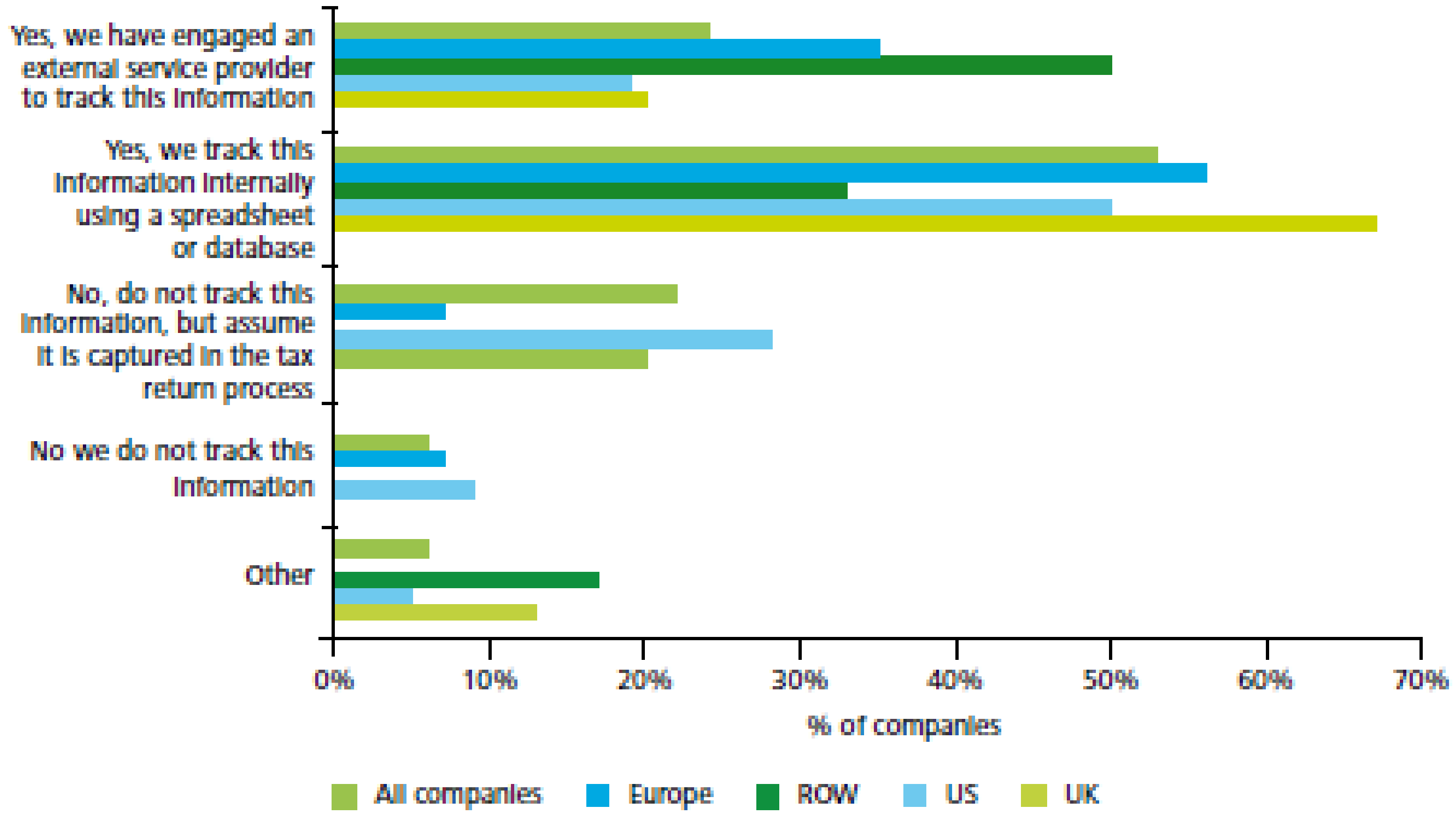
[4] 2012 Deloitte Global Equity Plan Survey

Addressing the equity mobility question

Globally mobile employees — tracking movement

Globally mobile employees — tracking movement

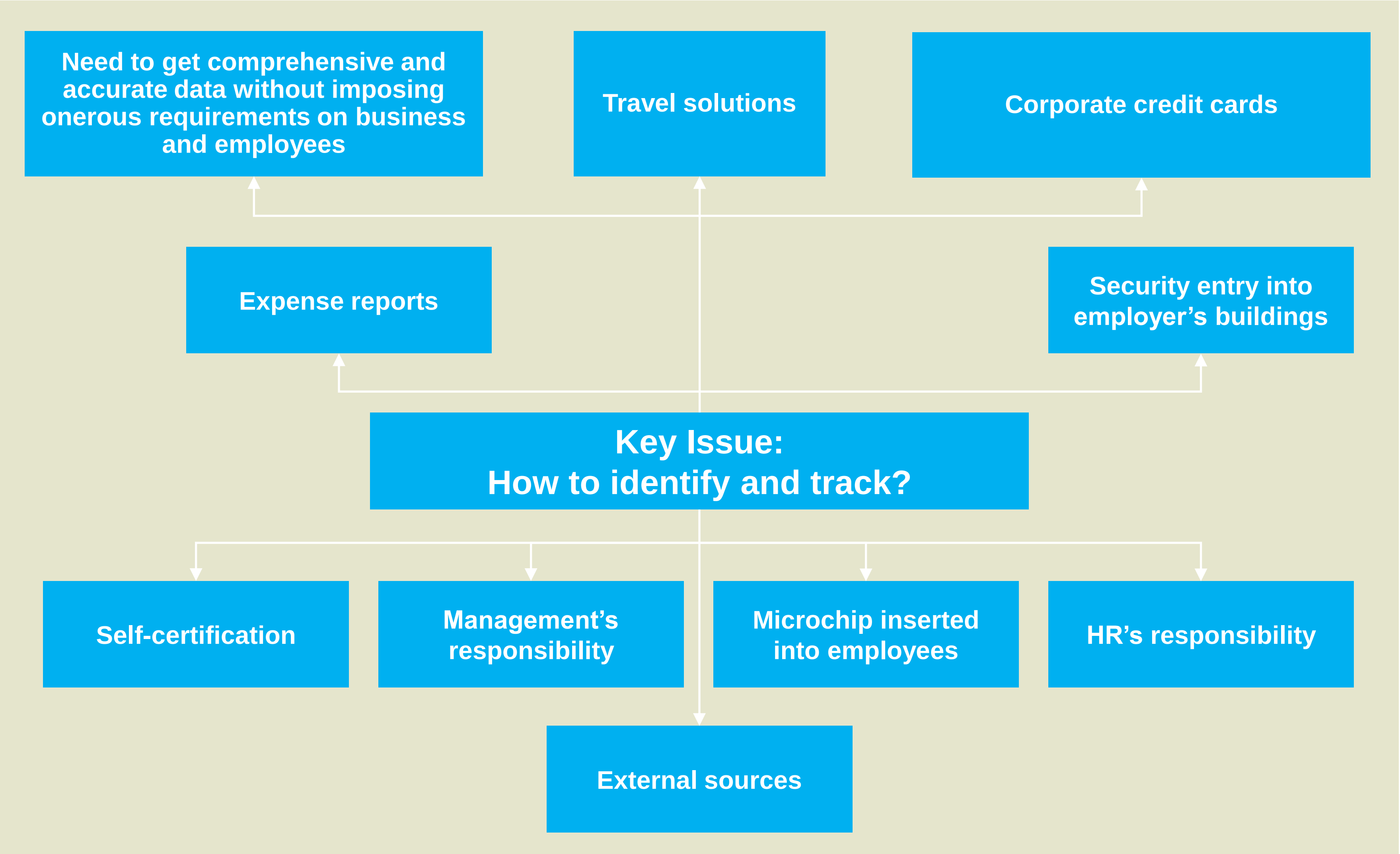
Methodology for tracking movement of employees [3]



9% of U.S. companies do not track the movement of their mobile employees at all.

[3] 2012 Deloitte Global Equity Plan Survey

How do we identify and track?



Practical approaches to risk management

Goal: To develop a policy that balances the company's desire to ensure corporate and individual tax compliance against the need for a functional program in practice

Step I: Identify individuals with exposure in multiple tax jurisdictions

Step II: Assess requirements and identify individuals for processing

Step III: Determine appropriate and practical process to apply

Step I: Identify potentially impacted individuals

A. Who are the mobile employees?

- Long-term expatriates
- Short-term assignees
- Permanent transfers (domestic or international)
- Commuters
- Business travelers

B. How do we identify who is mobile?

- Self disclosure via broker
- Prevest/exercise email to employees
- Corporate travel
- Corporate mobility (including external vendors)

C. Matching mobile employee data and equity data

Once populations and individuals are identified, the company can modify existing processes so mobility data can be used to meet equity award compliance requirements.

Practical approaches to risk management (cont.)

- Penalties for noncompliance
- Publicity
- Administrative complexities
  - Local company versus parent company requirement
  - Can parent company meet obligations?
- Where do you draw the line?
  - How long to track?
  - Minimum income thresholds
- Individual responsibilities

Tax grids

Approach: Client utilizes “generic” reports prepared in advance by an external consultant to identify and address compliance obligations

Advantages	Disadvantages
• Often a low-cost option • Ideal when large homogeneous employee groups result in repetitive transactions • Allows organizations to leverage strong internal resources	• Data in reports needs to be updated on an annual basis • Client must have sufficient resources to coordinate data, understand content of reports, perform calculations, and distribute results • Cost effectiveness declines when multiple plans, vehicles, and country combinations exist • Difficult to utilize for employees who have worked in more than two locations

Manual Calculations

Approach: Utilizing agreed positions, an external consultant performs employee specific calculations to identify defendable compensation reporting and tax withholding amounts.

Advantages	Disadvantages
• Analysis delivered quickly, 48 to 72 hours regardless of scale • Reports customized per client's data needs • Tax technical information (i.e., income and social tax rates) is current • Low implementation costs • Minimal reliance on client resources	• Requires annual review of tax positions • Costs vary with employee activity • Results not instantaneous

Automated Technology Solution

Approach: Automated calculations of defendable, employee-specific compensation reporting and tax withholding amounts

Advantages	Disadvantages
• Reports provided in seconds • Reports customized per client's data needs • Tax technical information (i.e., income and social tax rates) is current • Minimal reliance on client resources	• Easy to budget for costs • Generally not cost effective for programs that do not have significant populations / concentrations of employees • Company positions need to be updated annually and changes programmed into the system (resulting in additional fees)

Define a Process

Define Process/Setup
- Policy discussions
- Data flow/Tax withholding process
- Communication channels

Identify individuals impacted by mobility
- Global Mobility Function
- Tax Provider
- Stock Plan Administrator/Other

Set parameters of impacted population (deminimus thresholds)
- Country specific factors (P&I regime, SOL, etc)
- Individual thresholds (time or value based)
- Impact of recharge, sourcing positions

Perform calculations
- Format – Automated or Manual
- Timing – Batch or Live
- Roles and Responsibilities (i.e., gross-ups, $ value or %)

Communicate Results
- Stock Plan Administrator
- Mobility Function / Corp Tax
- Payroll

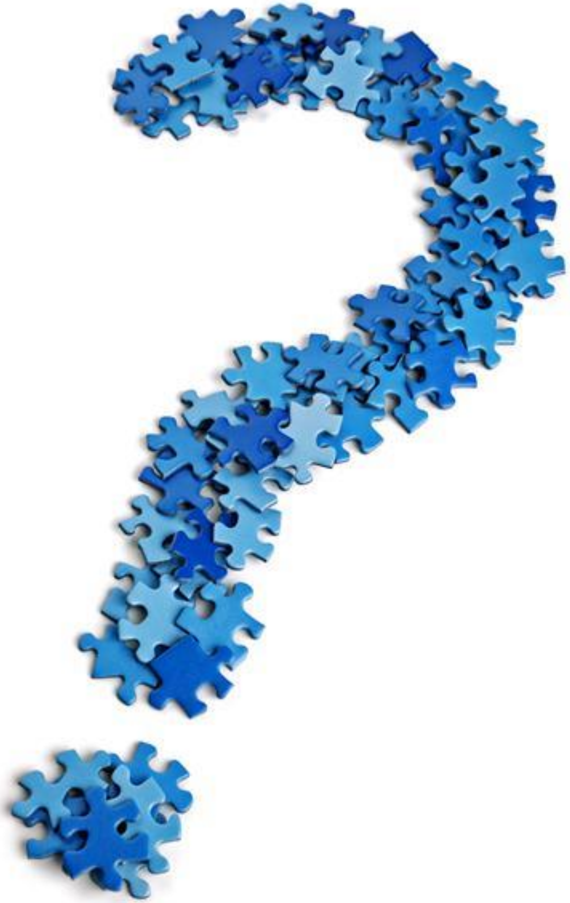
Execute Payroll
- System capabilities/limitations
- Complex requests
- Payroll strategy

Employee Communications
- At Grant, pre & post taxable event (vest or exercise)
- Q&As

Best practices to consider

- Determine the plans, population, and states and countries involved
- Business sponsorship across functions
- Access to decision makers and ability to signoff positions (i.e., delegated authority) is essential
- Teamwork is the key to success
  - Between organizations (consultant, company, broker)
  - Within the organizations (Tax, Information Technology, Human Resources, Legal, Finance, and Payroll)
  - Global (get buy-in from key locations at the outset)
- Know your data
  - Quality of data — knowing what data company houses, where it is located, and how it can be pulled together
- Communications, communication, communication
  - Among company stakeholders (both United States and global)
  - With employees, especially where there is a change in process
- Flexibility — balance practicality with risk management

Questions?



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