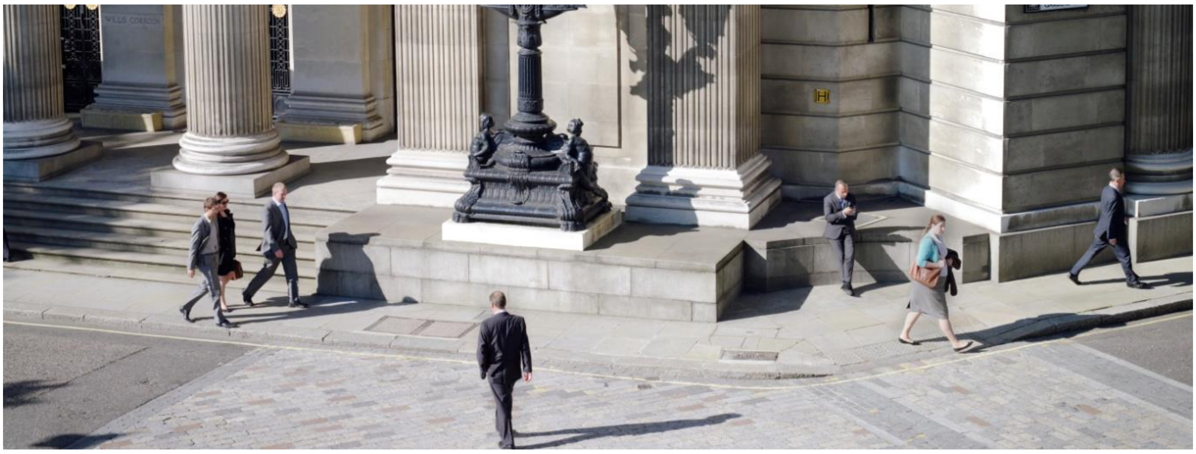
Recent legislative updates



This month's issue addresses recent tax and legal changes in various jurisdictions, such as:

- *China* — New circular on certain outbound remittances
- *France* — New employer-paid tax on employee compensation in excess of 1 million Euros
- *Hong Kong* – Clarification on the allocation of equity income for subsequently localized expatriates
- *India* — Reduction of the Liberalized Remittance Scheme threshold and ruling on the corporate tax deductibility of ESOPs
- *Mexico* — Increase in income tax rates pursuant to Mexico's 2014 Tax Reform
- *United Kingdom* — HMRC guidance regarding the classification of stock options as "legal options"
- *United States* — California reduces Section 409A penalty
- *United States* — PwC's 2013 W-2 Handbook released

Country summaries

For a more comprehensive discussion, please see *Country Discussions* starting on page 3.

China

New circular on certain outbound remittances

Under current Tax Clearance Certificate (TCC) requirements, foreign companies wishing to settle a recharge of equity plan costs to their Chinese affiliate have to go through cumbersome procedures, including tedious documentation requirements before funds can be remitted from China to settle the recharge of costs.

In an effort to simplify the TCC requirements, a new circular was jointly issued by State Administration of Taxation (SAT) and the State Administration of Foreign Exchange (SAFE) which sets out the guidelines for a new tax registration system for certain outbound remittances (e.g., service trade payments, dividends, interest, royalties, salaries, capital gains).

While this new record-filing system does not mean that the tax authorities are taking a more relaxed view towards administration for outward remittances, it does mean that their focus will shift from pre-remittance approvals to daily tax administration and post-remittance examinations.

France

New employer-paid tax on employee compensation in excess of 1 million Euros

On September 25, 2013, the French government presented the draft Finance Bill for 2014 which included the creation of a special tax due by employers on individual gross remuneration in excess of 1 million Euros to their corporate officers and employees. This special tax will be in the form of a 50% tax due on remuneration accrued or granted in 2013 and 2014 by any company, group, or individual doing business in France, in excess of 1 million Euros.

Please refer to our PwC France Alert for more information. This alert can be found by accessing this link and scrolling down to the English translation. The information presented above will not be discussed below under Country Discussions.

Hong Kong

Clarification on the allocation of equity income for subsequently localized expatriates

At the 2013 annual meeting between the Hong Kong Inland Revenue Department (IRD) and the Hong Kong Institute of Certified Public Accountants (HKICPA), the IRD expressed its views on a number of salary tax issues that may be of interest to taxpayers. Some of the issues discussed were solely related to the interpretation and application of the domestic law of Hong Kong while others involved application of the Hong Kong treaties.

One of the issues discussed was share awards for expatriates who are subsequently localized. In the past, there were uncertainties as to the correct salaries tax treatment and employers' reporting requirement of share award benefits received by expatriate employees who were initially seconded to work in Hong Kong and later localized (i.e., switched from non-Hong Kong employment to Hong Kong employment during their secondment).

Please refer to this PwC Hong Kong News Flash for more information. The information presented above will not be discussed below under Country Discussions.

India

Reduction of the Liberalized Remittance Scheme threshold and ruling on the corporate tax deductibility of ESOPs

In accordance with A.P. (DIR Series) Circular No. 23 dated August 14, 2013, the Reserve Bank of India (RBI) has reduced the monetary limit of remittance under the Liberalized Remittance Scheme (LRS) from USD 200,000 per financial year to USD 75,000 per financial year. As a result, Indian resident individuals are now permitted to freely remit only up to USD 75,000 per financial year for remittances outside of India under the LRS.

In addition, recent court decisions have provided important guidance on the deductibility of stock option expenses recharged by foreign parent companies to their Indian affiliates. Given there has previously been some uncertainty with respect to the corporate tax deductibility of employee stock option plans (ESOPs) in India, these recent decisions have provided additional guidance on the corporate tax deductibility requirements for foreign parent companies recharging their equity plan costs to India.

Mexico

Increase in income tax rates pursuant to Mexico's 2014 Tax Reform

Recent tax reforms have resulted in changes which will impact employees participating in equity compensation plans in Mexico. Effective January 1, 2014, the top marginal income tax rate will increase to 35% (previously 30%) on annual income in excess of approximately USD 250,000. Notably, dividends received from foreign corporations will be subject to a 10% tax payable by shareholders upon filing a monthly tax return. This 10% tax will be in addition to the income tax payable at the employee's marginal rate of tax on dividend income reported in the annual income tax return (a foreign tax credit will be available for any foreign taxes paid). As such, beginning in 2014, employees in the top bracket should expect to pay higher taxes on equity income including an additional element of compliance for dividend income. The information presented above will not be discussed below under Country Discussions.

United Kingdom

HMRC guidance regarding the classification of stock options as "legal options"

HM Revenue & Customs (HMRC) has amended their published guidance relating to stock options which they classify as "legal options." This update will be particularly relevant to non-UK resident employees who are granted stock options outside the UK. This is because a legal option which is granted to a non-UK resident employee and which is not related to the prospect of taking up UK employment or duties performed in the UK will be outside the scope of UK tax.

The amended guidance emphasizes that not all "securities options" - namely rights to acquire securities, will be considered "legal options." The updated guidance underlines the importance of analyzing what rights employees obtain at what time under the particular stock plan.

United States

California reduces Section 409A penalty

With the signing of the California Assembly Bill 1173 on October 4, 2013, the additional California state tax penalty for non-compliance under section 409A of the Internal Revenue Code has been reduced from 20% to 5% for taxable years beginning January 1, 2013. Prior to the adoption of this amendment, deferred compensation arrangements that were not in compliance with Section 409A regulations were subject to an additional California state tax of 20% plus interest penalties.

While Assembly Bill 1173 has reduced the state tax portion of the penalty to 5%, the federal tax remains at 20%, resulting in a new combined federal and state tax rate of 25%. This reduced rate will be applicable retroactively to January 1, 2013. The information presented above will not be discussed below under Country Discussions.

Country discussions

China

New circular on certain outbound remittances

Under the current Tax Clearance Certificate (TCC) requirements, foreign companies wishing to settle a recharge of equity plan costs to their Chinese affiliate have to go through complex procedures with tedious documentation requirements in order to obtain a TCC. In practice, these approvals are not obtained with ease before funds can be remitted from China to settle the recharge of costs. In an effort to simplify the TCC requirements, a new circular (Notice 40) was jointly issued by the State Administration of Taxation (SAT) and the State Administration of Foreign Exchange (SAFE). The Notice sets out guidelines of a new tax registration system for certain outbound remittances (e.g., service trade payments, dividends, interest, royalties, salaries, capital gains).

Under Notice 40, local entities wishing to settle a recharge of costs will have to file the necessary documentation with the in-charge local tax bureau in order to remit payments which exceed USD 50,000 or the equivalent. Starting September 2013, Notice 40 removed the requirement for the local Chinese entities to obtain a TCC from the tax authorities and will allow remittances to be processed as soon as the necessary documentation has been filed with the local in-charge tax bureau. As a result, it is anticipated that the processing of outward remittances will occur more quickly than the current TCC mechanism allows.

While this new record-filing system does not mean that the tax authorities are taking a more relaxed view towards the tax administration of outward remittances, their focus will shift from pre-remittance approvals to a more closely monitored daily tax administration process which will include post-remittance tax audits. With the removal of the TCC requirements from the Chinese tax authorities, it is important for foreign companies to make a correct assessment on their China tax liabilities at the time of remittance to avoid potential surcharges or penalties during the tax bureau's post-remittance examination. Please refer to this PwC China News Flash for more information.

India

Reduction of the Liberalized Remittance Scheme threshold

The Reserve Bank of India (RBI) in accordance with A.P. (DIR Series) Circular No. 23 dated August 14, 2013, has reduced the monetary limit of remittance under the Liberalized Remittance Scheme (LRS) from USD 200,000 per financial year to USD 75,000 per financial year.

In accordance with the LRS, Indian resident individuals are permitted to freely remit up to USD 75,000 per financial year (April – March for any permissible current or capital account transactions (or a combination of both). This limit applies to Indian resident individuals transferring funds from India.

Under the scheme, resident individuals can acquire and hold shares or debt instruments or any other assets outside of India, without prior approval of the RBI. However, the LRS cannot be used for acquisition of immovable property, directly or indirectly outside India. Individuals can also open, maintain and hold foreign currency accounts with banks outside of India, without prior approval of the RBI, for carrying out transactions connected with or arising from remittances permitted under the scheme.

Therefore, employees participating in employee share plans will not be subject to any foreign exchange controls and will be free to acquire and hold shares outside of India without prior approval from the RBI where the total remittal amount is less than or equal to the USD 75,000 LRS threshold. This is provided that resident individuals are either employees or directors of an Indian office or branch of a foreign company having a foreign holding of not less than 51%.

A separate exemption which applies to the **purchase** of shares by employees participating in an employee share plan is available where the following conditions are met:

1. The shares under the Plan are offered by the issuing company globally on uniform basis; and
2. The employer (i.e., the Indian company) submits an annual return in the prescribed format to the RBI through an Authorized Dealer Bank giving details of the remittances/beneficiaries, etc. No specific timelines have been provided for filing the annual return; however, the annual return should state the status for the year ended on March 31st.

A person resident in India is permitted to sell the shares acquired (i.e., as a result of exercising options) without obtaining approval from the RBI, provided that the proceeds of the sale are repatriated to India (e.g., to the employees' Indian bank account) within the prescribed time (i.e., 90 days from the date of sale shares).

Ruling on the corporate tax deductibility of ESOPs

In the past, there has been some uncertainty with respect to the corporate tax deductibility of employee stock option plans (ESOPs) in India. Recent decisions such as that in the case of Biocon Limited (July 2013) have provided important guidance on the deductibility of stock option expenses recharged by foreign parent companies to their Indian affiliates. In the case of Biocon Limited, the court put to rest the controversy surrounding the allowability of a deduction and also provided clarity and useful reference on the timing and amount of deduction that can be claimed in the Indian affiliate's books. The court held that a corporate tax deduction is available for the discount associated with a stock option on the basis it is considered a revenue expense and held that the stock option discount was in the nature of an employee cost and deductible at the time of vesting of the stock option.

It also held that the stock option discount is not in the nature of a contingent liability (as there is a risk the options may not vest or be exercised) and that the discount claimed as a deduction during vesting period should be adjusted in relation to any unvested or unexercised options. The employer is also required to make an adjustment based on the stock price upon exercise, resulting in an additional deduction or write off for the employer at the time of exercise. As the Biocon Limited case was specific to an Indian company, foreign companies will still need to recharge to their Indian affiliate in order to secure a deduction. The deduction will be available at the time of the taxable event (e.g., exercise for Stock Options or vesting for RSUs). It is recommended that a recharge agreement is in place for the Indian affiliate to secure a deduction.

The above mentioned judgement in the case of Biocon Limited has been relied upon in the case of Novo Nordisk (Bangalore Tribunal) in October 2013. The court in Novo Nordisk reconfirmed the position of deductibility of the stock option expenses recharged by the parent company to its Indian subsidiary in respect of shares allotted to the employees of the Indian Company under the stock option plan of the parent company. These recent decisions provide additional certainty on the corporate tax deductibility requirements to foreign parent companies recharging their equity plan costs to India.

United Kingdom

HMRC guidance regarding the classification of stock options as "legal options"

The HMRC has amended its published guidance relating to stock options which are classified as "legal options." By "legal options," HMRC refer to rights to acquire stock which are a contractual legal entitlement given by the employer to the employee for "consideration" or under deed under English law. The classification of "legal option" relates to a 1961 House of Lords case called *Abbott v. Philbin* in which the option was determined to be capable of being turned into money at the date of grant; therefore, the taxable employment income arose at grant. There are now statutory overrides to this case by virtue of which stock options are generally taxed in the UK when the underlying stock is acquired.

However, the "legal option" definition remains important for grants of stock options to non-UK residents. This is because a legal option which is granted to a non-UK resident and which is not related to the prospect of taking up UK employment or duties performed in the UK will be outside the scope of UK tax; as the right is deemed related to non-UK employment at grant.

In updated guidance, the HMRC emphasizes that they do not accept that all rights to acquire securities will be "legal options" and outside the scope of UK tax for non-UK residents at grant.

The updated guidance underlines the importance of analyzing what rights employees obtain at what time under the particular stock plan. For grants to non-residents, this will be particularly important if a position is taken that the award is not taxable in the UK relying on HMRC guidance relating to "legal options."

United States

PwC's 2013 W-2 Handbook

The W-2 Handbook is a comprehensive guide to U.S. payroll withholding and reporting.

In recent years the IRS has increased the number (and scope) of employment tax audits, and as such, compliance with W-2 wage withholding and reporting requirements is now more critical than ever. The IRS has begun intensive employment tax audits on employers; additional agents have been trained and are focusing on fringe benefits, executive compensation, employee expense reimbursement plans and worker classification. The W-2 Handbook is a detailed resource guide which addresses these issues as well as other common types of employee compensation and W-2 reporting requirements.

This year's edition provides specific information on more than fifty types of compensation and fringe benefits. The Handbook includes information on recent developments of interest to payroll and tax professionals, including the following:

- The impact of health care reform legislation on payroll taxes and employer reporting requirements;
- The impact of the recent U.S. Supreme Court decision regarding the Defense of Marriage Act ("DOMA") on payroll taxes and employer reporting requirements;
- Employer reporting requirements with respect to nonqualified deferred compensation plans under IRC section 409A;
- Reporting requirements with respect to certain equity-based compensation plans; and
- Current developments in fringe benefit taxation.

If you are interested in ordering a Handbook, please contact your client service representative.

Let's talk

For more information about any of these developments, please feel free to contact any of our team members listed below.

Bill Dunn (Partner), *Philadelphia, PA*
+1 (267) 330-6105
william.j.dunn@us.pwc.com

Kerri McKenna, *Philadelphia, PA*
+1 (267) 330-1723
kerri.l.mckenna@us.pwc.com

Paras Sarvia, *Chicago, IL*
+1 (312) 298-4520
paras.sarvia@us.pwc.com

Ari Solomon, *New York, NY*
+1 (646) 471-8477
ari.solomon@us.pwc.com

Jennifer George, *San Jose, CA/ San Francisco, CA*
+1 (408) 817-4370
jennifer.b.george@us.pwc.com

Anne Roest, *Chicago, IL*
+1 (312) 298-2646
anne.l.roest@us.pwc.com

AmyLynn Flood (Partner), *Philadelphia, PA*
+1 (267) 330-6274
amy.lynn.flood@us.pwc.com

Michael Shapson, *Philadelphia, PA*
+1 (267) 330-2114
michael.j.shapson@us.pwc.com

Parmjit Sandhu, *New York, NY*
+1 (646) 471-0819
parmjit.k.sandhu@us.pwc.com

Gemma Smith, *New York, NY*
+1 (646) 471-6623
gemma.a.x.smith@us.pwc.com

Aldona Gorman, *Chicago, IL*
+1 (312) 298-4445
aldona.n.gorman@us.pwc.com