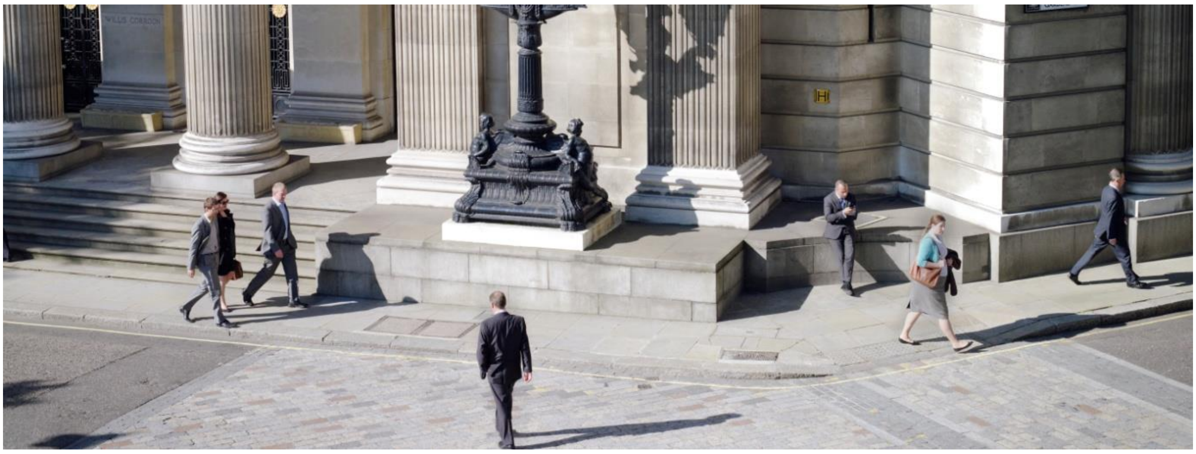
Recent legislative updates



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

- *Brazil* — Federal court exempts stock option transactions from social security contributions
- *Canada* — New non-resident trust rules and global equity plans
- *Canada* — The Transalta Case: Can stock plans be deductible in Canada?
- *France* — French Supreme Tax Court decision rendered regarding the nature of stock option gains generated by stock granted before June 20, 2007 (Pre-TEPA grants)

Country summaries

For a more comprehensive discussion, please see *Country Discussions* starting on page 2.

Brazil

Federal court exempts stock option transactions from social security contributions

Recently, a Brazilian court that judges federal contributions and tax issues concluded that a local company was not obligated to withhold social security contributions on income related to its stock option plan. The court reasoned that gains under the company's plan should not be considered employment income and, therefore, should not be subject to social security contributions. Although the decision is preliminary and not binding on all taxpayers, it may indicate a new trend with respect to future judicial decisions.

Canada

New non-resident trust rules and global equity plans

A new approach to the taxation of non-resident trusts came into effect in Canada when Bill C-48 received Royal Assent on June 26, 2013. The legislation is retroactive to tax years ending after 2006 and impacts the Canadian tax liability and administration of global equity plans with participants in Canada.

These new rules deem a non-resident trust (NRT) to be resident in Canada and taxable on its worldwide income, or on election only with respect to income on the portion of contributions made by or deemed to be made by Canadian residents. While the rules are complex and meant to combat offshore tax evasion, their impact on global equity plans means that foreign trusts used to hold shares for Canadian employees will now be subject to treatment similar to that of equity plans funded through Canadian-resident trusts or custodial arrangements.

Canada

The Transalta Case: Can stock plans be deductible in Canada?

Historically, the Canadian Revenue Agency (CRA) has taken the position that the benefit realized by employees from equity awards is not deductible by the employer for tax purposes, even where the parent company charges back the costs of the award to the Canadian subsidiary. In *Transalta Corporation v. The Queen* (2012 TCC 86), the Tax Court of Canada (TCC) found that shares issued under the company's performance share unit plan were a deductible corporate expense. The TCC's decision was based largely on the fact that the plan gave the employer the unusual right to determine, at the end of the service period, both the amount of the award and whether any compensation would be paid at all.

France

French Supreme Tax Court decision rendered regarding the nature of stock option gains generated by stock granted before June 20, 2007 (Pre-TEPA grants)

The French Supreme Tax Court, in a decision rendered on October 1, 2013 (no. 361440), has determined that stock option gains arising from the exercise of 'qualified' stock options granted prior to June 20, 2007 (Pre-TEPA grants) are by nature an element of taxable salary rather than a capital gain. On this basis, gains realized by French non-residents are taxable in France if they are related to services performed in France. The special flat-rate "capital gains" tax regime applicable to these gains does not change the fact that these gains are characterized as employment income. The predominant position among practitioners was to consider that these gains be treated as capital gains and, therefore, not taxable in France for non resident taxpayers. Additional comments are expected on the mechanics of the tax treatment of these gains, we will keep you informed of any developments.

Country discussions

Brazil

Federal court exempts stock option transactions from social security contributions

Recently, a Brazilian Federal court, the Tribunal Regional Federal - da 3a Região (TRF), issued a preliminary decision concluding that a local company is not required to withhold social security contributions on stock option transactions.

Under the company's plan, employees were able to purchase company shares abroad through voluntary payroll deductions and then receive matching shares if certain conditions were met. The TRF reasoned that while stock option plans usually arise from an employment relationship, this particular plan more closely resembled a commercial contract as oppose to compensation for services. The TRF noted that since the plan was optional and any gains were subject to market fluctuations, the income was not linked to the services performed. The TRF upheld this decision on an appeal by the federal government.

The decision did not discuss the impact a recharge of stock option costs may have on an employer's social security withholding requirements. Generally, where a parent company recharges the cost of stock option income to its Brazilian entity, stock option income is subject to social security withholding, however, there is no withholding requirement where there is no recharge of costs. PwC Brazil emphasizes that this decision is preliminary therefore not definitive or binding on all taxpayers, but is a precedent which shows a potential line of understanding for future judicial decisions. Please refer to this PwC Brazil Global Watch for more information.

Canada

New non-resident trust rules and global equity plans

A new approach to the taxation of non-resident trusts came into effect in Canada when Bill C-48 received Royal Assent on June 26, 2013. The legislation is retroactive to tax years ending after 2006 and impacts the Canadian tax liability and administration of global equity plans with participants in Canada.

These new rules deem a non-resident trust (NRT) to be resident in Canada and taxable on its worldwide income, or on election only with respect to income on the portion of contributions made by or deemed to be made by Canadian residents. While the rules are complex and meant to combat offshore tax evasion, their impact on global equity plans means that foreign trusts used to hold shares for Canadian employees will now be subject to treatment similar to that of equity plans funded through Canadian-resident trusts or custodial arrangements.

The new NRT rules provide that an NRT that is not an exempt foreign trust is deemed to be resident in Canada and liable to pay tax on its worldwide income if, at a specified time in respect of the trust for a taxation year (generally, the end of the taxation year), there is either a resident contributor to the trust or a resident beneficiary under the trust. Italicized terms are defined in the legislation.

While the definition of exempt foreign trust includes certain types of trusts that provide employee benefits, the only exemption that would typically apply to an incentive plan under which securities are held in trust requires that no benefits be provided under the trust other than benefits in respect of qualifying services. Qualifying services are defined as, among other things, services provided primarily by non-resident or temporarily resident employees – a definition that would exclude a trust providing benefits to employees ordinarily resident in Canada. Of course, given possible global variations on share-based arrangements, each particular circumstance should be reviewed to determine if the exempt foreign trust definition could apply to avoid application of the NRT rules in their entirety.

In a typical global equity plan or arrangement, shares of the global parent are purchased with contributions from the global parent or from participating employers for later distribution to employees who have been awarded Restricted Share Units, Performance Share Units or some other type of equity-based award. The employees of Canadian-resident subsidiaries participate in the global equity plan and receive shares from the NRT when their awards vest. In circumstances where a trust is used in connection with the distribution of shares or other benefits to Canadian employees, the arrangement should be reviewed to determine whether the new NRT rules apply. Please refer to this article from PwC Canada for additional information.

Canada

The Transalta Case: Can stock plans be deductible in Canada?

Historically, the Canadian Revenue Agency (CRA) has denied companies a corporate tax deduction for the costs of equity awards granted to employees. A deduction is not available regardless of what type of shares are utilized in grants to employees and regardless of whether the plan costs are charged back from the parent company to the Canadian subsidiary. However, a corporate tax deduction is generally available if the awards are settled in cash.

In Transalta Corporation v. The Queen (2012 TCC 86), the Tax Court of Canada (TCC) held that shares issued under the company's performance share unit plan were a deductible corporate expense. The TCC reasoned that the share plan rules under the Income Tax Act (ITA) deny a corporate deduction for shares issued pursuant to a legal contract to issue such shares. The TCC found that since the plan gave the employer the unusual right to determine, at the end of the service period, both the amount of the award and whether any compensation would be paid at all, no legal contract or agreement to issue the shares existed at any time under the Transalta plan. The TCC also found that the issuance of the shares was an outlay or expense.

The CRA's response to the case so far indicates that it will be reviewing any similar circumstances to determine whether an agreement to issue shares exists. While the case appears to create a planning opportunity, employers must ensure that any plan intended to fall within the reasoning of Transalta is, in fact, truly discretionary. Please refer to this PwC Canada Tax Insights for more information.

France

French Supreme Tax Court decision rendered regarding the nature of stock option gains generated by stock granted before June 20, 2007 (Pre-TEPA grants)

For gains resulting from the sale of shares acquired as a result of exercising Pre-TEPA stock option grants, the predominant position among practitioners is to consider that these gains be treated as capital gains and therefore not taxable in France for non-resident taxpayers. The France Supreme Tax Court, in a decision rendered on October 1, 2013 (no. 361440), has determined that these gains are by nature an element of taxable salary rather than a capital gain. On this basis, gains realized by French non-residents are taxable in France if they are related to a professional activity in France. The special flat-rate "capital gains" tax regime applicable to these gains does not change the fact that these gains are characterized as salaried income.

This decision re-aligns the treatment of stock option gains of Pre-TEPA grants with that of Post-TEPA grants. The decision was taken in the context of domestic French tax law, but PwC France believes that the principles underlying the decision are the same as those in other cases to which international tax treaties can be applied. As a result, the general principles regarding the allocation of taxation rights between different countries on the basis of working-time in each country could be applied to Pre-TEPA stock option gains (principles defined by the OECD and by the Supreme Tax Court in the "De Roux" case of March 17, 2010). Additional comments are expected on the mechanics of the tax treatment of these gains, we will keep you informed of any developments.

Let's talk

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

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