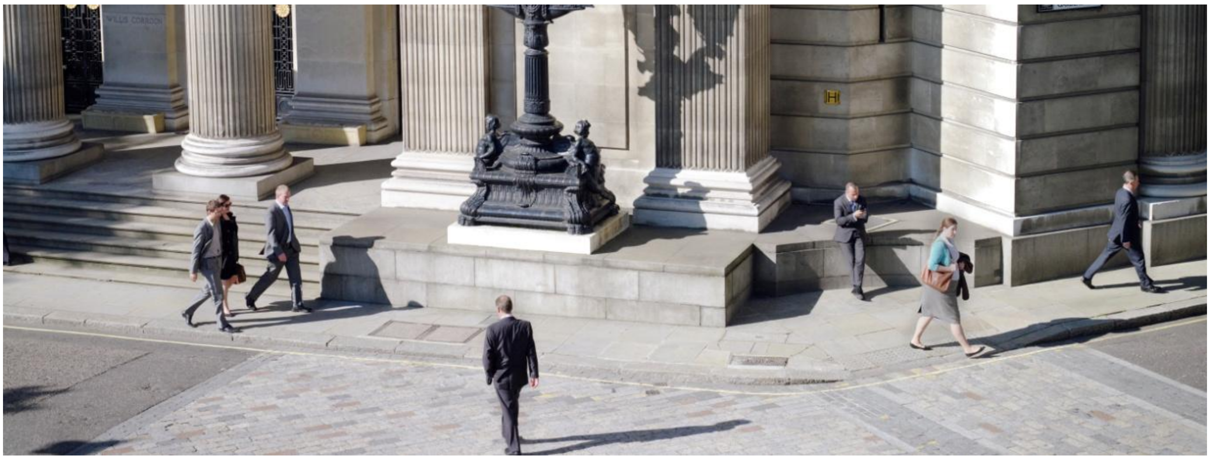
Recent legislative updates



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

- *Canada*—Tax Court ruling permits corporate tax deduction for treasury shares
- *Ireland*—Double taxation relief for withholding on RSU income for Irish residents
- *Malaysia*—Possible changes to filing requirements for employee share plans
- *Netherlands*—Clawback legislation adopted by Dutch Parliament
- *Philippines*—Stock options granted to certain employees may be subject to fringe benefits tax
- *United Kingdom*—Draft 2013 Finance Bill provides changes impacting share plans and internationally mobile staff
- *United States*—Congress passes fiscal cliff agreement to extend certain business and individual tax provisions

Country summaries

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

Canada

Tax Court ruling permits corporate tax deduction for treasury shares

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. However, a recent decision of the Tax Court of Canada allowed an employer to deduct the fair market value of treasury shares issued to executive employees under a discretionary performance share plan.

While the CRA has not released any announcements relating to this ruling, PwC-Canada is currently discussing this issue with the CRA and we expect further clarification in the near term.

Ireland

Double taxation relief for withholding on RSU income for Irish residents

The Irish Revenue has recently issued guidelines to the treatment of dual country withholding obligations for Restricted Stock Units (RSUs) for internationally mobile employees. Generally, 100% of the gains derived from RSUs at vesting is subject to Irish tax if the vesting occurs while the mobile employee is tax resident in Ireland. No apportionment is permitted. However, as of January 1, 2013, where the RSU income is also subject to tax withholding in another country which Ireland has a Double Taxation Agreement with, a foreign tax credit will be available for the employee to reduce the Irish payroll withholding provided certain conditions are met.

Malaysia

Possible changes to filing requirements for employee share plans

The Malaysian tax authorities recently issued two public rulings related to employee share plans. While several of the areas covered in the rulings require further clarification it is expected that the rulings will affect the current filing requirements associated with employee share plans. PwC-Malaysia expects further details to be released within the coming weeks. *Note that as we are waiting for clarification from the Malaysian tax authorities, the information presented above will not be discussed below under Country Discussions.*

Netherlands

Clawback legislation adopted by Dutch Parliament

On December 18, 2012, the Lower House of the Dutch Parliament adopted claw back legislation. This legislation covers, among other issues, the repayment of certain gains realized upon a corporate change in control by management board members of listed Dutch companies. The clawback only pertains to shares granted as remuneration as opposed to shares purchased by management. The bill will have to be approved by the Upper House of the Dutch Parliament. The proposed effective date is July 1, 2013.

Philippines

Stock options granted to certain employees may be subject to fringe benefits tax

On December 27, 2012, the Philippine tax authorities issued Revenue Memorandum Circular (RMC) No. 88-2012 which provided guidance on the tax treatment of income derived by employees when exercising their options. Based on the RMC, the income or gain derived from stock options, which are considered fringe benefits, granted to managerial and supervisory employees will be subject to fringe benefits tax (FBT) as opposed to compensation income subject to income tax. It is not clear from the circular what criteria will be used to determine whether stock option gains will be considered fringe benefits to managerial and supervisory employees or compensation income.

United Kingdom

Draft 2013 Finance Bill provides changes impacting share plans and internationally mobile staff

The draft Finance Bill for 2013 was published on December 11, 2012. The draft provides further details on the changes that will impact employee share plans and the statutory residence test affecting internationally mobile employees. The draft Finance Bill has been released for consultation and the deadline for comments is February 6, 2013.

United States

Congress passes fiscal cliff agreement to extend certain business and individual tax provisions

On January 2, 2013, the approved the fiscal cliff agreement (H.R. 8 as amended) that would extend permanently certain 2001 and 2003 tax provisions for individuals with incomes below $400,000, and joint filers with incomes below $450,000. In addition, the bill extends certain expired and expiring business and individual tax provisions through the end of 2013.

Country discussions

Canada

Tax Court ruling permits corporate tax deduction for treasury shares

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, if the awards are settled in cash, generally a corporate tax deduction is available.

In a recent ruling, the Tax Court of Canada ruled that a company could claim a deduction for the fair market value of the shares it issued to employees under its 'Performance Share Ownership Plan.' Pursuant to this plan, certain employees were eligible to receive a bonus at the end of the equity award's three-year term. The company would determine whether and to what extent the award would be paid in cash or by issuance of treasury shares. The court allowed the company to claim a tax deduction for each year equal to the fair market value of the shares issued under the plan. Key to the court's decision seemed to be that the company was not obligated to issue shares as there was no agreement requiring the company to issue shares. Instead, the company could have settled the awards in cash.

The CRA did not appeal the Court's decision as of yet and discussions of an amendment to the current tax rules based on the court's decision remains to be seen. PwC-Canada is currently discussing this issue with the CRA and we expect further clarification in the coming weeks.

Please note that settling awards in cash in Canada may give rise to adverse U.S. accounting treatment of the awards and adverse Canadian tax treatment of the awards to employees in Canada, depending on the terms.

Ireland

Double taxation relief for withholding on RSU income for Irish residents

The Irish Revenue has recently issued guidelines clarifying the tax treatment for Restricted Stock Units (RSUs) gains for internationally mobile employees. Where an employee is granted an RSU award in Ireland and then transfers out of Ireland and is not a tax resident in Ireland at vesting, the income at vesting will not be subject to tax in Ireland. Where an employee is granted RSU awards in another country and then transfers to Ireland and is tax resident in Ireland at vesting, 100% of such gains will be subject to Irish tax. This result may create double taxation issues where the awards were also taxed in the country of grant (or any country in which the employee worked during the vesting period).

The guidelines provide double taxation withholding relief by granting a foreign tax credit through the Irish payroll system (PAYE) for employees who are also subject to foreign income tax withholding on the RSU income. The withholding relief is available as of January 1, 2013.

In order to qualify for the foreign tax credit relief, the following conditions must be met:

- Ireland must have a Double Taxation Agreement (DTA) with the country where the foreign tax is withheld;
- The foreign tax must be non-refundable and the company must have supporting evidence of the amount of foreign tax paid;
- The company must be satisfied that the individual is entitled to the foreign tax credit (i.e., the individual must be resident in Ireland under the DTA)
- The company must provide details of the foreign tax credits allowed to Revenue in the prescribed form after year end (by March 31); and
- The individual must also file a tax return by March 31 as opposed to the regular October 31 deadline. Hence, employers should ensure that any foreign tax

credit processed through PAYE in 2013 is conditional on the employee's agreement to meet the earlier tax returning filing deadline of March 31, 2014.

Please refer to this *PwC Ireland Tax Update* for additional details regarding the changes for 2013.

Netherlands

Clawback legislation adopted by Dutch Parliament

On December 18, 2012, the Lower House of the Dutch Parliament adopted claw back legislation which includes a change of control gain capping rule applicable to management board members of Dutch listed companies to the extent shares have been received as part of a remuneration program. Company shares granted as remuneration would include performance shares, shares acquired through exercise of options, RSU vestings, matching shares, etc. Shares purchased and/or inherited by management board members will remain out of scope of this legislation.

The amount of the deemed windfall gain realized upon a change of control will be deducted from the management board member's gross salary. The amount of the gain realized and the clawback/deduction is capped and will depend on the timing of the following: (i) the day that is 4 weeks prior to the date of announcement of the change of control (ii) the day that is 4 weeks after the date the change of control is accepted (iii) the day the management board member sells his/her shares or the date of resignation.

The Upper House of Dutch Parliament has to approve this bill as well. The effective date is expected to be July 1, 2013. This new rule will be evaluated in 2016 and if no action is taken by the legislator, the rule will cease to apply on July 1, 2017.

Dutch listed companies should consider whether they wish to apply the new rule as is or alternatively, amend the change of control provisions in their board of management share plans so that the new rule will not have any impact on such share schemes. Dutch listed companies should also be prepared to be able to distinguish 'remuneration shares' from 'purchased shares' owned by their management board members and distinguish shares that were acquired by individuals prior to appointment as a management board member.

The new legislation also requires Dutch listed companies to submit the execution of their remuneration policy to the annual shareholders' meeting (AGM) as a separate agenda item. This aims to encourage transparency and accountability in respect of executive remuneration matters.

Please refer to this *PwC Netherlands Newsletter* for additional details regarding the clawback legislation.

Philippines

Stock options granted to certain employees may be subject to fringe benefits tax

Previously, the tax treatment of stock options in the Philippines was not entirely clear and there were conflicting rulings from the tax authorities as to whether the income at exercise should be treated as a fringe benefit subject to fringe benefits tax (FBT) or compensation income subject to income and possibly social taxes. The generally accepted approach was that such award should be treated as compensation income subject to income and possibly social taxes.

On December 27, 2012, the Philippine Bureau of Internal Revenue issued the Revenue Memorandum Circular (RMC) No. 88-2012 providing that income derived from stock options granted to managerial and supervisory employees will be subject to fringe benefits tax (FBT). While FBT is imposed on the income paid to the employee, the cost is required to be borne by the employer by grossing up the value of the stock option benefit. As a result, treating the income as a fringe benefit would equate to a higher cost to the employer.

However, the RMC did not categorically state that stock options granted to this category of employees will automatically be treated as fringe benefits and they did not rule out the compensatory nature of stock option income. Therefore, there is also a basis to continue treating the income as compensation, provided that the compensatory nature of the income can be supported.

While there is an absence of clear distinction between compensation income and fringe benefits under Philippine tax laws, the following criteria can provide reasonable basis for treating stock options as compensation income:

- The stock options form part of the employment contract, i.e., the employment contract provides for the employees' entitlement to the options under appropriate conditions.
- The employee pays income tax on the gain at exercise of the option.

While the above conditions provide a stronger basis for compensation treatment, the following, if present, can reinforce the argument:

- The options are granted in relation to the performance of the employee/and or the company.
- Grants are made to all employees, regardless of position in the company. This way, the options are not construed as a privilege available only to a particular group of employees.

While the RMC only mentions stock options, PwC-Philippines believes the same treatment will apply to other types of employee share plans, such as restricted stock units, etc.

While the above conditions are not necessarily determinative or exhaustive, meeting these criteria would provide employers with reasonable basis for treating stock option income as compensation income. Nonetheless, in light of the current tax climate in the Philippines and considering that stock option plans may vary among companies, a careful review of the specific circumstances is recommended. We also encourage companies to discuss issues associated with including stock option benefits in the employee's employment contract with their legal counsel in advance.

United Kingdom

Draft 2013 Finance Bill provides changes impacting share plans and internationally mobile staff

As provided in the December 2012 Global Legislative Update, the draft 2013 Finance Bill contains changes that will impact employee share plans and the statutory residence test affecting internationally mobile employees. A summary of the key provisions in the draft Finance Bill is found below.

Employee share plans

Simplification of tax favored plans

The draft Finance Bill contains numerous changes to simplify tax favored share plans. Some of these changes are expected to apply automatically by late July 2013. For changes that do not automatically apply, companies will need to consider the implications and decide whether they wish to adopt these changes. The changes include:

- **Cash takeovers**: There will be favorable tax treatment in some circumstances if shares leave the Share Incentive Plan (SIP) early or a tax favored approved option is exercised early, following a takeover of a company.
- **Share Incentive Plan:** In order to help companies hedge their liabilities, companies will be given the choice to hold a savings period (called an accumulation period) for the price to be paid by employees for partnership shares. In addition, the £1,500 dividend reinvestment limit will be removed.
- **Harmonization of Terms:** There will be an alignment to some of the rules and definitions across approved plans. The material interest test will be abolished for SIP and Save As You Earn (SAYE) plans while aligned at 25% for Company Share Option Plans (CSOP) and Enterprise Management Incentive (EMI) plans.
- **Enterprise Management Incentives:** The period in which tax advantages can be preserved if EMI options are exercised followed by a disqualifying event will increase from 40 days to 90 days.

Employee shareholder employment status

The detailed tax rules surrounding the new employee shareholder status have been drafted. Key details include that there will be complete capital gains tax exemption up to £50,000 of shares awarded and these shares must be fully paid up and awarded for no consideration other than giving up certain statutory employment rights. Furthermore, the value of the shares will be based on their 'unrestricted market value' (i.e., the value before any restrictions are taken in account) and anti-avoidance legislation will prevent employees who own, or have owned in the last year, 25% or more of the voting rights of the company (either by themselves or with people connected with them) from benefitting from the employee shareholder status.

Currently, the draft does not contain any income tax exemption allowing for an income tax charge to still possibly arise on acquisition. Potential income exemptions that were introduced by the Chancellor can be found in the December 2012 Global Legislative Update.

Entrepreneurs' relief and EMI options

EMI options acquired on exercise from April 6, 2012 will be eligible for a 10% entrepreneur's capital gains tax rate provided:

- The EMI option was granted at least a year before the sale of the shares and the shares are sold after April 5, 2013;
- The individual is an employee or director of the company in the year before the sale of the shares; and
- The normal conditions for favorable EMI tax treatment are satisfied.

This change to measure the 12 months from grant will make tax relief available to many more employees, such as those who exercise options and sell their shares on a change of control.

Positive news for employers of internationally mobile staff

The legislation to implement the Statutory Residence Test and reform of Ordinary Residence is included in the draft Finance Bill 2013.

For UK based employees who are sent by their employers to work abroad, the tests that will be applied going forward are stricter. Unless action is taken, the rules may lead to a significant number of employees inadvertently remaining UK tax residents, with consequential increase in the employment tax risk, cost and administrative burden for UK employers.

Key positive changes include:

- From April 6, 2013, foreign employees working in the UK will be entitled to overseas workday relief for three tax years (i.e., the year of arrival and the two following years). This will be granted irrespective of their intended length of stay, provided they were not resident in the previous three tax years.
- Transitional provisions will mean employees who are currently not ordinarily resident will, in some circumstances, be able to grandfather that status after April 6, 2013.
- If an employee has left the UK to work abroad and wishes to be non-resident, he or she must spend no more than 30 workdays back in the UK per tax year. This will be an increase from the 20 days included in the previous draft legislation.

Employers and employees will need to be aware and take action in respect of the following points:

- A UK workday will be any day in which the employee works in the UK for more than three hours.
- Foreign service relief on qualifying termination payments for periods when an individual is resident but not ordinarily resident has been identified as an anomaly and will no longer accrue after April 6, 2013.
- UK outbound employees who spend more than 31 days between full time employments abroad may not automatically qualify as nonresident under the full time working abroad test.

- Loss of overseas workday relief for UK domiciled individuals will impact a significant number of UK nationals who have settled overseas and return to work in the UK for a short period of time.

For further headlines from the draft Finance Bill, please visit the following PwC-UK website: www.pwc.co.uk/autumnstatement

United States

Congress passes fiscal cliff agreement to extend certain business and individual tax provisions

On January 2, 2013, Congress passed the 'fiscal cliff' agreement (H.R. 8 as amended) which has extended many expiring business and individual tax provisions.

Key elements of fiscal cliff agreement

- After December 31, 2012, a top rate of 39.6% will be effective for individuals with incomes above $400,000, and joint filers with incomes above $450,000.
- A top rate of 20% for capital gains and qualified dividends will also be effective for individuals that fall into this income range.
- Under the 2010 health care law, a separate 3.8% Medicare net investment tax is effective as of January 1, 2013 for single incomes above $200,000 (above $250,000 for joint incomes).
- The agreement does not continue the two-percentage point reduction in employee Social Security tax withholding that expired at the end of 2012 (which will now return to 6.2%).

Please refer to this *WNTS Insight* for additional details.

Contact information

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

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

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

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

Heather Royce, *Stamford, CT*
+1 (203) 539-4210
heather.royce@us.pwc.com

Aldona Gorman, *Los Angeles, CA*
+1 (213) 356-6127
aldona.n.gorman@us.pwc.com

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

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

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

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

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

Julie Rumberger, *San Jose, CA/ San Francisco, CA*
+1 (408) 817-4460
julie.rumberger@us.pwc.com

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

Karolyn Sadowski*
**currently seconded to Zurich, Switzerland*
+1 (267) 330-1935
karolyn.sadowski@us.pwc.com