Global equity compensation
Recent legislative updates

Summer 2011 Edition

Country Summaries

(for a more comprehensive discussion, please see the "Country Discussions" section below)

China

Individual Income Tax (IIT) reform impacts share based compensation

In the last few months, the China State Administration of Taxation (SAT) announced its intent to repeal various tax circulars (in whole or in part) which have widespread implications around China. From an equity compensation perspective, there were two noteworthy updates: (1) repeal of Circular 1030 creating uncertainty around the taxation of unlisted shares, and (2) relaxation of the corporate organizational rules governing preferential treatment of listed securities extending beneficial treatment to more companies.

IIT tax rate reform impacts high income earners

An amendment to the IIT Law, passed by China's National People's Congress, (effective on September 1, 2011) has adjusted the tax rates and brackets providing tax relief to lower and middle income payers but increasing tax liabilities of higher income earners. This is particularly important for expatriate employees on assignment in China and companies that may bear a portion of the assignee's tax burden. This may be a good time for Companies to review existing IIT planning and compensation structures to ensure compensation strategies are still being met.

Denmark

Potential uncertainty of the timing of restricted stock unit (RSU) taxation

A recent ruling from the Danish tax authorities has brought into question the timing of taxation of RSUs. The new ruling may mark a return to the tax authorities' former view that taxation of these awards may be triggered at grant rather than vesting, where graduated vesting is utilized. PwC-Denmark is monitoring the developments, as well as, the impact the ruling might have on other types of awards.

France

Confirmation on qualified plan term restrictions for US Issuers

A French ruling confirmed that US companies listed on the NYSE and NASDAQ exchanges are permitted to have qualified plans with a plan term that is consistent with local rules, so long as, the local rules observed are the same as the French laws concerning shareholder protection and transparency. This confirms that US public companies are generally permitted to have qualified plans with a 10 year term. This ruling was a welcome clarification given that French companies are limited to providing qualified plans with a 38 month term.

Ireland

Changes to PRSI impact equity remuneration

The Irish Minister for Social Protection released a statement confirming that, as of January 1, 2012, employee PRSI will apply to all share-based remuneration, regardless of when a written agreement related to the award was entered into. The statement indicated that the employee PRSI exemption would remain for equity awards delivered in calendar year 2011 which were the subject of a written agreement prior to January 1, 2011. The statement also confirmed that employers would remain exempt from PRSI on all share based remuneration. Finally the authorities have also provided a process for reclaiming any PRSI that may have been incorrectly submitted in 2011.

Japan

Expansion of securities law exemption to second tier entities

The Financial Services Agency (FSA) released amendments to the Cabinet Office Ordinance on Disclosure of Corporate Affairs which effectively extends the securities law exemptions to companies in the second tier of the corporate organizational structure whose shares are 100% owned by the parent company. Although not a significant legislative change, this may provide securities filing relief to some entities offering equity in Japan. As a result of the more expansive language, companies may want to review their corporate structure to confirm whether they may be eligible for an exemption from Japan's stringent securities filing requirements.

Korea

Unemployment insurance (UI) due on equity income

Recently, some clarification was provided regarding the calculation of an employee's social tax obligation in Korea. While irregular compensation such as one-time bonuses had not been included in calculating UI in the past, such compensation should now be included in the total taxable income figure upon which UI tax is assessed.

Netherlands

Potential extension of the "30%-ruling" to expatriate income

Recently, a Dutch Court of Appeal issued a ruling determining that the 30%-ruling (permitting some specific employer and employee allowances related to the expatriate's income) may apply to conditional (share) and stock option income received after an employee has departed from the Netherlands. The new ruling is contrary to the prior position taken by the Dutch Tax Authorities and the Appeals Court decision is currently on appeal to the Dutch Supreme Court. In the interim, Companies may want to reserve the right to apply the 30%-ruling for their employees.

New board of director rules for Dutch Corporations

Dutch Parliament recently adopted a bill regarding management and supervision of Dutch public limited liability companies (i.e., Naamloze Vennootschaps or NV's). One of the legislative changes concerns the legal position of management board members (i.e., statutory directors) of listed companies. As of January 1, 2012 such individuals will be considered non-employees of the Dutch entity. As a result, companies may want to revisit their director compensation and/or review their existing equity plans to confirm whether such individuals remain eligible for equity awards.

Poland

Potential tax deferral on equity awards

The Supreme Administrative Court (SAC) issued a ruling concerning the treatment of equity income under Employee Equity Plans (EEP). According to the ruling, the acquisition gain obtained upon a stock option exercise does not constitute employment income; rather such income can be considered capital in nature and only subject to tax at sale. This ruling is contrary to both a prior SAC ruling and the tax authority's position on the timing and nature of taxation. The most recent SAC ruling may not necessarily be relied upon by all global companies, but it can serve as a basis for seeking an individual entity tax ruling to obtain more beneficial tax treatment for Polish employees.

United States
Proposed 162(m) regulations affect equity disclosure

New proposed regulations governing Section 162(m) require that public companies disclose the maximum number of shares with respect to stock options and share appreciation rights (SARs) that may be granted to any one individual employee within plan document and via disclosure to the shareholders. Note that the effective date of these proposed regulations was June 24, 2011; indicating the IRS's view that this per-employee limit was previously set forth in 162(m)'s legislative history. Companies should review and/or update their plans accordingly.

In addition, the proposed regulations provided transition rules for stock based compensation granted during a private to public company transition period.

Certified Equity Professional Institute
Discount available for November 2011 Exam

PwC is on the CEPI Advisory Board. As such, the CEPI is extending a discount to our clients. This opportunity will save you $200* on new exam registration fees (normally $1295 for US registrations, $1495 for non-US) for the November 5, 2011 exam.

The CEPI curriculum is challenging and in-depth. It is updated frequently to reflect hot topics; including performance based awards, proxy disclosures, modification accounting, 6039 requirements, and IFRS 2. To take advantage of this discount offer, contact the CEPI at (408) 554-2187 or cepi@scu.edu. Now is the time to act; registration closes September 23, 2011.

** Eligible registrations include* ***new*** *Level 1, Level 2 or Level 3 registrations for individuals who are involved in administering or managing their own company's equity programs. There is no limit to the number of individuals at a company that can utilize this offer. Deferrals and re-tests are not eligible for a discount. Individuals already registered are not eligible for a retroactive discount.*

Country Discussions

China

Individual Income Tax (IIT) reform impacts share based compensation

In the last few months, the China State Administration of Taxation (SAT) announced its intent to repeal various tax circulars (in whole or in part) which have widespread implications around China. From an equity compensation perspective there were two noteworthy updates:

- Repeal of Guoshuihan [2007] No. 1030 (Circular 1030) regarding share options of unlisted companies; and
- Relaxation of the corporate organizational rules to allow more public companies to take advantage of the beneficial IIT tax treatment.

Repeal of Circular 1030

Under Circular 1030, gains from exercising stock options of unlisted companies were eligible for "preferential tax treatment". Additionally, unlisted shares acquired via share options were generally assessed based on the Net Asset Value (NAV) of the issuing company. However, due to the repeal of Circular 1030, unlisted share are no longer eligible for preferential tax treatment. As a result, such gains will now likely be added to regular monthly salary and taxed at an individual's progressive rate. This will push taxpayers into higher progressive income tax brackets, subjecting the individuals to a higher IIT liability. Nevertheless, it may still be possible to obtain beneficial tax treatment for such shares; however, consultation with each individual in-charge tax bureau will likely be required.

More widespread availability of preferential IIT for listed shares

In the past, preferential IIT treatment has been available for income derived from share plans of listed companies if the employing entity was (i) within two-tiers from the listed company (within the corporate organizational structure) and (ii) at least 30% owned by the listed company. The rules have been amended to remove the two-tier entity structure requirements from the legislation. As a result, more companies are now able to take advantage of this beneficial tax treatment assuming they have also completed the local tax bureau registrations.

In addition to the above, PwC-China has also provided a summary of important changes related to IIT that may now be imposed on mandatory contributions to overseas pension and insurance plans, as well as, IIT on dividends and capital gains paid to foreign shareholders of Chinese Tax Resident Entities (TREs). Please see the attached Global Watch - Tax and Business Advisory (China) for more information.

IIT tax rate reform impacts high income earners

China's National People's Congress passed an amendment to the IIT Law of the People's Republic of China that will provide tax relief to lower and middle income payers but will increase the tax owed by higher payers. Following a period of public comments, the amendment was passed on June 30, 2011, and will take effect on September 1, 2011.

The amendment incorporates the following changes to the IIT Law:

- The standard monthly deduction for employment income is now increased from RMB 2,000 to RMBC 3,500. Additional benefits for residents of Hong Kong, Macau, Taiwan and foreigners nationals working in China may apply.
- The number of tax brackets was reduced from 9 to 7.
- Compared to the previous regime, the marginal tax rates applied to the bottom six brackets were lowered from anywhere between 2% and 5%, and the size of each bracket was widened.
- The income level for the highest bracket was reduced from RMB 100,000 to RMB 80,000.

It is clear, from the changes in the rate structure, that this IIT reform gives tax relief to low and middle income earners, but imposes a more significant tax burden on high income earners. This is particularly significant for employers who bear the tax costs for their mobile employees, as foreign nationals working in China are generally higher income earners that will now be subject to a higher IIT burden under the revised tax brackets.

Employers and individuals should stay vigilant in managing their IIT compliance to ensure proper withholding and remittance during the transition period while the new law comes into effect. This may be a good time for Companies to review existing IIT planning and compensation structures to ensure compensation strategies are still being met.

Please see the attached Global Watch - International Assignment Update (China) for more information on this IIT Reform.

Denmark

Potential uncertainty of the timing of restricted stock unit (RSU) taxation

A recent ruling from the Danish tax authorities has brought into question the timing of taxation of RSUs. Historically in Denmark, there was a risk of taxation at grant if RSUs vested either: (i) graduated over the term of the incentive plan program (e.g., 1/3 per year over 3 years), or (ii) earlier than 3 years from the date of grant. In 2010, however, a ruling from the Danish tax authorities asserted that taxation, for equity granted with a minimum 3-year vesting period, could be deferred until the vesting date.

In a recent ruling, however, the Danish tax authorities may have returned to their former view on the timing of RSU taxation. The recently issued ruling states that for RSU programs with graduated vesting, taxation may be triggered at grant (regardless of the length of the graduated vesting period).

PwC-Denmark is monitoring developments related to this ruling, as well as, the potential that the ruling may apply to other types of share grants (e.g., restricted stock) as well.

France

Confirmation on qualified plan term restrictions for US Issuers

A French ruling confirmed that US companies listed on the NYSE and NASDAQ are permitted to have qualified plans with a term that is consistent with local rules, so long as, the local rules observed are the same as the French laws concerning shareholder protection an transparency. This ruling confirms that US public companies are generally permitted to have qualified plans with a 10 year term.

As background on the above, a French ruling issued in July 2010 determined that options granted by a US corporation to employees of a French subsidiary would not qualify for the favorable French tax regime. This ruling was based on the requirement applicable to French companies that shareholders must authorize the grant of qualified options for a period of no longer than 38 months. The original ruling, which was requested by a specific company, was not binding as law on all US issuers.

The recent ruling essentially reversed the July 2010 ruling for US issuers listed on the NYSE or NASDAQ and allows such companies to have plans with a longer term (assuming all other requirements are met). It should be noted, however, that French companies remain subject to the 38 month term rules.

Ireland

Changes to PRSI impact equity remuneration

The Irish Minister for Social Protection recently released a statement relating to the Employee PRSI charge on share based remuneration. The statement confirms:

- For 2011 only, an employee PRSI exemption will remain for share awards delivered in 2011 which were the subject to a written agreements prior to January 1, 2011;
- Employee PRSI will apply to all share based remuneration from January 1, 2012 onwards (regardless of when written agreements were entered into);
- The process for reclaiming PRSI already paid for 2011 (employer and employee); and
- Employers remain exempt from PRSI on share based remuneration.

The statement represents a window of opportunity for companies to settle certain share awards before 2012 so that employees are not faced with this additional liability. Furthermore, option holders may wish to consider whether they might exercise certain subsisting options before 2012.

Background to Employee PRSI charge

Earlier this year, a provisional announcement was made confirming no employee PRSI charge would apply to share based remuneration if the award was the subject of a written agreement, entered into between the employer and the employee, before January 1, 2011. The most recent announcement eliminates the exemption for all share based remuneration from the 2012 tax year onwards. This is irrespective of whether written agreements evidencing the share awards were entered into before or after January 1, 2011. The only exception to the revised rule will be for shares already held in an Irish tax approved Employee Share Ownership Trust (ESOT) before January 1, 2011; however, this exemption will have limited practical application.

Claiming PRSI Refunds

If employee PRSI (on pre-January 1, 2011 awards) or employer PRSI was incorrectly remitted during 2011, refunds can be offset against current PRSI liabilities through the monthly employer PAYE withholding system (i.e. the P30/year end P35 returns). PRSI refunds may not be offset against income tax or universal social charge liabilities. This refund process may not be utilized for former employees, certain low paid staff or employees with breaks of service in 2011. Applications for refunds in those circumstances must be made directly to the social security authorities after December 31, 2011.

Legislative measures to give effect to all of the above changes will be included in the next Social Welfare Bill.

Please see the attached PRSI Matrix (Ireland) for a summary of awards that are subject to PRSI.

Japan

Expansion of securities law exemption for to second tier entities

On April 6, 2011, the Financial Services Agency (FSA) released amendments to the Cabinet Office Ordinance on Disclosure of Corporate Affairs which effectively extends the securities law exemptions for equity grants to companies in the second tier of the corporate organizational structure who are 100% owned.

Prior to the amendments, the securities law exemption was only applicable to a company granting stock options to employees and officers of the issuing company and/or a first-tier entity on the corporate organizational chart whose shares were 100% owned by the parent company. As a result of the more expansive language, second-tier entities (i.e., two levels below the issuer) on a corporate organizational chart are now eligible for a securities filing exemption assuming their shares are 100% owned by the parent company.

In the course of gathering public comments, the FSA declined to adopt legislation to expand the exemption even further (e.g., to a third tier (or lower) entity on the corporate organizational chart or an entity that is not 100% owned). The FSA indicated that employees of a lower level entity would not necessarily have easy access to the parent company's financial information.

As a result, companies may want to review their corporate structure to confirm if they can take advantage of this more expansive securities exemption.

Korea

Unemployment insurance (UI) due on equity income

In Korea, all income earned from employment (except specific non-taxable income stipulated in the Korean Income Tax Act) is subject to social security taxes as long as the concerned employee is participating in the Korean Social Security regime.

Recently, some clarification was provided regarding the calculation of an employee's social tax obligation under the Social Security law. On January 1, 2011, a new rule governing the total income upon which taxpayers' UI tax liability is based went into effect. While irregular compensation such as one-time bonuses had not been included in calculating UI in the past, such compensation will be included in the total taxable income figure upon which UI tax is based.

Clients with local offices in Korea should take note of this change in calculation, and should encourage their local employees to plan accordingly.

Netherlands

Potential extension of the "30%-ruling" to expatriate income

A foreign employee assigned to the Netherlands may be granted the right to be taxed in accordance with a special Dutch tax regime called the 30%-ruling. Generally, under the 30%-ruling the employer and the employee are permitted specific allowances which assist in reducing the overall tax burden of the international assignment.

Recently, a Dutch Court of Appeal issued a decision clarifying that this 30%-ruling may apply to income and benefits (e.g., bonus payments, (conditional) shares and/or stock options) received after an employee departed the Netherlands which relate (in whole or in part) to Dutch services performed. This Court of Appeals ruling is contrary to the prevailing position which denied the application of the 30%-ruling to such benefits.

The decision is currently on appeal to the Dutch Supreme Court. In the interim, Companies may want to reserve the right to apply the 30%-ruling for their employees. Please see the attached Global Watch (Netherlands) for more information regarding the above.

New board of director rules for Dutch Corporations

Dutch Parliament recently adopted a bill regarding management and supervision of Dutch public limited liability companies (i.e., Naamloze Vennootschaps or NV's). One of the legislative changes concerns the legal position of management board members (i.e., a statutory director) of listed companies. As of January 1, 2012, newly appointed and/or reappointed management board members will be considered non-employees.

Although it seems that the upcoming non-employment status is not necessarily significant, there are a few important aspects of such a change that will affect equity awards, including:

- the terms and conditions of current arrangements that exclusively apply to employees (such as equity schemes) may need to be revised; and
- it may be worthwhile, at this time, to review existing contracts and compensation arrangements for current and/or future management board members to who will eventually be subject to this law.

PwC-Netherlands would be happy to assist Dutch NVs who may be affected by this new legislation.

Poland

Potential tax deferral on equity awards

The Supreme Administrative Court (SAC) issued a written ruling in June 2011 that may have significant tax implications for participants of Employee Equity Plans (EEP). According to the SAC, stock option income does not constitute employment income within the Personal income Tax Act (PIT Act). Additionally, in its interpretation of the PIT Act, the SAC confirmed that the spread at exercise is not subject to taxation until sale at which time the gain would be considered capital in nature.

In the case presented to the SAC, the Company's EEPs were approved by the foreign parent company, the Polish company had no influence in identifying employees entitled to participate in the plans, and the costs of the awards were recharged to the Polish company. In addition, while the specific ruling only covered stock options, PwC-Poland believes the same rationale could potentially apply to other forms of equity (e.g., RSUs/PSUs).

This ruling is contrary to both a prior ruling provided by the SAC (indicating that taxation occurred at share delivery) and the position taken by the Polish Tax Authorities. As a result, the new ruling has created some confusion in the timing of actual taxation. In Poland, rulings such as the one provided, are specific to the company seeking such clarification. As a result, this ruling may not be binding on other companies. The ruling may, however, serve as a basis for seeking an individual entity tax ruling to obtain more beneficial tax treatment for Polish employees.

Companies should consider applying for a tax ruling to clarify the treatment of equity awards.

Please see the attached Tax & Legal Alert (Poland) for additional information regarding the above.

United States

Proposed 162(m) regulations affect equity disclosure

Generally, public companies are not permitted to deduct compensation in excess of $1 million paid to a specific group of covered employees (i.e., the CEO and top three highest compensated officers, excluding the CFO). However, performance-based compensation and certain compensation paid after a private company goes public is excluded from this deduction limitation.

In June 2011, the Internal Revenue Service (IRS) issued proposed regulations related to two issues under Section 162(m) regarding stock compensation, including, the disclosure of performance based compensation share limits (specifically for stock options and stock appreciation rights (SARs)) and compensation granted during the private to public transition period.

<u>Performance based compensation via stock options and SAR grants</u>

The current final regulations provide general rules for ensuring compensation paid to executives can be considered qualified performance-based compensation. The proposed regulations clarify that the plan must specify the maximum number of shares with respect to which stock options or SARs may be granted to any one employee during a specified period. In addition, this per-employee limit must be disclosed to shareholders in order to meet shareholder approval requirements.

The effective date of this portion of the proposed regulations is June 24, 2011 (i.e., the date the proposed regulations were issued). The immediate effective date likely reflects the IRS's view that the per-employee limit was set forth in the legislative history, such that this clarification should not be significant.

Publicly held corporations should review stock option and SAR plans to ensure that the plans include a per-employee grant limit. If the plan does not provide for such a limit, a plan amendment and shareholder disclosure and approval of the limit are required.

<u>Compensation Granted During the Private-to-Public Transition Period</u>

The regulations for Section 162(m) provide for a transition period for a private corporation that becomes public. Under these rules, if a plan or agreement existed while the corporation was not publicly held, the limits under Section 162(m) do not apply with respect to certain compensation provided to covered employees during the reliance period as so defined. The proposed regulations clarify that the list of options, SARs, and restricted stock is a restrictive list and the rule does not apply to phantom stock plans, restricted stock units, or other forms of stock-based compensation. Thus, the deduction for compensation paid under a phantom stock plan or the transfer of stock under an RSU must arise during the defined reliance period (and otherwise meet the requirement for the transition period relief) in order to be excluded from Section 162(m).

The proposed regulations are open to comment until September 22, 2011, and the proposed rules are not effective until published in their final form. The delayed effective date may not provide taxpayers with much relief if the proposed regulations are finalized in 2011. It also raises questions on how the IRS will apply the proposed regulations to compensation that is granted under the current final regulations that the IRS believes are unclear but is paid and deductible after the effective date of the new regulations.

Please see the attached Tax Technical Briefing (USA) for additional information regarding the above.

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

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