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Taxation of Equity – Based Compensation

28 November 2012

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Agenda

- Equity-Based Compensation - Overview
- General Rules of Taxation
- Section 409A
- Other Issues to Consider

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Equity-Based Compensation - Overview

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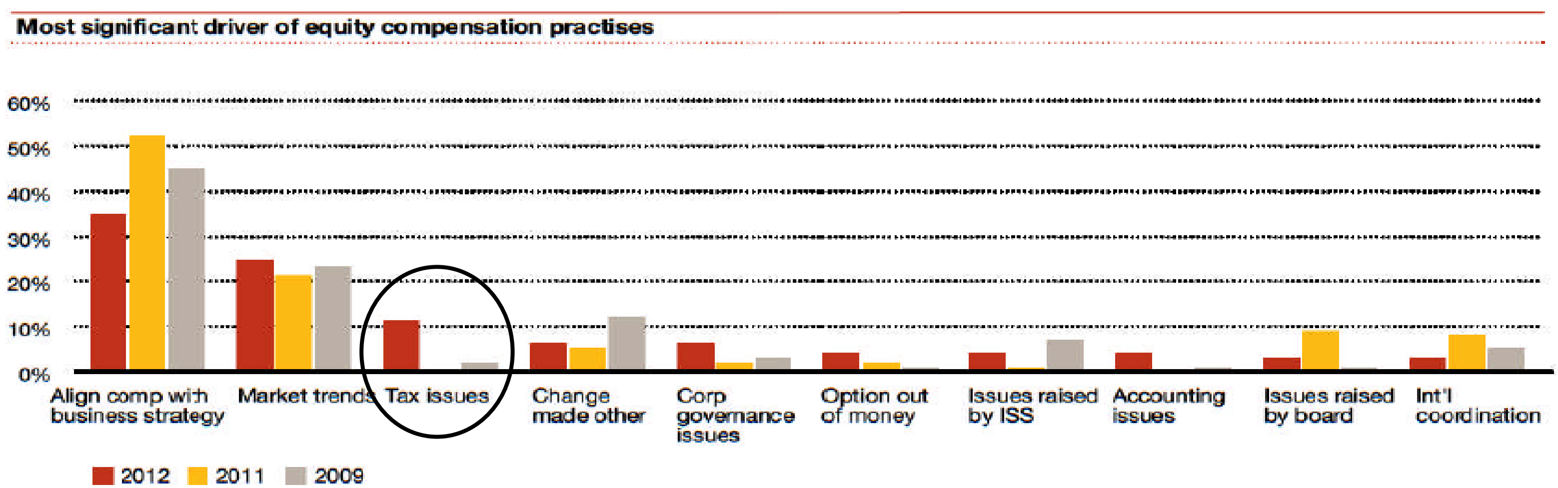
Award Types

Award Type	Description	Taxable Moment (US)
Nonqualified Stock Options (NQSOs)	Offer to purchase company shares at a fixed price	Exercise
Statutory Stock Options / Incentive Stock Options (ISOs)	Offer to purchase company shares at a fixed price	Sale
Stock Appreciation Rights (SARs)	Right to receive value equal to appreciation of company stock	Exercise
Restricted / Performance Stock Awards	Award of company shares that contain restrictions	Vesting (or Grant)
Restricted / Performance Stock Units (RSUs or PSUs)	Promise to deliver company shares after restrictions lapse	Vesting

Equity Grant Practices

PwC's 2012 Global Equity Incentive Survey

- Overall increase in the percentage of the employee population receiving grants
- Trends in types of equity grants: stock options and restricted stock/restricted stock units
- Predominant drivers remain the same:



Tax Compliance and Planning

- Global increase in tax legislation and audit activity related to equity compensation
- Complexities of mobile employee taxation
- The challenging compliance requirements

- Notable increase in the prevalence of tax issues driving equity compensation this year

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General Rules of Taxation

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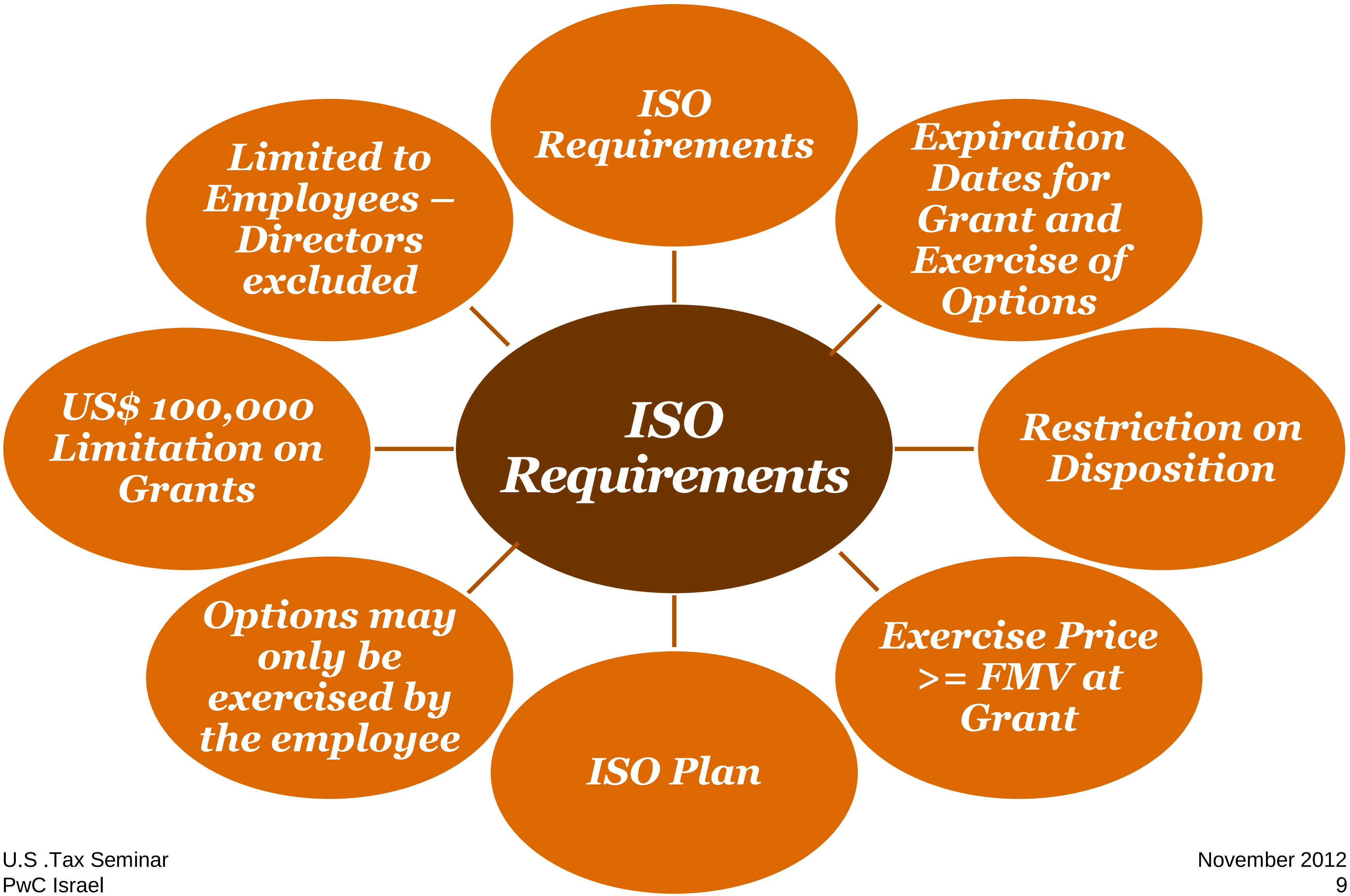
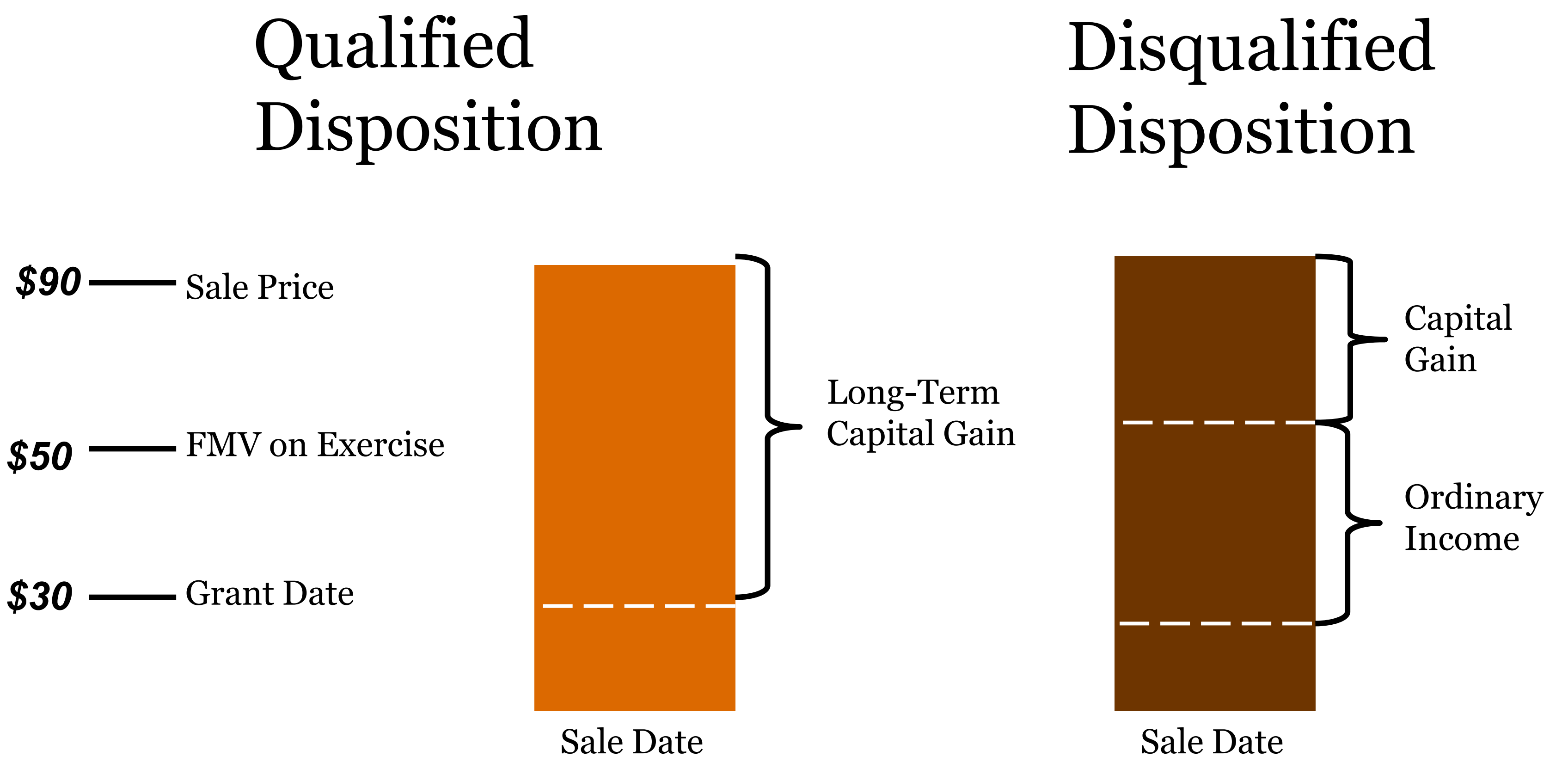
Scope of Application

- U.S. employees of U.S. employers
- U.S. employees of foreign employers
- Foreign employees of U.S. companies that perform services in the U.S.

Incentive Stock Options (ISOs)



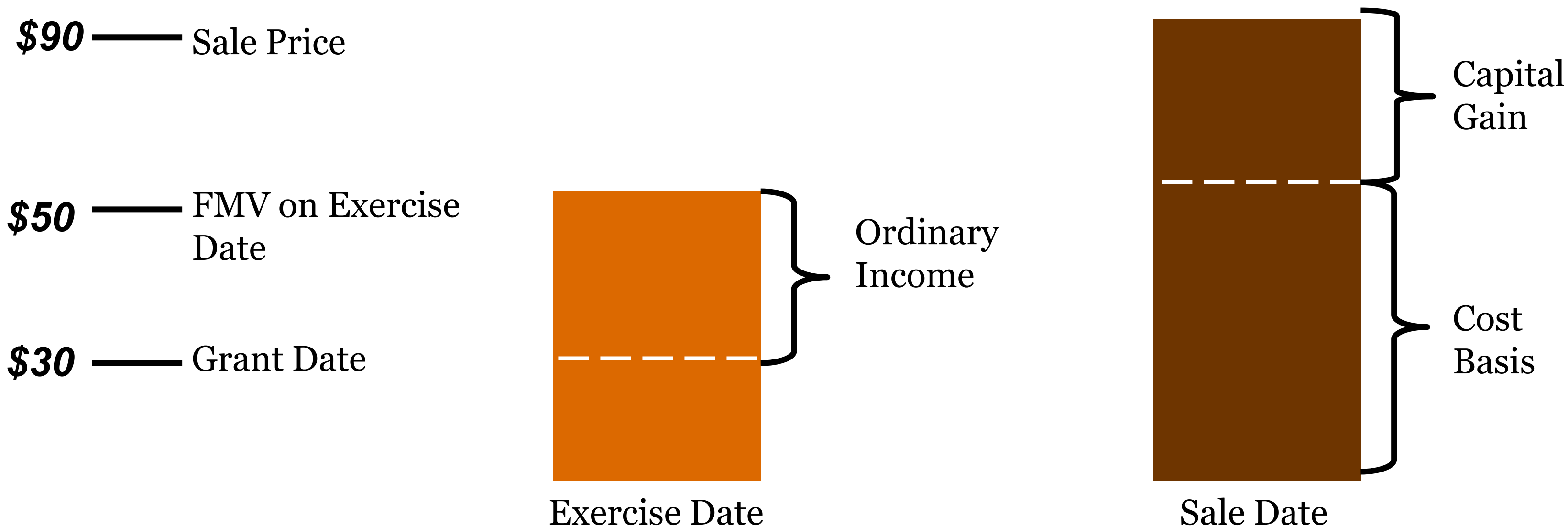
ISO Example



Qualified Disposition
Disqualified Disposition
$90 Sale Price
$50 FMV on Exercise
$30 Grant Date
Long-Term Capital Gain
Capital Gain
Ordinary Income
Sale Date
Sale Date

Non Qualified Stock Options

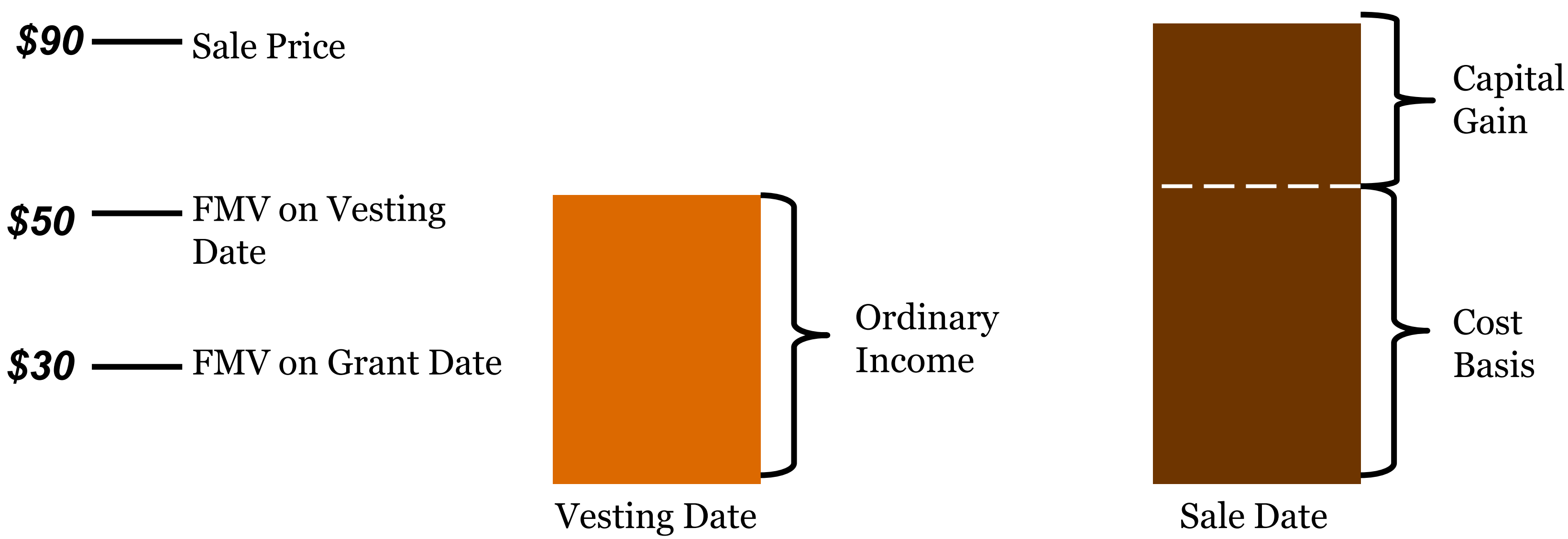
NQSO Example



- **Beware of Section 409A!**

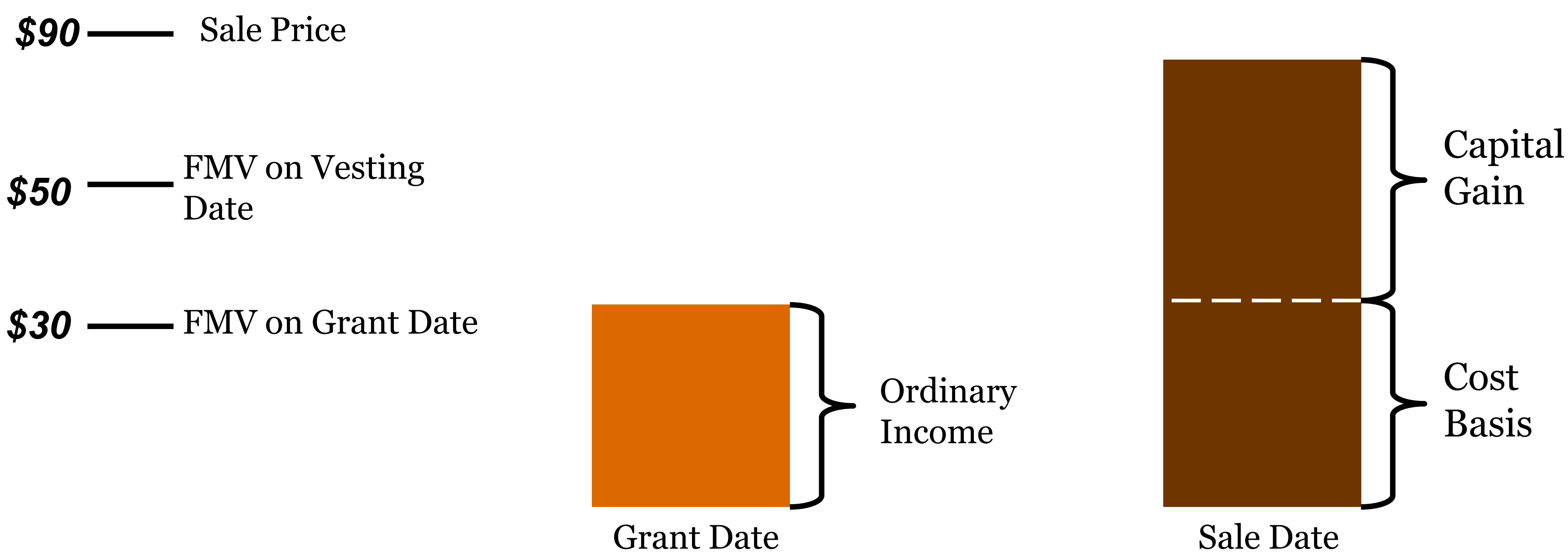
Restricted Stock

Restricted Stock Example



Restricted Stock – Cont.

Effect of Section 83(b) Election



*** Consider planning opportunities!***

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Section 409A

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What is Section 409A?

Section 409A covers "nonqualified deferred compensation"

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Compensation which a service provider has a legally binding right to receive in one taxable year and that is payable in a later year

Section 409A Applies to..

Section 409A applies to **any U.S. taxpayer**

- U.S. citizens and resident aliens working abroad for either a U.S.– based or a foreign-based employer
- Nonresident or resident aliens working in the U.S who participate in a plan maintained by current or former employer based in foreign country

Employer, whether U.S.-based or foreign-based, whose employees are potentially subject to U.S. income tax <u>should always analyze all of its deferred compensation plans for compliance with Section 409A</u>

What is <u>not</u> deferred compensation?

- Certain **non-discounted** stock options (e.g., ISOs) and SARs (Stock Appreciation Rights)
- **Restricted stock** which is taxed under section 83
- Certain **severance pay plans**
- **Short-term deferrals**: annual compensation paid within 2½ months after the end of the tax year
- **Qualified retirement plans and annuities**
- Certain **foreign benefit plans**
- Certain **medical reimbursement arrangements**
- Bona fide vacation leave, sick leave, compensatory time, disability pay and death benefit plans

Significant consequences imposed in case of violations

- **Income inclusion** in the year of the violation on all compensation deferred for that year and all preceding taxable years
- **Interest** at the underpayment rate plus 1% from the year in which the amount was first deferred or, if later, to the year in which it is included in income
- **Additional tax** equal to 20% of the compensation required to be included in gross income
- Note: **penalties apply to <u>individuals</u>, not the employer**

Other Issues to Consider

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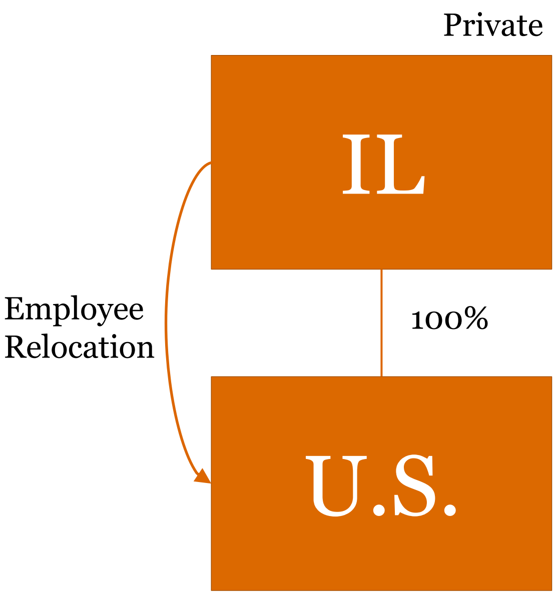
Other Issues to Consider…

- TP considerations
- Compliance considerations

Global Mobility

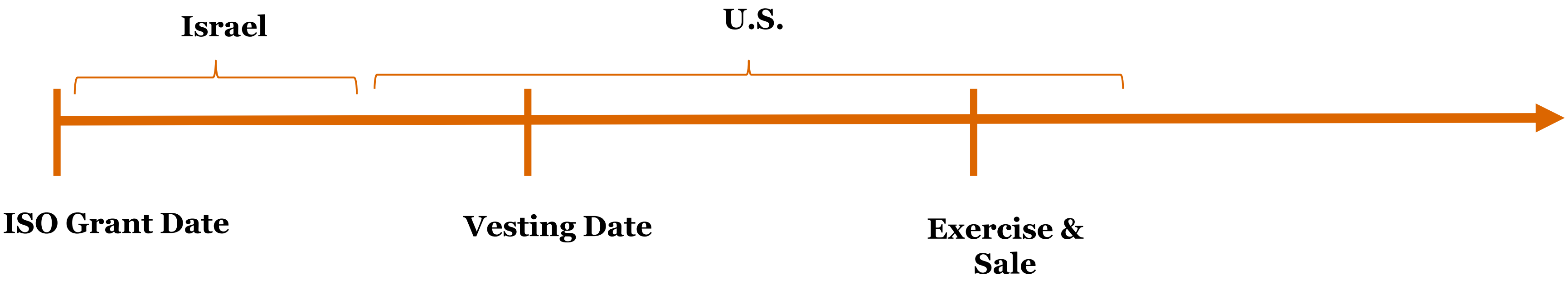


Assumptions:

- IL grants its employees with ISOs
- IL has chosen the Trustee Capital Gain route of taxation under section 102 of the ITO.
- Employees exercise the options and sell the underlying stock on the same day ("same day sale")
- Employees retain Israeli tax residency throughout relocation period under Israeli domestic law

Global Mobility – Cont.

Scenario I – Disposition When Optionee is a U.S. Resident



In Israel:

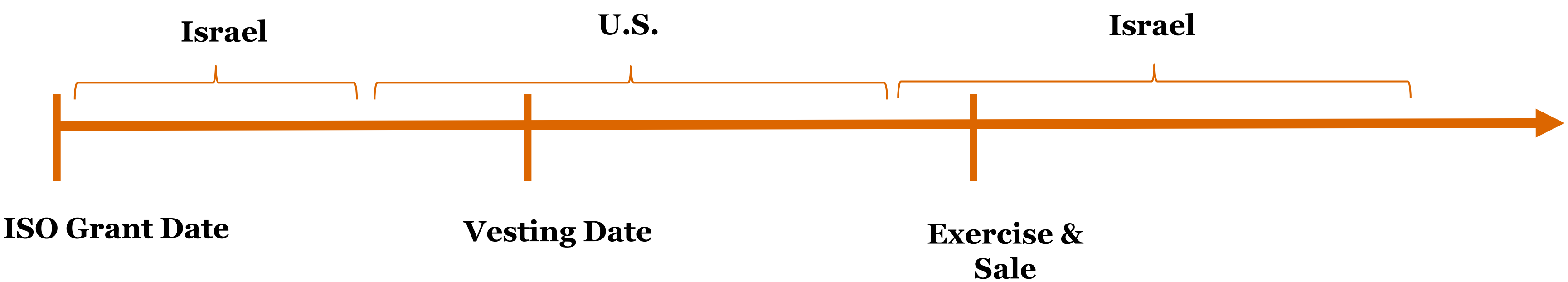
- Trustee withholds 25% of the entire gain (unless approval from the ITA is obtained)
- FTC allowed for taxes paid in the U.S. on U.S. source income

In the U.S.:

- Federal U.S. tax due (at the marginal tax rate) on entire amount of Compensation Element
- FTC allowed for taxes paid in Israel on Israeli source income

Global Mobility – Cont.

Scenario II – Disposition When Optionee is an Israeli Resident



In Israel:

- Trustee withholds 25% of the entire gain (unless approval from the ITA is obtained)
- FTC allowed for taxes paid in the U.S. on U.S. source income

In U.S.:

- Federal U.S. tax due (at the marginal tax rate) on U.S. source portion of Compensation Element
- Reporting requirements apply!

Scope and Limitations

- The information contained in this presentation is for general guidance on matters of interest only. As such, it should not be used as a substitute for consultation with professional tax advisers.

Circular 230: this document was not intended or written to be used, and it cannot be used, for the purpose of avoiding U.S. federal, state or local tax penalties that may be imposed on the taxpayer.

Thank you!

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