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Taxation of Equity – Based Compensation

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Agenda

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

Equity-Based Compensation - Overview

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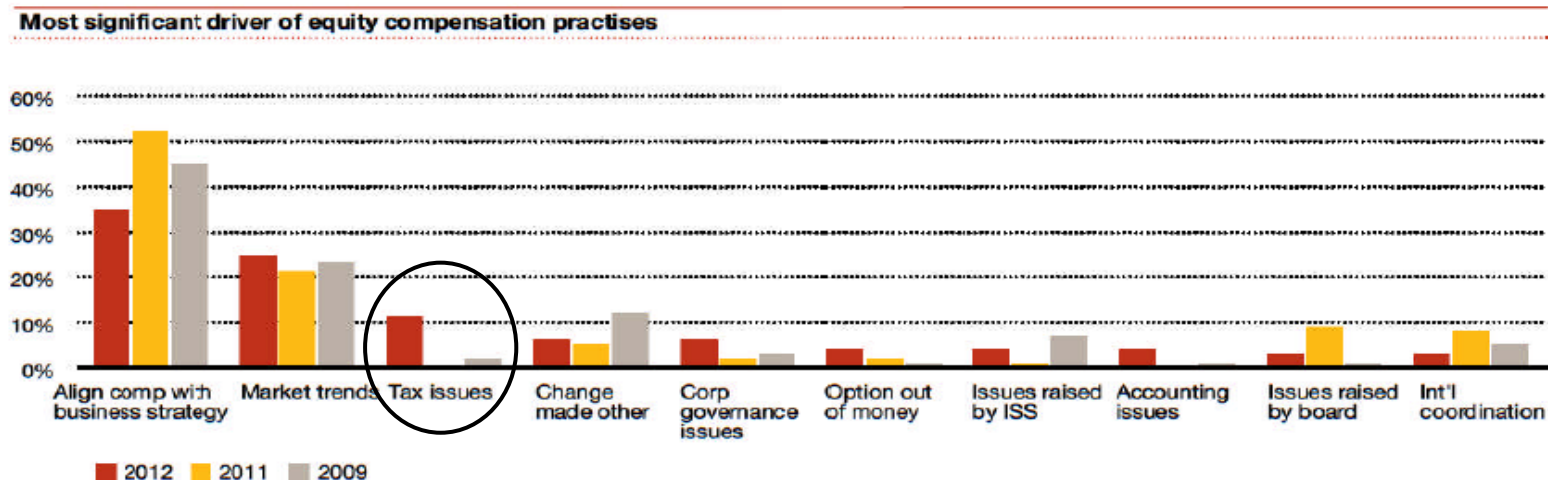
Award Types

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

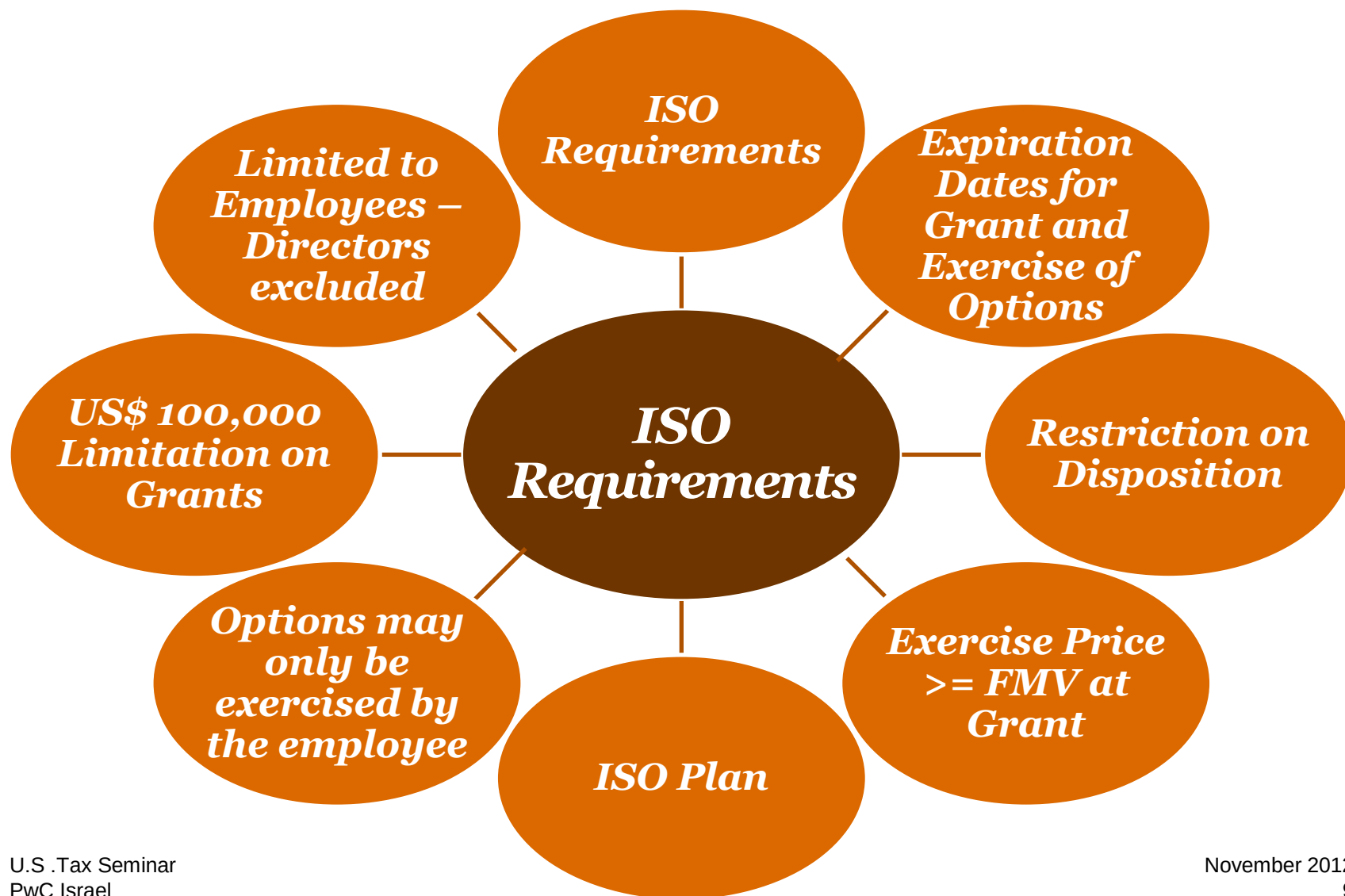
General Rules of Taxation

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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)



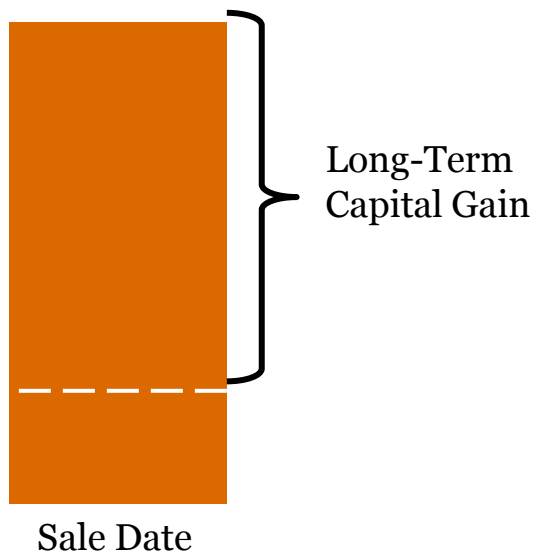
ISO Example

Qualified Disposition

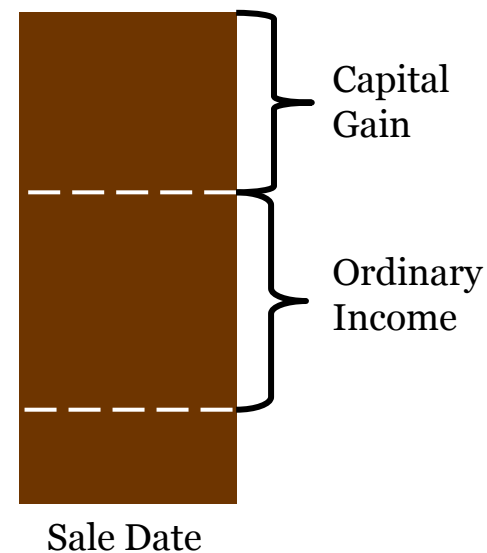
\$90 — Sale Price

\$50 — FMV on Exercise

\$30 — Grant Date

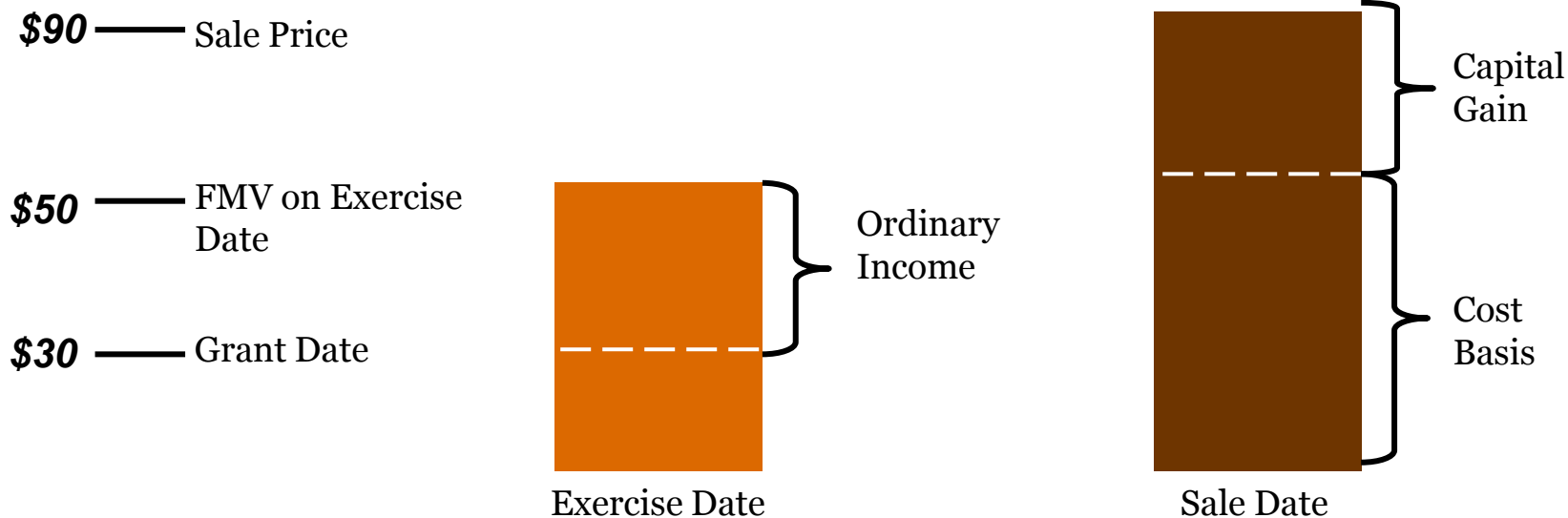


Disqualified Disposition



Non Qualified Stock Options

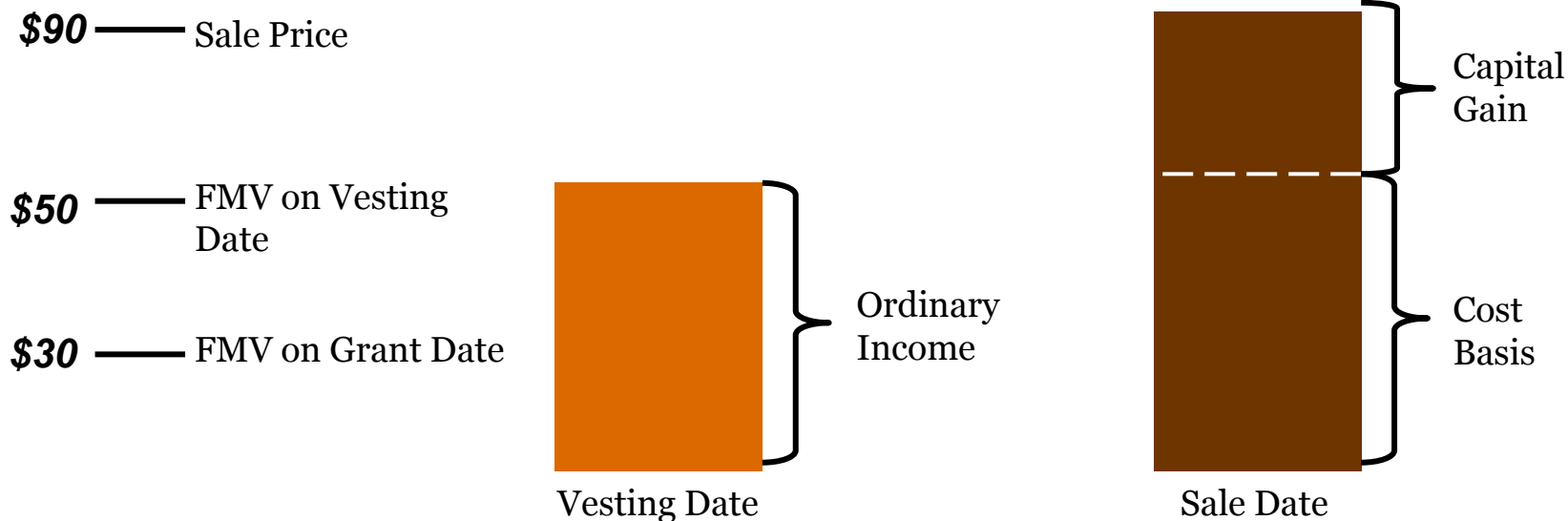
NQSO Example



- **Beware of Section 409A!**

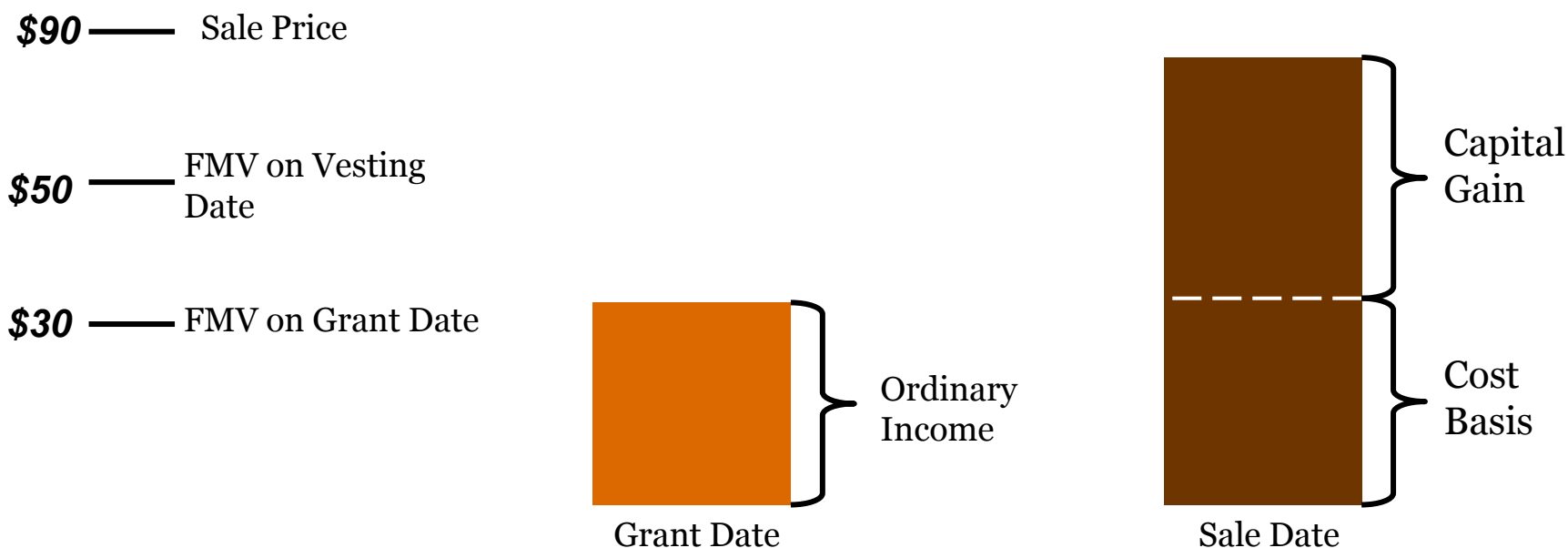
Restricted Stock

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”



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 should always analyze all of its deferred compensation plans for compliance with Section 409A

What is not 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 individuals, not the employer**

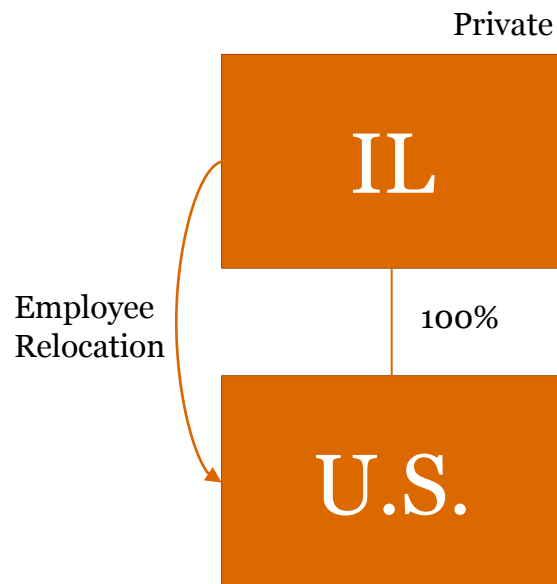
Other Issues to Consider

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Other Issues to Consider...

- TP considerations
- Compliance considerations

Global Mobility

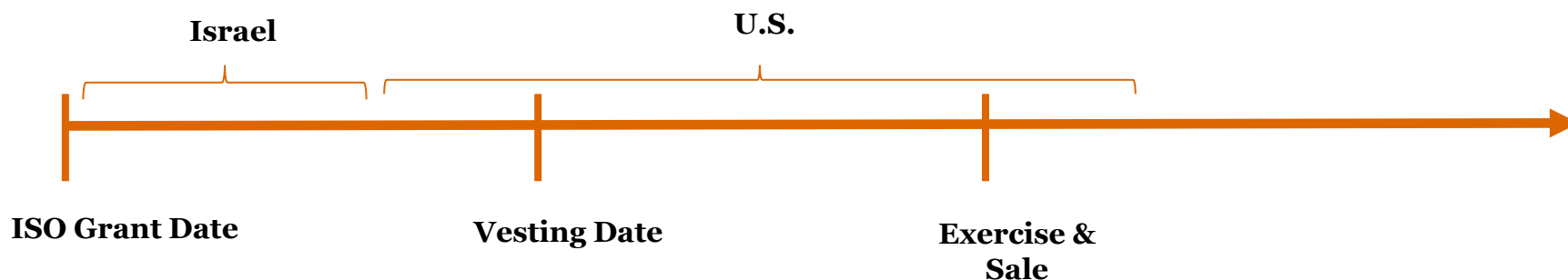


Assumptions:

- 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:

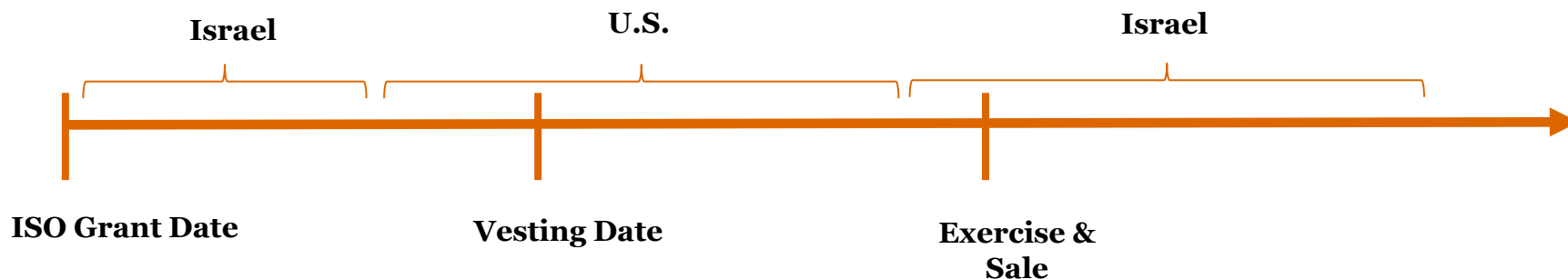
- Trustee withholds 25% of the entire gain (unless approval from the ITA is obtained)
- FTC allowed for taxes paid in the U.S. on U.S. source income

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

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Thank you!

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