Equity-Based Compensation

November 2016

Vered Kirshner, Tax Partner, PwC Israel

Hadas Fuhrer, International Tax Senior Manager, PwC Israel
Agenda

- Equity-Based Compensation - Overview
- General U.S. Tax Rules
- Section 409A
- Global Mobility Issues
Equity-Based Compensation - Overview
# Common Award Types

<table>
<thead>
<tr>
<th>Award Type</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock Options</td>
<td>Offer to purchase company shares at a fixed price</td>
</tr>
<tr>
<td>Stock Appreciation Rights (SAR)</td>
<td>Right to receive value equal to appreciation of company stock</td>
</tr>
<tr>
<td>Restricted / Performance Stock Awards</td>
<td>Awards of company shares that contain restrictions</td>
</tr>
<tr>
<td>Restricted Stock Units (RSU)</td>
<td>Promise to deliver company shares after restrictions lapse</td>
</tr>
<tr>
<td>Employee Stock Purchase Plan (ESPP)</td>
<td>A plan which enables the acquisition of company shares at a discount</td>
</tr>
</tbody>
</table>
Equity Grant Practices

PwC’s 2015 Global Equity Incentive Survey

- “Return to basics” (after periods of economic boom and bust)
- Expansion of global equity plans
- Primary equity vehicles – RSUs, ESPP and stock options
- No Change
- performance metrics: Revenue/ Growth
- performance metrics: EPS & TSR
**Equity Grant Practices**

**PwC’s 2015 Global Equity Incentive Survey (Cont.)**

- Predominant drivers remain the same (increase in “tax issues”):

  - Main priority in implementing a plan: **tax efficiency/savings for both the employee & the company.**
Tax Compliance and Planning (cont.)

- Complexities of mobile employee taxation
- Challenging compliance requirements

- Notable increase in the frequency of internal tax compliance reviews of equity-based compensation plans
General U.S. Tax Rules
Scope of Application

- **U.S. employees of U.S. companies**
- **U.S. citizens employed by foreign companies**
- **Employees of foreign affiliates performing services in the U.S.**
**Incentive Stock Options – ISO - Requirements**

- **ISO Requirements**
- **Aggregated fixed number of shares**
- **Restriction on Disposition**
- **Expiration Dates for Grant and Exercise of Options (10 years)**
- **Exercise Price >= FMV at Grant**
- **Shareholders Approval (12 months)**
- **Limited to Employees – Directors excluded**
- **$100,000 Limitation**
- **Exercise Price**
- **ISO Plan**
**ISO – Qualified Disposition**

- Long-Term Capital Gain = $150 \times 15\%/20\% + NIIT (3.8\%) + State Tax

**No deduction for employer**
**ISO – Disqualified Disposition**

Ordinary Income = $50

**Exercise price**
- $50

**FMV**
- $100

- Grant
- Exercise & Sale (Same day sale) *

**Employer allowed a deduction equal to the ordinary income of the employee**
Non-Qualified Stock Options

**Grant**

- **Exercise price**: $50
- **FMV**: $100

**Exercise**

- **FMV**: $200

**Sale**

Ordinary Income = **$50**  
LT/ST Capital Gain = **$100**

**Employer allowed a deduction equal to the ordinary income of the employee**

**Beware of Section 409A!**
Restricted Stock / RSUs

Ordinary Income = $100  LT/ST Capital Gain = $100

Employer allowed a deduction equal to the ordinary income of the employee
Restricted Stock – with 83(b) election

Employer allowed a deduction equal to the ordinary income of the employee

Ordinary Income = $50

LT/ST Capital Gain = $150

Consider planning opportunities!

U.S. Tax Seminar
PwC Israel
Section 409A
What is Section 409A?

Section 409A covers “nonqualified deferred compensation”

Compensation which employees/service providers have a legally binding right to receive in one taxable year and that is payable in a later year

What is not considered deferred compensation?
Section 409A Applies to...

Section 409A applies to any U.S. taxpayer

U.S. citizens / resident aliens

Non-resident / resident aliens
**Section 409A – Requirements and Consequences**

**Key Consequences:**

- Taxation upon vesting (instead of exercise)
- 20% additional tax
- Interest penalty
- State penalties
- Reporting and withholding requirements (W-2)
**Assumptions:**

- IL - grants ISOs
- IL - Trustee Capital Gain route (Sec. 102)
- Employee exercises options & sells the stocks **on the same day**
- Employee retains Israeli tax residency throughout relocation (under Israeli **domestic** law)
Scenario I – Disposition When Optionee is a U.S. Resident

IL - Capital Gain = $150 @25% + FTC on FSI
U.S. – Ordinary Income = $150 @marginal tax rate + FTC on FSI
Global Mobility – Cont.

Scenario II – Disposition When Optionee is an Israeli Resident

IL - Capital Gain = $150 @25% + FTC on FSI

U.S. – Ordinary Income on the portion of the U.S. source income @marginal tax rate
Thank you!

Vered Kirshner, Tax Partner, PwC Israel
972-3-7954510
vered.kirshner@il.pwc.com

Hadas Fuhrer, International Tax Senior Manager, PwC Israel
972-3-7954-742
hadass.fuhrer@il.pwc.com