global peRSpectives

A QUARTERLY LOOK AT INCENTIVE AND COMPENSATION ISSUES AROUND THE WORLD – SPRING 2012, Vol. II, No. 2

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EQUITY-RELATED ACTION ITEMS IN THE FAR EAST

Australia – Upcoming tax reporting deadlines for stock awards

Income tax reporting for stock award programs is a fairly new concept in Australia. However, in the three years since the reporting requirements went into effect, we have seen a greater focus by the Australian Taxation Office in enforcing the reporting requirements. By July 14, 2012, the Australian employer, on behalf of the issuing parent company, must issue an Employee Share Scheme Statement to the employees who had a taxable event related to the stock awards in the prior reporting period. The reporting period for 2012 is July 1, 2011 – June 30, 2012. By August 14, 2012, the Australian employer must file an Employee Share Scheme Annual Report with the Australian Taxation Office.

China – Time to review your company's currency exchange compliance for stock awards

The Chinese currency exchange restrictions for stock awards have been a significant roadblock for foreign companies in granting stock awards to employees based in China. The latest development concerning currency exchange restriction and stock plan registration is *Circular of the State Administration of Foreign Exchange on Issues concerning the Administration of Foreign Exchange Used for Domestic Individuals' Participation in Equity Incentive Plans of Companies Listed Overseas - Hui Fa [2012] No.7 dated February 15, 2012* (referred to as Circular 7). Circular 7 replaces Circular 78, which had been in effect since 2007. Both Circular 7 and Circular 78 are under the jurisdiction of the State Administration of Foreign Exchange (SAFE).

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In brief, the currency exchange restrictions have been a problem for offering stock award programs to employees in China because of the severe limitations on the conversion and transfer of local currency. Chinese employees have experienced significant challenges in transferring funds to purchase shares and in receiving funds from the sale of shares received through stock awards.

Circular 7 is intended to clarify the scope of the currency exchange restrictions for stock awards and to simplify the process for registering the stock plans with SAFE. The important new developments under Circular 7 are:

- Clarification that the currency exchange compliance requirements include all types of stock awards, such as options, RSUs, purchase rights, SARs and phantom plans.
- The compliance requirements extend to non-employees and non-Chinese nationals based in China who receive stock awards.
- The process for SAFE registration of the stock plans has been streamlined and fewer supporting documents are required.
- The quarterly reporting of currency transactions related to the stock awards following registration must occur within three days of the end of each quarter, and SAFE will intensify its review of the reports.
- Any amendments to the stock plan or the company structure will require the submission of a new application to SAFE.

For companies that are not yet compliant with the SAFE currency exchange restrictions, Circular 7 provides a more defined and streamlined route for SAFE approval. For a company that has registered its stock plans and received SAFE approval under Circular 78, a thorough review of the SAFE approval and the company's administration of the stock plans in China should be undertaken to ensure that the Circular 7 requirements are being met.

Japan – New reporting requirements for stock awards

There has been much uncertainty about the reporting obligations for stock award programs offered to employees in Japan. Starting in 2013, Japanese employers will be required to report all stock award vesting and/or exercise activity occurring in the prior calendar year. The first report will be due March 31, 2013, for the period of January 1, 2012 to December 31, 2012. Information that must be reported includes:

- Grantee information, including name and tax information
- Summary of the stock awards, including type of award, date of grant, number of shares, costs paid by grantee at grant, and exercise price
- Amount of income received by the grantee

For many companies, the stock award reporting will be a new administrative process as most companies currently do not report any information about stock awards in Japan. Companies should review their reporting obligations and coordinate with their Japanese subsidiary to comply with the reporting obligation.

UK UPDATE

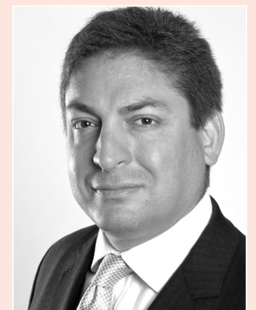
UK Share Plan filings

Some important deadlines are approaching for companies operating share plans in the UK. Companies are required to file with HM Revenue & Customs (**HMRC**) annual returns in relation to employee share plans and employee share acquisitions in the UK during the tax year to 5 April 2012.

Summary

Essentially the obligation is to:

- File annual returns in respect of HMRC approved plans operated during the tax year to 5 April 2012 by **7 July 2012**, unless a notice has been issued by HMRC to the company, in which case it has within three months of the date on that form
- File a Form 42 and provide details of any "reportable events" in relation to any other type of share plan or share acquisition during the tax year to 5 April 2012 by **6 July 2012**, unless a notice has been issued by HMRC to the company, in which case it has 30 days of the date of issue



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Form of returns

Currently, there is no facility for filing online and so the filings must be submitted in the required paper form; all forms are available online. HMRC will not automatically issue paper returns to companies, although it will generally issue notices to file share plan returns to those companies which are known to it.

Each type of approved scheme has its own bespoke return:

- Form 34 (for SAYE)
- Form 35 (for a Company Share Option Plan or CSOP)
- Form 39 (for a Share Incentive Plan or SIP)
- Form 40 (for Enterprise Management Incentives or EMI)

Even if there has been no activity, companies should file a nil return.

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FRANCE UPDATE

New Reporting Requirements on Stock Options, RSUs and BSPCE

On January 31, 2012, two decrees were issued by the French government to specify the tax reporting requirements of companies that grant stock options, RSUs (free shares) and BSPCE to their employees.

For stock options and BSPCE exercised on or after January 1, 2012, the current reporting requirements have been expanded.

Companies are now required to issue, by March 1 of the calendar year following the exercise, an individual statement mentioning its purpose, the name of the company issuing the shares, the identity and address of the recipient, the number of shares issued and the value of each share at the end of the exercise date, the granting and exercise dates, the end of the unavailability period, and the details of the French-source portion of the acquisition gain.

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A copy of this individual statement must also be sent to the administrator of the plan.

Such individual statement must be included by the recipients to their respective income tax return of the year of the exercise of the stock options and BSPCE.

Besides, companies will no more have to send the paper individual statement to the French tax administration before February 15 of the year following exercise. The only requirement is now that all information mentioned on the individual statement must be included in their employer annual wage returns (“DADS”).

In case the holding period would have not been respected by the recipient, an individual statement will have to be issued by the company before March 1 of the following calendar year and sent to its tax office, to the recipient and to the administrator of the plan.

For RSUs vested on or after January 1, 2012, similar new reporting requirements have been introduced.

Companies must issue, by March 1 following the year of vesting, individual statements including their purpose, the name of the company issuing the shares, the identity and address of the recipient, the number of shares issued and the value of each share at the end of the exercise date, the granting and exercise dates, the end of the unavailability period, and details of the French-source portion of the gain.

A copy of this individual statement must also be sent to the administrator of the plan.

Such individual statement must be included by the recipients to their respective income tax return of the year of vesting.

Companies are only required to report all information mentioned on the individual statement in their employer annual wage returns (“DADS”).

In case the two-year holding period would not have been respected by the recipient, an individual statement will have to be issued by the company before March 1 of the following calendar year and sent to its tax office, to the recipient and to the administrator of the plan.

For RSUs vested in 2011

Individual statements mentioning the details of the vested RSUs and the date of expiration of the two-year holding period after vesting must have been issued by companies and sent to their respective tax office before April 30, 2012. Recipients should also have enclosed such individual statements with their respective income tax return.

Clarification by the French tax administration of the equity compensation’s tax treatment in case of employees’ international mobility

The French tax authorities have published on March 13, 2012, two circulars on the equity compensation of internationally mobile employees, in particular when recipients have worked in more than one jurisdiction during the life of an equity award and when non-residents benefit from French-source equity income.

The first circular confirms the OECD general position that the acquisition gain made by beneficiaries of equity awards is taxable in the country in which the employment activities are carried out during the vesting period. In case of duties performed in several countries, the acquisition gain must be prorated according to the time spent in each of the countries in which the recipient has performed his or her professional activity during the vesting period.

The second circular clarifies the procedure applicable to the new withholding tax on French-source equity income (stock-options, RSUs and BSPCE) made by non-residents after April 1, 2011, by analysing the scope of this withholding tax, the taxable event, the taxable basis and the responsible party for withholding such tax (i.e. all the procedures for tax compliance and collection). The circular specifies also that this withholding tax does not apply to options granted prior to June 20, 2007.

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Failure to file on time or filing an inaccurate return may result in fines and penalties.

EMI Changes

The Enterprise Management Incentives (EMI) scheme allows small- and medium-sized companies to offer share options to employees in an extremely tax advantageous way. If the qualifying conditions are met, there may be no income tax or National Insurance contribution liability on exercise of the options. Instead, the gain made on the sale of the underlying shares will be subject to capital gains tax (CGT), which is at the flat rate of 18 percent or 28 percent, depending on what marginal rate of income tax the employee pays. The relevant employer may also get a corporation tax deduction for the gain made by the employee, and so this arrangement can be cash positive for companies.

The limit for the value of shares under option which may be held by an employee under an EMI plan is being increased from £120,000 to £250,000 from 16 June 2012. Also, the government intends in next year’s finance bill to allow exercises of EMI options eligible for entrepreneurs’ relief without the 5 percent shareholding requirement that otherwise applies to shareholdings.

Bonus Deferrals – Taking advantage of next year’s drop in tax rate

Many companies are deferring bonuses until after April 2013 to take advantage of the proposed reduction in the top rate of tax from 50 percent to 45 percent. Companies have a planning opportunity to defer bonuses for employees who earn above the £150,000 per year threshold. Care is required as HMRC is looking very closely at these deferral arrangements, and it is important to get advice on reducing the risks of a challenge. Certainly one thing to watch out for is to avoid giving individuals a choice over whether to accept the deferral.

CALIFORNIA: RESIDENCY MATTERS MORE THAN EVER

Proper tax planning and representation can save individual clients millions of dollars in income taxes. California's economic opportunities and high tax rates, coupled with lower tax rates in other states and countries, have made residency issues an area of focus for the California Franchise Tax Board ("FTB"). The FTB's Residency Unit is well-known for its aggressiveness. And with the state's current fiscal woes, the FTB will likely get more aggressive, especially as the recent wave of IPOs and other liquidation events create wealth for Silicon Valley investors—wealth the FTB wants to get its hands on.

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California Law

In California, as in most states, taxpayers who are residents of the state must pay personal income tax on most investment income. A taxpayer is a resident of California if he or she is domiciled in the state (has a fixed permanent home and, when absent, intends to return there), and is only out of California for a temporary or transitory purpose. A taxpayer who is not domiciled in California can also be a resident of California if he or she is in California for other than a temporary or transitory purpose. Ultimately, to determine residency, courts have often looked simply to where a person has his or her closest contacts—a tedious, fact-intensive inquiry. Proper tax planning can line up the facts in a client's favor.

Further, for nonresidents, income that is sourced to California is also subject to the personal income tax. Income can be sourced to California if it is for services performed in California. This often occurs if a taxpayer is subject to a deferred compensation plan for services performed while in California. Then the taxpayer leaves California, becomes a nonresident of the state, and is paid out of the plan. Under certain circumstances, this income may be sourced to California and subject to California personal income tax. Again, proper tax planning can best position a client to minimize California's tax bite.

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Common Residency and Sourcing Issues

Because California taxes all income of residents and California source-income of nonresidents, the FTB has multiple arguments to subject individuals' income to California personal income taxes. The FTB is increasingly arguing that on a certain date or during a certain period when the individual receives payment, he or she resided in California.

The FTB may argue that the individual was always a resident of California, despite living in another state. Increasingly, the FTB argues that the individual may have left the state, but not until after recognizing the income. Thus, all of the individual's income from the sale of stock, exercise of options, or other similar investment-type activities, would be taxable in California, in addition to wages and other active endeavors.

Finally, when the FTB has no valid argument that an individual resided in California at the time the income was recognized, it argues that the source of income was California and, therefore, it is still subject to California tax. Thus, the FTB has at least three arguments to tax income—(1) the individual was always a California resident, (2) the individual moved after recognizing income, or (3) the source of income was California—and it only has to win on one to subject the income to California tax.

How to Steer Clear of California's Tax Traps

We have increasingly seen the FTB audit individuals who were one-time residents of California, claiming that they continue to be residents of California. Even when these individuals leave the state, the FTB has used every loose end that was not tied up before the individual left to argue a continued connection with the state. With the most recent technology boom in California—with stocks of companies such as Facebook going public and allowing investors and employees to cash out—the FTB Residency Unit will crank up the heat. The FTB will increase audits both for individuals who may have a connection to California and those who may at one time have had such a connection.

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To avoid falling into the trap of being deemed a California resident despite moving out, individuals must document all the ties that they sever with California and also the new ties that they create with their new home state. If a client has ongoing business or personal ties with California, there are ways to neutralize those ties to minimize the impact on a residency determination. A thorough understanding of how the FTB chooses and audits individuals is also important to avoid walking right into the California residency trap. Undaunted by its recent $400 million tort liability for inappropriately auditing a Nevada resident (*See Hyatt v. FTB*, Dkt. Nos. 47141 and 53264 (Nev. Supreme Ct.)), the FTB is increasing its aggressiveness in search of more revenue in cash-strapped California. Taxpayers must know this and plan accordingly as early as possible.

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