



# Import-Export: rules and guidance for broad based stock plans

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# Agenda

- Broad based stock plans - exporting or importing
- The classic designs
- The problems
  - Securities laws
  - Tax laws and other regulations
- The solutions



# Broad based stock plans - exporting or importing 1

- Many more participants than executive plans
- Constrained by design of plan approved by stockholders (and by legislation governing plans)
- Securities laws issues can arise – criminal sanction if get it wrong, could involve expensive filings and may not in fact have a solution
- Local tax or other regulatory approvals which may take time/increase costs
- What is tax efficient at home is not always tax efficient abroad



## Broad based stock plans - exporting or importing 2

- Many broad-based plans have a savings element
- Savings element – issues when exporting savings plans:-
  - Deductions from wages
  - Identity of savings carrier
  - Individual or pooled accounts
  - Interest on savings



# Broad based stock plans - exporting or importing 3

- Option plans that give growth in value to participants – sometimes over a discounted price
  - UK has Sharesave (SAYE) options with up to a 20% discount permitted
  - US has broad-based §423 Stock Purchase Plans (ESPP) with a up to a 15% discount permitted
  - Low risk opportunity for participation in equity growth
- Share matching arrangements that give employees free shares if they buy one or more
  - UK has Share Incentive Plan (SIP) with Partnership, Matching and Free Shares
  - US has broad-based §401(k) plan with voluntary deferrals, encouraged with matching contributions (often in shares)
  - Higher risk opportunity but with advantages of real ownership



## The classic designs – US §401(k) v UK SIP

- US §401(k)
  - Voluntary deferral by employee is from pre-tax but not pre-FICA pay
  - Matching contribution by employer is tax deductible to employer
  - Matching contribution by employer is not taxable on employee when made
  - Withdrawals from plan are taxable on employee – tax is **deferred** until withdrawal
  - Withdrawals before age 59.5 have penalty tax of additional 10% applied
- UK SIP
  - Voluntary purchase of partnership shares is from pre-tax pre-NICs pay
  - Matching shares contribution by employer is tax deductible to employer
  - Matching shares contribution by employee is not taxable on employee when made
  - Withdrawals from plan are **tax free** if made after 5 year holding period – no income tax, NICs or capital gains tax
  - Income tax and NICs may arise on early withdrawals



# The classic designs – US ESPP v UK SAYE

## ○ US ESPP

- Monthly saving from after-tax after-FICA pay
- Opportunity to buy shares with savings at up to **15%** discount
- Discount can be applied to lower of share price at beginning or end (purchase)
- Maximum grant period for discount at beginning is 27 months – typical practice is **6 – 12** month periods
- Discount liable to income tax when shares sold, CGT treatment if shares held for a period – no CGT exempt amounts

## ○ UK SAYE

- Monthly saving from after-tax after-NICs pay
- Opportunity to buy shares with savings at up to **20%** discount
- Discount can only be applied to share price at beginning
- Maximum grant period is 7 years – typical practice is minimum period of **3 years**
- Normally no income tax arises on exercise
- Gains on sale liable to CGT but significant annual exemption from CGT – 2007/08 £9,600



# Securities laws - UK

- In the past importing plans into UK was relatively easy – little in the way of securities law issues PROVIDED that plan was confined to employees
- Now the EU Prospectus Directive (EUPD) applies:
  - Is the plan caught by EUPD? (In UK and elsewhere, options/free shares are not subject to EUPD, but share purchase plans are)
  - Are there securities admitted to trading on an EU regulated market? If yes, you can use the “employee share schemes” exemption – information document required
  - Are the 100 person or €2.5 m exemptions available? Caution, these are applied differently across the EU!



# Securities laws - UK

- Financial Services and Markets Act 2000 (FSMA) regulates investment activities and communications – general prohibition on carrying out “regulated activities” or “financial promotions” unless an “authorised person”
- “Employees’ share schemes” exemption from general prohibitions
- Criminal sanction if breach of Act



# Other regulatory issues – UK

- Company law:-
  - Employees' share scheme?
  - Financial assistance/source of shares
- Trusts
  - Class of beneficiaries
  - US tax issues (grantor/non-grantor trusts)
- Taxation
  - withholding is responsibility of employer
  - no statutory right to recover tax/NICs from employee = need adequate provisions to require employee to reimburse
- Employment law
  - claw back provisions
  - exercises of discretion/acceleration



# Securities laws – US

- US is potentially difficult and needs specialist solutions for larger numbers of non-discretionary awards (if securities not registered with SEC)
  - Rule 701 generally gives an exemption for sales of up to US\$5 million a year (options treated as “sale” at time of grant)
  - Going over limit needs extensive disclosures and US GAAP accounts – although
  - State securities laws vary substantially in scope and effect – always necessary to check



# Securities laws – US – practical tips

- Sales of unregistered shares are prohibited without exemptions, disclosures etc
- Awards of free shares are generally not a problem, under the “no-sale” doctrine
  - Remember to incorporate restrictions on re-sale of shares awarded as bonuses to your employees
  - Keep stock certificates out of US
  - Use brokers in UK to sell shares on the UK markets
- How do you convert an option into free shares?
  - Grant a stock settled SAR instead, deliver appreciation as bonus shares



# Taxation - UK

- It makes sense to use HMRC approved plans if possible
  - Only possible if plan confined to employees
  - Income tax saving for employee
  - NICs saving for employee and employer
  - Corporation tax deduction for employer even for approved options
  - Change in UK capital gains tax regime (CGT) (now no holding period needed to obtain favourable rate – 18% rate for all gains) means HMRC approved plans look even more attractive



# Taxation - UK

- UK unapproved plans:-
  - Employee - income tax at marginal rate and NICs on whole of gain
  - Employer's NICs – can be transferred to employee
  - If sell immediately, no benefit from lower CGT rates (as gain charged as income, not capital)
  - But corporation tax deductions available
  - Non-employees should not participate (employees' share scheme/EUPD/FSMA)
  - Non-employees would be taxed differently
- NB! HMRC annual returns required for all plans



# Non-Employees & Mobile Employees – UK

- Plans imported to UK should exclude non-employees (EUPD/FSMA issues)
- Separate plan for non-employees recommended (and specialist advice on EUPD and FSMA)
- What about mobile employees?
  - May not receive tax benefit under UK tax approved plans
  - Administrative difficulties in including such employees in tax approved plans (may need overseas withholding/reporting)
  - Solution – parallel non-resident secondees' or mobile employees' plan?



# Taxation - US

- Qualified plans may not always be best option
  - Income tax and social security saving for employee
  - BUT qualifying option (ISO) status denies employer a corporate income tax deduction if shares retained for required holding periods
- Non-qualified plans:
  - Employee - income tax and social security on whole of gain
  - BUT employer can claim corporate income tax deduction
- Beware §409A, which imposes substantial tax penalties on most discounted options



# Solutions by accountants!

- The expensing of options has levelled the playing field significantly (options v full share awards)
- A SAR settled in shares has the same accounting expense as an option
- No accounting disadvantage arises from delivering SARs to US employees instead of options – US securities law advantage - benefit from the “no sale” doctrine (especially where SAR cannot be settled for at least one year following grant)



# Question and Answer session

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# Appendices

Additional information



# Exporting stock plans – practical tips

- Get stockholder consent to modify your plan to take account of taxation and securities laws when exporting to overseas jurisdictions
  - UK standard approach in shareholder resolutions to approve the plan – if not, may need shareholder approval to amend plan (timing issue)
  - US plans nearly always contain necessary powers of amendment, even in §423 plans – if not, would need shareholder approval to amend plan
- Case study tips
  - Introduce necessary amendments as a schedule to the original plan (US plans frequently call these “subplans”)
  - HMRC approval required before making awards under SAYE or SIP – timing issue (no comparable requirement in US)



# Securities laws – UK – practical tips

- EUPD issues:
  - Investigate – if prospectus required will add time and costs
  - Prospectus filed in another EU jurisdiction? Passporting relatively straightforward
  - Shares (or debt) listed on an EU regulated market? Remember to include information memorandum in launch documents!
  - Consider restructuring plan to take advantage of exemption from EUPD for options/free shares
- FSMA issues:
  - Who is going to make invitations/awards?
  - If sign off by “authorised person” required will add time and costs
  - Investigate non-employee issues early



# Taxation - US

## ○ Background to §409A

- Pre §409A – tax rules -general tax principles and individual court decisions— no comprehensive regulation
- In grey areas, some individuals were engaging in aggressive or abusive practices
- As a reaction to ENRON, Worldcom, Global Crossing etc various laws including §409A were passed
- Example: ENRON employees were locked into their matching §401(k) shares until termination of employment
  - They could not sell even when the executives were bailing out of their shares, including shares in more flexibly designed non-qualified deferred compensation plans
  - These and other inequities - political opportunity to introduce legislation to comprehensively regulate non-qualified deferred compensation - impose substantial tax penalties on arrangements not satisfying detailed requirements as determined by the US Treasury Dept and IRS!



# Taxation - US

## ○ Update on §409A

- Law became generally effective on 1/1/2005, but final commentary and regulations (almost 500 pages long) not issued until April 2007.
- Have been in a lengthy transition period for the past 2+ years
- Final regulations to become fully effective and all affected arrangements need to be amended by the end of 2008, although substantial compliance is in practice required now
- Impact of §409A on stock awards is mostly with respect to stock options and RSUs (and UK style discounted/nil-cost discretionary awards)
  - ISOs and §423 stock purchase plans are exempt
  - Options and SARs with exercise price at least equal to 100% of fair market value are exempt (but watch out for amendments where stock price has appreciated)
  - RSUs that are settled upon vesting are not subject to §409A, but ability to defer tax liability beyond vesting will cause §409A to apply.
  - “Short term deferral” exemption