



**Critical Developments
in 2005**

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Topics Covered


1. Impact of New Accounting Standards on Equity Plan Design
2. Impact of American JOBS Act on Equity Plans for U.S. Employees
3. Tax Compliance/Audit Issues
 - Netherlands as a case study
4. New Tax Regime for RSUs in France
5. Increasing Employment Law Impact
 - Denmark as a case study



GEO 1

Impact of New Accounting Standards

- FAS 123R and IFRS 2 require expensing of stock options and other share-based payments




GEO 2

Impact of New Accounting Standards

Burmeister's Proposition:

- Option pricing models (Black Scholes, Lattice Binomial, etc.) overvalue options and SARs relative to full value awards
- Institutional shareholders resist dilution, share pool size, burn rate, etc. Again, options come off worse than full value awards




GEO 3

Impact of New Accounting Standards

Therefore, unless

- FASB/IFRS modify valuation approach for options/SARS or
- The market value approach (e.g., Cisco's reported EFORS), which reduces option expense, proves viable . . .




GEO 4

Impact of New Accounting Standards

Then,

- Full value awards are in your future and restricted stock units are preferred



GEO 5

Example of Option Accounting

1000 shares at \$50/share 4 year ratable vesting
 Expected forfeitures = 25% Effective tax rate = 35%
 B.S. Value = \$24,000 (48%)

GAAP Expense for NQSO

	Year 1	Year 2	Year 3	Year 4
Black-Scholes Value	\$6,000	\$6,000	\$6,000	\$6,000
Adjustment for Forfeitures	(1,500) \$4,500	(1,500) \$4,500	(1,500) \$4,500	(1,500) \$4,500
Less Projected Tax Benefit	(\$1,575)	(\$1,575)	(\$1,575)	(\$1,575)
GAAP Expense	\$2,925	\$2,925	\$2,925	\$2,925

GEO 6

Example of RSU Accounting

300 shares at \$50/share 4 year ratable vesting
 Expected forfeitures = 25% Effective tax rate = 35%
 Value = \$15,000

GAAP Expense for RSU

	Year 1	Year 2	Year 3	Year 4
Value	\$3,750	\$3,750	\$3,750	\$3,750
Less Expected Forfeitures	(938) \$2,812	(938) \$2,812	(938) \$2,812	(938) \$2,812
Less Projected Tax Benefit	(984)	(984)	(984)	(984)
GAAP Expense	\$1,828	\$1,828	\$1,828	\$1,828

GEO 7

Options vs. New Forms of Awards

Advantages of Options


- Well understood and accepted
- Positive cash flow for company
- More upside than RSUs
- Withholding easy to handle
- Employee can time taxable event

GEO 8

Options vs. New Forms of Awards

Disadvantages of Options

- High GAAP cost vs. perceived value
- High dilution/share pool usage
- No retention value in down market




GEO 9

Options vs. New Forms of Awards

Advantages of RSUs

- Lower GAAP cost relative to options-based on perceived value
- Retention value in down market
- Valuation is simple
- Low share usage/dilution
- Shorter overhang period
- Easier non-U.S. compliance




GEO 10

Options vs. New Forms of Awards

Disadvantages of RSUs

- Less upside than options
- No ability of employee to time taxable event (409A)
- Withholding issues
- No cash flow to company




GEO 11

Impact of American JOBS Act

Equity Plan Design

- Section 409A – Huge change in U.S. tax treatment of “Non-qualified Deferred Compensation”
- Covers:
 - Discounted options
 - Discounted or non-public company SARs or SARs paid in cash
 - RSUs




GEO 12

Impact of American JOBS Act

Trap for Unwary

- Modification of existing options affecting price
 - Brings option within 409A unless satisfies ratio/spread test of Section 424




GEO 13

Impact of American JOBS Act

If Covered by Section 409A

- Option will be taxed at vesting
- 20% additional tax
- Interest on tax from vesting for modified options




GEO 14

Impact of American JOBS Act

If Covered by Section 409A


- RSUs may not permit deferral beyond vesting (unless deferral elections made in year before award)
- Short-term deferral (until 2_ months after later of employees or employee's tax year end)
 - But must specify payout timing within plan documents



GEO 15

Impact of American JOBS Act

- SARs paid in cash are dead (liability accounting doesn't help)
- Plan aggregation
 - If 409A violation, interest or penalty applies for all amounts deferred by that individual under all equity plans



GEO 16

Netherlands - Tax Audits


- October 4, 2004 announcement by the tax authorities of two year stock option Audit Program ending December 31, 2006
- Audits of personal income tax and wealth tax
- Focus - foreign (US) stock options
- Years under investigation 1992-2002



GEO 17

Netherlands - Tax Audits

- Tax years under audit: 1992-2002
- Statute of limitations – five years for wage tax and income tax
- However, special twelve-year statute of limitations because the tax authorities take the position that stock option income is derived from abroad




GEO 18

Netherlands - Tax Audits

Background Audit Program


- Stock options constitute taxable employment income
- Usually the Dutch employer is required to withhold and report wage tax
- Employees (also) have to report stock option income in their income tax returns



GEO 19

Netherlands - Tax Audits


- In some cases, Dutch employers did not withhold the correct amounts or did withhold but not at the right time
- In all cases, Dutch tax authorities suspect that stock option income has not been reported (correctly) by the employees in their income tax returns
- The rules are complicated and have changed frequently over the past years



GEO 20

Netherlands - Tax Audits

- The tax authorities already approached more than 700 employees with the request to provide information regarding stock options for which income had to be recognized during the years 1992-2002
- The tax authorities also requested information from foreign parent companies through the local tax authorities (IRS) based on the article for exchange of information of various tax treaties




GEO 21

Netherlands - Tax Audits

Amnesty Program

- Employees can voluntarily disclose option income
- Employees will have to pay back taxes and the statutory interest
- Employees who do not voluntarily come forward and are subject to the audit will be assessed with penalties up to 100% of the back taxes and possibly criminal charges



GEO 22

Netherlands - Tax Audits

What to do Now?

- Inform employees in the Netherlands of the tax audit program
- Encourage employees to review their tax position and possibly to make use of the amnesty program to prevent penalties and criminal charges
- Refer employees to the website of the Dutch tax authorities for further information




GEO 23

Netherlands - Tax Audits

What to do Now?

- Companies should review the tax position of the Dutch entity
- Did the Dutch entity qualify as wage tax agent?
- Did the Dutch entity withhold and report the taxes correctly?
- Did the Dutch entity make special arrangements with tax authorities?
- Review communications provided to employees in the past




GEO 24

Netherlands - Tax Audits

What to do if Audit?


- Check with in-house counsel to understand scope/tone of information to be provided
- Provide copies of option agreements
- Inform employees of possible rulings with the tax authorities
- The employer cannot deal with the tax authorities on behalf of the employees. All tax assessments/court cases/penalties/criminal charges will be handled on an individual level.
- Prepare for claims



GEO 25

France - New Tax Favored Program

- New Form of Tax-Preferential Equity Plan Effective 1/1/2005 – Shares Requiring No Cash Consideration
 - Restricted Stock Units
- No Social Insurance Contributions
- Income Taxes Deferred from Vesting to Sale
- Preferential Tax Rates upon Sale of Shares



GEO 26

France - New Tax Favored Program

Requirements

- Establishment of Sub-plan of U.S. Plan to Provide for French Specific Requirements
- Shareholder/board Approval of Grant
- Vesting Period of at Least Two (2) Years From Grant
- Shares Held for at Least Two (2) Years From Issuance of Shares
- Closed Periods at Grant? At Sale?




GEO 27

Denmark - Stock Options

Novo Case

- Danish Supreme Court decision
- Option grants made for past performance
- Employee terminated employment voluntarily
- Court ruled employee terminating employment was entitled to retain pro-rata share of options
- Uncertainty of application to options not granted for past performance



GEO 28

Denmark - Stock Options

Intel Case

- Option grant made by Intel (U.S. multinational company)
- Grant not made for past performance
- Danish Supreme Court permitted employee to retain options when employee voluntarily terminated employment




GEO 29

Denmark - Stock Options

Application of Case Law

- Grants made prior to July 1, 2004
- Under Intel and Novo cases, terminated employees (even voluntary terminations) will retain unvested options for entire term



GEO 30

Denmark - New Stock Option Act

Purpose

- To make the law on stock options more clear

Application

- All grants made on or after July 1, 2004
- Covers stock options, stock purchase rights, restricted stock units and other future rights to purchase shares

Employees Covered

- All employees in Denmark except members of the Danish company's management who are not considered salaried employees under Danish law



GEO 31

Denmark - New Stock Option Act

Granting Companies Covered

- Intended to be applied to all granting companies including U.S. multinational companies. However, the New Act contemplates situations in which the New Act does not apply. At this time, it is not yet certain how limited the exceptions will be. The application of the New Act may depend on the level of the local Danish subsidiary's involvement in the Plan.




GEO 32

Denmark - New Stock Option Act

Requirements

- Information Requirement
 - Employers are required to provide certain information about the grants (*i.e.*, grant date, vesting schedule, etc.) to employees in Denmark in the form of an employer statement
 - Distribute employer statement within 30 days of grant
 - Must translate employer statement into Danish
 - Employer statement must be separate from option agreement/enrollment form



GEO 33

Denmark - New Stock Option Act

Requirements

- To Allow Certain Grants to be Retained Upon Termination
 - Involuntary Termination Not for Cause (and possibly certain types of retirement terminations and constructive dismissals)
 - ESPP - probably no additional contributions need to be permitted
 - Options - retain all outstanding vested/unvested options




GEO 34

Denmark - New Stock Option Act

Requirements

- To Grant Certain Employees Pro-rata Share of Grants they Expected to Receive in Accounting Year of Termination
 - Involuntary Termination Not For Cause (and possibly certain types of retirement terminations and constructive dismissals)
 - ESPP - probably no right to future grants
 - Options - "expected" future grants determined by specific facts and circumstances




GEO 35

Denmark - New Stock Option Act

Requirements

- Note: For the purpose of the New Act, the termination date is the last day following the notice of termination period. The exact notice period that must be given will depend on length of service, etc.



GEO 36

Denmark - U.S. Multinationals Issues with New Stock Option Act

423 Issues for ESPPs

- Not employees within 3 months of when grant/purchase made
- "Equal Rights and Privileges" clause
 - Possible Solutions: Non 423 component of ESPP and/or cash pay-out alternative




GEO 37

Denmark - U.S. Multinationals Issues with New Stock Option Act

Accounting Issues

- Allowing former employees to receive grants/purchase shares or extending the term of an option beyond normal post-termination period
- Cash pay-out will be an expense
 - Possible Solution: Language in Denmark grants authorizing post-termination adjustments to comply with local law or making the original term of the grant incorporate the terms of the New Law with respect to termination of employment



GEO 38

Denmark - U.S. Multinationals Issues with New Stock Option Act

Tax Issues

- Does non-forfeatability of RSU create immediate tax?

Plan Constraints

- Grants to former employees
- Purchase under ESPP for former employees
 - Possible Solution: Cash pay-out alternative?



GEO 39

Questions?

Thank you for your participation

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GEO 40
