

East Meets West:

***Managing the Challenges of Global Share
Plans Outside the U.S. & U.K.***

Friday, 29 June 2007,
11:25 – 12:25, Session 7:5

Ernst & Young



Agenda

- Introduction – Tracy Robarge, Boston, MA USA
- Germany – Britta Schmitt, Munich, Germany
- France – Colin Bernier, Paris, France
- India – Amitabh Singh, New Delhi, India
- China – Winnie Ng, China Competence Center in Hamburg, Germany

Objectives

- Provide insight on how to address the multitude of issues related to offering equity compensation globally
- Provide insight into issues specific to Germany, France, China and India

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Global Plans – what to think about

- Different issues for different countries
 - Legal considerations
 - Securities law
 - Foreign exchange and stock ownership requirements
 - Data protection
 - Labor law
 - Tax considerations
 - Timing
 - Applicable taxes – income/social; employee/employer
 - Compliance requirements – reporting and withholding
 - Cross-border issues (expats/inpats/TCNs/permanent transfers)
 - Plan qualification/beneficial tax treatment opportunities
 - Corporate Issues

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Global Plans – what to think about

- Different issues for different equity vehicles
 - ESPP vs. others
 - Stock Options vs. Restricted Stock
- Different issues for different participants
 - Local Nationals vs. cross border
 - Cross border – short term vs. long term
 - Tax Treaties and Totalization Agreements
 - Favorable tax treatment



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Global Plans – Putting it All Together

Requirements _ Timing _ Costs _ Ongoing

Plan objectives – are they being met globally?



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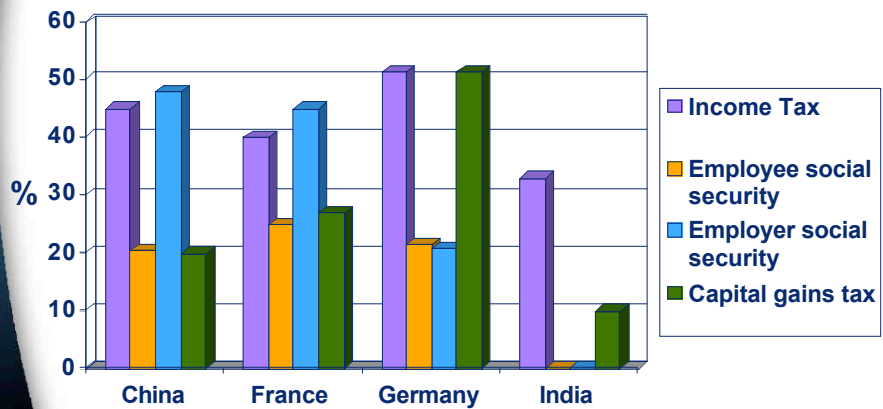
Timing of Taxation

Award	China	France	Germany	India
Stock Options	Exercise	Exercise	Exercise	Exercise
Restricted Stock Award	Grant	Grant	Grant	Vest
Restricted Stock Unit	Vest	Vest	Vest	Vest

Shaded = Preferential Tax Treatment Available

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Top Marginal Tax and Social Security Rates



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Share Plans in Germany

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Germany – Managing the Challenge

- **Securities Law**
 - Some Germany specifics in the interpretation and implementation of the European prospectus directive
- **Employment Law**
 - Risk from forfeiture provisions and acquired rights issues
- **Data Protection**
 - European / German regulations are quite strict
 - Consent required from employees (e.g. for US companies to transfer data to the US)
- **Company Law**
 - More limitations for German companies to implement share plans (e.g. restricted stock or stock award plans)

Germany – Managing the Challenge

- Recent court decisions and statement of practices
 - Clarity on taxation of stock options but open issues remain
- Major challenge in respect of expatriates
 - German tax authorities have own understanding of vesting for purposes of sourcing option income
- New German subject to tax clauses for resident taxpayers
 - Risk that full benefit in case of expatriates is taxed and additional administrative requirements
- Recharge agreements
 - Transfer pricing issues
- German GAAP and tax accounting
 - Different approach compared to IFRS and US GAAP

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Share Plans in France

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Exporting Stock Options to France

- NQSOs
 - Commonly used.
 - Income tax and employer and employee social security at exercise on the spread.
 - Any rise in value after exercise is taxed at sale as capital gain.



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Exporting Stock Options to France (cont.)

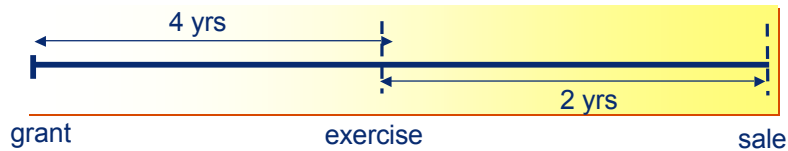
- French qualifying options
 - No direct equivalent of US ISO, however, a French qualified plan is available.
 - Some conditions for French qualification:
 - The option price must not be less than 80% of the average market price
 - Options can in general, only be granted to employees
 - The shares must be kept in an individual securities account in the name of each employee
 - The option cannot be transferable or disposable
 - Specific filing requirements must be met
 - There are also further rules relating to when options can be granted



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Exporting Stock Options to France (cont.)

Tax treatment of French qualifying options:



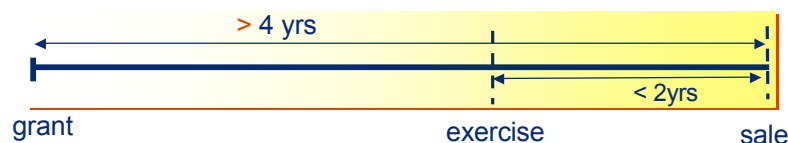
Minimum 4 yr period from date of grant & shares held \geq 2 years from date of exercise then:

- the taxation of the spread is deferred at sale and the spread is taxed at more favourable tax rates (27% up to 152,500 euros)
- Spread is exempt from social security contributions (both employee and employer shares)

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Exporting Stock Options to France (cont.)

Tax treatment of French qualifying options:



Minimum 4 yr period from date of grant before sale, but < 2 years from exercise then:

- the taxation of the spread is deferred at sale and the spread is taxed at flat tax rates (41% up to 152,500 euros). Is it still favourable?
- Spread is exempt from social security contributions (both employee and employer shares)

As with the US ISO, **options could vest in tranches, but still receive favourable tax treatment**, if held for a minimum period of 4 years from grant.

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Exporting Restricted Stock to France

- Restricted stock
 - Likely to be taxed at award.
 - However, could be taxed at vesting if employee has “ownership” at vesting only.
 - The market value of the stock at the date of award less the cash consideration paid, if any, is subject to income tax at award.
 - Employer and employee social security also due.



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Exporting RSUs to France

- RSUs
 - RSUs are taxed at vesting and stock delivered to employee.
 - The taxable amount is the market value of the stock at the vesting date less the cash consideration paid, if any.
 - This amount is subject to income tax and employer and employee social security at vesting.



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Exporting RSUs to France (cont.)

- Qualifying RSUs
 - Newly available from January 2005.
 - Main conditions for qualifying:
 - The plan must be approved by shareholders or an authorised sub-committee.
 - The award of shares must be **free**.
 - Participants must be employees or directors (as defined in the relevant French legislation) of the issuing company or one of its subsidiaries.

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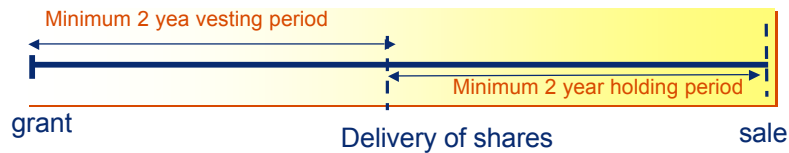
Exporting RSUs to France (cont.)

- Conditions for qualifying (cont.):
 - Minimum period of two years during which the shares can not be delivered
 - Minimum holding period of two years after the delivery of the shares, except in the event of death and disability
 - At the end of the holding period shares may not be disposed of during certain close periods currently required under French law insider rules
 - Payment of the stock award must be in shares. A cash payment is not permitted

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Exporting RSUs to France (cont.)

Tax treatment of French qualifying RSU:



- The taxation of the gain (Fair market value of the shares at the date of delivery) is deferred at sale
- The gain is taxed at flat tax rates (41%) or at the employee's usual progressive income tax rates + 11%, if more advantageous. Is it still favourable?
- Gain is exempt from social security contributions (both employee and employer shares)

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France - Challenges

Others aspects have also to be contemplated when implementing a plan (qualified or not) in France.

- Regulatory issues and data protection
- Labour law issues
- Mobile employees (French favourable regime is tax effective only in France) and Current draft tax legislation on the allocation of the gain

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Share Plans in India

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India – Taxation of Employee Share Plans

- Effective April 1, 2007, India has introduced new regime for taxation of employee share plans
- Allotment of shares/securities (including sweat equity) to employees treated as a Fringe Benefit
- Employer will be required to pay Fringe Benefit Tax (FBT) on the value of the Fringe Benefit at 30% (33.99% after surcharge and cess)
- The value of the Fringe Benefit = Difference between Fair Market Value at vesting and any amount recovered from / paid by the employee
- Provisions permit employer to recover FBT from the employee
- Employee will be liable to pay Capital Gains Tax on sale of shares. Fair Market Value at vesting will be the cost base.

India – Taxation of Employee Share Plans

- “Plan Qualification” opportunity for deferral of tax until sale withdrawn. Earlier qualified plans also covered under new regime.
- The new legislation is intended to cover all Plans which involve allotment of shares to employees including Employee Stock Purchase Plan and Restricted Share Plan
- Restricted Stock Units (RSUs) which are converted into shares will attract Fringe Benefit Tax to be paid by the employer on allotment of shares
- Stock Appreciation Rights (SARs) or any other pure cash settled plans may not attract FBT but be taxed in employee’s hands as compensation income.
- Guidelines for calculation of Fair Market Value are yet to be notified by the Government

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India – New Legislation Vs. Old Legislation

Particulars	New legislation	Old legislation	
		Qualified plan	Non-qualified plan
First taxable event	Allotment/ transfer of shares	Refer to Note Below	Exercise/ Allotment of shares
Whose liability	Employer		Employee
Taxable value	FMV of shares on vesting less: price paid by the employee		FMV of shares on exercise less: price paid by the employee
Rate of tax	30% plus applicable surcharge and cess		Slab rates plus applicable surcharge and cess

Note – Under old legislation (up to March 31, 2007), if the plan was qualified as per Indian Government Guidelines, taxation was deferred until sale of shares

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India – New Legislation Vs. Old Legislation

Particulars	New legislation	Old legislation	
		Qualified plan	Non-qualified plan
Subsequent taxable event		Sale of shares	
Whose liability		Employee	
Cost basis	FMV of shares on vesting	Price paid by the employee	FMV of shares on exercise
Taxable value	Sale price less: FMV of shares on vesting	Sale price less: price paid by the employee	Sale price less: FMV of shares on exercise
Rate of tax	If shares held for 12 months or more - 20% plus applicable surcharge and cess; else Slab rates plus applicable surcharge and cess		

Note – Under a “qualified plan” in case of shares of a Company listed in a recognised stock exchange in India, it was possible for an employee to have tax free income provided shares were held for more than 12 months after exercise

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India – Challenges / Issues in the FBT Regime

- Increased cost of share plan awards to the employer
- Potential double taxation
- Whether foreign parent issuing shares to employees of the Indian subsidiary liable to pay FBT?
- Whether plans can be modified retrospectively to recover FBT from employees?
- US GAAP / IFRS implications for modification of share plans
- What would be the mechanism for recovery of Fringe Benefit Tax?
- Whether the FBT recovered from the employee would form the cost basis for employee for calculating Capital Gain on subsequent sale of shares?
- Accounting and Tax treatment of FBT recovered from employees?
- Whether employer needs to make accounting provision for FBT liability upon vesting?

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India – Challenges in the FBT Regime

- Cross Border issues on the FBT triggers for previously vested options/awards.
- Whether pro ration of FB possible to lower Indian FBT?
- Administrative burden for tracking vesting schedules and the availability of Fair market value data
- Whether FBT is payable irrespective of chargeback?

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India – Other regulatory issues

Securities Law

- Companies listed on an Indian stock exchange/ to be listed companies need to comply with the Disclosure and Investor Protection guidelines and listing requirements as set out by Securities Exchange Control Board of India

Exchange Control Law

- Indian companies allowed to issue shares to a person resident outside India if they are employed with the company, its joint venture or its wholly owned subsidiary on fulfillment of certain conditions
- The Central Bank authorizes the Authorized Dealers to allow remittances for stock options given by a foreign company to employees of its related Indian company provided the foreign company holds not less than 51% stake in the India company. Prior permission of Central Bank required if the foreign company wants to repurchase shares from Indian employees. The Indian entity is required to file an annual return with the Central Bank giving details of:
 - Stock allotted to Indian employees
 - Stock repurchased by the foreign company from Indian employees

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Share Plans in China

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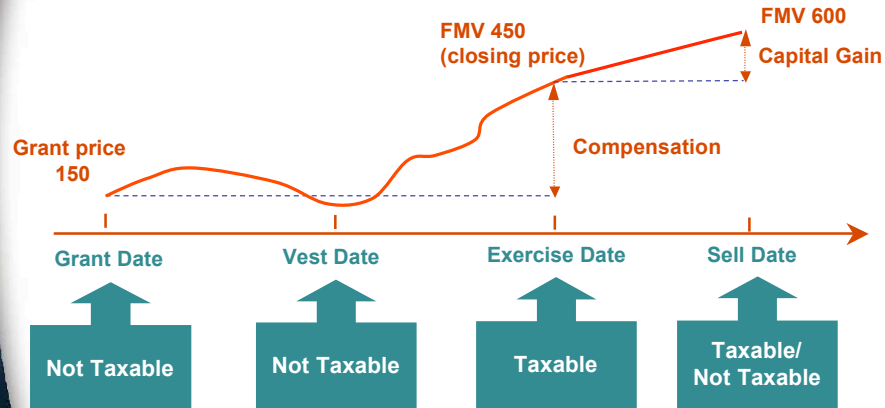
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Stock Option – Taxing Rules

- General rule: receipt of stock option is not a taxable event until the option is exercised
 - Exception: public tradable stock options
- Withholding obligations
 - Employer as withholding agent has the responsibility to withhold and report individual income tax (“IIT”) for the employee’s stock option income.
- Stock option benefits are not taxable if:
 - Attributed employment services were rendered by the expatriates outside of China; or
 - Exercised outside of China after the employee has completed his assignment in China and the cost is not charged back to the Chinese entity

Stock Option - Timing of Taxation



- Exception: public tradable stock options

- PRC listed shares currently tax exempt
- Overseas shares subject to IIT @20% as "gains on transfer of property"

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Taxation of Stock Option Gain

- If the underlying stocks are listed (PRC or overseas)
 - Stock option benefits as a stand alone employment related income
 - Taxable income can be divided by the related service period in China (capped at 12 months) to determine the applicable IIT rate
- If the underlying stocks are unlisted
 - Stock option benefits added to the monthly employment remuneration → likely taxed at the top bracket rate
 - May elect to spread the benefits over a period of six months → will not save any IIT if an employee has already been subject to IIT at the highest marginal rate

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IIT Calculation Formula (if the underlying shares are listed)

- Taxable income

$$= \left(\begin{array}{l} \text{closing market price} \\ \text{on exercise} \\ \text{date/share} \end{array} - \begin{array}{l} \text{exercise} \\ \text{price/share} \end{array} \right) \times \text{number of shares}$$

- IIT payable (Formula A)

$$= \left(\begin{array}{l} \text{Taxable income from} \\ \text{exercising stock options} \\ \text{Stipulated no. of months} \end{array} \times \begin{array}{l} \text{Applicable} \\ \text{IIT rate} \end{array} - \begin{array}{l} \text{Quick} \\ \text{Deduction} \end{array} \right) \times \begin{array}{l} \text{Stipulated} \\ \text{no. of} \\ \text{months} \end{array}$$

- Stipulated number of months
 - Period from the grant date to the vesting date,
 - Refers to service period in China only, and
 - Capped at 12 months

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Cashless Exercise of Stock Options

- Employee exercises the stock option without purchasing the underlying listed shares
- Instead, receives a cash payout equal to the difference between the market price and the exercise price on the date of exercise
- The gain is subject to IIT under the stipulated Formula A

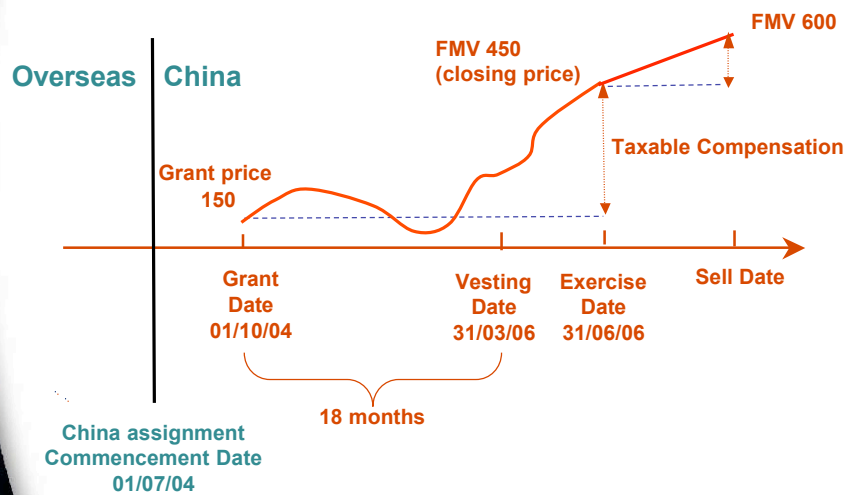
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Example 1: Assumptions Stock Option granted after start of China Assignment

Assumptions	
China assignment commencement date	1st July 2004
Grant Date & price	1st October 2004 @ RMB150/share
Number of shares	200
Vesting period	1_year
Exercise date & closing market price	31 June 2006 @ RMB450/share
Liability to IIT	Borne by employee

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Example 1: Time Line Stock Option granted after start of China assignment



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Example 1: IIT Calculation Option Granted after start of China Assignment

- Taxable income:
 - = $\text{RMB}(450 - 150) \times 200 = \text{RMB}60,000$
- IIT Payable:
 - = $(\text{RMB}60,000 \div 12^* \times 15\% - \text{RMB}125) \times 12^*$
 - = $\text{RMB}7,500$

** Note*

- *Stipulated number months*
 - *period from "grant date" to "vesting date" = 18 months*
- *Capped at 12 months in the calculation formula*

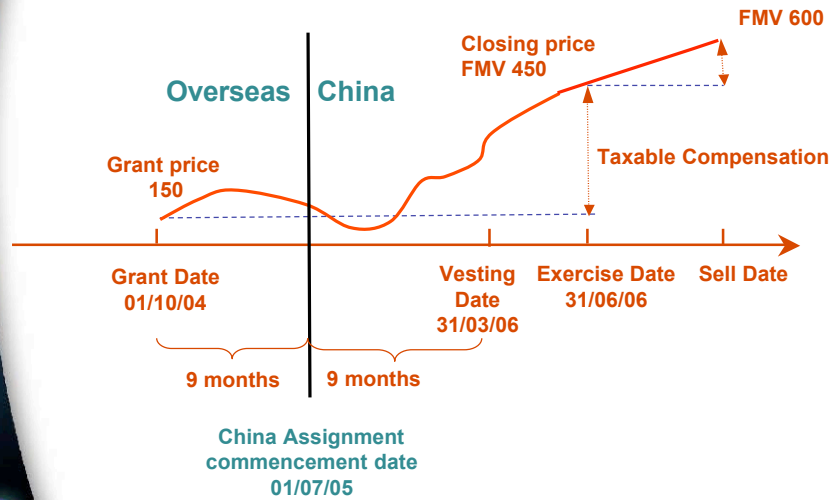
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Example 2 : Assumptions Stock Option Granted before China Assignment

Assumptions	
China assignment commencement date	1st July 2005
Grant Date & price	1st October 2004 @ RMB150/share
Number of shares	200
Vesting period	1_ year
Exercise date & closing market price	31 June 2006 @ RMB450/share
Liability to IIT	Borne by employee

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Example 2: Time Line Stock Option Granted Before China Assignment



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Example 2: IIT Calculation Stock Option granted before China Assignment

- Stock Option income
 - = RMB $(450 - 150) \times 200$ = RMB 60,000
- Stock option income related to China services
 - = RMB $60,000 \times 9^* \div 18^{**}$ = RMB 30,000
- IIT payable
 - = $(\text{RMB } 30,000 \div 9^* \times 15\% - \text{RMB } 125) \times 9^*$ = RMB 3,375

Note:

- ** = related service period of the stock option
- * = related service period in China

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Example 3 : Assumptions Multiple Exercises of Stock Option in a Calendar Year

Exercise Date	Stock Option Income (RMB) (a)	Related PRC Service Period (b)	Total (c)= (a) x (b)
1 st : 18 Oct. 2006	30,000	15 months	450,000
2 nd : 20 Nov. 2006	30,000	15 months	450,000
Total	60,000		900,000

Weighted average service period for the multiple exercise

$$= (c) \div (a) = 900,000 \div 60,000 = 15 \text{ months (capped at 12)}$$

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Example 3: IIT Calculation Multiple Exercises of Stock Option in a Calendar Year

Stock Option exercised on 18 October 2006

IIT payable =	$(\text{RMB } 30,000 \div 12^* \times 15\% - \text{RMB } 125) \times 12^*$	=	RMB 3,000
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Stock Option exercised on 20 November 2006

IIT payable =	$[\text{RMB } (30,000 + 30,000) \div 12^* \times 15\% - \text{RMB } 125] \times 12^* - \text{RMB } 3,000$	=	RMB 4,500
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* capped at 12 months

- Implications:
 - Accumulate the stock option income in the determination of applicable IIT rate for the multiple exercises
 - spreading the exercise of stock options in a year will not reduce the overall tax liability → loophole plugged

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Registration Requirements: Tax Authorities

- Notification to tax authorities prior to grant
- Registration of stock option plan with local tax authorities. Documents generally required are:
 - Stock option plan
 - Documentation for the stock option granted to the employees
 - Details of exercised stock option
 - Chinese translation if the documents are in other languages
 - Potentially pre-exercise notification (administratively impossible)

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Forex Issues : State Administration of Foreign Exchange (“SAFE”)

- SAFE’s approval is required for Chinese nationals to transfer funds to acquire overseas shares
 - In practice, usually not granted
- Chinese nationals will generally be limited to the “exercise & sell” alternative for stock option plan
 - Convert amounts payable to Chinese nationals into local currency prior to settlement
- New Implementation Rules for the Administration of Individual Foreign Exchange (“New Rules”)
 - Effective from 1st February 2007
 - Special requirements for employee share option/purchase plan

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Forex Issues : State Administration of Foreign Exchange (SAFE) (cont'd)

- Requirements under the New Rules:
 - Chinese nationals participating in overseas stock option/purchase plan should submit an application to SAFE through a local affiliated company or trust agency i.e. local representative ("LR") for approval
 - LR applies to SAFE for the employees' yearly foreign exchange quota and the opening of special foreign exchange account in China (& overseas)
 - Dividend or sale proceeds of shares shall be remitted to the employer or local agency's special foreign currency bank account
 - Amount can then be converted into RMB or be transferred to the employee's personal foreign exchange saving account
 - New Rules will facilitate
 - Local employees' overseas fund remittance for share purchase & receipt of sales proceeds in foreign currency
 - Employer's tax withholding obligation

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Other Considerations for China

- Securities law
 - Position is complex as relatively new regulation
 - Review of filing requirements required
- Social security rates vary between the different cities and regions
 - Renders administration complex
- Recharges
 - Chinese entity may not be able to reimburse the overseas head office for the stock option cost incurred due to forex control

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Lessons

UNDERSTAND YOUR PLANS

ask the right questions – RSUs or restricted stock?

GET ADVICE EARLY

- Feasibility
 - Full due diligence
 - Broad ranging
- UPDATE
REGULARLY

ADMIN

- Think global
- Reporting
- Deadlines

ACCURATE DATA

- Gather the right data
- Tracking



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Questions?

Thank you for your participation



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