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The Real Impact of an International Tax Structuring on Global Employee Equity Plans

Eimear Fay, EMEA Tax Director, Twitter

Jennifer George, Director, PwC

Brían Ó Cuív, Partner, PwC

Agenda

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- Deferred Tax Assets
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Twitter Background

- Twitter is a U.S. multinational company with approximately 3,860 employees worldwide
- Twitter has employees in over 20 countries.
- Twitter currently grants restricted stock units ("RSUs") to employees in almost every country and also offers an employee stock purchase plan ("ESPP") to employees in many countries.
- Historically, Twitter has also granted stock options but has very few stock options still outstanding.
- Twitter IPOed in November 2013 and upon IPO, a large number of RSUs became due and payable 3 months after IPO.

Basics of Impact of Equity Awards on Effective Corporate Tax Rates

- Companies can reduce their overall worldwide effective tax rates by minimizing income subject to tax and increasing the amount of corporate tax deductions.
- One way to maximize corporate tax deductions is to claim local tax deductions for the cost of equity awards granted to employees.
- The U.S. will only allow a tax deduction for the cost of awards granted to service providers performing services to the U.S. company.
- Outside the U.S., many countries allow corporate tax deduction if the local entity must pay for the cost of the awards

(i.e., recharge the cost of the equity awards)

Twitter's Story…

- As Twitter moved close to an IPO, its corporate tax group was preparing to book a large expense related to the upcoming RSU vesting.
- As employees lay sleeping, dreaming about their IPO riches, the corporate tax group scurried at night looking for ways to reduce the expense to the company!
- Twitter's corporate tax group (with the help of some PwC elves ☺) reviewed the potential of obtaining corporate tax deductions through recharging the cost of RSU grants.

Twitter’s Story… (cont’d)

- Two of Twitter’s largest offices outside the U.S. are in Ireland (where a recharge is required to secure a deduction) and the UK.

- Before implementing any recharge agreements, Twitter looked at the following potential issues:
  - Whether there would be a change in tax consequences to the employee or the employer if recharge agreements were implemented
  - Whether corporate tax deductions would be available if cost was recharged
  - Whether there were any regulatory restrictions on recharging the costs
  - Impact to cost pool calculations under Cost Sharing Agreements

Twitter's Story… (cont'd)

- Twitter next reviewed the potential issues for each country and also reviewed the values of the outstanding equity awards in each country and made decisions on where it made sense to recharge.
- Recharge agreements were entered into and processes were set up to ensure proper administration of the recharging including the following:
  - Process to invoice the foreign sub(s) and collect the recharge amounts (or intercompany offsets)
  - Inclusion of the cost in the cost pool for the purposes of the Cost Sharing Agreement(s)
  - Ensuring that the accounting team includes the expected value of the foreign tax deductions in the DTA calculation

Twitter's Story… (cont'd)

- Implementation of the Recharge Agreements involved the following teams:
  - Tax (overall responsibility)
  - Stock Admin
  - Accounting
  - Treasury
  - Legal

Deeper Dive…

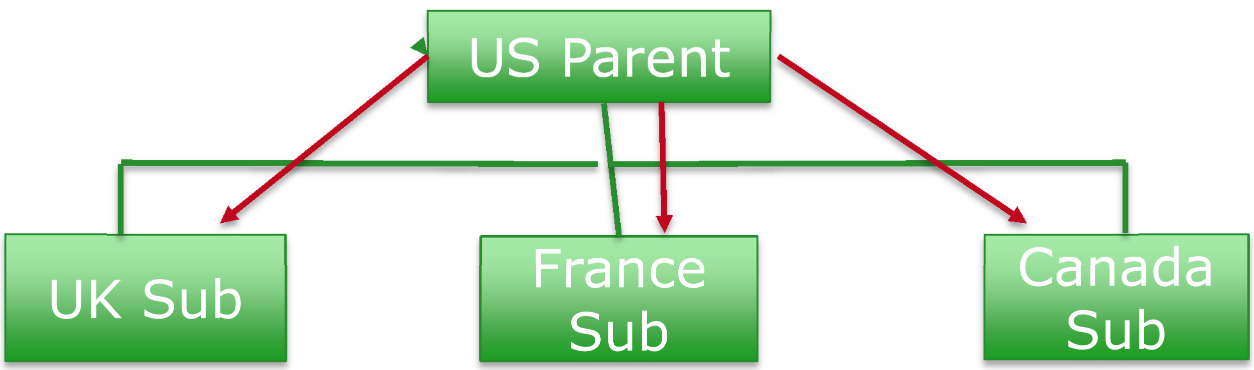
- <u>Recharges</u>: Basically, a contract between parent company and subsidiary for subsidiary to pay for the cost of the equity awards granted to employees of the subsidiary. To secure a corporate tax deduction, there usually has to be a legally enforceable agreement documented in writing.
  - Timing: Generally, recharge is made when shares are issued (i.e., for RSUs at vesting, for options, at exercise, etc.) for U.S. tax reasons
  - Amount of Recharge: Generally, the FMV of shares at issuance less the amount (if any) that the employee pays for the shares, again for U.S. tax reasons (i.e., IRC Section 1032)

Deeper Dive…

- Services Agreements: For companies that have services agreements with their subsidiaries, the subsidiary is typically compensated by receiving an arm’s length services fee. Most commonly this fee is calculated by marking up the local subsidiary’s cost (“cost base”) by an appropriate percentage.
- If recharge is done, then the equity award costs must be included in the cost base for mark up.
- This is less clear if there is no recharge in place.

Deeper Dive: Services Agreement Impact (cont'd)

- Most U.S. multinational companies have a U.S. parent company with foreign subsidiaries and/or branch offices under it.
- For less mature organizations, it is common for these foreign entities to be compensated by the U.S. parent based on a marked up basis.
- Sample Structure:



Deeper Dive: Services Agreement Impact (cont'd)

- If equity comp. cost is included in the cost base, then essentially, the U.S. parent company pays the foreign sub. for the cost of the equity awards it granted to employees of the foreign sub. plus a percentage mark up and the U.S. parent company usually gets a tax deduction for the total payment that it pays to the foreign sub.
- Net effect is that may wind up with a U.S. corporate tax deduction for the equity comp. cost for the foreign sub. employees and if recharge is done, may wind up with income to the foreign sub of the mark up amount. In addition, may also be able to claim LTD for recharge amt.

Deeper Dive…

- Deferred Tax Assets: For book purposes, the company is required to record the expected value of the corporate tax deductions it will receive in the future for outstanding equity awards.
  - The value of expected future corporate tax deductions for foreign subsidiaries is also included in the DTA calculation if financials are being prepared on a consolidated basis including the foreign subsidiary.
  - The corporate tax group will need to calculate DTA for each reporting period
  - Once established, DTAs are adjusted for changes in tax rates, modifications, unexercised stock options, and cancellations

Working Effectively with Corporate Tax

- Ensure they understand the “full picture” of recharge (not just deductibility)
- Understand the reports they need to book the DTA, calculate recharge amounts, etc.
- Have regular meetings to review changes in rules and policies for recharging and corporate tax deductions
- Ensure that there is a clear understanding of responsibilities and timing (e.g., who is going to invoice for recharge and when?)

Questions?

Thank You

Eimear Fay
Twitter
efay@twitter.com

Jennifer George
PwC
jennifer.b.george@pwc.com

Brían Ó Cuív
PwC
brian.x.ocuiv@pwc.com

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