Tax Qualified Plans Throughout the World: One Size Does Not Fit All

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Agenda

• General considerations
• France, Israel, the UK and the US
  • Establishing and implementing qualified plans
  • Tax benefits of qualified plans
  • Administrative burdens of qualified plans
  • Maintaining qualified status
• eBay’s experience and challenges
General Considerations

- Common features of qualified plans
  - Tax / social security benefits for employee and/or employer
  - Internal and/or external approvals
  - Holding periods and other timing considerations
  - Special reporting requirements
  - Challenges for corporate transactions and other adjustments
- Deciding whether a qualified plan makes sense

**One size does not fit all**
FRANCE
France – Types of Qualified Plans

- Qualified Stock Options
  - Regular stock options with special terms
- Qualified RSUs
  - Regular RSUs with special terms
- Plan d'Epargne d'Entreprise, or PEE
  - Savings scheme established by French company that can invest in company stock
  - Not typical US-style ESPP – likely requires separate shareholder approval
- Today’s session will focus on options and RSUs
France – Establishing & Implementing Qualified Plan

- French sub-plan approved by Board/Comp Committee
- French award agreement with special terms
- No filing with or approval from French authorities
- But many special requirements apply
  - Note – no holding period for options granted after September 28, 2012
Establishing & Implementing Qualified Option Plan

Legal
- No grant during “closed periods” for listed company
- Exercise price > 80% of the average of FMV during 20 trading days preceding grant date or equal to 100% of FMV for private company
- Employee’s heirs have right to exercise options within 6 months after death of option holder
- Limited adjustments permissible in case of reorganization

Social Tax
- Payment of employer social tax at grant
- Shares must not be sold prior to 4 years from grant date – not required for grants from September 28, 2012
- Reporting obligations to be satisfied by local employer and option holders in the year following exercise
Establishing & Implementing Qualified RSU Plan

Legal
- Minimum 2-year vesting period before shares issued
- Heirs can request issuance of unvested shares within 6 months
- Corporate officer grants could imply broad based grants or certain increase of profit sharing scheme locally!
- No payment permitted for shares (except minimal consideration)

Social Tax
- Payment of employer social tax at grant
- Minimum 2-year holding period of shares after vesting
- No sale during closed periods
- Reporting obligations to be satisfied by local employer and RSU holders in the year following vesting
France – Qualified Award Tax Benefits - Employees

Non-qualified Awards - Taxed on spread at exercise of options / FMV of shares at vesting of RSUs
  • Income tax up to 45% (after deductions of social contributions)
  • Social security contributions up to 23%

Qualified Awards - Tax deferred to sale of shares
  • Grants prior to September 28, 2012 – generally lower taxes on award income plus 10% +15.5% social contributions/taxes
  • Grants from September 28, 2012 - regular income tax on award income, plus 10% +15.5% social contributions/taxes
France – Qualified Award Tax Benefits - Employers

Non-Qualified Awards: Social contributions due at exercise / vesting
- Cons: Rate could be up to 46% - but depends on total compensation of employee – reduced to 25% if annual compensation greater than €300,000
- Pros: Contributions paid only on exercised options / vested RSUs

Qualified Awards: Social contribution of 7.5% / 30% of FMV due at grant
- Cons: Paid on all awards, not refunded even if awards are forfeited (or options are never exercised)
- Pros: Could reduce employer cost if FMV of shares significantly increases between grant and exercise / vesting or if social contributions due on non-qualified awards are around same as contribution at grant
France – Qualified Award Tax Benefits

Generally no **employee** tax benefit for grants on or after September 28, 2012

- Qualified award income now subject to a maximum combined rate of approx. 61% (maximum combined rate for non-qualified award income is approx. 59%) - not including existing surtax that may be applicable to high earners
- But taxation is deferred to sale

Possibly an **employer** social cost benefit – depends on forfeiture rate, projected stock price increase, income levels of employees – need comparison to determine what makes sense
France – Administrative Burdens of Qualified Awards

Monitoring of closed periods for option grants – can be difficult to find open window

Monitoring of exercise price – can cause disparities with exercise prices in US and other countries

Monitoring of holding periods and closed periods for RSUs (and holding periods for pre-9/28/2012 option grants)

Special reporting on annual declaration of salaries for the year of exercise / vesting and preparation of individual statements with details on exercise / vest (including French source gain)
France – Maintaining Qualified Status

Qualified status may be lost for:

- Failure to meet requirements – exercise price, closed periods, holding periods, special reporting, etc.
- Adjustments in transactions not provided for under French Commercial Code

Adjustments permitted in certain types of transactions

Ruling may be requested to confirm qualified status of awards after transaction
France – eBay’s Experience / Challenges

eBay has been granting French-qualified options and RSUs since November 1999

- Challenges
  - Holding periods
  - Reporting requirements
  - Mobile employees
  - Termination provisions
ISRAEL
Israel – Tax Routes for Equity Plans

Section 102 of the Israeli Income Tax Ordinance (ITO) for grants to employees and officers of Israeli subsidiaries

• Non Trustee Route
• Trustee Ordinary Income Route
• Trustee Capital Gains Route

• Today’s session will focus on this route as it is most commonly used

Section 3(i) of the ITO for grants to consultants, service providers and controlling shareholders
Israel – Establishing & Implementing a Capital Gains Route Trustee Plan

Israeli sub-plan approved by Board/Comp Committee

Plan and sub-plan need to be filed with the Israeli Tax Authority under the capital gains tax route and deemed approved after 30 days.

Trustee required

Special tax rulings may be required (e.g., for grant of RSUs, ESPP, grants with performance conditions, etc.)
Israel – Implementing Capital Gains Route Equity Awards

Awards cannot be granted until 30 days after filing plan for approval
Grant agreement must include special terms
  • Grantees must consent to the tax route
Deposit requirements with the trustee (see further information below)
Two-year holding period between date of grant and sale of shares
Awards can only be settled in shares (not cash)
Israel – Tax Benefits under Capital Gains Route

Non-trustee awards:

- Taxed at ordinary income tax rates of up to 50% on sale (for options and RSUs) or upon grant (shares)
- Social security payments of approximately 12% (employee) and 6.5% (employer) up to certain threshold
- No corporate deduction allowed

Trustee ordinary income awards:

- Taxed at ordinary income tax rates on sale.
- Social security payments of approximately 12% (employee) and 6.5% (employer) up to certain threshold
- Corporate tax deduction allowed, subject to charge back
Israel – Tax Benefits under Capital Gains Route

Trustee capital gains awards:

- Taxed at 25% on sale (spread at grant, if any, subject to ordinary income tax, including social security payments of approximately 12% (employee) and 6.5% (employer) up to certain threshold)
- No corporate deduction allowed, other than for spread at grant, subject to charge back and only in the tax year when the employee sells the shares

Accounting expenses and charge back mechanisms will affect the tax-efficient route

HR issues generally direct companies to the capital gains route
Israel – Deposit Requirements

Deposit requirements as of July 24, 2012:

- Provide trustee with copy of board resolution within 45 days of grant
- Provide trustee with copies of signed grant agreements or any other document in which employee has consented to the tax route within 90 days of grant (it is possible to receive a ruling to obtain consent electronically)
- Provide trustee with share certificates or electronic shares within 90 days

Grants that do not comply treated as non-trustee awards
Israel – Deposit Requirements

Deposit requirements prior to July 24, 2012:
• Written notification to the trustee within 90 days of grant
• Grants that do not comply treated as non-trustee awards
• Tax rulings for non-compliant awards prior to July 24, 2012:
  • Re-deposit notification
  • Ruling applying a linear calculation method
Israel – Supervisory Trustee Ruling

Supervisory trustee – special arrangement for companies in which the awards and shares are managed by a broker (not the trustee)

Requires a ruling from the ITA

Ruling generally granted will potentially eliminate the deposit requirements; trustees expecting to receive a ruling from the ITA confirming special requirements for companies under supervisor trustee arrangements
Israel - Maintaining Qualified Status

Qualified status may be lost for:

- Failure to meet requirements – grants only to employees or officers of Israeli companies, 30 day waiting period, deposit requirements, 2 year holding period, etc.
- Adjustments such as dividend adjustment or re-pricing (and more), unless the appropriate tax ruling is received

Any assumption, exchange or cash-out prior to the end of the holding period will be considered a taxable event unless tax ruling obtained.
eBay has been granting options and RSUs under capital gains route trustee plan since August 2005

- Challenges
  - Acquisitions
  - Option exchange
  - Mobile employees
UNITED KINGDOM
UK – Types of Qualified Plans

- **Company Share Option Plan** (approved options)
  - can be adopted as sub-plan to parent’s stock plan

- **Save As You Earn plan**
  - option to purchase shares after 3 or 5 year savings contract
  - not US-style ESPP
  - likely needs s/h approval

- **Share Incentive Plan**
  - stock purchase plan
  - not US-style ESPP
  - likely needs s/h approval

- **Enterprise Management Incentive options**
  - no HMRC approval
  - limited to companies with < £30m gross assets, < 250 FTEs, and majority of business in UK
UK – Establishing & Implementing a CSOP

Company Share Option Plan (CSOP)

- Plan or UK sub-plan approved by Board/Comp Committee, plus option agreement
- Advance approval by HMRC of plan/sub-plan, agreement and all ancillary documents required

NB move to self-certification from 2014 and related changes
UK – CSOP Key Requirements

- £30,000 limit on approved options per employee – running tab based on MV at grant
- No net exercise or share withholding features
- Options must be non-transferable
- 12 month post-termination exercise upon death
- Exercise must generally occur after three years from grant for favourable tax treatment (no mandatory hold period)
- Need to communicate special requirements to employees – tax summaries, presentations, etc.
UK – CSOP Tax Benefits

• Approved options tax free on exercise if:
  • Exercised after 3 years from grant; or
  • Within 6 months of “good leaver” termination

• Tax deferred to sale, when favourable capital gains treatment applies:
  • No tax on annual gains below £10,900 (2013/2014)
  • Gains taxed at 18% or 28%, depending on whether total income and gains exceed £32,010 (2013/2014)
UK – CSOP Tax Benefits

Great employee tax savings

- And employer saves 13.8% NICs
  - But can achieve same employer result by transferring employer NICs to employees via joint election
  - Consider combining CSOP with NICs joint election – employee must bear employer NICs if taxable on exercise
- No impact on statutory corporate tax deduction
UK – Administrative Burdens of CSOP

- Obtaining HMRC approval
- Administration of £30,000 limit and need to bifurcate option grants between approved and unapproved
- Need to obtain HMRC approval of subsequent changes to “key features”
- Limited ability to adjust options on stock splits, etc. or retain approval on option exchange in transaction context
- Special Annual Return on Form 35 (in lieu of Form 42 for unapproved options) by July 6th
UK – Establishing & Implementing a SIP

Share Incentive Plan (SIP)

- Need UK resident trustee to purchase and hold shares
- Adoption of trust deed and plan rules, enrollment form and plan brochure
- Need advance HMRC approval of all materials

NB move to self-certification from 2014 and related changes
UK – SIP Key Requirements

- Maximum annual limits:
  - “partnership shares” up to £1,500 (employee pays)
  - “matching shares” up to £3,000 in a ratio of up to two matching shares for each partnership share
  - “free shares” up to £3,000
  - “dividend shares” now unlimited
- SIP must be offered to all eligible employees
- Shares must be withdrawn from trust upon termination of employment - tax liability will depend on “good leaver” status
UK – SIP Tax Benefits

- Employee buys partnership shares with pre-tax earnings
- No tax on receipt of free or matching shares
- If shares held at least 5 years, no income tax or NICs upon release from trust
- If shares held 3 – 5 years:
  - Free/Matching Shares – tax/NICs on lower of MV at award and withdrawal from trust
  - Partnership Shares – tax/NICs on lower of salary used to purchase shares and MV at withdrawal from trust
- Shares held < 3 years – tax on MV at withdrawal
- No tax/NICs if a good leaver
UK – SIP Tax Benefits

- Capital gains tax upon sale (on appreciation between withdrawal from trust and sale), subject to annual exemption
- Employer saves on employer NICs if share holding periods are met
  - But could achieve same employer result with ESPP and joint election requiring employee to bear employer NICs
- No impact on statutory corporate deduction – available for free and matching shares
UK – Administrative Burdens of SIP

- Obtaining HMRC approval
- Need to appoint UK Trustee - but Trustee handles most administration
  - Monitoring of value of shares acquired and holding periods
  - Tax withholding on any shares not held for qualifying periods
  - Special Annual Report on Form 39 (in lieu of Form 42 for unapproved options) by July 6th
- Need to obtain HMRC approval of “key feature” changes to SIP or changes in capital, e.g., stock split or other adjustment
UK – In a state of change

Changes to approved plans from 6/4/2013, include:

- Harmonizing “retirement” and good leavers
- Broadening of circumstances in which plans remain qualified in corporate transactions (after cash takeovers)
- Permitting the use of shares subject to restrictions

Many of these changes take effect without requiring changes to plan rules, but this should be confirmed against plan rules.

More changes expected from 2014 due to the move to self-certification; no details yet.
UK – EMI options

- No HMRC approval required
- Restrictive rules as to the companies that may be eligible to grant EMI options
- Option over up to £250,000 shares per employee
- Very tax favourable, and can now benefit from entrepreneurs’ relief; if all conditions are met:
  - no income tax or NICs on exercise
  - capital gains tax as low as 10% on sale
eBay – Experience & Challenges

eBay does not offer CSOP or SIP

eBay has previously assumed and administered EMI options and has previously had a NIC joint election

• Challenges
  • EMI options in subsequent transaction
  • Termination Provisions
  • Mobile employees
UNITED STATES
US – Types of Qualified Plans

Incentive Stock Options (ISOs)
- Regular stock options with special terms
- Section 423 ESPP
- Stock purchase plan with specific requirements
US – Establishing & Implementing Qualified Plan

ISOs

- Employees only
- Share reserve and eligible class of employees set forth in plan
- Approved by stockholders within 12 months before or after adoption of plan by board of directors
- Plan term and option term not to exceed ten years
- Exercise price not less than FMV of underlying stock on date of grant
- $100,000 limitation
- Option nontransferable except upon death
- Good faith effort to value stock
US – Establishing & Implementing Qualified Plan

ISOs (cont’d)

- If employee owns stock possessing more than 10% of the total combined voting power of all classes of stock of the company, then
  - Exercise price at least 110% of FMV on date of grant AND
  - Term of option not to exceed five years
- Exercises > 3 months following termination don’t qualify for ISO treatment
- Holding periods
  - More than two years from grant date AND
  - More than one year from exercise date
US – Establishing & Implementing Qualified Plan

ESPP
- Plan must state the maximum number of shares that can be issued
- Shareholder approval required within 12 months of board adoption
- Employees only (also, no 5% shareholders)
- Purchase price cannot be less than the lower of 85% of FMV at grant or purchase
- Offerings/options under the plan cannot have a term of longer than 27 months (5 years, if purchase price based on purchase date FMV only)
US – Establishing & Implementing Qualified Plan

ESPP (con’d)

- Not transferable other than by will or laws of descent and distribution
- $25,000 limitation
- All employees must have the same rights and privileges
- Holding periods
  - More than two years from grant date (beginning of offering period or participation) AND
  - More than one year from purchase date
US – Tax Benefits of Qualified Plans

Non-qualified stock options / non-423 ESPP

- Taxed at exercise / purchase on spread
- Subject to FICA/FUTA
- Withholding required (generally can use supplemental rate)
- Reporting required (W-2 for employees; 1099-MISC for non-employees)
US – Tax Benefits of Qualified Plans

ISOs

- Not taxed at exercise
  - Spread at exercise of ISOs is an adjustment to income for AMT purposes
- Taxed at qualifying disposition of ISO shares (i.e., holding periods met)
  - Long term capital gain on spread (difference between sales price and exercise price)
- Or taxed at disqualifying disposition of ISO shares
  - Ordinary income on lesser of (i) difference between FMV on date of exercise and exercise price and (ii) difference between sales price and exercise price
  - Capital gain (or loss) on any additional gain (or loss)
US – Tax Benefits of Qualified Plans

ESPP

• Not taxed at purchase
• Taxed at qualifying disposition of ESPP shares (i.e., holding periods met)
  • Ordinary income on lesser of (i) difference between sale price and purchase price and (ii) plan discount (e.g., 15%) multiplied by FMV of shares on grant date
  • Long term capital gain on additional gain
• Or taxed at disqualifying disposition of ESPP shares
  • Ordinary income on difference between FMV on date of purchase and purchase price
  • Capital gain (or loss) on any additional gain (or loss)
US – Administrative Burdens of Qualified Awards

Special reporting requirements apply:

• ISOs
  - W-2 reporting for disqualifying dispositions
  - Section 6039 reporting (Form 3921)
• ESPP
  - W-2 reporting for qualifying and disqualifying dispositions
  - Section 6039 reporting (Form 3922)

Adjustments during corporate transactions subject to special rules
US – eBay Experience & Challenges

eBay does not currently grant ISOs but has done so in the past and currently acquires ISOs thru assuming equity in corporate transactions.
eBay offers Section 423 ESPP (with non-423 component for some non-US jurisdictions)

• Challenges
  • Mobile employees
  • Communication
QUESTIONS?
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