

**Session 7.5: US - UK Importing and Exporting Broad-Based Stock Plans.**

**Navigating favorable tax regimes and avoiding US securities laws and section 409A pitfalls**

**Friday, 11 April 2008 13:45 - 15:00**

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# Agenda

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- " Exporting your stock plans – general considerations
- " Importing your plans into the UK
- " Importing your plans into the US
- " Securities laws
- " Taxation
- " Accounting



# Exporting your stock plans I

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## " Initial considerations:-

### " What intending to achieve?

- " same/similar tax position
- " locally favourable tax treatment
- " simply equity participation (tax treatment not the driver)

### " Is it feasible to export to the countries you have in mind?

- " can you do it at all?
- " can you do it at reasonable cost etc?

### " Are there savings arrangements involved?

### " Where will the shares be sourced from? (UK company law issues, tax issues with trusts etc)



# Exporting your stock plans II

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- " Most companies have exported their executive incentive arrangements relatively easily
  - " Small numbers of participants
  - " More flexible plan design
  - " Cost v benefit considerations
  - " Expected/accepted by executives and stockholders – “part of the package”



# Exporting your stock plans III

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- " Exporting broad-based stock plans is not as easy
  - " Many more participants
  - " 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



# Exporting your stock plans IV

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- " 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



# Exporting your stock plans V

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- " Many companies have 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
- " Many companies have 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)



# Exporting your stock plans – practical tips

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- " 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 CSOP, SAYE or SIP – timing issue (no comparable requirement in US)



# Importing your plans into the UK

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- " Decide on structure – option v full share award
- " Which (broad based) plan are you replicating?
  - " §423 plan can easily become a UK approved SAYE plan
  - " §401(k) plan can easily become a UK approved SIP
- " If importing discretionary plans:-
  - " ISOs can become UK approved Company Share Option Plan (CSOP) (NB different participation limits)
  - " Non-qualified options – may need minor modifications, but broadly same in UK (taxed in similar way)
  - " Restricted stock/RSUs – may need minor modifications, but broadly same in UK (UK tax position can be different – need specialist advice)



# Importing your plans into the US

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- " Decide on structure – option v full share award
- " Which (broad based) plan are you replicating?
  - " UK approved SAYE plan can be modified to become a US qualified §423 plan
  - " UK approved SIP can be modified to become a US qualified §401(a)&(k) plan
- " If importing discretionary plans:-
  - " CSOP can become ISO plan (NB different participation limits)
  - " Unapproved, performance share plans, co-investment plans may need modifications – NB §409A in relation to discounted awards: need to take local advice on structure of awards for US participants



# Comparison – US §401(k) v UK SIP

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## " 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



# Comparison – US ESPP v UK SAYE

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## " 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 purchased, 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 £9,200



# Securities laws - UK

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- " Historically, exporting plans to UK was relatively easy – little in the way of securities law issues PROVIDED plan 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, whilst share purchase plans are)
  - " Do you have securities admitted to trading on an EU regulated market? If so, you can utilise the “employee share schemes” exemption – information document required – only applicable if plan confined to employees
  - " Can you benefit from the 100 person or €2.5 m exemptions? Beware, these are applied differently across the EU!



# Securities laws – UK

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- " 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”
- " Criminal sanction if breach
- " Exemption from general prohibitions for “employees’ share schemes” (UK company law definition) – NB only assists if plan confined to employees
- " If non-employees to participate – take specialist advice



# Securities laws – UK – practical tips

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## " EUPD issues:

- " Investigate the EUPD position early – if prospectus required will add time and substantial 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



# Other regulatory issues – UK companies

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- " 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

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- " 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
  - " State securities laws vary substantially in scope and effect – always necessary to check



# Securities laws – US – practical tips

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- " Sales of unregistered shares are prohibited without exemptions, disclosures etc
- " Grants of bonus 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 bonus shares?
  - " Grant a stock settled SAR instead, deliver appreciation as bonus shares



# Taxation - UK

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- " 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

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- " 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

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- " 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

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- " 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



# Taxation - US

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## " 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

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## " 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



# Accounting

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- " 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)



# Questions?

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Thank you for your participation  
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