Global Talent, Local Compliance: Employer Share Schemes For Internationally Mobile Executives

Equity planning for employees can be complicated. International working arrangements can be complicated. Put the two together? Yes, it's definitely complicated. As is the case with many tax-related issues though, with acknowledgement of some of these complexities and advance planning, processes can be put in place to ensure that things run smoothly, and compliant reporting can be appropriately managed in any relevant jurisdiction.

Most companies understand how powerful their employee share plans can be in incentivising and retaining employees, and in aligning the interests of employees with those of the company. With increased globalisation and a more internationally mobile workforce, it is increasingly important that employee incentive compensation and equity share plans be designed so they are efficient and effective on a global level. Expanding an incentive compensation and employee share plan can, however, give rise to a number of difficult issues. Indeed, tax compliance, regulatory constraints, and accounting requirements in multiple countries can be a major burden. When implementing a global incentive compensation or employee share plan, retirement plan, or overall compensation structure, companies need robust systems in place to ensure that the programmes are cost-effective, well structured, incentivising to employees, and compliant with all tax and regulatory requirements.

We will consider some of the issues you might face when offering share incentives to an internationally mobile workforce. In many organisations, this will chiefly be for your executives, who are invariably among the participants. Then we'll consider some potentially helpful actions and considerations for companies dealing with these issues, and alternatives to mitigate some of this complexity.

For simplicity, this article will use the term internationally mobile employees (IMEs) to also include employees with international remote working arrangements.

(1) The Fundamental Questions

Before you can determine what the likely implications are of offering share incentives to their IMEs, employers need to be confident of which employees fall into this population. Some of the fundamental questions for employers are:

- Who are they?
- What are they doing?
- Where are they?
- How long will they be there?
- What awards do they have already?

Employers must then ensure that there are robust processes and policies in place to govern these arrangements and track them. Some IME scenarios, like permanent transfers or formal secondments, may be more straightforward to identify if they are monitored actively by a central team, but those IMEs who may trigger overseas tax obligations by international business travel may not be so well captured in employer data. This can be a particular risk area for executives who travel frequently.

(2) Trailing Issues

It is common for employer share schemes like PSPs (Performance Share Plans) or RSU/PSUs (Restricted Stock or Performance Stock Units) to include vesting periods and/or performance conditions, which could span several years and multiple tax trigger events (e.g. where tranches of awards vest annually). It is usual for the tax treatment of such awards to be assessed over the relevant earnings period, typically viewed as the period from grant to vest of the award. If there is even a temporary period of international working during an earnings period (or, indeed, multiple award earnings periods), then this could impact the tax treatment and reporting of vesting awards over a series of tax years. Employers require processes to document where employees have worked internationally, potentially in multiple locations, and how this impacts the tax treatment and employer reporting in all relevant jurisdictions.

This may not be a huge problem once tracking processes have been set up, particularly if there is an established annual process on or around the vesting date where such reporting assessments are made, and tax calculations prepared. However, it may become more challenging to administer if you are also dealing with longer-term plans without fixed trigger events. For example, you may have stock option plans that vest after a certain period but then have an extended window for the employee to choose when they exercise the option. This can often be up to ten years after the grant of the option. Processes will need to be put in place to track such share events and ensure that the required compliance actions are taken as and when they exercise options with an international dimension.

(3) Local Reporting Requirements And Restrictions

There may be local rules that require employers to declare employment-related share awards to local tax authorities, whether via payroll or in an alternative format or annual filing. For example, for the UK there are potential PAYE reporting requirements for employers issuing shares to employees as well as annual employment-related securities reporting to HMRC, which is due by 6 July, following the end of the relevant tax year. These rules also apply to employees who may only be taxable on part of their overall share award in the UK. Employers need to assess and understand any such local obligations in all locations where they have IMEs; many countries including Australia, Belgium and Ireland have comparable reporting requirements.

You also need to consider periodic local rule changes in relevant jurisdictions and ensure your processes and reporting are up to date. For example, there has been a recent change in Ireland for the reporting of share option exercises which previously were reported outside payroll but now require payroll reporting and withholding of tax and social security.

(4) The Use Of Cash Or Phantom Share Plans

Some countries may have securities laws or exchange controls which effectively prevent

employees from owning securities directly, so alternative provisions may need to be considered. In such cases, the employer may include a cash settlement discretion in the plan, or a separate 'phantom' share plan which allows an employer to replicate the incentivisation by a stock-based plan (based on performance conditions, and a certain number of 'shares') with a relevant 'exercise price' that will crystallise in cash value on a fixed date or event. The Company does need to have the funds available to pay cash bonuses, but the upside is that by issuing phantom shares instead of actual shares the company can conserve its equity and avoid dilution of existing holdings (depending on the intent of the plan).

There may also be other circumstances where cash/phantom plans may be needed to work around specific local rules and restraints. For example, in Singapore, non-citizens will typically be deemed to exercise their unexercised stock options and unvested share awards when they cease employment in Singapore. This means that assignees leaving Singapore after an assignment may face a 'dry' tax charge before they are able to liquidate any funds in connection with the share awards, creating a cash flow issue as well as a challenge if the value of the award subsequently falls. The use of phantom/cash plans could be helpful in mitigating these issues for Singapore-based assignees.

(5) Tax Advantaged Schemes

Many employers in the UK (and elsewhere) make use of tax-advantaged plans to incentivise their employees in a tax-efficient manner. Employees and employers should be aware that locally recognised plans in one jurisdiction are unlikely to attract the same tax efficiencies in other jurisdictions, so there may be unexpected host country income tax, social security and capital gains tax implications and cost exposures. The company's assignment/tax policy will need to indicate who should be responsible for settling any such taxes.

Clearly, employers should consider whether local hires and IMEs should be enrolled in these tax-advantaged schemes at all. For EMI (Enterprise Management Incentive) schemes in the UK, for example, there is an overall limit on the value of shares that can be subject to unexercised EMI options, so it may be preferable to allocate this limited pool to employees who will benefit from the tax advantages and use an alternative provision for IMEs.

It may also be possible to review international schemes to assess the viability of introducing local sub-plans which benefit from tax-advantaged treatment in that jurisdiction, and access tax and/or social security savings for the employee and/or employer.

(6) International Remote Workers And Professional Employer Organisations (PEOs)

The number of organisations purporting to offer a one-stop-shop solution for the needs of employers with international remote workers has sky-rocketed over the past few years. They will typically operate as the legal employer of such employees on a local basis, arranging employment contracts, tax and social security arrangements, local payroll reporting, HR needs etc., (for a fee). For employers with a widespread international employee basis but without a local infrastructure (or the desire to create one) to support the admin, PEOs can be an attractive proposition. On many levels reputable providers can be a good solution, but they come with health warnings - particularly for employers using share incentive schemes.

Standard or existing plan rules may not permit you to award shares/options to individuals who are not legally your employees. This could be as per the terms of specific Company drafted rules, or the general requirements of certain types of schemes. For example, in the UK companies cannot grant qualifying EMI (Enterprise Management Incentive) options to non-employees of the company (or a group company), and in France non-employees cannot participate in qualified share option plans. This can result in unexpected tax consequences for existing employees who transfer to PEO employment to facilitate international remote work arrangements, or even a legal challenge to their ability to participate in equity plans at all.

(7) The Complexity Of 'US Persons'

US citizens and Green Card holders are essentially perpetual US tax residents, with their worldwide income and gains remaining permanently within the US tax net even if residing outside the US. The same applies to resident aliens of the US. For an employee being a 'US person' for tax purposes also means that IRS tax regulations, some more esoteric than others, continue to apply to them. These rules may not align with the tax rules in their country of employment, and this can cause issues. There are specific US tax rules around non-qualified deferred compensation which can apply to stock-based compensation, and non-US share plans will commonly not be compliant with these rules. This can cause significant issues for US taxpayers, potentially creating unexpected tax liabilities at unexpected times, and a 20% penalty tax if a solution is not implemented. It is, therefore, important to understand if your international plans are properly structured to ensure the penalty charge is not triggered, either for your local US participants or other US persons employed in other locations. Identifying these employee populations is key to effective reward planning.

For employers who tax-protect, or tax-equalise, their IMEs on share-based incentives, there are additional associated tax costs.

(8) Corporate Tax Considerations

In the UK, statutory corporate tax deductions for employer share plans have been available for many years. However, there can still be many practical issues with claiming these deductions, one of which is how to deal with claims in connection with IMEs. The specific nature of the underlying plan and the employee's tax residency and working status in/outside the UK at points of grant and vest/exercise will potentially impact the nature of any deductions available from a UK corporate tax perspective. Similar considerations may arise in other jurisdictions that the employee works in, and determining the appropriate deductions available to claim in multiple jurisdictions should be considered to secure the overall tax-efficiency of the scheme.

Key Takeaways

Getting the tax right, especially in a global context, is key to the effective implementation of global incentive plans. The design of your overall reward package needs careful thought to attract, retain and incentivise your top talent. Internationally mobile employees can increase the complexity, as different tax regimes in the home and host locations may not be compatible, and the interactions of both tax regimes and their tax and payroll reporting requirements must be considered by the employer to maximise efficiency and ensure compliance.

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