The Changing Environment For Share Awards In 2018

Taxation of individuals moving across borders can be difficult enough when looking solely at regular employment income, but the complexities multiply when considering share awards, potentially spanning several years and jurisdictions.

Share awards (and for the purpose of this article we will include all share based remuneration such as options, stock units, phantom awards and qualifying and non-qualifying plans), have long formed a vital part of an employee's total remuneration. This is especially true for executives and senior employees who often form the core of the Internationally Mobile Employee (IME) workforce. Equity is seen as a way of incentivising them based on the performance of the company, providing a competitive reward and also tying them in long-term. For broader, 'all employee' plans, the focus is again on providing competitive reward but also on expanding the culture of share ownership.

Companies are typically using free share plans such as US Restricted Stock Units (RSU), Stock Appreciation Rights (SAR) and Long-Term Incentive Plan (LTIP) awards for executives and share purchase plans such as Employee Stock Purchase Plans (ESPP) for broader groups of participants.

Many awards have a minimum vesting period which is typically three years. The award is typically treated as earned over the vesting period. For IME, moving country during this period typically means that the income has to be split and allocated to each country. This will be based on where the IME was resident and/or working during the life cycle of an award.

Companies are also looking at minimum share retention policies to encourage executives to hold a significant number of shares relative to seniority. New awards may be subject to malus and clawback provisions. Under the former, the size of awards can be reduced if certain events occur and under clawback the company can recover some of the shares or cash which has already been delivered (and taxed!).

There has been a focus on tax compliance and reporting for share based income in recent years. The key trends are the movement towards greater reporting obligations and more focus on collecting tax via payroll.

The rules surrounding the taxation of share awards are complex, even when dealing with local employees. For mobile employees the complexity doubles or trebles because it is necessary to consider the tax and social security treatment in multiple countries and have a robust system for tracking employees.

There are potentially multiple points of taxation (grant, vest, exercise and sale to name the most common). Income and/or capital gains tax (CGT) may apply depending on the type of award. Further information about the treatment of equity awards in over 30 countries can be found in the BDO Global Equity App which can be downloaded for free: www.bdo.co.uk/en-gb/insights/tax/human-capital/global-employee-share-rewards.

Generally speaking, a non-qualifying award will be subject to income tax and CGT will be payable on a qualifying award. A qualifying award enables individuals to benefit from lower tax rates applicable. Many countries also have separate rules for social security with rates for non-qualifying awards being significantly higher, and these add an additional layer of complexity. Examples of countries where qualifying plans can deliver significant benefits are the UK, with the Company Share Option Plan for market value share options and all employee Save As You Earn and Share Incentive Plans. In the US, Incentive Share Options can be used, and in France we have the 'Macron' free share plan.

Where a parent company operates a share plan on a global basis, it should consider if and how local employing companies pay for the value received by employees. It is sensible to consider the use of recharges from both a transfer pricing and tax optimisation perspective. In a recharge scenario the parent agrees to make share awards to employees of a local subsidiary subject to this company agreeing to make a payment to the parent. In effect, some of the costs of the share plan are recharged to the local, employing company. If this arrangement is correctly structured the payment is deductible for corporation tax in the employing company and may be tax free in the hands of the parent. A recharge can be an effective way of reflecting the commercial costs of share plans and repatriating profits to the parent. Care is needed when implementing them, ideally before awards are made. In some countries the use of a recharge will change the tax treatment and potentially mean that payroll tax and or social security is payable. Country specific tax advice is therefore required.

The typical approach for a global company launching a new share plan is a 'one size fits all' approach. This inevitably leads to compromises and local compliance issues. The plan will almost certainly be non-qualifying and there will be no tax or social security benefits for participants, the employing company and the parent company. It is inevitable that local payroll issues will have to be resolved. For instance, in the UK it is possible to transfer employer's social security (which is typically payable at 13.8% of the equity income) to employees as a condition of award. This can save a significant cost for the employer, but adds to the employee overall tax cost to give top earners a combined rate of nearly 55%, and raises questions about fairness compared to other countries.

Effective employee communications are key to the success of a share plan and many companies are struggling with how to ensure that equity plans are perceived to be valuable by younger employees in their twenties and thirties. Greater use of technology such as portals, smartphone apps and self-service communications can help with take up and perception.

As mentioned above, for IMEs the waters are muddied even further. The income tax position is typically based on a sourcing approach, dependent on where an employee has been resident and/or working during the life cycle of an award. For example, where an individual has been resident and working in the UK for twelve months during a total award period of thirty-six months, the UK will seek to tax 1/3 of the gain. The social security system may follow this sourcing approach or be based on an entirely different logic. For instance, if a certificate of coverage applies, the employee may continue to pay social security in the home country on the full gain.

It is already imperative to track awards made to cross-border workers. The employer is tasked with ensuring that they withhold the correct amount of withholding tax which can only happen by maintaining accurate records. There are a number of technology solutions to this such as BDO QuickTrip. The use of these tools gives you accurate and real time information on your employees travel. This not only assists in ensuring the correct reporting of share payments but also helps with wider issues. Areas to consider include business visitor reporting requirements, visa & work permit applications, social security documentation and corporate requirements.

Accurate equity reporting is just the tip of the iceberg where IMEs are concerned!

Each country has its own rules on how share awards are taxed, and these are varied and numerous. It is not uncommon for two or more countries to want to tax the same income. Companies and tax advisors alike need to be clear on the amount of the gain liable to tax in each location and the correct way to alleviate any double taxation. This will mostly be set out in the terms of double tax treaties which give guidance on which country has the right to tax the income and how the other country must address this to ensure true double taxation does not occur. Greater uncertainty is more likely where there is no double tax treaty in place where the approach will be to look at local tax laws and agreement of the competent authorities.

Selected Recent Developments

The tax treatment of equity awards is constantly evolving. We have highlighted developments in two jurisdictions below:

Belgium

Payroll tax must be withheld by a Belgian employer if it has granted the awards or is actively involved in the administration. Social security will be due on a similar basis or if costs are recharged to the local company. If there is no payroll obligation the employees are still required to report and self-assess. It appears that the Belgian authorities are concerned at the lack of employee reporting and are querying the level of local involvement in share plans. This often results in a determination that the local Belgian employer should have withheld income tax and this can be retrospective going back 5 years. A recent Court decision has suggested that all equity income is subject to social security regardless of the recharge situation. Companies operating share plans in Belgium should review the payroll and social security position carefully.

France

A new, qualified free share plan, was approved in 2017, and applies to shares granted after 1 January 2018. Under this plan there is a 50% reduction in the rate of income tax payable on gains of up to €300,000 and the rate of employer's social security is reduced from 30% to 20%. Employers will need to consider employee communications and utilising the new rules for 2018 awards.

Although the planned introduction of company withholding tax obligations has been postponed to 1 January 2019, employers should plan for the impact on equity plans. A ruling of the Constitutional Council may mean that companies can claim refunds of employer social contributions paid in respect of certain free shares awards made before 8 August 2015. This would apply where awards were made but shares forfeited.

The IME Withholding Maze

Withholding for IMEs is complex. As a company you need to be aware of the type of award, the correct tax & social security treatment in each country and the residence status and working pattern of the individual to ensure you correctly deduct withholding via payroll. We have set out key areas to focus on below:

- Keep track of where your IMEs work
- Equity taxation is based on location during the 'earnings' period, establish if this is based on grant – vest or grant – exercise for each relevant country
- Show good faith by using a robust tracking system and taking regular tax advice
- Remember to consider impact of exit charges (i.e. when an IME moves country) and corporate recharges
- Consider tax and social security treatment and who has a withholding obligation
- Prepare in advance for anticipated withholding events
- Accept that IMEs may have different tax treatment to local employees and may have a higher tax/social security burden
- Consider the impact of 'over withholding' on IME remuneration and double tax issues
- Consider tax equalisation policy - does this apply to trailing liabilities or only when on secondment
- Consider bespoke equity employee communications for IMEs both before secondment and on taxable events
- Do not assume that tax and social security treatment will mirror each other
- Consider how you will be able to access compensation information from different countries and systems – a central payroll system makes equity withholding easier
- Consider ongoing tax and legal compliance.

Share Plan Reporting

Since 2004, there has been mandatory year end reporting in the UK, notifying HMRC of employees receiving, vesting and exercising share awards. From 6 April 2015, this moved to online submission which must be completed using the HMRC interface. The filing deadline for the forms is 6 July following the end of the relevant UK tax year (which is 5 April) and automatic late filing penalties apply of up to £700 per return with daily penalties applying after nine months. Transactions involving internationally mobile employees have to be identified. BDO Equity Reporter is able to automate the reporting process and offers additional services such as payroll verification and calculations of UK corporation tax relief and apprenticeship levy due on equity income.

In 2016, Japan expanded its employer reporting obligations to cover former employees and directors and to increase the level of detail in respect of non-residents receiving Japanese income.

Relevant transactions must be declared on end of year forms both for local employees and expats. As for the tax and social security liabilities, it is therefore imperative that companies have robust tracking mechanisms in place to keep a handle on where their employees are resident/working, dates of moving between locations and awards made. The table on the next page highlights reporting obligations in selected jurisdictions.

Pay Reporting

A key global remuneration trend is the ever growing focus on equality and transparency. Two thirds of OECD countries have introduced new policies on pay equality since 2013, while the UK, Australia, Japan, Germany and Sweden are among a handful of countries that require some employers to publish calculations every year showing the gender pay gap.

A key part of this trend is to identify and reduce the gap in remuneration between male and female employees. This is impacting on all employers, but probably has scope for greater impact on global employers who may have to deal with more adverse publicity and the implications of cross-country comparisons.

The UK has introduced mandatory Gender Pay Reporting (GPR) for every employer who had more than 250 employees or workers on 5 April 2017. This will be an annual reporting requirement and is generating significant media coverage. Under GPR an employer must report six ratios on a government and internal website. This includes an analysis of most forms of pay and bonus. Equity income is potentially included in both calculations and there are complex issues around the calculations for equity and internationally mobile employees. The likely position for IMEs is to include them if they would see the UK Courts as the appropriate route for employment related claims. If they are included it is also likely that a number of elements in the typical expatriate package such as cost of living allowance would be included.

BDO is able to help clients with GPR, using a secure portal to download confidential data and the BDO Gender Pay Reporter to prepare the calculations.

In Germany, the new Pay Transparency Act came into force in January 2018. Where this applies, employees are able to request information about pay for co-workers in similar positions and the employer is subject to mandatory review and reporting procedures.

US public companies are now required to disclose CEO compensation, median employee total annual compensation and the ratio of CEO pay compared to median employee pay. On 21 September 2017, the SEC issued an interpretive release on the new rule that reinforced the perceived implementation flexibility, including the setting of parameters for statistical sampling methods. This process could potentially cover worldwide median compensation.

Share Plan Reporting Summary By Country

Country	Report Type	Awards	Due Date
Australia	ESS Statement	All	14 July - employee
Australia	Payroll reconciliation	All	21 July – tax authorities
Australia	ESS Report	All	14 August – tax authorities
China	SAFE	All	31 December & quarterly
France	DSN	All	Monthly – tax authorities
France	Individual certificates	Qualified free shares or optionsfree shares or options	31 March - employee
India	Exchange Control	Awards where funds sent outside India	30 September (suggested)
Ireland	Electronic Form RSS1	Options & ESPP	31 March
Japan	Annual Statement Form 9 (3)	All equity & cash	31 March
Portugal	Form 19	All	30 June – tax authorities
Portugal	Tax Report Form 19	All	20 January – employees
Singapore	Tax Report Form IR8A/IR8E	All	1 March
South Africa	Section 97 Securities Lodgement	All	Within 60 days of fiscal year end
Switzerland	Tax Report	All	After year-end but 15 March suggested
United Kingdom	Employment Related Securities	All	6 July
United Kingdom	Sharesave (SAYE) Company Share Option Plan (CSOP)	Options	6 July
United Kingdom	Share Incentive Plan (SIP)	Free & share purchase	6 July
United Kingdom	Enterprise Management Incentive (EMI)	Options	6 July
United States	Form 3921	ISO	31 January - employees
United States	Form 3921	ISO	28 Feb (paper) or 31 March (electronic) – tax authorities
United States	Form 3922	Employee stock purchase plan (S.423)	31 January - employees
United States	Form 3922	Employee stock purchase plan (S.423)	28 Feb (paper) or 31 March (electronic) – tax authorities

Summary

Authorities have a clear focus on tax compliance for share awards and changes to increase transparency. They want to ensure that the right amount of tax and social security is paid and the onus is very much on companies to track and report awards. With the complexities surrounding share based income this will only add further compliance requirements to internal HR and tax teams.

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