Executive Compensation & Benefits

May 12, 2011

Going Global with U.S. Employee Stock Plans

by Scott E. Landau and Bradley A. Benedict

Rewarding employees with stock options or other equity-based compensation is a well-established practice in the United States, and publicly traded multinational corporations are increasingly extending these benefits to employees in other parts of the world. Stock options, restricted stock awards and other forms of equity-based pay can be used to incentivize employees to build share value, adapt to cash flow pressures, take advantage of certain tax benefits, and to encourage employee ownership, among other reasons. However, U.S. companies seeking to expand these programs to other countries often face a variety of unfamiliar local securities, tax and accounting laws. This Advisory addresses just a few of the many issues that should be considered when designing and implementing a global stock-based bonus program.

Choice of Award and Plan Design

Equity-based compensation comes in many forms—traditional stock options, restricted stock, restricted stock units, stock appreciation rights, performance shares, stock purchase rights and others. The type of award offered and the incentive plan design are two primary factors that affect compliance issues relevant to the implementation of a program in a new jurisdiction.

Tax Treatment. Local tax laws may influence the form of equity compensation to be used in a country. For example, "restricted stock" awards (i.e., nontransferable shares of employer stock that are subject to forfeiture unless certain service or performance requirements are met) have become commonplace in the United States. Elsewhere, these awards are less familiar, which can result in unfavorable tax treatment in countries where such awards are taxed at the time of grant (as opposed to the time of vesting, as under section 83 of the U.S. Internal Revenue Code). Consequently, restricted stock units may be a better choice in these countries. Other foreign tax laws may also result in awards being taxed prior to the employee's receipt of all or a portion of the award to offset the tax liability (e.g., under recent law changes in Australia, stock options granted after July 1, 2009 are generally taxed at grant, unless they are subject to a "real risk of forfeiture," whether or not they are exercisable at that time). It is important to understand the tax implications for all aspects of proposed equity-based plan awards, including the treatment of dividends and/or dividend equivalents, acceleration of vesting and change-in-control provisions.

Tax regimes in some countries (e.g., Australia, the UK, Germany and France) provide tax advantages for certain qualifying stock-based bonus arrangements. Like incentive stock option plans and employee stock purchase plans in the United States, these arrangements are subject to restrictions as to eligibility, holding requirements and grant limitations. These plan designs may be considered where the applicable restrictions are compatible with the goals for a company's incentive arrangements, but the tax benefits offered will ultimately have to be weighed against the sacrifice in flexibility or any increase in administrative complexity.

Securities Laws. Local securities laws are another important factor in award selection and plan design. Registration and prospectus requirements may apply to award grants, although exemptions are sometimes available, including for employee bonus plans. It is often desirable to tailor the plan to qualify for an exemption, as the registration and prospectus rules can be burdensome or expensive. Recent amendments to the European Union Prospectus Directive exempt many share offerings in the European Economic Area (EEA), provided the issuer's stock is traded on a U.S. stock exchange recognized by the European Commission as comparable to a European Union exchange (see our December 14, 2009, Advisory "EU Prospectus Directive to Exempt Employee Share Plans of U.S. Public Companies").

U.S. securities laws should also not be ignored. Stock options and employee stock purchase plans involve an offer of securities and need to be registered under the Securities Act of 1933 unless an exemption applies. Among the information that must be contained in a Form S-8 prospectus (aside from the material terms of the plan and the nature of the securities) is a description of the local tax consequences of participation in the plan. This can be accomplished by separate inserts for employees in different countries.

Currency Exchange Controls. Implementing equity-based incentive plans in countries with strict exchange control regulations, such as China, can be especially challenging, and will often require customizing a plan for use in the country.

Employment Laws. Employment law considerations include taking steps to reduce the risk that equity compensation will be construed as an "acquired right" of plan participants, understanding the impact of awards on employees' compensation with respect to governmental and other employee benefit programs, and compliance with union or works council obligations relating to new or changing compensation programs. Another issue is the enforceability of award agreement provisions in each applicable jurisdiction. Two areas to highlight in this regard are restrictive covenants (such as noncompetition and nonsolicitation clauses) and recoupment (or "clawback") provisions. In some cases, clawbacks may not be enforceable under applicable law (e.g., in Canada, France and Germany, courts will not enforce clawbacks triggered by noncompetition or nonsolicitation breaches). For a number of jurisdictions, questions have been raised over the enforceability of the "no-fault" clawback provisions that will be required for public companies under the Dodd-Frank Wall Street Reform and Consumer Protection Act. Due diligence on the enforceability of these provisions should be undertaken where the U.S. company desires or is mandated to include clawback provisions.

Administration. Plan administrative practices need to be considered prior to the issuing of awards in each jurisdiction, including, as applicable, tax withholding requirements, filing and reporting obligations, payroll and accounting information flow, data privacy compliance, arrangements for share custody accounts and share transfers and similar matters. Cross-border equity grants give rise to special administrative issues. For example, plans having a sell-to-cover feature for tax withholding (where a portion of the shares issued are sold to cover the employer's withholding obligation) in foreign jurisdictions can be complicated by fluctuating currency exchange rates and sale restrictions under local securities laws. Other considerations are the proper allocation of equity plan expenses and the availability of corresponding deductions between the parent issuing company and the local subsidiary employer. Charge-back agreements are often used to deal with expense allocation, exchange control and stamp duty matters.

Mobile Employees. The mobility of today's workforce across international boundaries raises further issues for the design and administration of equity-based compensation plans. As individuals transfer from one tax regime to another, they may be at risk of incurring double taxation or other adverse consequences, subject to treaty relief. Sometimes these effects can be mitigated by structuring an award so that vesting or exercisability accelerates prior to an international relocation (where permissible under applicable law). Outbound transfers can also be difficult for a former employer to track, as may be necessary to meet withholding and reporting requirements relating to outstanding awards. Implementing effective monitoring procedures, whether managed internally or in coordination with third-party service providers, can help companies meet these challenges.

Ongoing Compliance. It is imperative to keep up to date on developments in the relevant laws in each jurisdiction in which awards are or may be granted. In just the last six months, for example, substantial changes to the tax treatment of equity awards have taken effect in the UK, Ireland and France. Regular compliance reviews are an important responsibility of global equity plan sponsors.

Non-Legal Challenges

Companies also face non-legal challenges when expanding their equity-based compensation plans to employees overseas. For example, benchmarking target values for grants to non-U.S. participants can be difficult. There is generally less industry comparison data available on which to base these decisions, and compensation comparisons across jurisdictions are complicated by fluctuating exchange rates, disparate wage and cost-of-living rates, eligibility for other company or governmental benefit programs and other factors.

Cultural factors should also be considered; employees in countries where equity-based compensation is rare may be uncomfortable or suspicious of non-cash remuneration. A thoughtful communication strategy is key to the successful introduction of a plan granting unfamiliar types of awards and/or having complicated design features. Plan summaries, offer letters and tax information (updated, as required, to reflect changes in the law and/or plan amendments) can be useful supplements to plan documents, award agreements and enrollment forms. Note also that translation of some plan-related documents may be required.

Takeaway: Plan Ahead

Despite the complexities and obstacles touched on above, equity-based compensation can be a fundamental part of compensation planning for employees worldwide. Companies can usually achieve their objectives in most countries, but successful implementation depends on advanced planning, a flexible approach and informed decision-making based on a thorough country-specific analysis for each jurisdiction where awards may be granted.

If you have any questions about the content of this publication, please contact the Pillsbury attorney with whom you regularly work or one of the members of our Executive Compensation & Benefits group.

New York

Susan P. Serota (bio)
+1.212.858.1125
susan.serota@pillsburylaw.com

Peter J. Hunt (bio)
+1.212.858.1139
peter.hunt@pillsburylaw.com

Scott E. Landau (bio)
+1.212.858.1598
scott.landau@pillsburylaw.com

John J. Battaglia (bio)
+1.212.858.1738
john.battaglia@pillsburylaw.com

James P. Klein (bio)
+1.212.858.1447
james.klein@pillsburylaw.com

Kathleen D. Bardunias (bio)
+1.212.858.1905
kathleen.bardunias@pillsburylaw.com

Bradley A. Benedict (bio)
+1.212.858.1523
bradley.benedict@pillsburylaw.com

Los Angeles

Mark C. Jones (bio)
+1.213.488.7337
mark.jones@pillsburylaw.com

San Francisco

Christine L. Richardson (bio)
+1.415.983.1826
crichardson@pillsburylaw.com

Marta K. Porwit (bio)
+1.415.983.1808
marta.porwit@pillsburylaw.com

San Diego—North County

Jan H. Webster (bio)
+1.858.509.4012
jan.webster@pillsburylaw.com

Daniel N. Riesenberg (bio)
+1.858.847.4130
daniel.riesenberg@pillsburylaw.com

Lori Partrick (bio)
+1.858.509.4087
lori.partrick@pillsburylaw.com

Silicon Valley

Cindy V. Schlaefer (bio)
+1.650.233.4023
cindy.schlaefer@pillsburylaw.com

Washington, DC / Northern Virginia

Howard L. Clemons (bio)
+1.703.770.7997
howard.clemons@pillsburylaw.com