Baker & McKenzie

Newsletter

June 27, 2013

In This Issue:

Recent Developments for the First Quarter 2013

The North American Global Equity Services ("GES") practice group is pleased to provide the current edition of our Clients and Friends Newsletter summarizing notable developments from around the world affecting global equity and incentive plans occurring primarily between January and March 2013. In some instances, topics previously discussed in prior newsletters are addressed further here. Attorneys in the GES practice group in San Francisco, Chicago and New York work extensively with multinational companies to design, implement, and maintain equity based compensation programs, including stock option, stock appreciation right ("SAR"), restricted stock ("RS"), restricted stock unit ("RSU") and stock purchase plans ("ESPPs"), for employees, consultants and directors around the world. Within this context, we provide advice regarding U.S. and non-U.S. tax, securities, labor and employment, exchange control, data privacy and other legal and regulatory requirements. We design equity based compensation programs to take into account a client's overall international tax structure and accounting requirements. We also offer sophisticated and experienced perspectives on option repricing/exchange programs and ways to preserve equity incentives in all types of corporate transactions, including spin offs, mergers and acquisitions. In addition to legal services, we provide project management services and prepare employee communications. To complement our equity based compensation practice, we also furnish guidance in connection with global and domestic benefit and incentive arrangements to document fiduciary decisions, compare benefit and incentive programs and attain compliance. For additional information about the GES practice group, please visit our website at www.bakermckenzie.com/GES.

This newsletter should not be relied upon for specific tax/legal advice and is not a substitute for obtaining such advice. The newsletter should only be used as a guide to potential tax/legal issues/consequences and you should seek additional information/advice from legal counsel.

Newsletter

March 18, 2013

First Quarter 2013 — The Trends

Although the world of global equity compensation is never static, it is fair to say that, for the most part, there have not been any dramatic developments causing multinationals to significantly modify their approach to equity compensation. We have been through the turmoil created by FAS 123R/ASC 718, Section 409A and Dodd-Frank. IFRS 2, once looming on the horizon, seems unlikely to be adopted as a U.S. standard any time soon (although it does have international consequences for local tax deductions and chargebacks and even payroll tax issues). Things have settled down a bit now.

The trend toward full value awards (RS and primarily RSUs and away from options) continues. ESPPs are gaining new life as companies are either implementing these or enhancing the features of an existing ESPP. Performance awards for the top executives continue to increase in prevalence, creating challenges as to how and when to measure performance.

Of course, on the international front, there are always developments, as noted in this issue. Australia once again seems to shoot itself in the foot as far as encouraging equity compensation, with the securities law treatment of RSUs and SARs as the latest example. France continues on the path of increasing taxes and makes it difficult for companies to settle on a decision with regard to French-qualified awards. And, of course, the ever-changing SAFE requirements remain a challenge for our clients making grants in the People's Republic of China.

Nonetheless, in this time of relative calm, it is advisable to do a check on international compliance, as we continue to see companies struggling with ongoing compliance, primarily with regard to tax withholding and reporting obligations, which continue to evolve, as many countries aggressively seek new ways to raise revenue and implement new employer tax reporting obligations.

Lastly, on the employee education/communication front, it is important to note that several countries are following in the United States' footsteps and are implementing foreign asset/account reporting obligations. Often, the only foreign assets an employee holds are shares or awards over parent company stock, and companies should consider notifying employees of any resulting reporting obligations.

Upcoming Events & Announcements

NASPP Carolinas Chapter, Charlotte and Raleigh North Carolina, July 11, 2013

June Anne Burke and Barbara Klementz will present on *Key International Updates* to update on recent changes in the global landscape of equity compensation. For more information and to register please visit our GES Upcoming Events webpage.

NASPP Boston/Connecticut Chapter Annual Regional Conference, Boston, Massachusetts, July 19, 2013.

Valerie Diamond and June Anne Burke will speak on the topic It's Worth The Effort: Targeting Awards to Ease Compliance Burdens and Maximize Plan Effectiveness. For more information and to register, please visit our GES Upcoming Events webpage.

Global Equity Webinar Series, July 24, 2013

June Anne Burke and Aimee Soodan will host a webinar on *Key International Developments for Equity Plans.* In recent months there have been considerable legislative and regulatory changes affected equity awards around the globe. For more information and to register, please visit our GES Upcoming Events webpage.

NASPP Washington DC Chapter Meeting, Washington, DC, August 2, 2013

June Anne Burke and Sinead Kelly will discuss *International Updates and Grant Acceptances for Equity Plans*. For more information and to register, please visit our GES Upcoming Events webpage.

NASPP 21st Annual Conference, Washington, DC, September 23-26, 2013

We are please to announce that six Baker & McKenzie partners were selected to speak at the upcoming 21st Annual NASPP Conference. Along with a panel of industry professionals, Aimee Soodan and June Anne Burke will discuss *The Top 10 Most Expensive Compliance Mistakes for Global Stock Plans,* Denise Glagau and Narendra Acharya will provide an comprehensive overview of *Dividends, Equivalents, and Stock Awards,* and Valerie Diamond and Brian Wydajewski will discuss *Key International Updates* that are affecting the world of equity compensation. For more information and to register, please visit our GES Upcoming Events webpage.

New Baker & McKenzie Offices

We are pleased to announce that Habib Al Mulla, one of the most respected and well-established law firms in the United Arab Emirates (“UAE”), will merge with us effective July 1. This expands and enhances our Gulf, Middle East and North America presence, adding to our offices in Riyadh, Cairo, Bahrain, Abu Dhabi, Istanbul, Doha, and Casablanca. We are also opening an office in Seoul, South Korea to be headed by Mr. Nam Hung Park, a senior Baker & McKenzie lawyer with 25 years experience advising Korean and multinational corporations. This will be our 73rd office globally and the 15th in Asia Pacific.

Global Equity Questions? There's an app for that.

Wondering if you have to withhold taxes on option exercises in Japan? Do you need to register your plan in Australia?

Baker & McKenzie's free Global Equity Matrix app puts the answers you need at your fingertips before you make the grant to employees, with info on the key tax and securities, exchange control, labor and data privacy issues in nearly 40 countries.

- Designed for stock plan professionals, tax directors, human resources managers, employee benefit lawyers, and corporate & securities counsel.
- Regularly updated summary of select legal and tax consequences for public company grants of employee stock options, stock purchase rights, and restricted stock and restricted stock units.
- Filter information by equity type (e.g. options, RSU, ESPP), by country, and by specific area of interest.
- Updates to important developments as they happen, delivered right to your device.

Click here to download the Global Equity Matrix app.

Global Equity Services "Like" Us on Facebook

To keep our clients and friends current on the latest global equity developments, we are proud to announce our new Facebook page. "Like" us to learn more about new developments, upcoming events and more. Click here to see our page and join in the community.

Australia

2013 Employee Share Scheme Return Changes

The Australian Tax Office (ATO) has confirmed that, for the tax year ending June 30, 2013 and for future tax years, Employee Share Scheme (ESS) returns should be prepared and filed by the "provider" (i.e., the issuing company). This is different from previous years for which the ATO has accepted ESS returns filed by a local entity on the provider's behalf, where the provider had delegated authority to the local entity to file the ESS return. In order to facilitate the new process, the ATO plans to amend its Bulk Load Spreadsheet for the 2013 ESS returns so that non-Australian companies that do not have an Australian Business Number can use the bulk load system instead of filing paper returns. Companies also will be able to use the amended Bulk Load Spreadsheet to produce printed ESS statements, thereby eliminating the need for the ESS Data Capture Tool used in prior years for this purpose.

In addition, as those of you with mobile employees may know, the ATO has previously advised that the full amount of the equity award income should be reported on the ESS Statements and ESS Annual Report for employees who have spent any portion of the vesting period in Australia. More recently, the ATO has indicated that you should now report the pro-rated amount (based upon the portion of the vesting period that the employee worked in Australia) if it can be provided by the due date. Otherwise, you can report the full amount, but if you subsequently become aware of facts which allow you to work out the pro-rated amount, an amended report should be submitted. Please click here for more detailed information from the ATO regarding this revised reporting policy.

Please recall that the ESS returns will be due by August 14, 2013 and the ESS statements to be provided to employees are due by July 14, 2013, so please contact your GES attorney if you need assistance with preparing the returns/statements. For more information, you may also want to read our latest client alert on this topic.

Further Changes to Securities Requirements for RSUs and SARs in Australia

As reported in our October 29, 2012 client alert, the Australian Securities and Investments Commission ("ASIC") officials orally informed our Sydney office that they do not consider RSUs to be the equivalent of "nil price" options, which means that the Class Order exemption would not be available for RSUs. At that time, it still appeared possible for companies with fewer than 20 grantees in Australia to rely on the so-called "20-in-12" exemption available for offers to 20 or fewer individuals in any 12-month period provided the value of the offer does not exceed A$ 2 million. However, in more recent discussions with ASIC, ASIC has expressed the view that RSUs are "derivatives" which means that, not only would the Class Order exemption not apply, but certain other exemptions would also be inapplicable, including the "20-in-12" exemption. In addition, we have clarified that SARs are in the same situation and can, therefore, no longer benefit from most of the exemptions in Australia.

ASIC has announced that it is reviewing the various exemption requirements and is planning to issue a revised draft policy by the end of July 2013, which may expressly extend all or some of the exemptions to RSUs and SARs. Of course, we cannot be certain that ASIC will actually do so. To eliminate any uncertainty in this regard, it is possible to apply for "specific relief" from ASIC, thereby requesting that RSUs and SARs be covered under one of the exemptions. Please speak to your GES attorney if you are granting RSUs or SARs to Australian employees to determine which approach makes the most sense for your company.

Canada

The Canada Revenue Agency Clarifies Allocation Rules Applicable to Stock Option Income

The Canada Revenue Agency (“CRA”) recently clarified its position on the allocation rules applicable to stock option income where income tax treaty relief does not specifically apply. In its technical interpretation issued on September 25, 2012, *Allocation of cross-border employee stock options* (Document No. 2012-0459411C6), the CRA adopted the Organisation for Economic Co-operation and Development (“OECD”) Model Convention on Income and on Capital (“Model Convention”) approach to the allocation of stock option income. Under this approach, stock option income is generally allocated to a particular country based on the number of work days that the employee spent in that country between the grant and vest dates.

This a significant change in the CRA’s position. The CRA previously considered stock option grants to be related to services prior to the grant date and, therefore, if the taxpayer was a Canadian taxpayer at grant, the full spread at exercise would be subject to income tax in Canada (even when the taxpayer was no longer a Canadian tax resident at exercise). For option exercises on or after January 1, 2013, the CRA will apply the OECD Model Convention approach and allocate the stock option income based on the number of works days spent in Canada between the grant and vest dates, “unless an income tax treaty otherwise specifically applies.” The CRA indicated that for option exercises prior to January 1, 2013, taxpayers could take the OECD Model Convention approach or the previous CRA approach.

Note that while the CRA did not specifically address other forms of equity income, it is assumed that this interpretation would apply to other equity awards, including RSUs and ESPPs.

If you have previously been advised on global mobility issues in Canada or if you have questions regarding how this development will affect your current processes, please contact your GES attorney.

European Union

Status of Employee Share Plan Exemption for Non-EU/EEA Listed Companies

As we previously reported, the European Union ("EU") Prospectus Directive (the "Directive") has been amended to broaden the application of the Employee Share Plan exemption which currently applies only to issuers with securities listed on an EU-regulated exchange. Under the amended Directive, which has largely been implemented into local law by the EU member states, the exemption applies also to issuers that are listed on an exchange that is considered equivalent to an EU-regulated exchange. However, to make the exemption effective, the EU

Commission will need to determine which exchanges are to be considered equivalent. This process has been stalled, and we have now learned that the Commission is unlikely to make the determination until late 2014 or 2015. This means that issuers that are not able to rely on another exemption or exclusion from the prospectus filing requirements will need to continue their annual prospectus filings at least through 2014. If you have any questions regarding the prospectus filing or the availability of other exemptions/exclusions, please contact your GES attorney.

France

French Government Seeks to Impose Higher Social Taxes on Employers Paying High Earners

As previously reported, the French Finance Act of 2013 was enacted by the French Parliament in December after several provisions of the draft legislation were rejected by the French Constitutional Court, including a provision that would have added an 18% surtax on high income earners (*i.e.*, individuals earning more than €1 million per year), which would have raised the total tax burden for such individuals to 75% on income over €1 million.

The Hollande government has responded to this rejection with an alternative method of imposing increased tax rates on high earners; namely, to increase taxes due by the entities paying employees who are high earners. There is currently no draft law available and, therefore, the actual format and impact of these proposals remain to be seen. However, companies with operations in France should anticipate a proposal calling for increased employer-paid social taxes in France for payments made to high earners, potentially up to the 75% level the French government originally sought to impose on individuals.

At this time, it is uncertain if or how this increase tax will affect equity award income, but companies will need to monitor these proposals very closely as this could (again!) impact their decision whether or not to grant French-qualified awards. If you need more information on the potential advantages/disadvantages, please contact your GES attorney.

Germany

German Securities Regulator Changes Position on Stock Options

The European Union Prospectus Directive (the “Directive”) generally requires that companies file a prospectus in connection with the offering of securities within the European Economic Area (“EEA”), unless an exemption or exclusion is available.

Offers of non-transferable stock options are considered by most EEA members as falling outside the scope of the Directive. However, the German securities regulator (“BaFin”) had taken the position that stock options constitute an offering of securities at the time that the stock options vest for the first time. As a result, companies granting stock options in Germany had to fall under an exclusion or exemption in order to avoid triggering a prospectus filing requirement under the Directive.

Recently, however, BaFin changed its position and now views non-transferable options granted under an employee equity program as not constituting an offering of securities. Therefore, companies may freely grant stock options in Germany without regard to available exclusions or exemptions under the Directive. Please note that offers of ESPPs to more than 150 persons in Germany will continue to trigger prospectus filing requirements under the Directive unless an exclusion or exemption applies.

Ireland

Changes to RSS1 Reporting Requirements for RSUs

RSUs no longer need to be reported on the annual share report (Form RSS1) due to the Pay-As-You-Earn (PAYE) withholding requirements that now apply to RSUs. Please make sure to work with your Irish entity to withhold tax upon vesting of RSUs and change the process for reporting awards on the Form RSS1 to exclude RSUs.

Israel

The Israeli Tax Authority Changes its Position on Dividend Adjustment Tax Rulings

This change affects options granted under the capital gains tax route of an Israeli trustee plan, which are adjusted by the issuer after grant to reflect payment of an extraordinary dividend. The adjustment typically involves a decrease of the exercise price. Effective January 1, 2013, companies that make such a downward adjustment can obtain a ruling from the Israeli Tax Authority ("ITA") which states that, upon the sale of the shares issued at exercise of such options, the entire gain may continue to be subject to the preferential tax treatment available for trustee plan options granted under the capital gains tax route. Previously, rulings regarding option adjustments due to a dividend payment generally stipulated that only 75% or 80% of the gain which relates to the adjustment could benefit from preferential tax treatment, while the remaining gain was subject to tax at the ordinary income tax rate. Companies that have an existing ruling can approach the ITA to obtain an updated ruling. Note that, if no ruling is obtained, the entire gain related to the adjustment will be subject to tax at the ordinary income tax rate.

The ITA also indicated that it will soon publish a general circular on this topic, a "green track" form for obtaining an expedited ruling, and a more detailed policy.

If you have questions regarding this recent update, please contact your GES attorney.

Japan

Tax Reform Proposal Results in Tax Rate Increases

Japan's government recently introduced a proposal to increase certain tax rates applicable to equity awards. This includes marginal income tax rates beginning in January 1, 2015. Under the current proposal, the highest marginal income tax rate would increase from 40% to 45%.

Also, effective January 1, 2014, the effective capital gains and dividends tax rate would increase to 20.315% -- from a current 10% (the 10% rate only applies if certain requirements are satisfied). Consequently, the 10% rate would be abolished under the proposal as of December 31, 2013, and the effective rate would take into account the standard capital gains tax rate of 20% (15% national tax and 5% local inhabitants tax) and the 2.1% surtax (that is, the tsunami recovery) due on the national tax.

We are monitoring these proposals. Please contact your GES attorney if you require an update.

New Zealand

Overseas Issuer Exemption Notice Extended to 2017

As you may know, the Securities Act Exemption Notice 2002 (the "Exemption Notice") in New Zealand exempts certain overseas issuers from the prospectus and investment statement requirements for the grant of stock options and the offer of ESPPs, providing certain conditions are met (RS and RSUs are generally not subject to securities requirements in New Zealand).

The Exemption Notice covers companies that are incorporated in certain overseas jurisdictions ("Specified Overseas Jurisdictions"), including the United States, which are listed and quoted on a securities exchange in a Specified Overseas Jurisdiction. To obtain the benefit of the exemption, certain requirements must be met including: (i) providing certain award and company documentation to plan participants in New Zealand and filing the same documentation with the Registrar of Companies and (ii) filing published financial statements with the Registrar of Companies on an ongoing basis.

In good news, the Exemption Notice, which was set to expire on March 31, 2013, has been extended to September 30, 2017 by the Securities Act Exemption Notice 2013.

Romania

Tax Compliance Obligations for Equity Awards in Romania Uncertain

Previously, it was understood that tax withholding and reporting, as well as payment of social insurance contributions, was not required for equity award income where the Romanian entity does not bear the cost of the awards. Due to recent changes to the Romanian Tax Code, Romanian counsel now advises that equity award income should be treated as "assimilated salary income," which is subject to income tax withholding and reporting, and employee and employer social insurance contributions regardless of any reimbursement/charge-back arrangement.

Under Romanian tax law, the "payer" of the income is responsible for ensuring that withholding and reporting take place. However, in the absence of a reimbursement/charge-back arrangement, the payer is the U.S. issuer. To the extent the payer is a non-EU company, it is unclear whether the Romanian authorities have any real ability to enforce the obligations As it is not reasonable to assume that a U.S. issuer could directly comply with these requirements, in the absence of a reimbursement arrangement, U.S. companies should appoint the local Romanian entity as their tax agent for purposes of complying with the withholding and reporting obligations. Note that the procedure for appointing the local entity as tax agent has not been confirmed with local tax authorities.

While there may still be arguments in favor of the position that tax withholding/reporting and payment of employer social insurance contributions is not required unless the local entity is bearing the cost of the awards, tax authorities may challenge this position in the event of an audit. Therefore, U.S. issuers offering equity awards in Romania should evaluate their current practices in Romania to ensure that these practices comply with recent interpretations of Romanian tax law.

Please contact your GES attorney for further information.

Russia

Ministry of Finance Comments on Taxation of Stock Options

As previously reported, legislative amendments to the Russian Tax Code in 2010 suggested that stock options received pursuant to an employee stock plan should be treated as a non-traded "Financial Instrument of a Term Transaction" (a "FITT") and, thus, subject to tax at grant (in addition to the normal taxation of the option spread at exercise). Recently, however, the Ministry of Finance issued an official clarification addressed to an individual taxpayer stating that stock options should not be classified as a FITT and, as such, not taxable at grant. While the guidance can be relied on only by the taxpayer who sought the clarification, it may provide companies granting stock options in Russia with some insight into the Ministry of Finance's view as to when stock options are taxable. If your company is interested in seeking clarification from the Ministry of Finance for its own option grants, please contact your GES attorney.

Exchange Control Rules May Prohibit Payments into Non-Russian Account

Recent amendments to Russian currency regulations have brought uncertainty as to whether Russian nationals may receive payments related to equity awards into accounts located outside of Russia. Under the new rules, which were implemented in February 2013, Russian national employees who receive most types of cash payments (e.g., salary, bonuses, cash-settled awards, cash awards, cash dividends, etc.) directly into bank accounts outside of Russia may be subject to severe penalties (*i.e.*, 75%-100% of the total amount of payments).

In the context of equity awards granted to Russian national employees, it is not certain if the new rules cover shares or proceeds resulting from the awards (*e.g.*, sale proceeds, dividend payments) issued into a non-Russian brokerage account. It may be possible to argue that payments into a foreign *brokerage* (rather than a foreign bank) account do not fall under said restrictions, but we would strongly recommend that issuers confirm this with the Russian exchange control authorities. Alternatively, companies may consider making payments pursuant to equity awards directly to employees in Russia (e.g., either through local payroll or into accounts with Russian banks).

If you are interested in pursuing a request for clarification with the Russian exchange control authorities, please contact your GES attorney.

Anti-Corruption Laws Target Foreign Accounts of Russian State Officials

Anti-corruption laws recently implemented in Russia prohibit Russian state officials, their spouses and their underage children from holding foreign bank accounts and securities. These laws became effective on May 19, 2013 with a 3-month transition period allowing officials (and their spouses and underage children) to comply with the new regulations.

The impact of this will likely be limited for most issuers; however, there may be circumstances in which an employee of an issuer is married to a Russian state official, thus barring the spouse from maintaining a U.S. bank or brokerage account. Issuers may have to explore alternative methods of administering awards for employees impacted by this new requirement.

Please contact your GES attorney for further information.

Singapore

Phase-out of Equity Remuneration Incentive Scheme

The Singapore government has announced that the Equity Remuneration Incentive Scheme ("ERIS") will no longer be available after December 31, 2013. Awards granted under an ERIS before January 1, 2014 will continue to qualify for beneficial income tax treatment if the gains are realized on or before December 31, 2023.

Please note that there are no proposals at this time to change the Qualified Employee Equity Based Remuneration ("QEEBR") scheme.

If your company maintains an ERIS to offer equity awards, contact your GES attorney for further information about how these changes will impact your plan.

Switzerland

Swiss Voters Approve Tough “Say on Pay” Legislation

On March 3, 2013, the Swiss voting population approved the “Minder Initiative.” The Minder Initiative is aimed at curbing executive remuneration, establishing new principles of corporate governance and generally protecting and broadening shareholders’ rights by giving shareholders’ of publicly-traded Swiss companies broad authority over executive pay. The rules are applicable to companies incorporated in Switzerland (even if shares are listed on a stock exchange outside Switzerland) as well as any companies listed on a stock exchange in Switzerland (even if incorporated outside Switzerland).

For more detailed information on the Minder Initiative and its implications, please see the March 2013 client alert prepared by our Zurich office.

Turkey

Clarification of Intermediary Rules for Purchase/Sale of Foreign Securities

Turkish residents are generally free to invest in securities of a foreign corporation (*e.g.*, a U.S. parent company), subject to certain outbound investment restrictions pursuant to Decree No. 32 on the Protection of the Value of the Turkish Currency ("Decree No. 32") and Communiqué No. 2008-32/34 on Decree No. 32.

Our Istanbul office recently clarified that one of the restrictions contained in Decree No. 32 is that Turkish residents must use a Turkish intermediary in order to purchase or sell shares traded on a foreign market. The purpose of this requirement is to monitor foreign investments made by Turkish residents. If the individual does not make a payment to purchase the shares (which would be the case for RSUs or options restricted to a cashless exercise method) or if there is no actual open-market purchase of the shares (which will typically be the case under an ESPP), it may be possible to argue that the financial intermediary requirement does not apply, but the requirement would continue to apply to the sale of the shares. In any event, it should be noted that the requirement applies to the purchaser/seller of the shares and not the issuer. Nonetheless, companies will want to notify their employees of these potential obligations.

Please contact your GES attorney for more information regarding this requirement or if you need assistance with an employee communication.

United Kingdom

Office of Tax Simplification ("OTS") Proposes Changes to Taxation of Unapproved Share Plans

As mentioned in our Fourth Quarter 2011 Clients & Friends Newsletter and our First Quarter 2012 Clients & Friends Newsletter, the OTS has now turned its focus from approved share plans to unapproved share plans. In January 2013, the OTS submitted its recommendations to the Chancellor of the Exchequer for consideration as part of the 2013 UK Budget. The proposed changes relate to: (i) the timing of when awards are taxed; (ii) aligning the tax treatment of equity awards granted to mobile employees with the tax treatment of other earnings and extending the availability of the corporate tax deduction to seconded employees subject to tax in the UK; (iii) establishing a new employee shareholding vehicle; (iv) amending the employer withholding and reporting obligations for equity awards (*e.g.*, by simplifying PAYE deadlines and Form 42 reporting requirements); and (v) creating new rules for valuation of shares.

On March 20, 2013, the Exchequer Secretary responded to the OTS's recommendations and indicated that the government intends to consult on the recommendations later this year to assess the potential impact with a view to implementing changes (if any) in the UK Finance Bill 2014.

We will continue to monitor these developments and update you as we learn more.

UK 2013 Budget Summary for Share Plans and Employee Taxation

The UK 2013 Budget, which was delivered on March 20, 2013, has little impact on employee equity plans other than decreasing the maximum tax rate from 50% to 45%, the adoption of certain changes to approved plans as proposed by the OTS, the adoption of the new statutory residence test, and the PAYE Real-Time Information penalty system. For more details on the 2013 budget measures as they impact employees and employers, please see the March 2013 client alert prepared by our London office. The UK Finance Bill 2013, which was released on March 28, 2013, also contains very few provisions that are relevant to the taxation of employee equity awards.

Please contact your GES attorney if you have any questions regarding the impact of the 2013 Budget.

UK Tax Reporting Deadline Approaching

Companies offering equity awards to employees in the UK should be aware that certain year-end returns need to be filed with the UK tax authority (known as HMRC) by July 6, 2013 for the tax year ended April 5, 2013. In particular, Form 42 is due for unapproved stock options, RSUs, restricted stock awards and ESPP rights and Form 35 is due for HMRC-approved (tax-qualified) options.

Please refer to our client alert dated April 29, 2013 for more detailed information regarding the reporting requirements as well as links to PDF copies of the applicable forms.

Real Time Reporting for Pay-As-You-Earn and National Insurance Contributions for Employee Equity Awards

As reported in our First Quarter 2012 Clients & Friends Newsletter, HMRC has rolled out a new framework for reporting of Pay-As-You-Earn ("PAYE") and National Insurance Contributions ("NICs") known as Real Time Information ("RTI"). Our UK Colleagues have recently clarified that RTI requires that employers (or their accountant, bookkeeper or payroll bureau) have to: (i) send details to HMRC every time they pay an employee, at the time they pay them; and (ii) use payroll software to send this information electronically as part of their routine payroll process. In relation to notional payments to employees, the RTI regulations provide that if an employer is unable to comply with the requirement to report the required information at the time of payment, the employer must instead deliver the information to HMRC "as soon as reasonably practicable after the payment is made and in any event no later than 14 days after the end of the tax month in which the payment is made." Notional payments would include employment income received by employees in respect of employment-related securities acquired upon the exercise of options, the vesting of RSUs, the grant or vesting of restricted stock awards and the acquisition of shares under an ESPP.

Despite extensive lobbying by companies, there is no legislative carve-out from the RTI reporting deadline for notional payments related to the acquisition of employment-related securities. HMRC has, however, recognized the fact that employers will face practical difficulties in complying with RTI, particularly with respect to employee equity awards. As a result, HMRC has confirmed that, in relation to employment income paid in respect of employment-related securities, it will apply a "common sense approach" in determining whether employers have a reasonable excuse for not reporting the required information by the end of the pay period or 19th of the following month (*i.e.*, 14 days after the end of the tax month in which the payment is made). In determining whether a reasonable excuse exists, HMRC has further indicated that it is not expecting employers to change their current withholding practices or plan operation. HMRC does expect, however, that the late reporting will normally take place no later than the next regular monthly payroll date, and that the relevant payment will be made within the normal PAYE deadlines for that month (*i.e.*, 14 days after the end of the tax month (slightly later if returns are filed electronically)).

If you need assistance working through the practicalities of the RTI system and its impact on your payroll processes, please contact your GES attorney.

United States

IRS Prevails on Application of Section 409A to Discounted Stock Options

In *Sutardja v. United States*, No. 11-724T (Fed. Cl. Feb. 27, 2013), the Federal Court of Claims granted the government's motion for partial summary judgment on February 28, 2013, holding that discounted stock options are subject to excise taxes and interest penalties under Code Section 409A. The case involved a refund claim by plaintiffs to recover more than $3.1 million in Code Section 409A excise taxes and more than $300,000 in interest penalties that the IRS assessed on income attributable to plaintiffs' exercise of stock options that, according to the IRS, were granted with an exercise price that was less than the fair market value of the underlying stock on the date of grant ("discounted options").

In *Sutardja*, the plaintiffs argued that the characterization of stock options as "deferrals of compensation" under IRS Notice 2005-1 (the applicable authority at the time of transactions at issue in this case) was contrary to U.S. Supreme Court precedent, citing *Smith v. Commissioner*, 324 U.S. 177 (1945), the seminal case in which the Supreme Court held that the mere grant of an option is not a taxable event. The court rejected plaintiffs' argument because the Supreme Court's holding in *Smith* applied explicitly to a non-discounted option and, therefore, IRS Notice 2005-1 was not contrary to *Smith*.

The plaintiffs also argued that discounted options do not constitute deferral of compensation under Code Section 409A because the definition of deferred compensation under the Federal Insurance Contributions Act ("FICA") regulations explicitly excludes the grant of options for purposes of determining FICA obligations under Code Section 3121(v). The court disagreed, holding that the IRS properly disregarded the definition of deferred compensation under the FICA regulations because the FICA regulations, by their terms, provide that they are applicable only for purposes of determining the treatment of deferred compensation under Code Section 3121(v).

Finally, the plaintiffs argued that, even if their options were discounted options subject to Code Section 409A, any deferral of income would fall under the Code Section 409A "short-term deferral exception," which generally provides that payments that must be made within two-and-a-half months after the end of the year in which they vest are not deferred compensation under Code Section 409A. Plaintiffs claimed that their options fell within the short-term deferral exception because the options were exercised in January following the year in which they became vested. The court rejected plaintiffs' argument because the terms of the applicable option plan document allowed for vested options to be exercised any time within ten years from the grant date, thus exceeding the two-and-a-half-month short term deferral period.

After granting the government's partial motion for summary judgment on the issue of whether discounted options are subject to Code Section 409A, the court remanded the case to the trial court to determine whether the options were in fact discounted options, which is a question of fact.

Target Stock Option Deductions May No Longer Be Available to Acquiring Corporations

The IRS has published a general legal advice memorandum ("GLAM") on whether the seller or buyer in an acquisition may claim certain stock option-related deductions, among other deductions associated with transaction-related expenses. The deduction related to amounts payable by a target company to its employees pursuant to a change of control provision in connection with the cash-out of compensatory stock options and stock appreciation rights. The GLAM, in relevant part, addressed whether the deduction was allocable to the short taxable year of the acquired corporation entering (and leaving) a consolidated group as a result of the acquisition of the corporation's stock.

Under the applicable default tax rules, accrued deductions generally are allocable to the target corporation's short taxable year ending on the closing date of the acquisition. However, under the "next-day" rule, if the transaction giving rise to the deduction is "properly allocable" to a portion of the target corporation's day after it has become a member of the acquiring group, the target corporation's deduction usually would be available to the acquiring group. The IRS concluded that allocating this deduction to the post-closing period would not be "proper" or "reasonable" because the obligation to make the payments became fixed and determinable at closing and arose from the performance of services for the target corporation prior to the closing. Consequently, the IRS concludes in the GLAM that the seller – not the buyer – in an acquisition receives the tax deduction benefits of the target company's deductible compensatory stock options and SARs accruing on the closing date. The GLAM is not binding legal authority, but it is a significant statement on the IRS's position on this issue.

Recent Developments in US Privacy Law

Baker & McKenzie LLP has recently published an client alert providing a summary of key recent developments in US privacy law, including HIPAA, COPPA, state data security, and Federal Trade Commission initiatives.

New Proxy Disclosure Guidance

The U.S. Securities and Exchange Commission released new Compliance & Disclosure Interpretations ("CD&Is") on May 17, 2013. These CD&Is are part of the SEC's interpretation of Regulation S-K. The following are new items of guidance related to equity compensation and proxy disclosure:

- Many companies use non-GAAP performance goals and targets in their performance-based compensation plans. The updated CD&Is specify that companies must disclose how the non-GAAP financial measure is calculated using the company's audited financial statements. This is the case both if the non-GAAP financial measure is used to set target levels www.bakermckenzie.com

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or the actual target (provided that the actual target is disclosed in connection with the target levels).

- The updated CD&Is specify that when cash payments of salary or bonus are foregone at the election of a named executive officer and payment in the form of stock or another form of compensation is received instead, the amounts are still reported under the salary and bonus columns of the Summary Compensation Table and are not reported in any other column, provided the value of the stock or other non-cash compensation is equal to the amount of foregone salary or bonus. If stock is received in lieu of salary or bonus and the value of the stock exceeds the value of the salary or bonus, then the incremental value would be reported in the Stock Awards or Option Awards columns. Furthermore if the arrangement that governs the exchange of salary or bonus for stock is within the scope of FAS 123R, then the full award is reported in the Stock Awards or Option Awards columns. In both of these special cases, the amount client alert reported in the Stock Awards or Option Awards columns is the grant date fair value of the equity award, and footnote disclosure should be provided regarding the circumstances of the award. Finally, appropriate disclosure about equity-based compensation received instead of salary or bonus must be provided in the Grants of Plan-Based Awards Table, the Outstanding Equity Awards at Fiscal Year End Table and the Option Exercises and Stock Vested Table.

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