

# Insight: Global equity-based compensation

March 2010

## Recent changes in law – Canada, Ireland, Portugal and the UK

### Canada – Federal Budget 2010

On 4 March 2010 several important changes were announced to the Canadian federal income tax rules which may affect various types of equity-based compensation plans. The more significant of these from an employer's perspective in relation to equity-based compensation are:

#### Treatment of cash cancellation

Previously, if an employee exchanged his or her stock options for a cash payment from his or her employer, the employer was entitled to a corporation tax deduction and the employee to favorable income tax treatment (i.e. halving of the applicable rate). As a result of the announced changes, the tax benefits will only be available for either the corporation (through the payment deduction) or the employee (through the half rate of tax), but not for both. The reduced tax rate will therefore only be available to employees when the employer elects to forgo the corporation tax deduction.

#### Taxation deferral

The new rules propose to repeal the tax deferral election available on stock options granted to employees of publicly traded companies. Therefore, with the exception of Canadian-controlled private corporations, it will not be possible to defer the taxation of stock option benefits from exercise to sale of the underlying stock.

Employees who have already elected to defer taxation of their stock option benefits until the sale of the shares arising from exercise (the "**optioned securities**"), may find that the value of the optioned securities are less than the amount on which the deferred tax liability on the underlying stock option benefit is calculated. To provide relief, a special election will ensure that the tax liability on a deferred stock option benefit does not exceed the resulting sale proceeds of disposition of the optioned securities and will take into account tax relief resulting from the use of capital losses.

### Ireland – the Irish Finance Bill

The Irish Finance Bill, published by the Department of Finance on 4 February 2010, contains a variety of provisions which affect equity-based compensation plans.

#### Relief for restricted shares

From 4 February 2010, employees who are awarded free or discounted shares which are subject to a time-based restriction from dealing, can benefit from tax relief on up to 60% of the taxable value of the shares, if the shares have been held in a trust or another Irish Revenue-approved holding vehicle established in Ireland and another EEA state during the restricted period.



Our global equity-based compensation practice is a key part of the Global Executive Compensation Benefits and Employment Law group which numbers more than 100 professionals worldwide. We offer extensive expertise in dealing with the key issues involved in operating international equity-based compensation plans. Our work includes:

- implementing global employee stock plans
- advising companies on the effects of major M&A transactions on their equity incentive plans
- implementing equity incentive plans for companies preparing for an IPO
- establishing offshore trusts for the benefit of employees
- implementing global profit-sharing plans
- implementing global re-pricing and exchange programs for underwater options
- implementing global stock appreciation rights plans
- advising non-US companies on offering equity-based compensation in the US
- advising companies regarding equity-based plans with respect to the spin-off of divisions

### New employer reporting obligation

New reporting requirements apply to all awards of shares (including interests in shares) and securities made to employees or directors since 1 January 2009. These requirements bring other arrangements in line with the requirements already in place for share options and Revenue-approved schemes. Returns must be filed with the Irish Revenue by 31 March after the end of the relevant tax year (1 January to 31 December). Various penalties apply in the event of failure to report, or filing incorrect returns which are negligently or fraudulently produced.

### Approved Profit Sharing Schemes (APSS)

APSS legislation provides an income tax break to employees in respect of free shares issued by their employer or its parent company. As of 4 February 2010, two anti-avoidance measures will take effect to counteract the use of loans and service companies. Firstly, the Irish Revenue will not approve a scheme unless it is satisfied that there are no loan or credit arrangements, connected in any way with the scheme, which would enable some or all employees to participate in the scheme. Secondly, shares in a service company (or a company which has control of a service company) may not be used for APSS purposes.

### Social security charges

Contrary to expectations, the Irish Government has not introduced social security charges on share-based awards, for either employees or employers. This is of significant benefit to companies, comparing very favorably to cash bonuses and other non-cash benefits which typically attract such social security charges.

However, the position regarding social security charges is still expected to change in 2011, although any such change is unlikely to be retrospective.

### Tax tightening measures

The Irish Finance Bill demonstrates the Revenue's desire to exert greater control over tax avoidance through a general tightening of tax measures, particularly with regards to high net worth individuals.

The measures include a domicile levy, whereby Irish citizens living in Ireland, with a worldwide income exceeding €1 million, income tax liability in Ireland of less than €200,000, and with assets, located in Ireland, worth over €5 million, will be subject to a "domicile levy" of €200,000. Moreover, Irish citizens will no longer benefit from the remittance basis of taxation applying to foreign investment and employment income which had previously been available to citizens returning to Ireland for the first three years after their return.

However, various tax reliefs have also been introduced that are particularly aimed at encouraging employees from overseas to live and work in Ireland. For example, certain internationally mobile employees will be exempt from the income levy on gross income which was introduced in 2009. Moreover, Cross Border Workers relief is available for employees residing in Ireland but working in a country with which Ireland has a Double Taxation Agreement for at least a 13-week period, and who spend at least 1 day per week in Ireland. Non-Irish citizens, working in Ireland for more than 12 months, under a European Economic Area (EEA) contract, will qualify for income tax relief, provided it is the employee's first assignment to Ireland, and he/she was never previously tax resident there.

### Portugal – new social security tax

A number of changes are set to affect the social security tax regime in Portugal from 1 January 2011. These changes, which were originally planned to come into effect from 1 January 2010, are likely to receive a mixed reception from employers and employees.

### "Regular" remuneration

Historically, there has been much confusion under the rules in Portugal relating to the application of social security tax to equity-based compensation plans. These rules have required social security contributions to be paid on "regular" remuneration without setting out what would be caught by this term. In the absence of guidance, employers have classified income derived from equity-based compensation plans as irregular income and consequently regarded social security contributions as inapplicable.

### "Discount" on acquisition

Under the new Social Security Code (the "**Code**"), social security contributions will be payable on all cash payments, including income derived from cash-settled share awards, where the point of taxation arises on or after 1 January 2011.

An exemption is available under the Code where the plan in question gives employees a "discount" on the acquisition of shares. Although the matter is not beyond doubt, it appears that this exemption will apply to restricted stock or option plans, and plans under which payment is not required upon the delivery of shares on vesting/exercise. Plans which do not involve a delivery of actual shares, such as phantom plans, are unlikely to benefit from the exemption.

### Employer contribution rates

Changes are also being made to the rate of employer social security tax with effect from 1 January 2011, which currently stands at 23.75%. The new rates will discriminate between employees on fixed-term contracts and those with permanent contracts. Employer contributions will increase to 26.75% in respect of fixed-term contracts but will benefit from a 1% fall to 22.75% in the case of permanent contracts. The rate of employee social security contributions will remain the same at 11%.

### Next steps

Employers, where they have not already done so, should now begin thinking about amending their payroll systems to deal separately with cash-settled and stock-settled awards with effect from 1 January 2011.

## UK – changes to income tax and national insurance contributions

As previously reported, a number of significant changes to income tax rates and liability will come into effect in the UK from 6 April 2010. This includes a rise in the higher rate of income tax from 40% to 50% for those earning in excess of £150,000 per annum. There will also be reductions in personal allowances for high earners. The value of the personal allowance will be restricted for those with incomes of over £100,000, tapering down to zero for incomes over approximately £113,000. Furthermore, there remains a planned increase from 6 April 2011, of 1% to both employees' and employers' National Insurance Contributions, rising to 2% (above the Upper Earnings Limit) and 13.8% respectively.

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