

# Insight

## Global Equity-based Compensation

### SAYE it isn't so – US "409A" rules may impact UK equity-based compensation plans

Companies based in the United Kingdom sponsor a number of different types of equity-based compensation plans. Some of these plans, including in particular the "save-as-you-earn" ("SAYE") plan, involve the grant of discounted options. Now that transition relief has expired under the relatively new Section 409A of the U.S. Internal Revenue Code of 1986, as amended, and the Section 409A rules have now become fully effective, it has come to our attention that some UK plan sponsors may still not yet be fully aware of the potential need to conform their plans to the requirements under Section 409A. The purpose of this note is to alert you to the possibility that SAYE plans, as well as other structures, could raise issues under Section 409A, notwithstanding that they may be commonplace or standard in the UK and may even be approved by HM Revenue & Customs ("HMRC").

The issues could arise in any case in which a participant in any of these types of plan is subject to US taxation. The issues are therefore of concern to UK companies that offer participation in these types of plan to:

- their own employees in the US or employees of their US subsidiaries; and
- employees who are living and working in the UK (or elsewhere) but are subject to US taxation, because they are Green Card holders or US citizens.

Section 409A for the first time comprehensively codifies the US federal income-tax treatment of nonqualified deferred compensation. In general, Section 409A provides that amounts deferred under a nonqualified deferred compensation plan are immediately taxable to the extent such compensation is not subject to a substantial risk of forfeiture and was not previously taxed, unless certain requirements are met. Further, non-complying deferrals are subject to an additional 20% tax and additional interest on any related underpayment of taxes. Final regulations were issued in 2007, and became fully effective for the first time on 1 January 2009. It is at this point axiomatic that Section 409A has caused substantial consternation among employers, and has exposed a wide range of employees to penalties and other adverse tax consequences.

The SAYE plan is a type of UK plan approved by HMRC which is entitled to favourable tax treatment. The plan must be operated on an "all-employee" basis, meaning broadly that the sponsoring employer must offer participation in its SAYE plan to all of its UK resident employees. Each employee who chooses to participate is granted an option linked to a savings contract that runs for a fixed period of 3, 5, or 7 years. Participants are required to make regular contributions from their salary into their savings contract.



**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 lawyers 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 re-pricing and exchange programs for underwater options
- implementing global stock appreciation rights plans
- implementing global profit-sharing 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

Under an SAYE plan, the exercise price of the options can be set at a discount of up to 20% below the current market value of a share in the company as at the date of grant. At the end of the savings contract period, a participant can exercise his or her option using the cash held in his or her savings contract. The option can normally be exercised only within a limited period of up to 6 months after the end of the 3, 5 or 7 year savings period. Exceptions apply if the employee leaves in certain "good leaver" circumstances. Provided certain statutory conditions are met, no income tax or National Insurance Contributions (UK social security) will be charged on exercise of the option. The employee will instead pay capital gains tax when he sells the shares on the excess of the sale proceeds over the amount paid for the shares. Capital gains tax is payable at a relatively low flat rate of 18%.

A number of large multi-national companies headquartered in the UK have adopted "international SAYE" plans which mirror the provisions of their UK-approved SAYE plans in all material respects and which run in parallel with their UK-approved SAYE plans, but which do not benefit from favourable UK tax treatment.

SAYE plans may raise issues under Section 409A and therefore lead to additional tax and interest. UK approval does not ensure compliance with the relevant US rules. Plans modelled on SAYE plans that are not UK-approved may raise additional questions.

UK companies may also operate other plans such as "unapproved" long term incentive plans involving the grant of nil cost options that could raise difficult issues under Section 409A.

White & Case would be happy to discuss your UK equity-based compensation plans in light of Section 409A and provide solutions that will help you avoid the additional tax and interest associated with non-compliance. Please note that there is already a correctional programme for operational non-compliance with 409A and there may be in the future a similar programme for documentary non-compliance.

Please do not hesitate to contact us if you require further information:



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