United States

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EMPLOYEE PARTICIPATION

1. Is it common for employees to be offered participation in an employee share plan?

Most public companies and many private companies offer employee share plans. Companies often limit participation to senior executives (for example, through share option grants), but some companies offer broad-based equity plans to all employees. The number of employees owning shares in their employers has decreased slightly in the last few years, possibly because accounting rules now require options to be recorded on company books at fair value as expenses.

The National Center for Employee Ownership (NCEO) released in March 2010 statistics indicating that, as of early 2010, there were 3,000 broad-based individual equity plans in the US, with approximately 10 million participants. The NCEO study cites to a 2009 Bureau of Labor Statistics Survey that indicates about 9% of all private-sector employees hold share options.

On the basis of a 2007 National Association of Stock Plan Professionals and Deloitte Consulting Survey, the NCEO concluded that the larger the company, the smaller the percentage of employees with equity compensation (which may include restricted share awards in addition to share options). In companies with more than 30,000 employees, only 3% of the employees hold equity compensation. In companies with 251 to 750 employees, 75% of employees hold equity compensation, and in smaller companies, the percentage increases to 100%.

2. Is it lawful to offer participation in an employee share plan where the shares to be acquired are shares in a foreign parent company?

It is lawful to offer employees shares in a foreign parent company. However, a non-US parent company that wishes to compensate its US employees with equity in itself faces regulatory hurdles at the federal and state level.

In addition to complying with US corporate governance rules, non-US employers must generally either register equity-based compensation arrangements offered to employees under federal and state securities laws and regulations or comply with an exemption from registration. The vast majority of non-US employers operating in the US do not register their securities because of the steep cost in resources and money involved, and instead use an exemption from registration. If the non-US employer's shares are trading in the US as American depository receipts (ADRs), the non-US employer can use the short-form registration, which simplifies its compliance burden.

In addition, offering shares in a non-US parent company does not necessarily avoid taxation and other US legislative requirements.

SHARE OPTION PLANS

3. Please list each type of share option plan operated in your jurisdiction (if more than one).

There are two types of share option plan:

- Incentive share option (ISO) plans.
- Non-qualified share option (NQSO) plans.
- A single plan may issue both ISOs and NQSOs.

4. In relation to the share option plan:

- **What are the plan's main characteristics?**
- **Which types of company can offer the plan?**
- **Is this type of plan popular? If so, among which types of company is this plan particularly popular?**

ISO plans

Main characteristics. ISOs are share options that are structured to qualify under section 422 of the US Internal Revenue Code (Code). An employee who exercises this kind of option pays no tax on exercise. However, the employer cannot claim a deduction for the employee's exercise gain (*see Question 7, ISO plan: Tax/social security on exercise*).

To qualify for favourable tax treatment under US federal tax rules ISOs must satisfy several requirements:

- The ISO must be granted only to an employee of the issuing corporation (or its parent or subsidiary), who must generally remain an employee until exercise of the option, although an employee may exercise the option within three months following termination of employment (within one year if disabled).
- The plan under which the ISOs are granted must be approved by the corporation's stockholders within 12 months before or after the plan is adopted by the employer's board of directors.
- The ISO must be exercised within ten years after it is granted (this period is reduced to five years for ISOs granted to shareholders who hold 10% or more of the voting power of the company's outstanding total shares).

Country Q&A

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- The ISO must be granted within ten years after the earlier of either:
  - the date the plan was adopted; or
  - the date the plan was approved by the shareholders.
- The ISO must specify that it can only be transferred by the employee at death (through a will or by the laws of descent and distribution) and that only the employee can exercise the ISO to purchase stock during his lifetime.
- The ISO exercise price must not be less than the fair market value (FMV) of the stock on the date of grant (in the case of a 10% or more shareholder, the ISO exercise price must be at least 110% of the FMV of the stock).
- The maximum total value of the stock (determined as of the grant date) that is first exercisable during any one calendar year must not exceed US$100,000 for any one employee (as at 1 August 2010, US$1 was about EUR0.77).

For other restrictions, see *Question 5, ISOs*.

Types of company. Only a corporation can grant ISOs. Limited liability companies (LLCs) cannot grant ISOs.

Popularity. ISOs are less popular than NQSOs because (*see below, NQSO plans: Popularity*):

- The employer does not receive any tax deductions on ISOs and may take the view that the tax cost to itself outweighs the tax benefit to the employee.
- The employee may be exposed to alternative minimum tax.

NQSO plans

Main characteristics. NQSOs are options that are not structured to receive the special tax treatment of an ISO. NQSOs afford employers more flexibility in design than ISOs.

Types of company. Generally, any type of company, including a limited liability company, can offer NQSOs.

Popularity. NQSOs are the most popular type of employee share options used by employers to compensate their employees. Many employers choose to offer NQSOs because of the flexibility in design permitted, and because NQSOs allow tax deductions to be available to the employer, unlike ISOs.

5. In relation to the grant of share options under the plan:

- **Can options be granted on a discretionary basis or must they be offered to all employees on the same terms?**
- **Is there a maximum value of shares over which options can be granted, either on a per-company or per-employee basis?**
- **Must the options have an exercise price equivalent to market value at the date of grant?**
- **What are the tax and social security obligations arising from the grant of the option?**

ISO plans

Discretionary/all-employee. ISOs can only be granted to employees of the issuing company (or its parent or subsidiary company) (*section 422, Code*). They cannot be granted to directors and independent contractors. Otherwise, ISOs are discretionary, so the employer can select which employees participate in the plan and offer ISOs on varying terms. ISOs are typically limited to senior or management executives.

Maximum value of shares. No more than US$100,000 worth of ISOs per employee can become exercisable for the first time in any calendar year, based on the shares' market value on the date of grant. Any ISOs granted in excess of this limit are considered NQSOs.

There is no other limit on the value of shares that can be granted per employee, as a grant can vest over several years. However, ISOs cannot be exercisable more than ten years from grant (*see Question 4, ISOs: Main characteristics*).

Market value. The ISO's exercise price must be at least equal to the shares' fair market value on the date of grant. For ISOs granted to shareholders who hold 10% or more of voting power of all outstanding company shares, the exercise price must be equal to at least 110% of the fair market value on the date of grant.

Tax/social security. No tax is charged on grant.

NQSO plans

Discretionary/all-employee. Non-qualified share options are fully discretionary. The employer can grant them to anyone, including directors and independent contractors, on any terms.

Maximum value of shares. There is no limit to the value of shares that can be granted, per company or per employee.

Market value. While the shares subject to a NQSO may provide for an exercise price that is discounted below fair market value on the date of grant, if the shares' exercise price is below fair market value on the date of grant, the NQSOs may be subject to additional restrictions governing deferred compensation (*section 409A, Code*) (*see Question 24, Trends and developments*).

Tax/social security. No tax is charged on grant.

6. In relation to the vesting of share options:

- **Can the company specify that the options are only exercisable if certain performance or time-based vesting conditions are met?**
- **Are any tax/social security contributions payable when these performance or time-based vesting conditions are met?**

ISO plans

Exercisable only on conditions being met. The employer may place performance or time-based vesting conditions on an ISO. Typically, a percentage of the ISO vests over a specific time period, although performance-based vesting conditions are becoming more popular (but may affect the options' accounting treatment).

Tax/social security. No tax or social security contributions are payable on vesting.

NQSO plans

Exercisable only on conditions being met. The employer can place performance or time-based vesting conditions on the option (*see above, ISO plan: Exercisable only on conditions being met*).

Tax/social security. No tax or social security contributions are payable on vesting.

7. Do any tax or social security implications arise when the:

- **Option is exercised?**
- **Shares are sold?**

ISO

Tax/social security on exercise. The employee pays no tax on exercise. However, the spread between the option exercise price and the fair market value of the shares on exercise, that is, the gain that the employee receives on exercise, may be subject to alternative minimum tax (AMT) calculations (*Section 55, Code*).

AMT is generally charged at:

- 26% for the first US$175,000.
- 28% above US$175,000.
- For married people filing separately, the 26% bracket ends at US$87,500.

If an employee exercises an ISO, he must calculate both his AMT tax liability and regular federal income tax liability (in relation, for example, to his salary). The employee must pay AMT if his AMT tax liability is higher than the regular federal income tax liability. However, the AMT paid can be applied as a credit in future years to reduce regular federal income tax liability.

The employer receives no tax deduction on exercise of an ISO.

Tax/social security on sale. The taxation of shares sold depends on whether the sale constitutes a qualifying or disqualifying disposition.

The disposition is qualifying if the employee holds the shares for a minimum of both:

- Two years from grant.
- One year from exercise.

If the employee meets both these requirements (the ISO holding period), he pays capital gains tax on the difference between the sale price and exercise price.

If the employee sells the shares before either of these dates, the sale is a disqualifying disposition and income tax is charged on the difference between the shares' exercise price and market value on exercise.

The employer receives a deduction for this amount. The employer does not withhold the tax from the employee's salary but it may be necessary for the employer to report on form W-2 to claim a deduction. The employee either pays capital gains tax on the gain, or realises a capital loss.

The long-term capital gains tax rate is currently 15% for most individuals.

Income tax is charged at progressive rates of 10% to 35%.

NQSO

Tax/social security on exercise. The employee pays income tax and Federal Insurance Contributions Act (FICA) tax (which funds social security and hospital insurance benefits) on the difference between the exercise price and the shares' fair market value. The employer can take a tax deduction on the same amount. The employer withholds the tax from the employee's salary.

Tax/social security on sale. The employee pays capital gains tax on any increase in the shares' value since exercise. The employee can take a capital loss if the share's value has decreased since exercise.

SHARE ACQUISITION OR PURCHASE PLANS

8. Please list each type of share acquisition or purchase plan operated in your jurisdiction (if more than one).

There are five main types of share acquisition or purchase plan:

- Restricted share plans.
- Qualified employee share purchase plans (ESPPs).
- Non-qualified ESPPs.
- Employee stock ownership plans (ESOPs).
- 401(k) plans.

9. In relation to the share acquisition or purchase plan:

- **What are the plan's main characteristics?**
- **Which types of company can offer the plan?**
- **Is this type of plan popular? If so, among which types of company is this plan particularly popular?**

Restricted share plan

Main characteristics. Under this type of plan, which may be a part of a broad-based equity plan, employees receive shares that are subject to vesting criteria. Typically, until the vesting criteria are met:

- The employee does not have possession of and cannot transfer the shares.
- Before the shares become unrestricted, the employee may or may not receive dividends or voting rights on the shares.

Employers can also offer restricted share units (RSUs). Employees participate on a similar basis as above, but do not actually own any shares until the restrictions are met.

Types of company. Any type of company can offer a restricted share plan.

Popularity. Although share options have historically been more popular than restricted shares, some companies have moved from share options to restricted shares for various reasons, including changes in accounting rules (*see Question 24, Trends and developments*), and the fact that employees tend to hold restricted shares longer, even after they vest.

Qualified ESPP

Main characteristics. This type of plan is structured to qualify for special tax treatment under section 423 of the Code.

Under an ESPP plan, the employees contribute part of their salary to the plan through regular after-tax payroll deductions. The deducted funds are accumulated during a specified offering or purchase period (typically six to 12 months). At the end of the offering period, the funds are used to buy shares at a discounted price (typically 85% of their market value, the maximum allowable discount). Many plans have a look-back feature, which allows the price to be set by reference to the lower of the market price at the beginning and the price at the end of the offer period. The shares are then issued to the employee.

The trend has been towards offering lesser discounts, because of accounting rules (*see Question 24, Trends and developments*).

Types of company. Generally, only publicly traded companies offer ESPPs, because the offer would trigger securities registration requirements, which typically involve a high cost (*see Question 23, Prospectus requirements*). Private companies may be able to offer ESPPs, because offers limited to employees may qualify for an exemption from securities law requirements, but this is unusual.

Popularity. ESPPs are a very popular type of employee share plan, although mainly for publicly traded companies (*see above, Types of company*). The 2010 Culpepper Equity Compensation & Long-Term Incentives Practices Survey indicates that an increasing number of companies are turning to ESPPs as an alternative vehicle to provide broad-based employee ownership (*see Question 1*).

Non-qualified ESPP

Main characteristics. This is an employee share purchase plan (*see above, Qualified ESPP: Main characteristics*) that is not structured to receive special tax treatment.

Types of company. See above, *Qualified ESPP: Types of company*.

Popularity. Although non-qualified ESPPs do not offer the same tax advantages as qualified ESPPs, they are still popular because they do not have to meet the requirements of section 423 of the Code.

ESOP

Main characteristics. An ESOP is a retirement plan with many tax benefits, typically set up as a trust that can receive money from the employer or borrow money to purchase and hold the employer's shares, which are then distributed to employees on their retirement or leaving the employer.

Types of company. Any type of company can offer an ESOP.

Popularity. ESOPs are the most common form of employee ownership in the US. About 11,000 companies now have these plans, covering over 13 million employees. Because employees are not making investment decisions, securities law does not hinder private companies from implementing ESOPs, so they are much more commonly used by private companies.

401(k) plan

Main characteristics. A 401(k) plan is a retirement plan that is structured to receive tax benefits under section 401(k) of the Code. Employees can elect to contribute part of their pre-tax salary to an investment fund set up by the employer. The employer typically contributes an amount in proportion to the employee's contributions. Although 401(k) plans are perhaps not technically employee share plans, employers often match employees' contributions through contributions of their own company shares. Generally, when the employee leaves employment, he receives his vested account balance.

Types of company. Any type of company can offer a 401(k) plan.

Popularity. 401(k) plans are very popular for their tax savings and, when combined with employer share contributions, are the fastest growing mechanism for employee ownership. This combination is particularly popular with public companies, which can contribute treasury shares at no cash cost and receive a tax deduction.

10. In relation to the initial acquisition or purchase of shares:

- **Can entitlement to acquire shares be awarded on a discretionary basis or must it be offered to all employees on the same terms?**
- **Is there a maximum value of shares that can be awarded under the plan, either on a per-company or per-employee basis?**
- **Must employees pay for the shares and, if so, are there any rules governing the price?**
- **Are any tax/social security contributions payable when the shares are awarded?**

Restricted share plan

Discretionary/all-employee. The employer can offer restricted shares on a discretionary basis.

Maximum value of shares. There is no maximum value of shares that can be awarded.

Payment of shares and price. Employees can be offered the shares at any price. However, restricted share plans are typically awarded for no consideration and are subject to time-vesting or performance conditions.

Tax/social security. If the employee receives restricted shares, he can make an election under section 83(b) of the Code to pay income tax on the award at the time of grant, based on the value of the shares at that time. The employer is entitled to a deduction for the amount on which the employee pays tax (subject to a maximum amount in relation to certain executives receiving grants). If the employee receives RSUs, he pays income tax on vesting, that is, when he receives the shares. No section 83(b) election is available for RSUs.

The employee can either pay the tax withholding in cash or allow the company to withhold an appropriate number of shares to cover the tax.

Qualified ESPP

Discretionary/all-employee. The employer must offer a qualified ESPP to all employees.

With certain exceptions for non-US employees, the company must offer the plan to all employees on the same terms. However, a company can withhold participation from employees of a subsidiary as long as it does not offer it to any employees of that subsidiary. In addition, the company can exclude certain non-US employees from participating if local law prohibits this.

The employer's shareholders must approve the offer of a qualified ESPP.

Maximum value of shares. No employee can purchase more than US$25,000 worth of shares annually.

Payment of shares and price. The purchase price cannot be less than 85% of the shares' market value.

Tax/social security. The employee pays no income tax or social security tax on award.

Non-qualified ESPP

Discretionary/all-employee. Non-qualified ESPPs are discretionary.

Maximum value of shares. There is no maximum value of shares that can be awarded, although employers typically stipulate a maximum amount that employees can contribute and therefore purchase (for example, 10% of their salary).

Payment of shares and price. Employees typically pay for the shares at a discounted price through payroll deductions.

Tax/social security. The employee pays income tax and social security tax on the difference between the shares' purchase price and their market value at the time of purchase.

ESOP

Discretionary/all-employee. With certain exceptions, employees must generally be allowed to participate in an ESOP if they are at least 21 years old and work more than 1,000 hours in a plan year.

Maximum value of shares. Shares held by the fund are allocated to employees based on their relative compensation.

Payment of shares and price. Employees do not pay for the shares.

Tax/social security. Employees pay no tax while the shares are still held in the plan before they are paid out.

401(k) plan

Discretionary/all-employee. With certain exceptions, employees must generally be allowed to participate in a 401(k) plan if they are at least 21 years old and work more than 1,000 hours in a plan year.

Maximum value of shares. Shares held by the plan's trust fund are typically allocated to employees based on their relative contributions. There is no limit on the value of shares an employee can hold in his 401(k) account. However, for public companies with 401(k) plans, the Pension Protection Act of 2006 requires that employees be able to diversify out of any employer stock they have purchased with their own deferrals. In addition, employees must be able to diversify out of employer stock that was contributed by the employer if they have three years of service or more.

Payment of shares and price. Employees do not directly purchase shares, but they contribute a portion of their salary, on a pre-tax basis, to the plan. The employer can match a portion of the employee's contribution by contributing company shares.

Tax/social security. Employees pay no tax on salary contributed to the plan or shares held in their plan accounts.

11. In relation to the vesting of share acquisition or purchase awards:

- **Can the company award the shares subject to restrictions that are only removed when performance or time-based vesting conditions are met?**
- **Are any tax/social security contributions payable when these performance or time-based vesting conditions are met?**

Restricted share plan

Restrictions removed only on conditions being met. Restricted share plans are generally subject to some kind of vesting criterion. The most common restriction is time-based, often with a percentage of the shares vesting each year over several years, or cliff-vesting, where all of the shares vest after a certain number of years. However, performance conditions can also be attached.

Tax/social security. If the employee received restricted shares and did not make a section 83(b) election, he pays ordinary income tax and social security tax on vesting. Income tax is charged on the shares' fair market value on vesting.

Qualified ESPP

Restrictions removed only on conditions being met. The employer cannot place performance or time-based conditions on the shares.

Tax/social security. No additional tax arises.

Non-qualified ESPP

Restrictions removed only on conditions being met. The employer cannot place performance or time-based conditions on the shares.

Tax/social security. No additional tax arises.

ESOP

Restrictions removed only on conditions being met. Shares allocated to employees are subject to vesting. Typically, shares vest after three years of employment service. When an employee reaches the age of 55 and has participated in the plan for ten years, he can either:

- Diversify 25% of his account balance among other investment alternatives.

- Receive a payout of 25%.

When an employee reaches the age of 60, he can have 50% diversified or paid out.

Tax/social security. When vesting conditions are met and the shares are paid out, they are generally subject to income tax on the amounts that the employer contributed, unless they are rolled over into another qualified plan. If the employee receives the distribution before the age of 59 and one-half and does not roll over the distribution, he owes an additional 10% tax.

401(k) plan

Restrictions removed only on conditions being met. Contributions that the employee makes vest immediately. The employer's contributions can be subject to vesting conditions, but these cannot exceed five years.

Tax/social security. Tax is charged on 401(k) plans in the same way as ESOPs (*see above, ESOP*).

12. What are the tax and social security implications when the shares are sold?

Restricted share plan

Irrespective of whether the employee made a section 83(b) election, capital gains tax is charged on the sale of the shares. The taxable base is the increase in the shares' value since their vesting.

Qualified ESPP

The taxation of a qualified ESPP depends on whether the sale is a qualifying or disqualifying disposition.

The disposition is qualifying if the employee holds the shares for a minimum of:

- Two years from the first day of the offering period during which the shares were purchased.
- One year from purchase.

If the employee meets both these requirements, he pays capital gains tax on the gain realised from sale, less the discount he received on purchase.

If the employee sells the shares before either of these dates, the sale is a disqualifying disposition, and income tax is charged on the difference between the shares' purchase price and market value on the date of purchase. The employer receives a deduction for this amount. The employee still pays capital gains tax on the sale.

Non-qualified ESPP

The employee pays capital gains tax on the difference between the sale price and the shares' market value on the date of purchase.

ESOP

The employee pays capital gains tax on the difference between the sale price and the shares' market value on the date of distribution.

401(k) plan

Tax is charged on 401(k) plans in the same way as ESOPs (*see above, ESOP: Tax/social security*).

PHANTOM OR CASH-SETTLED SHARE PLANS

13. Please list each type of phantom or cash-settled share plan operated in your jurisdiction (if more than one).

There are two types of phantom share plan:

- Phantom share plans.
- Share appreciation rights.

14. In relation to the phantom or cash-settled share plan:

- **What are the plan's main characteristics?**
- **Which types of company can offer the plan?**
- **Is this type of plan popular? If so, among which types of company is this plan particularly popular?**

Phantom share plan

Main characteristics. The employee receives a cash bonus that is linked to the value of a stated number of underlying shares at the end of a specified period of time. For example, the employer grants the employee 100 phantom shares, and at the end of the period the employees receives cash equal to the market value of 100 of the employer's shares. Employees can receive payments equivalent to dividends on the phantom shares. Sometimes, employees are paid in shares rather than cash.

Types of company. Any type of company can offer a phantom share plan.

Popularity. In the US, phantom share plans are less commonly used than other types of employee share plan, but they remain an attractive way to incentivise employees without granting them equity. However, because the employer needs cash to pay out the award, phantom share plans are often less popular with small companies because they often cannot afford the cash drain. Phantom share plans are also subject to regulation under Section 409A of the Code (*see Question 24, Trends and developments*).

Share appreciation rights

Main characteristics. Share appreciation rights consist of a cash bonus tied to the value of the employer's shares. The employee receives a cash payment that is based on the shares' increase in value over a specified period. Employees can choose when to exercise share appreciation rights, and they do not receive dividends.

Types of company. Any type of company can offer share appreciation rights.

Popularity. The same considerations apply as for phantom share awards (*see above, Phantom share plan: Popularity*). However, share appreciation rights are less popular than phantom share plans with public companies because of the new accounting rules (*see Question 24, Trends and developments*).

15. In relation to the grant of phantom or cash-settled awards:

- **Can the awards be granted on a discretionary basis or must they be offered to all employees on the same terms?**
- **Is there a maximum award value that can be granted under the plan, either on a per-company or per-employee basis?**
- **Are any tax/social security contributions payable when the award is made?**

Phantom share plan

Discretionary/all-employee. Phantom share plans are discretionary. The employer can offer them to anyone, including directors and independent contractors, and to selected employees. However, if the employer makes grants under a phantom share plan generally to all employees, it may be considered a retirement plan and therefore subject to strict regulations under the US Employee Retirement Income Security Act 1974.

Maximum value of awards. There is no maximum value of awards that can be made.

Tax/social security. No tax or social security contributions are payable on award. However, if an employer grants phantom shares irrevocably to employees, the award may be considered deferred compensation under section 409A of the Code and subject to additional regulations (*see Question 24, Trends and developments*). In addition, the benefit may be taxable to the employee before the employee actually receives the cash payment.

Share appreciation rights

Discretionary/all-employee. The same rules apply as for phantom share plans (*see above, Phantom share plan: Discretionary/all-employee*).

Maximum value of awards. There is no maximum value of awards that can be made.

Tax/social security. The same rules apply as for phantom share plans (*see above, Phantom share plan: Tax/social security*).

16. In relation to the vesting of phantom or cash-settled awards:

- **Can the awards be made to vest only where performance or time-based vesting conditions are met?**
- **Are any tax/social security contributions payable when these performance or time-based vesting conditions are met?**

Phantom share plan

Award vested only on conditions being met. The employer can place performance or time-based vesting conditions on the award. Phantom shares that vest subject to performance criteria are often referred to as performance units.

Tax/social security. Employees only pay income tax when the pay-out is made (*see Question 17, Phantom share plan*).

Share appreciation rights

Award vested only on conditions being met. The employer can place performance or time-based vesting conditions on the rights.

Tax/social security. Employees only pay income tax when the pay-out is made (*see Question 17, Phantom share plan*).

17. What are the tax and social security implications when the award is paid out?

Phantom share plan

The employee pays income tax on the award when it is paid out. The employer can claim a tax deduction for this.

Share appreciation rights

Income tax is charged on the increase of the shares' market value between grant and payout. The employer can claim a tax deduction for this.

INSTITUTIONAL, SHAREHOLDER, MARKET OR OTHER GUIDELINES

18. Are there any institutional, shareholder, market or other guidelines that apply to any of the above plans, and which types of companies are subject to them? What are their principal terms?

Although there are no statutory guidelines that apply to any of the above plans, the companies that provide these plans are subject to various obligations imposed by securities laws and regulations, as well as stock exchange requirements. Different obligations apply to different types of companies.

Private companies

A private company incorporated in the US is subject to the:

- Provisions of its articles of incorporation and bye-laws.
- Company and securities laws of the state in which it was incorporated.

Depending on the state, different obligations may apply. For example, shareholder approval may be required for the implementation of an employee share plan.

Public companies

With certain exceptions, companies listed on the New York Stock Exchange (NYSE), the National Association of Securities Dealers Automated Quotation System (NASDAQ), or the American Stock Exchange (AMEX), must obtain shareholder approval to either:

- Adopt new equity compensation plans. Equity compensation plans include all share awards granted to any employee, director or other service provider, irrespective of whether granted through a formal plan.

- Materially amend an existing employee share plan.

Exemptions from the listing requirements

For companies listed on NYSE, NASDAQ or AMEX, certain plans are exempt from the shareholder approval requirement, including:

- ESOPs.
- Qualified ESPPs.
- Plans that are made available to all shareholders, such as plans that offer the opportunity to reinvest dividends.

However, these plans:

- Must still be approved by the company's independent compensation committee or a majority of its independent directors.
- Are subject to notification requirements.

Most non-qualified plans do not qualify for an exemption. The rules also impose additional restrictions, including prohibiting a listed company from using repurchased shares to fund employee share plans without prior shareholder approval.

Investor scrutiny

Investors are frequently guided by information provided by organisations such as Riskmetrics Group or Institutional Shareholder Services in their review of equity compensation arrangements.

EMPLOYEE REPRESENTATIVES

19. Is consultation or agreement with, or notification to, employee representative bodies required before an employee share plan can be launched?

No consultation or agreement with or notification to employee representative bodies is legally required before an employee share plan can be launched. However, in the case of employees under a union contract, employee share plans are subject to negotiation with employee representatives, that is, collective bargaining.

EXCHANGE CONTROL

20. Do exchange control regulations prevent employees sending money from your jurisdiction to another to purchase shares under an employee share plan?

The US Treasury Department through its Office of Foreign Assets Control (OFAC) administers and enforces economic and trade sanctions, including exchange control regulations, against certain countries and entities, for reasons generally related to US foreign policy and national security concerns. OFAC's website maintains an updated list of current restrictions affecting countries, organisations or individuals (*www.treas.gov/offices/enforcement/ofac/index.html*). The list should be consulted to confirm whether transfers of money to or from the US may be restricted.

21. Do exchange control regulations permit employees to repatriate proceeds derived from selling shares in another jurisdiction?

There are no other restrictions that specifically govern the repatriation of proceeds derived from selling shares in another jurisdiction (*see Question 20*).

INTERNATIONALLY MOBILE EMPLOYEES

22. What is the tax position when:

- **An employee who is resident in your jurisdiction at the time of grant of a share plan award leaves your jurisdiction before any taxable event affecting the award takes place?**
- **An employee is sent to your jurisdiction holding share plan awards granted to him before he is resident in your jurisdiction?**

Resident employee

US citizens and resident foreign nationals (foreign nationals that satisfy a permanent residency or substantial presence test in the US) are subject to US taxation on their worldwide income (that is, not only US-source income), except for certain foreign-earned income exclusions and tax credits. Therefore, their US tax position does not change on moving to another jurisdiction. However, if a non-resident foreign national receives a right under a share plan in the US and leaves the US before vesting or exercise, only the benefit received that is attributable to services performed in the US is subject to US taxation. Apportionment of income is generally determined by calculating the number of days worked in the US compared to the number of days worked elsewhere during the vesting period.

Foreign tax obligations may also apply. The employee's double taxation, social security and withholding requirements may depend on whether there is a double taxation treaty in force between the US and the other jurisdiction.

Non-resident employee

When an employee who is not ordinarily resident in the US is sent to the US while holding share awards already granted in another jurisdiction, he pays US income tax on income attributable to services performed in the US.

PROSPECTUS REQUIREMENTS AND OTHER CONSENTS OR FILINGS

23. For the offer of and participation in an employee share plan:

- **What prospectus requirements (if any) must be completed and by when? What exemptions (if any) are available?**
- **What other regulatory consents or filings (if any) must be completed and by when? What exemptions (if any) are available?**

Prospectus requirements

An employer cannot offer or sell securities unless either (*US Securities Act of 1933*):

- It has filed an effective registration statement with the US Securities and Exchange Commission (SEC).
- An exemption from registration is otherwise available.

Registration. US listed companies, including foreign companies, can generally register their employee share plans through SEC Form S-8, which is effective on filing. The employer must then provide the employees with a prospectus that summarises and describes, among other things:

- The terms of the plan.
- The securities to be offered.
- Applicable forfeiture provisions.
- Relevant tax consequences.

The employer must deliver the prospectus in time to allow employees to make an informed decision on participation in the plan.

Exemption. Due to the high cost of registering securities underlying a share plan, companies that are not listed in the US usually rely on the exemption under Rule 701 of the Securities Act 1933 (Rule 701). This provides that an offer is exempt from registration requirements if it is made under a written employee share plan and made by one of the following:

- The issuer.
- The issuer's parent company.
- The issuer's majority-owned subsidiary.
- The issuer's parent company's majority-owned subsidiary.

Use of Rule 701 is limited to, in any 12-month period, sales of shares that reach less than the greatest of the following:

- US$1 million (measured by reference to the exercise price of the shares acquired).
- 15% of outstanding shares of the same class.
- 15% of the company's total assets.

Although a prospectus is not required for offers that fall under Rule 701, the issuer should still provide employees with plan documents and contracts to enable them to make informed decisions regarding investment in the plan.

In addition, when sales of securities exceed US$5 million in any 12-month period, the issuer must provide employees with both:

- A summary of the offer's material terms.
- Financial statements that comply with US generally accepted accounting principles.

In all cases, it must also inform employees of any risk factors associated with the investment.

In addition to Rule 701, certain other exemptions may also be available in limited circumstances, including an exemption for private placements, that is, offerings to a limited number of sophisticated investors. As with the Rule 701 exemption, although no prospectus is required, certain material information must still be disclosed to employees.

Other regulatory consents or filings

In addition to federal securities laws, state securities laws concerning offers of unregistered securities to state residents may also apply. Although most such "blue-sky" securities laws mirror Rule 701 by exempting non-US listed companies from their requirements, some states may have additional filing or other requirements. In addition, some states, in particular California, have independent securities laws. Therefore, a state-specific securities law review is recommended for any state in which employees receive offers.

DEVELOPMENTS AND REFORM

24. Please briefly summarise:

- **The main trends and developments relating to employee share plans over the last year.**
- **Any official proposals for reform of the law on employee share plans.**

Trends and developments

There continues to be a trend away from conventional share options and toward the use of restricted shares, RSUs, certain share appreciation rights and performance-based awards. Last year, just over three-quarters of the companies in the S&P 1500 (which tracks small- and mid-cap stocks as well as the conventional S&P 500 index) used share options to compensate their CEOs. Five years ago that figure stood at nearly 93%.

Companies offering share options may also now be granting them with shorter option terms or vesting periods, to more limited groups of employees, or for particular business or compensation objectives. Similarly, companies may be offering ESPPs with lesser discounts. ESOPs continue to grow in popularity.

Much attention has been paid to the deferred compensation regulations under section 409A of the Code, which became effective on 1 January 2009. Section 409A provides more restrictive rules for deferring compensation and for the time and form of receipt

of deferred compensation. It covers almost all forms of deferred compensation, including long-term incentive plans. However, there are exceptions from section 409A, including for share option plans granted at fair market value (*see Question 5, Non-qualified share option plan: Market value*), share appreciation rights granted at fair market value, and tax-qualified retirement plans (for example, 401(k) plans and ESOPs).

Reform proposals

On 15 July 2010, the US Senate passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) and President Obama signed the bill into law on 21 July 2010. The sweeping law, widely considered to be one of the most comprehensive reforms of the US financial industry in years, contains significant provisions affecting corporate governance and executive compensation.

Under Dodd-Frank, shareholders of US public companies will have a non-binding say-on-pay vote over the compensation packages (including equity compensation) of named executive officers. Dodd-Frank also imposes new standards for the independence of compensation committees. These issues are subject to additional rulemaking by the SEC that will likely affect public companies' annual meetings and proxy statements from 2011.

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