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Considerations and requirements when providing equity income to your mobile employees

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Equity income is an important part of the compensation and talent management strategy for many companies. The provision of equity income can assist in attracting new talent as well as in motivating and retaining current employees. It allows companies the ability to directly reward employees for business growth over specified periods of time.

Depending on the type of award, the employee may receive compensation when they earn the right to receive a benefit (at the time of "vest") or when they decide to buy or sell stock at a specified price (at the time of "exercise"). By design, the right to receive, buy, or sell the equity may take place over several years, further helping to align employee goals with long-term strategies and providing the company with an important retention tool for key employees.

The same characteristics that make equity income such a valuable part of a compensation strategy also lead to tax compliance challenges for the employer, especially when the equity income is provided to mobile employees who work in multiple domestic or international locations. Below we focus on the income tax risks for companies and employees with equity income, legal considerations relating to the provision of equity income to mobile employees, and the current global and US legislative tax landscape. By understanding the tax and legal requirements and by monitoring the changing legislative landscape, your organization can effectively manage risk and utilize equity income to drive business results.

Income tax considerations

Mobile employees create challenges for a company's global and domestic payroll reporting. The vesting requirements for most equity-based compensation are linked to the employee's service over several years.

When an employee works across state lines or international borders on a regular basis or for extended periods, taxing jurisdictions often require the employer to report taxable compensation and withhold the required taxes for payroll purposes. This reporting may relate to the employee's tax residency status at the time of a taxable event (e.g., grant, vest, exercise of the equity award). This reporting could also be based on the employee's work locations during the period that the compensation was earned (e.g., based on the proportion of workdays in the taxing jurisdiction between the grant and vest or restricted stock units).

Similarly, the employee is expected to appropriately report income to the various jurisdictions in which they have worked on their annual income tax returns. Similar to the employer's tax reporting requirements, employee taxation may be linked to tax residency status or the location of workdays during the earnings period for the equity award.

US companies need to be aware of specific challenges if they provide equity income to employees who work in other countries or in multiple states.

Global tax considerations
US-based equity compensation plans may not have consistent tax treatment in other countries. These differences can create risk and unforeseen tax consequences that, in extreme cases, can result in the equity income becoming a disincentive, rather than an incentive, to the employee. Common equity related tax and payroll challenges for employers with globally mobile employees include:

- Reporting and withholding rules vary by country, award type, and corporate recharge processes.
- Country laws may limit payroll tax withholding for employees who have departed the country under the relevant labor law.
- Payroll may need to re-register employees who have departed a country and later have an equity transaction that results in required trailing equity reporting and withholding.
- Inconsistent rules between the US and non-US location can create timing differences on when the income is considered taxable.
    - This timing issue can reduce benefits of income tax treaties and complicate tax withholding methods.
    - For example, US resident participants of an Israeli-based plan may have US reporting and withholding on a transaction that is not a taxable event for Israeli tax purposes.
- Employer and employee social security obligations must also be considered.

It is important for employers to review the individual plans and determine the appropriate tax treatment in the various countries.

For the employee, individual income tax return filing obligations can also vary from country to country and are often not aligned with the employer payroll tax withholding obligations. It is important for a company to provide employee communications that will outline the employee and employer tax reporting and withholding requirements related to equity-based compensation.

US state tax considerations
Employee relocations or employees who work in multiple states can create compliance burdens for the employer. As the employer, there is often a requirement to report and withhold state individual income tax for both the state in which the employee is a resident <u>and</u> other state(s) in which income may be attributable. In order for the employer to be compliant, they must know the tax residency status of the employee, as well as where the employee has worked.

It is important for companies to understand both the technical US state laws, along with practical considerations relating to payroll administration. For example, many companies have challenges in reporting income to multiple states for year-end Form W-2 purposes. Companies may need to weigh the cost/benefit of upgrading payroll systems with the potential risks for failing to comply with all possible non-resident state reporting and withholding requirements.

For both global and US domestic tax purposes, it is important for companies to share their current reporting and withholding practices with the company-sponsored mobility tax provider. For instance, an executive may receive a Form W-2 reporting in one jurisdiction, but provide a completed travel calendar to their tax provider showing work in multiple jurisdictions. It is important for the employer and

employee to be both compliant and consistent in the reporting for equity compensation in multiple jurisdictions. The development and communication of appropriate processes and policies will assist in minimizing and managing risks (and surprises) for both the company and employee.

Mobility professionals should work closely with their payroll teams and stock administrators in order to develop processes and policies that will:

- Identify mobile employees
- Obtain relevant workday details
- Determine the appropriate reporting and withholding obligations for the equity transaction
- Coordinate with payroll for implementation of the appropriate reporting and withholding
- Provide employees with the transaction reporting and withholding summary
- Clearly identify both employer and employee responsibilities in the process and any company tax reimbursement policies relating to the taxation of equity income

Legal ramifications

It is critical for companies to seek guidance from legal counsel if they have, or plan to have, global participants in their stock plans (including international business travelers with equity income). Common legal considerations for equity-related compensation include:

- Securities law: Since laws vary throughout the world, offering equity compensation to employees in other countries can require securities registration or other filing requirements under local law.
- Foreign exchange: Foreign currency exchange filings or limits may apply. For example, China requires all foreign-listed companies to submit an initial filing with the State Administration of Foreign Exchange before awards of any equity compensation are allowed to be made to Chinese nationals and certain foreign nationals residing in China. Ongoing quarterly filings are also required.
- Data privacy: Since the administration of a global equity program involves the collection, use, and transfer of an award recipient's personal data by the employer and third-party plan administrators, some jurisdictions require companies to inform local data privacy authorities about the intention or processing of personal data. As of May 2018, companies located in or that have staff in the European Union must comply with the General Data Protection Regulation.
- Labor/employment law: It is important to review the labor or employment issues associated with the offer of equity based compensation in each jurisdiction.

The above is not a complete list of the potential legal ramifications, but should provide your team with talking points for consideration by your legal counsel.

Legislative landscape

The US and many countries have enacted new oversight and accounting rules, with stock-based compensation increasingly becoming a focus of regulatory action. As this element of compensation has grown in popularity, tax authorities have looked for ways to revisit tax policy and legislation.

Global developments

The requirement to withhold taxes is an area of focus for many tax authorities since they understand that many employers encounter payroll compliance challenges for their internationally mobile employees. Recent examples of changes in legislative or regulatory activity include:

- In Belgium, many US-based companies (large and small) are being targeted by audits. In addition, potential new tax reporting and withholding obligations for companies with foreign

equity plans would require a tax withholding obligation for equity incentives granted as of January 1, 2019.

- Currently in Brazil, the treatment of equity compensation is subject to interpretation when the costs of equity compensation plans are not charged to the local Brazilian employer. Recent court decisions suggest that stock option income should be treated as remuneration.
- France has implemented a tax withholding system as of January 1, 2019. Companies will need to determine if their equity compensation will be subject to this system. If so, the company will need to determine:
    - The population impacted by the French Pay As You Earn withholding system
    - The amount of income subject to withholding
- A “deemed exercise” rule applies to foreign employees who leave Singapore. A foreign employee is deemed to have derived gains from unvested or unexercised awards, granted while in Singapore.
- UK payroll audits increasingly consider how a company tracks and reports equity compensation to the UK for employees who have left the UK and are working in other countries.

US – non-resident states

States are also focused on the reporting and withholding challenges for equity income provided to employees working in multiple states. There are not consistent state reporting and withholding rules for the employer or consistent state income tax filing requirements for the employee. As such, employees traveling for business to non-resident states can generate tax reporting and withholding obligations for their employer and state income tax return filing requirements for themselves. To make it more complicated, many payroll systems are not able to track employees working in more than one state. Of particular note:

- New York is one of the most challenging states for compliance, since the employer and employee requirements are not consistent.
- As states are increasing audit activity for non-resident business travelers, executives entitled to equity compensation are a target for potential revenue based on their workdays in the non-resident state during the earnings period for the equity income.

It is important for companies to understand their obligations, and work with their mobility, payroll, and stock teams, as well as their external vendors to develop and manage appropriate policies and procedures. By taking proactive steps now, your company can understand and manage the risks and compliance requirements related to its equity plans, while providing compensation packages that will attract, motivate, and retain highly qualified employees.

For further information, or if you have questions regarding this topic, contact me at +1.484.885.2438 or lcarbo@gtn.com, or visit our Mobility Tax Services page to see what assistance we can provide.

The information provided in this newsletter is for general guidance only and should not be utilized in lieu of obtaining professional tax and/or legal advice.

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Lynn is a Director in GTN’s Atlantic region. She has over 20 years of experience in expatriate and individual taxation, and in addition to consulting with companies on equity compensation issues, she works with clients and their employees to accomplish solutions to their global challenges.