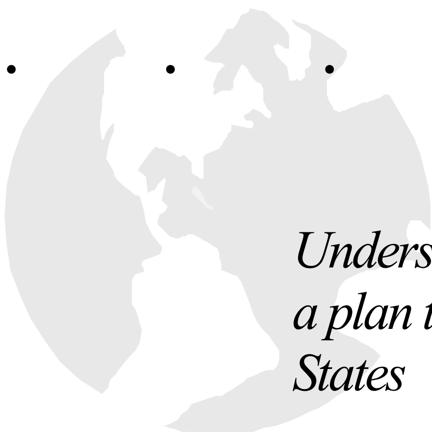
# An Overview of Global Employee Stock Plan Concepts



*Understanding the basics when offering a plan to participants outside the United States*

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*In preparing this article, the authors have attempted to provide the most current information available. Please note, however, that recent amendments and legal interpretations of foreign law may not be included in this article. You should not rely on the information provided in this article when implementing your equity compensation plan. Please contact legal counsel and/or a tax adviser for developing a comprehensive strategy for offering your company equity compensation plan globally.*

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# 1 Overview

As companies look for ways to take advantage of opportunities in the global marketplace, they often encounter challenges created by the culture, local law, taxation regimes, and business and employment practices of the markets into which they are expanding. How well a company handles these matters directly affects its ability to hire and retain key employees and motivate existing employees. One approach that many companies have found to be successful in attracting and retaining employees is offering them additional compensation based on equity in the company.

Implementation of equity-based compensation programs abroad can require radically different solutions addressing quite different challenges to those encountered in the U.S. Failure to identify and plan for these issues may result in employee dissatisfaction, negative publicity for the company, costly fines, unnecessary tax liabilities, and burdensome administrative costs and, in some cases, criminal penalties. We have found the key to successfully implement a global equity compensation program is to assess the cultural, tax, and legal landscape in each country before offering the program benefits to local employees. In other words "**Think Globally, Act Locally.**"

This article provides a general understanding of the high level concepts and challenges that may potentially impact equity-based compensation plans outside the United States. It is important to not only understand these concepts, but to identify issues and plan resolution strategies, and also to develop the capability of assessing any potential risks. This document is not intended to address every possible issue that may arise when employing and compensating people outside of the United States – it is rather an introduction to the concepts for further study. This article does not cover international accounting issues related to stock plans, as they are too numerous to cover in this article.

Although the concept of a global stock plan has been around for a long time, only in the past 20 years have companies designed and implemented truly global stock plans. American companies have led the way, starting with PepsiCo's SharePower. High-technology companies have almost always offered stock to employees around the world, but even those companies do not always grant stock options to all employees worldwide or offer employee stock purchase plans globally.

Several years ago, the drive to implement "true" global stock plans became more common. Companies such as Bank of America, Citigroup, Starbucks, and Microsoft granted options to all full time employees worldwide. Some programs were a one-time grant, but more often the plans provided for annual or biannual grants. Bank of America went as far as granting stock options twice a year to all employees, including part-time employees.[1] Many of these "global" plans were offered to in excess of 50,000 employees, and the task of administering them became highly complex.

U.S. companies (and non U.S. companies traded on a U.S. exchange) generally must comply with FAS 123R beginning in 2006. Under FAS 123R, companies are required to recognize the fair value of equity compensation as an expense for financial accounting purposes. It appears from early data that U.S. companies seek innovative plan designs rather than to abandon their employee stock plans.

Whether or not your company provides stock plans to employees outside of the U.S., the concepts you will learn in this paper may appear novel to you – but they are important and form part of the greater picture of "think globally, act locally" which all multi-national

[1] 60 hours worked in the previous quarter.

organizations should employ. Through international merger and acquisition activity, your tried and tested U.S.-only stock plans may very rapidly become a global or international plan: an eventuality for which you must be prepared!

## 2 Implementation

The ever-changing legal and regulatory environment that characterizes many economies means that local compliance continues to be one of the most challenging aspects facing multinational companies when offering and maintaining global equity compensation programs.

Employee stock plan implementation in many countries can be complex, time-consuming, and costly in terms of legal and tax advice, particularly where local laws require ongoing compliance over the life of a stock award. The development of an international regulatory compliance program greatly facilitates the extension of employee stock plan benefits to the company's global workforce, and helps link the interests of those employees with the company's shareholders. The importance of local legal and regulatory compliance of equity compensation programs cannot be over-emphasized. Failure to meet such requirements can result in employee dissatisfaction, negative publicity, costly fines, additional administrative costs, unnecessary tax liabilities, and possibly criminal penalties.

Companies also need to be aware of relevant tax rules in the local jurisdiction. In many instances, administrative costs, and tax liabilities can be mitigated or avoided by simply restructuring the terms of the equity compensation program and the individual grants. In addition, some countries have beneficial tax regimes that are designed to permit employers to deliver benefits more effectively to employees.

Multinational companies offering an equity compensation program in a non-U.S. jurisdiction should engage local legal and tax advisers to help identify any relevant issues or requirements. Ideally, this engagement should occur within six to twelve months prior to the offering to allow enough time to plan, prepare, and implement plans. Companies with prior grants should audit to ensure their compliance in the local jurisdiction. Generally, working with local officials and maintaining compliance on a prospective basis can prevent violations. Although violations may remain undetected for some time, they can be revealed at inopportune moments (*e.g.,* as a result of a tax audit or a disgruntled employee advising local authorities). Outstanding liabilities for violations may impede corporate mergers or other transactions and may result in the undesired effects we have outlined above.

Clearly, the importance of the implementation team is key and its composition should be given very careful consideration, including the need for general cultural expertise. Social Anthropologists, as cultural "experts," are increasingly used by multi-nationals in assessing and recommending training programs that are inclusive of local cultural norms. We are all aware of the Japanese tendency never to say "no," which we sometimes read as "yes"! This is a very specific feature of Japanese social interaction that spans from feeding the dog to agreeing to a major business proposition. You might think you have one outcome but actually, you have quite the opposite! Another case of Think Global, Act Local.

### Implementation Time Frame

If your company is considering implementing a global stock plan, the time frame initially suggested will almost certainly be unrealistic ("Can we do this in four or five weeks?"). Most successful stock plans require four to six months at a minimum to design and implement.

The implementation time frame depends on the speed at which your company can commit to making decisions, how long it takes you to obtain legal and tax opinions, and it may depend on the outside service providers you select (*e.g*., the communications consultant, or the plan administrator). A sample schedule is provided, but the very first thing a company should

consider when implementing the plan is to double the amount of time estimated to introduce the plan.

A critical point to bear in mind here is that concepts that are well understood in the U.S. may be alien to employees in other parts of the world and adequate time and resource should be given to such matters. In person training is perhaps the most important part of the budget.

## Sample Timeline

*Month One*

- Determine the countries in which the stock plan will be offered, and the number and type of individuals (*e.g.*, employees or consultants) in such countries to which the stock plan will be offered;
- Determine the implementation team both locally and in the U.S.;
- Select advisers to assist in designing the plan, and to advise on local legal, tax and cultural advice;
- Organize an initial meeting to discuss the overall project and goal; and
- Begin due diligence.

*Month Two*

- Finalize the implementation team and determine roles and responsibilities;
- Finalize the project budget (this may require consideration of currency matters. Be aware that implementation in some countries may be more expensive than in others);
- Begin selecting necessary outside vendors (communications consultants, stockbrokers, stock plan administrator/software);
- Notify key project stakeholders around the world; and
- Finalize the plan design.

*Month Three*

- Devise a local cultural strategy and consult on any training needs;
- Begin communications strategy; and
- Coordinate all legal requirements.

*Month Four*

- Finalize communications strategy and begin developing communications tools;
- Test key stakeholders on the plan design, message, etc., through focus groups;
- Determine administrative needs and meet with selected outsourcer, broker, etc.

*Month Five*

- Distribute communications materials to all locations;
- Organize a “train the trainers” meeting;
- Finalize legal and tax due diligence; and
- Test all systems.

*Month Six*

- Determine who will participate in the plan;
- Finalize all administrative logistics; and

- Prepare internal groups (investor relations, public relations, accounting, etc.) for the introduction of the plan.

*Month Seven*

- Introduce the plan

## 3 Labor Law and Employment Concerns

Labor law issues are important in the offer and administration of equity compensation programs. For example, in many countries, the repeated grant of equity compensation may result in the employee having a claim that he or she is entitled to the continued grant of equity compensation as a term or condition of employment, even if under the terms of the equity plan, the company has the sole discretion to determine who will be granted equity compensation. In many cases, having the employee agree to standard waiver and consent provisions may reduce the risk of the employee succeeding on such claims. As another example, in many countries, employees who are terminated from employment are entitled to exercise their options for an extended period (*e.g.*, until the expiration of the option term). Therefore, companies may need to customize the offer and administration of the equity compensation programs to take into account the variations in local labor laws.

In general, before offering an equity compensation program in any country, companies should assess the following labor-related issues (including but not limited to the following):

- Whether labor unions or works councils must be consulted before extending the program to local employees;
- Whether labor laws regulate the selection of participating employees;
- Whether anti-discrimination laws permit the exclusion of part-time employees;
- Whether following termination of employment, employees are entitled to continued vesting or extended exercise periods;
- Whether the repeated grant of equity compensation may result in a claim by an employee that the employee is entitled to the continued grant of equity compensation as a term or condition of employment;
- Whether program benefits are included in base pay for purposes of calculating severance or retirement benefits;
- Whether the local jurisdictions' labor laws restrict the company from changing or terminating the program;
- Whether there are any restrictions on the content of employee communications materials that are issued to employees and, of the content of any verbal communications that are made in order to support the launch of the plan; and
- Whether there is any requirement to translate employee communications into the local language.

Structuring automatic payroll deductions of contributions to a stock purchase plan may create legal issues in some countries. For example, some countries have laws that provide employees with an inalienable right to salary, which may render the employees' written authorization of payroll deductions ineffective.

Labor law is particular to each jurisdiction, and multinational companies will find that local compliance, as well as the handling of any local labor law issues, which may arise from time, should be handled by appropriate local advisers and/or administrators.

## Examples:

**Canada**

Employers are required to provide employees with advance notice of termination of employment. The notice period varies on a case-by-case basis but will be longer for senior employees and employees who are 50 years and older. Generally, employees must continue to be compensated and allowed to participate in all employee benefit programs, including stock option plans, until the last day of the notice period, which is the "lawful termination date." Employees generally have the right to vest in and exercise stock awards until their lawful termination date regardless of the terms of the plan. Furthermore, Canadian courts are generally very reluctant to enforce any agreement or waiver that denies benefits an employee would have been entitled to had the employee remained employed throughout the notice period.

**Denmark**

In 2004, Denmark passed the Danish Law on Stock Options (the "Act"), which addresses the treatment of stock-based awards offered on or after July 1, 2004. The Act requires companies to provide disclosure information (*e.g.*, time of grant, criteria for grant) translated in Danish to employees. The Act also permits employees in many circumstances to retain their stock options (whether vested or unvested) if their employment ends before exercise. Under the Act, employees also may be entitled to a portion of future option grants made in the year in which they are terminated.

**Japan**

In many countries, including Japan, employees are entitled to various statutory leaves of absence (*e.g.*, maternity leave). An important consideration is how such leaves of absence interplay with employee stock plans. Generally, in Japan, companies can suspend the vesting of an award during the leave period provided that the language in the employee stock plan and the award agreement clearly state that vesting ceases during such leave of absence.

**New Zealand**

In New Zealand, to reduce the risk of potential entitlement claims, employees should acknowledge in writing that any option plan benefits are provided at the discretion of the parent company and that the plan is not a term or condition of employment. The parent company and the subsidiary should review labor contracts and the Holidays Act 2003 to determine whether option plan benefits could be considered "salary" for labor law purposes and/or "gross earnings" for the purposes of calculating holiday pay. In addition, the criteria for determining eligible participants should not be discriminatory.

**United Kingdom**

The European Union ("EU") Employment Framework Directive 2000/78/EC requires EU Member States to enact legislation by December 2006 to prohibit "direct or indirect" discrimination based on religious beliefs, disability, age, or sexual orientation in connection with an individual's employment. The Directive's prohibition against age discrimination has been implemented in the U.K. via the Employment Equality (Age) Relations 2006 (the "Age Relations Act"). Under the Age Relations Act, unless a company can demonstrate that treatment based on age under its employee stock plan is a "proportionate means of achieving a legitimate aim," such treatment may be unlawful under the Age Relations Act.

# 4 Securities Compliance

In most countries, companies providing benefits under equity compensation programs are subject to securities laws restrictions and compliance obligations. Such restrictions and obligations may include registering the equity compensation programs or company stock with the local securities authorities, drafting prospectuses, and satisfying ongoing filing requirements. Moreover, the acquisition, holding, and sale of company stock also may trigger further requirements under the local securities laws. Although compliance with such requirements may be time-consuming and expensive, generally it is easier to comply with securities laws prior to making grants, than to correct mistakes later.

Fortunately, many countries provide exceptions to the more onerous disclosure and registration requirements of their securities laws for equity compensation programs. For example, exceptions may apply so long as the number of participating employees and the aggregate value of the offering remain below certain thresholds. In countries that do not provide relief from burdensome securities law compliance obligations, companies should consider other arrangements, such as cashless exercise programs.

## EU Securities Compliance

On December 31, 2003, the European Parliament published Directive 2003/71/EC on the Prospectus to be Published when Securities are Offered to the Public or Admitted to Trading (the “EU Prospectus Directive” or “Directive”). The EU Prospectus Directive has received significant interest from multi-national companies that have operations within the EU. The interest is due to the sweeping changes that the EU Prospectus Directive creates for non-EU companies that offer securities, including stock awards under employee stock plans, in the EU. The Directive is intended to harmonize the regulation of capital markets within the EU. For this purpose, the Directive introduces a single regime to govern the content, format, approval, and distribution of a prospectus in connection with a securities offering within the EU. The Member States were required to enact domestic legislation implementing the Directive by July 1, 2005.

However, some of the Member States have not yet implemented the Directive and those that have, have not done so consistently. Uncertainties remain on interpretation of the new rules, as there is currently very limited administrative guidance and no case law to assist in interpretation.

The Committee of European Securities Regulators (“CESR”) (an independent body established by the European Commission) has suggested that offers to employees under employer sponsored equity plans should be treated as nontransferable, and, therefore, should fall outside the scope of the prospectus requirements of the EU Prospectus Directive. This is thought to be the view of securities regulators in some Member States. However, securities regulators in several other Member States have taken the position that a prospectus should be required at some point in the equity plan process.

On July 18, 2006, CESR published a Frequently Asked Questions (“FAQ”) that addresses Prospectus Directive requirements and the status of employee share option schemes under the Prospectus Directive. CESR concluded that stock options are non-transferable and, as such, are not subject to the Prospectus Directive. CESR also concluded that the offer of a non-transferable option under an employee share option scheme does not constitute a public offer at either the time of exercise or conversion. However, CESR did not provide any guidance regarding whether a stock purchase right is a transferable security.

Of particular importance under the Directive is the selection of the "home Member State." The "home Member State" of a company will determine what law will be applied to its security offerings, including offerings under employee stock plans and equity plans. A company offering securities in the EU to employees or otherwise must be careful not to inadvertently trigger designation of its "home Member State" as, thereafter, the regulators in the company's "home Member State" are required to approve a form of prospectus for each offering the company makes in the EU for which a prospectus is required – even if the offering at issue is not made in the "home Member State".

The Directive, and its implementing legislation in each EU Member State, will determine which Member State is the "home Member State" for the purposes of prospectus review and approval. The "home Member State" will, in turn, determine whether a prospectus has to be issued by the employer planning to embark on an employee stock plan and, if so, the contents and form of the prospectus.

*Home Member State Designation*

If an issuer is not incorporated in the EU, the determination of its "home Member State" will be based on the date the issuer first made (or plans to make) an "offer of securities to the public".

(i) *Prior to publication of the Directive (i.e., prior to December 31, 2003)*

If a non-EU issuer made an "offer of securities to the public" or had an admission to listing on a regulated market within the EU prior to publication of the Directive then it has/had until December 31, 2005 to choose a Member State as its "home Member State." Unfortunately it is unclear what the consequences are if no such determination is or has been made by December 31, 2005.

(ii) *Designated Period – January 1, 2004 to June 30, 2005*

The determination of a non-EU issuer's "home Member State" during the designated period depends upon whether, during such time, the issuer engaged in (i) an offer of securities to the public under the home Member State's pre-Directive laws, and (ii) an "offer of securities to the public" within the meaning of the Directive. If both requirements are met then the Member State in which the offer of securities to the public was made will be the "home Member State" of the issuer.

(iii) *Post-July 1, 2005*

The Member State in which the issuer first makes an "offer of securities to the public" will be the issuer's "home Member State." In theory, whether an "offer of securities to the public" has been made should not differ under each Member State's post-directive laws. However, in reality, as mentioned above, since certain provisions of the Directive have yet to

be clarified by the authorities, it is unclear whether offerings under employee stock plans constitute an "offer of securities to the public." For example, the general consensus among securities regulators appears to be that the grant of stock options should be outside the scope of the Directive, and should not constitute an offer of securities to the public and therefore trigger "home Member State" designation. However, this position is yet to be adopted officially by the Commission and securities regulators in some Member States take the opposite view.

*Prospectus Requirements*

Under the Directive, as implemented in most EU countries, a prospectus must accompany all "offers of securities to the public" – unless an exemption applies. An "offer of securities to the public" is made if one of the following requirements is met:

(i) the offer relates to securities that are listed on a "regulated market" (*e.g.,* the New York Stock Exchange); or

(ii) the offer relates to securities that are offered for sale to the public either by way of advertising or solicitation or sold by financial institutions.

It is worth noting that "offer" is defined extremely broadly, meaning a "communication to persons in any form and by any means, presenting sufficient information on the terms of the offer and the securities to be offered, so as to enable an investor to decide to purchase or subscribe to these securities."

Notwithstanding the above definition of an "offer of securities to the public" the following will <u>not</u> be an "offer of securities to the public" and will therefore fall outside the Directive and not trigger the designation of a "home Member State" (assuming the issuer does not already have a designated "home Member State") or the obligation to publish a prospectus:

(i) an offer of securities where the total value of the securities is less than €2,500,000 when added to the value of any other securities offered by the relevant company in the previous 12 months;

(ii) an offer of securities where the value of the offer is less than €100,000 over a period of 12 months; or

(iii) an offer of securities where the value of the offer is between €100,000 and €2,500,000 over a period of 12 months and the offer concerns securities that do not represent more than 50% of the issuer's shareholder equity; or

(iii) an offer of securities where the offer concerns securities addressed to investors who would acquire the securities for a total consideration of at least €50,000 per investor; or

(iv) an offer of securities where the offer concerns securities, the denomination per unit of which amounts to at least €50,000; or

(v) an offer of securities where the offer concerns securities which are issued or sold to "qualified investors" (*e.g.*, institutional investors).

The following constitute exempt "offers of securities to the public." Such exempt public offers <u>do</u> fall within the Directive and will trigger the designation of a "home Member State" (assuming the issuer does not already have a designated "home Member State"), however, other provisions of the Directive, for example, the obligation to publish a prospectus may not apply or may only apply in a limited form:

(i) an offer of securities where the offer is made to a group of 100 or fewer persons in any Member State.

(ii) an offer of securities where the securities are being offered or allocated to existing or former directors or employees by their employer which has securities already admitted to trading on a regulated market or by an affiliated undertaking, provided that a document is made available containing information on the number and nature of the securities and the reasons for and details of the offer.

If an offer of securities falls within the Directive and is not an exempt public offer then the company issuing the securities must file a prospectus detailing the following with respect to the offering:

(i) details of the individual(s) with the responsibility for preparing the prospectus and details of the auditors that prepare and approve the annual report and accounts of the parent company awarding the stock awards;

(ii) a description of the equity plan, including any eligibility requirements, vesting provisions, and applicable tax rules;

(iii) a description of the parent company awarding the stock awards, including a description of the company's business, details of the company's articles of association or by-laws, and a breakdown of the company's share capital;

(iv) details of the financial position of the parent company awarding the stock awards, including the company's financial accounts;

(v) a description of the board of directors of the parent company awarding the stock awards; and

(vi) a description of the growth of the parent company and predicted future development of the company.

The submission procedure for the prospectus can usually be concluded over a three-month period. The same securities law requirements apply whether the shares underlying the stock awards are newly issued shares or treasury shares.

## Examples:

**Argentina**

As long as an offer pursuant to an employee stock plan constitutes a private placement, there are no securities law restrictions in Argentina. Generally, the sale of securities to a limited number of investors for investment purposes constitutes a private placement.

**Australia**

Generally, a foreign parent company offering securities to employees of an Australian subsidiary is required to file a prospectus unless the offer is exempt because it is offered by a foreign company in Australia. Although there are a number of potential exemptions, the most common for stock plans are discussed below.

One exemption to the prospectus requirement is Corporations Law Section 708. Under this exemption, an issuer may offer securities to investors without filing a prospectus with the Australian Securities and Investment Commission ("ASIC") where the following requirements are satisfied: (i) the offer is "personal,"(*i.e.*, made directly to employees who are likely interested in the offer due to a professional connection with the issuer) (ii) no more than twenty investors in Australia are issued or transferred securities in the company in any twelve-month period as a result of offers received in Australia, and (iii) no more than A$2,000,000 is raised by the company in any twelve-month period as a result of offers received in Australia.

Another exemption is ASIC Class Order 03/184. This exemption, which preempts other Class Orders relating to employee share schemes effective June 30, 2003, is available for U.S.

issuers that are listed on approved foreign exchanges, such as the New York Stock Exchange, for twelve or more consecutive months. To qualify an offering under the option plan under Class Order 03/184, an issuer must, inter alia, (i) prepare Australia-specific grant materials, (ii) provide the value of the shares based on the most current A$/US$ exchange rate at the time of the offer and subsequently to optionees upon request, (iii) lodge copies of all employee communications related to the option plan with ASIC no later than seven days after the offer has been made, and (iv) ensure that the number of shares issuable in Australia under all employee stock plans during the previous five years does not exceed 5% of the total shares of the company at the time of the offer. In addition, under an employee stock purchase plan, U.S. issuers listed on approved foreign exchanges must (i) hold the purchase funds of the employees in an Australian bank trust account until shares are purchased, (ii) provide employees with details of the Australian bank holding the purchase funds such as the bank's name and interest rates payable, and (iii) permit employees to withdraw from the purchase plan.

**China**

The public offer of securities in China requires approval from the China Securities Regulatory Commission ("CSRC"). However, the CSRC generally has been unwilling to approve such offers.

New legislation effective January 1, 2006 helped clarify this issue. The new legislation defines a "public offering of securities" as (i) the issuance of securities to "non-specified persons" (*i.e.*, to the public at large); (ii) the issuance of securities to more than 200 "specified persons" (*e.g.*, employees of the issuer); or (iii) other issuance activity as stipulated by laws and regulations. Under the new securities law, if an offer of securities is a public offering of securities, the CSRC's approval must be obtained. Thus, an employer should be able to offer securities to up to 200 employees without obtaining the CSRC's approval.

However, an informal consultation with the CSRC indicated that the CSRC would not deem the grant of stock options, stock purchase rights, or restricted stock under an employee stock plan as constituting a public offering (regardless of the number of employees). The officials suggested that such grants may be viewed as a type of "fringe benefit," rather than as an offer of securities. The officials further noted that, at this time, the CSRC does not intend to issue any guidance regarding the offer of equity compensation by a foreign parent company to Chinese employees or to implement approval procedures for such offer. Further, based on the officials' comments, it appears that the CSRC is not encouraging foreign companies to approach the CSRC to apply for and seek approval under the new securities law in order to offer equity compensation to Chinese employees.

**Colombia**

Public offers of securities are subject to securities requirements in Columbia. As long as stock options and stock purchase rights are awarded to 99 or fewer employees and all communications are addressed to individual employees, such awards should not be deemed public offers. Recent legislation provides that an offer is deemed to be a public offer when it is made to an undetermined number of people, is targeted to undetermined sectors or groups of entities or individuals, or is offered through mass media.

**France**

The Autorité des Marchés Financiers ("AMF") is the stock exchange authority responsible for regulating and monitoring compliance with the EU Prospectus Directive in France. Generally, the AMF has concluded that stock options are considered non-transferable securities, and as such should be exempt from the prospectus requirements. However, the AMF has concluded that stock purchase rights are considered transferable securities, and as

such a prospectus is required unless offers are otherwise exempt (*e.g.*, offers to fewer than 100 individuals). Non-compliance with the prospectus requirements of the AMF is considered a criminal offense and subject to fines and imprisonment. The amount of the fine generally remains in the AMF's discretion and can be based on the gravity of the acts committed and in proportion to the profits realized or other advantages gained by virtue of such acts.

**Japan**

Offers of options to employees of local subsidiaries in Japan that are directly and wholly owned by the parent company are not subject to notification and registration requirements. Otherwise, the necessity for disclosure and registration filings is determined based upon the aggregate price of securities offered and the number of offerees. A securities notification (Form 6) is required for grants that are in excess of ¥10,000,000 but less than ¥100,000,000 and offered to 50 or more employees. For grants that are in excess of ¥100,000,000, depending on whether the company is a reporting company and the number of employees, a securities registration statement (Form 7) is required. A company is a reporting company if it has filed or is required to file the Form 7. In addition, annual and semi-annual filings are required once a Form 7 has been filed.

# 5 Taxation

## Employee Tax Treatment

Even though employee taxation tends to be the primary focus of local regulators, it is one of the more common areas for non-compliance in administering global equity compensation programs. In many countries, employees granted options or purchase rights are taxed at exercise or purchase on the difference between the fair market value of shares on the date of exercise and the exercise price (*i.e.*, the "spread") and upon the subsequent sale of the shares. However, in a few countries, tax may be imposed at the time of grant, or vesting. Restricted stock and RSUs generally are taxed either at the time of grant or vesting and at the sale of the shares.

The taxation of stock awards also may trigger withholding and reporting obligations for the employer. Companies need to be aware of and comply with these obligations because of the scrutiny imposed by local tax authorities.

Before offering a stock award in a particular jurisdiction, companies should address the following with respect to the taxation of employees:

- The tax consequences at grant for the stock options, purchase rights, restricted stock, or RSUs;
- The tax consequences at vesting for the stock options (purchase rights generally are not subject to a vesting schedule), restricted stock, or RSUs;
- The tax consequences upon exercise of a stock option or purchase right;
- The tax consequences of the subsequent sale of the shares received under the awards;
- The availability of special tax-favored programs;
- The impact parent company reimbursement and a local subsidiary tax deduction have on employee taxation;
- Any special rules applicable to expatriates and third country nationals; and
- The withholding and reporting obligations of the local subsidiary and parent company.

Each issue indicated above does not apply in every country. The wide variety of tax regimes currently in force around the globe will be discussed, with specific examples, later in this chapter.

Ironically, in an age where executive employees are becoming increasingly mobile, the ability to deal with these complex tax issues may arise whenever an executive makes an international transfer and the willingness to address them on a "one-off" basis is necessary.

## Social Insurance Contributions

Many countries impose social insurance taxes on benefits received by employees through equity compensation programs. Such taxes may include medical and employment insurance, workers' compensation and national pension fund contributions. Social insurance contributions imposed on the benefit at either grant, vesting, or exercise of an award can be extremely costly for both the local subsidiary and the employee. For this reason, some companies attempt to shift liability for social insurance taxes to the employees or forgo offering equity compensation programs in countries with particularly high social insurance obligations.

Before implementing an equity compensation program, companies should consider the following:

- Whether the social insurance taxes imposed on the spread are so costly that offering the stock awards is not economically feasible; and
- Whether the stock awards can be modified to allow the local subsidiary and the employees to mitigate, defer, or eliminate social insurance obligations.

## Tax-Favored Programs

In many countries, companies offering equity compensation programs have the opportunity to modify the stock awards to provide their employees with tax-favored programs. Such programs may provide an exemption from both income tax and social insurance contributions on the benefit at grant, vesting or exercise; or defer the taxable event until the underlying shares are sold. Both the participant and the local subsidiary may benefit from the exemption or deferral of tax liabilities. In most cases, offering a tax-favored program to local employees increases participation and satisfaction. However, in some countries the benefits allowed under these programs are limited, making such programs less attractive. Qualifying for tax-favored programs may require modification to the plan and grant terms, and restrictions may need to be imposed on the subsequent sale of the underlying shares.

## Withholding and Reporting

Companies must determine whether the parent company or the local subsidiary is required to withhold income tax and social insurance on the benefits received by employees. In addition, the local subsidiary and employees may have certain tax reporting obligations for benefits provided pursuant to the stock awards. When granting stock awards, companies should consider:

- Whether the local tax laws require withholding and reporting of income tax and social insurance on the benefits received by the employees, and if so, the appropriate withholding rates;
- Providing notices to the employees of their personal reporting obligations; and
- Adopting procedures for withholding and reporting between the broker, parent company, and local subsidiary.

## Employer Tax Treatment

Many countries permit a local tax deduction when the parent company is reimbursed the cost of the benefits under the plan (which generally is the spread realized upon exercise of an option or purchase right). Such a charge-back suggests that the local subsidiary is entitled to a tax deduction because, theoretically, it caused the parent company to grant options to its employees in exchange for the reimbursement.

Although it may allow local subsidiaries to obtain beneficial tax deductions, a charge-back can also present other complications. An independent-minded subsidiary generally is inclined to resist a charge against its operating budget because the global program is viewed as a benefit provided by and, in part, for the parent company, not the local subsidiary (*e.g.,* aligning the interest of the employees with that of the parent's shareholders). The charge-back may increase the likelihood that benefits provided under an equity compensation program will be considered a part of "regular salary" and will become an "acquired right" that would then need to be included as part of an employee's retirement or termination benefit calculations.

Finally, companies may need to weigh the benefit of the charge-back and corresponding local tax deduction against potential negative tax consequences to the employees.

When granting stock awards, companies should address the following issues relating to the taxation of the local entity:

- The tax consequences to the local subsidiary of extending the program to the local employees; and
- The tax consequences of the local subsidiary's reimbursement of the parent company for the spread realized upon exercise of options or purchase rights held by local employees.

## Examples:

**Argentina**

If the parent company is reimbursed by the Argentine subsidiary for the cost of option benefits, the subsidiary should be able to deduct such costs from its income taxes. However, Argentina imposes a 29.7% withholding tax on the payment. In addition, a subsidiary's payment and a parent company's subsequent reimbursement may trigger labor issues.

**China**

The PRC Ministry of Finance and the State Administration of Taxation ("SAT") issued a circular, Caishui (2005) No. 35 ("Circular No. 35"), which became effective on July 1, 2005. Circular No. 35 provides that companies offering stock options in the PRC through stock option plans implemented on or after July 1, 2005 are required to translate into Chinese and submit the following documents, to the extent applicable, to their local tax bureau: (1) stock option plan, (2) stock option agreement, (3) grant notice, (4) exercise notice, and (5) exercise adjustment notice. Circular No. 35 requires that these disclosure requirements be interpreted by local tax bureaus. In October 2006, SAT issued tax circular Guoshuihan No. 902 ("Circular 902") to clarify the rules on the taxation of stock options and to provide additional guidance on Circular No. 35. The penalty for noncompliance is a monetary fine, which ranges from approximately $250 to $1,200.

**France**

In general, there are two types of options that may be granted to French employees. Under the first type of option, the non-qualified option, the employee is taxed on the spread at the time the option is exercised. The proceeds from the sale of shares may be subject to tax depending on the total amount of capital gains for the tax year. Social insurance contributions are due on any income recognized on the exercise of the option. These social insurance contributions are uncapped and are payable at rates as high as 45%.

Under the second type of option, the qualified option, there is a deferral of tax for employees as well as elimination of employer social insurance tax if the shares underlying the option are held for at least four years from the date of grant.

The cost of option plan benefits may be deducted if: (i) the parent company uses treasury shares; and (ii) if the French subsidiary reimburses the parent company. The deduction may not exceed the costs paid by the parent company for the purchase and reissuance of the shares to the employee.

**India**

An employee is taxed on the spread at exercise of the shares. However, favorable treatment exists for stock options and purchase rights issued in accordance with guidelines implemented by the Central Government of India ("Central Government"). Several noteworthy guidelines include, but are not limited to (i) inclusion of language in a company's stock option plan regarding employee consent for employer withholdings, (ii) inclusion of language in the company stock plan regarding "employees stock option scheme" where a company provides its employees with the option of purchasing a specified number of shares at a specified price and during a specified period, and (iii) compliance by any foreign company with the Securities and Exchange Board of India or any other regulatory entity. If a company offers a tax-deferred program in accordance with such Central Government guidelines, taxes are deferred until sale for income received from the sale.

**Malaysia**

Effective January 1, 2006, the taxation of stock awards was modified. Under the prior tax regime, stock options were taxable on the difference between the fair markets value ("FMV") of the shares on the grant date and the exercise price. For options with an exercise price set at the FMV on the grant date, the taxable amount was zero. Other stock awards, such as RSUs, were based on the FMV at vesting.

Under the modified tax law, the calculation for the taxable of a stock option will be the lower of: (a) the difference between the FMV of the shares on the vesting date and the exercise price, or (b) the spread at exercise. The tax is payable at the time of exercise.

Because of the confusion created by the new tax law, the Malaysian Ministry of Finance issued transitional guidance for the taxation of outstanding options as of January 1, 2006. For those options, the employee may elect to be taxed upon either (a) the difference between the FMV of the shares at grant and the exercise price, or (b) the spread at exercise. Malaysian law defined the FMV as a share as the average.

**The Netherlands**

The Minister of Finance has stated that cash-settled stock appreciation rights will not be subject to the new law for options or shares granted before May 24, 2006. A deduction is available until 2010 irrespective of whether a company has a chargeback arrangement. Effective January 1, 2007, a chargeback arrangement needs to be in place between the parent company and the subsidiary in order to receive a corporate tax deduction for options or shares granted after May 24, 2006

**Singapore**

Generally, employees are taxed when the options are exercised. However, expatriate employees who receive options (*e.g.*, stock purchase rights, stock options) on or after January 1, 2003 and are no longer employed in or are leaving Singapore are deemed to exercise those options and are be subject to taxation.

**United Kingdom**

The HM Revenue & Customs ("HMRC") has established reporting requirements for employee stock plans. Companies that issue awards in the United Kingdom are required to report the awards to the HMRC by July 6 following the tax year in which the grant was made.

## 6 Exchange Control

### Foreign Exchange

Currency exchange controls are focused upon the inbound and outbound transfer of local currency. These controls directly impact employee stock option and stock purchase plans in several areas; including:

- The ability of the local subsidiary to transfer payroll deductions collected under a stock purchase plan to the parent company;
- The ability of the employees to convert and transfer local currency to a third-party broker upon the exercise of a stock option;
- The ability of the employee to receive the proceeds following the sale of shares; and
- The ability of the local subsidiary to convert and transfer local currency to reimburse the parent company for the costs of the programs (*i.e.,* to facilitate a charge-back to the local subsidiary).

Today, most countries allow employees to transfer local currency abroad to exercise stock options or purchase stock under an equity compensation program. In those countries that restrict the ability of employees to convert local currency into U.S. dollars, it may be possible to modify the stock awards to avoid these restrictions.

For example, many companies have restricted the exercise methods available for stock options to eliminate the necessity for employees to transfer cash payments. The exercise method is referred to as a cashless exercise or same-day-sale. The Exchange control authorities are often satisfied by the use of a mandatory cashless exercise procedure, provided that employees are not issued share certificates and the employees immediately convert the proceeds into the local currency. Under such an arrangement, currency only flows inbound (with the employee's repatriation of his or her earnings). (Companies should discuss with their auditors the accounting implications of using mandatory cashless exercise.)

### Examples:

**Brazil**

In 2005, the Brazilian Central Bank (BACEN) issued rules (effective March 14, 2005) removing tedious foreign exchange control restrictions. For example, BACEN approval is no longer required for remittances of funds outside of Brazil used to purchase foreign company shares. Also, entities are not required to return proceeds from the sale of shares acquired under an employee stock plan to Brazil if an employee is terminated. Also, remittance outside of Brazil used to purchase foreign company shares can be conducted by the employee or a local Brazilian bank.

However, certain transfers of funds in Brazil remain problematic. Generally, exchange control laws affect chargeback policies where the local subsidiary reimburses the parent company for the cost of the benefits of the plan. Despite Brazil's removal of strict foreign exchange control regulations, remittance under certain stock swards such as stock purchase rights remains a challenge. In Brazil, it may not be possible to implement a cash-netting procedure that would pay for accumulated payroll deductions to the U.S. parent corporation. Therefore, companies that are considering the offer of stock purchase rights in Brazil should assess the likely risks in providing this type of stock award, and how compliance would be structured under Brazilian laws.

**China**

Chinese foreign exchange regulations impose significant restrictions on the inflow and outflow of foreign currency. When an employee converts local currency and transfers foreign currency out of China to exercise foreign stock options, or converts the proceeds from the sale of the shares acquired from the exercise of stock options from foreign to local currency, approval from the State Administration of Foreign Exchange ("SAFE") may be necessary, depending on whether the transaction is considered a current or a capital account transaction. Under the PRC foreign exchange regulations, current account transactions above US$50,000 and capital account transactions above US$10,000 require the approval of SAFE. The approval is difficult, if not impossible, to obtain.

Because of the currency exchange restrictions in China, most companies have limited the type of stock awards offered in the country and further limited the terms and conditions of the stock awards offered to limit the transfer of currency. With these restrictions, stock options with a cashless exercise have been the most common stock award offered.

By using the cashless exercise method, there is no outflow of cash from employees to exercise their options. Accordingly, the exchange control requirements for transfers of funds from China are not applicable. With respect to the transfer of proceeds from the cashless exercise of stock option to the employee in China, a practical approach would be to conduct transfers in installments of less than US$10,000. Under this arrangement, SAFE approval will not be required.

**India**

Employees of an Indian subsidiary may remit an unlimited amount of funds outside of India to purchase shares in a foreign parent company under an option plan if the foreign company owns at least 51% of the local Indian subsidiary. Option plans with a mandatory cashless exercise provision are not subject to the foreign exchange controls. In addition, repatriation requirements apply with respect to the proceeds from the sale of shares acquired under option plans. Generally, immediate repatriation is required and in any case, not later than 90 days from the date of sale.

**Russia**

The Russian Central Bank can require that settlement of all transactions involving foreign securities (which could include the exercise of options, purchase rights, restricted stock and/or sale of the underlying stock) by Russian residents be made in Russian rubles. Russian citizens generally may purchase and sell foreign securities (up to US$150,000) under certain conditions. For securities with values that exceed US$150,000, a mandatory reserve requirement and a special account requirement apply. A Russian citizen also may sell foreign securities, so long as the securities are purchased with funds that were properly transferred through the Russian banking system. Permission from the Central Bank may be obtained to allow exercise under a stock option plan through the cashless exercise method. Repatriation requirements apply to the proceeds from the sale of shares.

Fortunately for employees resident in Russia, the local currency exchange restrictions have been liberalized. Effective January 1, 2007, the requirements for a mandatory reserve and special account for transactions exceeding US$150,000 will be eliminated. Over the next few years, further liberalization of the currency exchange restrictions is anticipated.

Until January 1, 2007, Russian law provides that the Bank of Russia may establish a requirement for the use of a special account. As of January 1, 2007, currency operations with respect to foreign securities will no longer be subject to such requirements.

**South Africa**

As with other countries, South Africa has liberalized their foreign exchange control requirements. Currently, exchange control approval for South African employees participating in a company stock option plan is no longer required. Employees can participate so long as the ZAR $2 million foreign capital allowance limit is not exceeded.

# 7 Data Protection

Data protection laws have been enacted in various jurisdictions around the world to control the way in which personal information about individuals is collected and used, and to protect the confidentiality of such personal information. The existence of these laws and the differences from country to country can pose a major challenge for multinationals, particularly companies that manage human resources or other personnel functions in a central location, where personal information is transferred cross-border. Data protection regulation may impact a number of activities of companies such as recruitment, payroll, work performance evaluations, benefits (*e.g.*, retirement, bonus, equity incentive plans), disciplinary actions, and company directories.

The US has historically taken a self-regulatory approach to privacy law. Western European countries have been the most active jurisdictions in putting data protection laws in place. The first such laws were enacted in the early 1970s in countries such as France. Additional Member States of the EU developed similar laws over the following twenty years.

In an effort to rationalize the international regulation of data flows, the Organization for Economic Cooperation and Development ("OECD") recommended a set of guidelines on the protection of privacy and trans-border flow of personal data (the “OECD Guidelines") on September 23, 1980. Although lacking in legal force in the territorial sense, the OECD Guidelines represented a significant international consensus on the appropriate principles concerning the protection of privacy and individual liberties.

In the mid-1990s, the EU enacted Directive 95/46/EC on the protection of personal information (the “EU Data Protection Directive” or the “Directive”) to harmonize the European approach to the regulation of data protection and promote the free movement of personal data within the EU. The Directive became effective on October 25, 1998 and requires the 25 Member States of the EU to adopt national legislation on data protection.
As with most European Directives, the EU Data Protection Directive only sets out the minimum requirements that each country is required to implement in relation to its national legislation. Each country is permitted to enact stricter regulations than the standards set out in the Directive. If the privacy laws of a particular Member State already meet certain minimum requirements set forth in the Directive, the Member State is only required to supplement those laws to fulfill all of the requirements of the Directive. As a consequence, while the majority of EU Member States meet the minimum standards required by the Directive, national laws on data protection within the EU vary from country to country and companies that collect and process data within those countries must ensure that they comply with all of the requirements of the local jurisdiction. For example, certain jurisdictions (*e.g.*, Portugal) require the approval of local data protection authorities before data can be transferred outside of the EU.

Personal data is defined by the Directive as any information relating to an identified or identifiable natural person. Therefore, details such as name, address, social security number, date of birth, telephone number, and any other information that serves to identify an individual qualify as personal data. Individuals from whom data is collected are referred to in the Directive as “data subjects.” The Directive then imposes restrictions on any entities that act as “data controllers” (*i.e.*, those entities that collect and process personal data from data subjects). The term “data processing” covers a wide range of activities: the collection, use, storage, retrieval, and recording of personal data all fall within the definition.
Under the terms of the Directive (as implemented by national legislation) data controllers are prohibited from either processing personal data or transferring personal data to a jurisdiction

that does not have "adequate" data protection regulations, unless one of the following circumstances is satisfied:

- The data subject gives his or her unambiguous consent to the data processing;
- The data processing is required in order to perform a contract to which the data subject is a party (*e.g.,* an employment contract);
- The data processing is required to comply with a legal obligation of the data controller (*e.g.,* a tax withholding obligation);
- The data processing is required to protect the data subject's "vital interests";
- The data processing is required to perform a task carried out in the "public interest" or in the exercise of official authority; and
- Where the data processing is in the "legitimate interest" of the data controller or a third party.

It can be difficult to determine whether an action is in the "legitimate interest" of a data controller or whether processing is required for a data subject's vital interests, and there is very little national case law to provide guidance on these issues. Often the most straightforward method of legitimizing data processing and transfer is by obtaining the consent of the data subject (*e.g.*, the employee). Many multinational companies have started to follow this approach by incorporating specific consent language in consumer contract terms and conditions, employment contracts, and stock option agreements.

Specific rules apply where a data controller seeks to process "sensitive" personal data. This is defined under the Directive as being data relating to an individual's ethnic origin, religious or other beliefs, health, sexual orientation, political opinions or affiliations, criminal convictions, and labor union membership. For such data, the data subject must give explicit consent for data processing, or the data controller must fall within other very limited exceptions to this rule.

As noted above, the data subject's consent to processing or transfer is valid only if it is unambiguous or freely given. An independent working party set up by the European Commission called the "Article 29 Working Party" (the "Working Party") issued an opinion on the use of consent in an employment context (*i.e.*, where the data subject is the employee) and has questioned the validity of consent given by an employee in circumstances where refusal to give consent adversely affects the employee's ability to obtain the employment in question. The validity of consent is even more questionable where an entire industry requires such employee consent as a condition of employment. On the basis of the Working Party's opinion, employers must be careful to give employees a free choice on whether to give their consent and should provide that the employee is able to withdraw consent at any time without suffering adverse consequences, namely the loss of employment. The loss of benefits, such as stock option income, also may constitute an adverse consequence. This result is problematic in the context of human resource activities where a person's name, social insurance I.D. and salary are needed in order to provide benefits, but nonetheless it is the current approach of the Working Party.

The Directive also sets out a number of data protection principles that data controllers must comply with in relation to the processing of personal data. These include the following: the processing of data must be limited to a specific purpose; personal data should be retained only for as long as necessary; data should be accurate and kept updated; the data subject must be notified of the purpose of any data processing; the identity of the data controller and any third party recipient or transferee of the data must be disclosed; data must be protected by adequate security measures; and data subjects must have access to their personal data held by a data controller and be permitted to correct any mistakes in such data. Companies often choose to fulfill the disclosure principle by including the required information as part of the consent signed by the data subject.

In relation to the transfer of personal data, under the terms of the Directive (as implemented by national legislation) data controllers that collect personal data within the EU are able to transfer personal data to any country within the European Economic Area ("EEA") (*i.e.,* the EU countries plus Iceland, Liechtenstein and Norway) without fulfilling one of the circumstances set out above. Data controllers also are permitted to transfer personal data to other jurisdictions recognized by the EU as providing "adequate" protection for personal data. These countries currently are: Argentina, Canada, Switzerland, Guernsey, and the Isle of Man. The European Commission currently is considering "adequacy finding" applications from Australia, New Zealand, Japan, and South Korea.

The US is not currently recognized by the EU as providing "adequate" protection for personal data because the US does not have any generally applicable data protection laws. The US has historically adopted a piecemeal, sector-specific approach to data protection based on the Federal Trade Commission Act and regulations, Gramm-Leach-Bliley Act of 1999, Children's Online Privacy Protection Act of 1998, and the Health Insurance Portability and Accountability Act of 1996. However, the EU and the US have negotiated a "safe harbor" agreement, pursuant to which US-based companies may voluntarily adhere to the principles of the Directive by agreeing to comply with the requirements of the safe harbor.
In order to satisfy the requirements for safe harbor protection, the US employer must:
be subject to the jurisdiction of the US Federal Trade Commission ("FTC"); revise its privacy policy to comply with the safe harbor principles; publicly disclose its privacy policy; and unambiguously and publicly disclose its dedication to conform to the safe harbor principles.

Companies also are required to certify to the US Department of Commerce that they are in compliance with the safe harbor principles. Agreeing to the safe harbor gives certainty to EU companies dealing with US companies that data can be transferred to such companies without the EU companies having to put additional safeguards in place, and also allows US multinationals to transfer personal data within the organization. However, only companies that are subject to the jurisdiction of the FTC or the US Department of Transportation may use the safe harbor, which excludes, for example, financial institutions and health providers. To date, approximately 300 US companies have agreed to the safe harbor agreement.
If the safe harbor option is not available, the cross-border transfer of personal data from EU jurisdictions to countries without adequate protection also is possible using transfer agreements containing certain mandatory clauses ("standard contractual clauses") approved by the EU Commission. Both the sender and recipient of the personal data sign the transfer agreement and the standard contractual clauses require the data recipient to comply with the same standards with respect to the personal data as those set out under the Directive and the national law of the sender. The recipient of the data also agrees to be subject to the jurisdiction of the courts of the EU Member State in which the sender is domiciled, and both parties agree to be jointly and severally liable for damages to the data subject resulting from any unlawful processing of his or her personal data.

Transfer agreements also are useful to ensure that third party administrators (or the parent company) comply with the local data protection laws. Such agreements may be necessary to obtain permission from the local data protection authorities to transfer personal data abroad. Often, transfer agreements are used as an alternative to obtaining employee consent. Lastly, transfer agreements are important in allocating the liability associated with any violation of the local data protection laws by third party administrators.

The use of a transfer agreement containing the standard contractual clauses also may allow the entity transferring the data to avoid the requirement to obtain permission from local data protection authorities before transferring data to a country without adequate data protection. However, certain EU countries still require permission to transfer in all circumstances if data is being transferred to countries without adequate data protection legislation, notwithstanding the use of the standard contractual clauses (*e.g.*, Czech Republic and Portugal). Companies

that intend to transfer personal data outside of the EU should familiarize themselves with all of the national requirements before implementing any such transfer.

The Working Party's recent approval of Binding Corporate Rules ("BCRs") provides multinational companies with a mechanism to facilitate internal data transfers outside of the EEA. BCRs are a set of legally binding provisions which set forth the company's policies and guidelines related to its data processing activities (*e.g.*, number of data subjects concerned and the countries of data export and import) and are submitted to a lead data protection authority ("lead authority") in the EU. Generally, the lead authority will be located in the country where the company has its European headquarters. The lead authority then forwards the BCRs to multiple data protection authorities for approval. Upon receipt of approval, the company and its subsidiaries are legally bound by and must comply with the BCRs. For BCR's to be approved by the EEA lead authority, they must be:

*legally binding internally within the group.*
This means that the rules must be binding both (i) between the various companies within the group, and (ii) on their employees. To achieve the former, a code of conduct supported by intra-group company agreements could be put in place. The latter could be done by including specific provisions in individual employment contacts, or by using disciplinary procedures if the group's data protection code of conduct is breached.

*legally binding on sub-contractors*
This could be ensured by including adequate obligations in the relevant sub-contracts.

*legally binding externally for the benefit of data subjects*
Depending on the jurisdictions in question, the BCRs can be made legally binding, *e.g.*, by unilateral undertakings by the parent company of the group, or by ensuring that data subjects have legally enforceable rights under intra-group contracts.

BCRs must:

- Ensure compliance with the requirements of the EU Data Protection Directive and describe the standards of data protection safeguards in place;
- Emphasize the safeguards and also contain some practical guidance (*e.g.*, how compliance should be achieved in a given situation);
- Set out an audit procedure regarding compliance with the BCRs and adequate measures in case of breach;
- Describe the intended processing of personal data, namely the nature of the data, the purpose of the processing and the extent of cross-border data transfers; and
- Include mechanisms to report changes of the BCRs both within the group and to the relevant data protection authorities.

BCRs may not be suitable for every multinational in every circumstance and it remains to be seen how enthusiastic some data protection authorities will be in practice to implement this new procedure. However, the strength of BCRs is that they constitute a proactive approach where a multinational group (entities related to a single parent company) can create tailored procedures and a culture to comply with ever-demanding global data protection regimes on the one hand, and maintain a sustainable and cost-effective environment for its international data transfers on the other.

An additional requirement of many EU jurisdictions is that data controllers register their data processing activities and the maintenance of databases with the relevant local data protection authority. This requirement usually comprises an initial filing when the data processing commences and additional filings on an annual basis. To register a database, the company must submit details regarding the data controller, the types of data stored and the purpose of

establishing the database. Personal data may then only be processed in accordance with the purposes for which the database was established.

Although the US has not enacted a comprehensive data protection law, many other countries have followed the EU's lead in the area of data protection and have used the Directive as a model when enacting their own data protection legislation. For instance, the 10 countries that joined the EU as Member States in May 2004 either have implemented, or are in the process of implementing, legislation that meets the minimum requirements of the EU Data Protection Directive. As of this writing, these countries are Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovenia, and the Slovak Republic. Numerous other countries around the world also have proposed or are considering similar data protection regulation.

## Examples:

**Argentina**

As with Member States of the EU required to comply with Directive 95/46/EC, Argentina has enacted its own data protection laws. For example, (i) the use of personal data must not exceed the context and purpose for which it was obtained, (ii) no employee can be forced to provide "sensitive data", and (iii) databases containing employees' personal data must be registered with Argentina's data protection authorities. Accordingly, companies should consider obtaining an employee's written consent for the processing and transfer of his or her personal data in order to comply with protection requirements.

**Denmark**

Denmark allows personal data to be processed in circumstances including where: 1) the employee has given his or her explicit consent; 2) processing is necessary (a) for the performance of a contract to which the employee is a party (*e.g.*, an employment relationship is a *de facto* contract) or (b) to take steps at the employee's request prior to entering into a contract; or 3) processing is necessary for compliance with a legal obligation to which the employee is subject.

Absent an exemption (*e.g.*, employee's explicit consent), sensitive data (*e.g.*, racial or ethnic origin, political opinions, party affiliation, and religion) may not be processed.
When processing an employee's personal data, an employer must provide the employee with information including: 1) the data being processed, 2) the purpose(s) of the processing, 3) the recipients of the data, 4) any available information as to the source of such data, and 5) rules on the right of access to and the right to rectify the data relating to the employee.

Generally, the government agency in Denmark responsible for data protection (DPA) must be notified prior to the processing of personal data. The DPA is required to record data processing activities in a register accessible by the general public. However, an exemption from the notification requirement exists for the processing of personal data regarding employees.

The employer must implement appropriate technical and organizational security measures to protect data against accidental or unlawful destruction, loss or alteration and against unauthorized disclosure, abuse or other processing in violation of the provisions set forth in the Act.

An employee may withdraw his or her consent to the processing of data relating to him or her. The employer must, at the request of the employee, rectify, erase, or block data which turns

out to be inaccurate or misleading or is in any other way processed in violation of law or regulations.

**Germany**

Germany has enacted data protection laws. A company offering awards under an employee stock plan complies with German laws if it obtains written consent from the employees for the collection, use, and transfer of personal data. Personal data cannot be transferred outside the EU without such consent. If the consent is given together with other declarations in the employee stock option agreement, it must be distinguishable in its appearance from the other declarations (*e.g*., by using a different type-face). Germany also requires consent to be comprehensive, and explain the reasons for which the data is being used and collected.

In addition, if "automated data processing" is used, the German law requires registration with the Federal Commissioner of Data Protection. The collection and processing of information via the use of computers would fall under this requirement. Registration is not required if less than 5 employees are involved in the collecting, using or transfer of the employees' personal data.

**India**

Currently, there are no data protection restrictions specifically applicable to employee stock plans. However, Indian law has held that privacy is implicit in the fundamental right to life and liberty. In addition, the Indian Industrial Employment (Standing Order) Act of 1946 requires companies to provide employees with access to their personal data if the company has 100 or more employees. To ensure that an employee stock plan remain consistent with such laws, companies should consider obtaining an employee's written consent for the processing and transfer of his or her personal data.

**Japan**

Japan does not have any mandatory laws regulating or restricting the use and transfer of private data. Nonetheless, in 1997 and 1998, the Ministry of International Trade issued guidelines concerning the protection of personal data. These publications provide that the employer should collect data for "just" reasons, disclose to employees the purpose for collecting and processing the data, and properly maintain the confidentiality of the data. Accordingly, companies should consider obtaining an employee's written consent for the processing and transfer of his or her personal data in order to comply with protection requirements.

**Hong Kong**

Hong Kong's Personal Data (Privacy) Ordinance imposes registration and notification requirements on the processing and/or transferring of data in connection with employee stock plans. In addition, US-based companies should consider whether confidentiality agreements should be entered into between the Hong Kong subsidiary and any third parties who will process data. A model agreement can be found at the website of the Office of the Privacy Commissioner for Personal Data, Hong Kong (http://www.pco.org.hk).

## 8 Communications

The success or failure of an equity compensation program often is dictated by how successfully the program's benefits and terms are communicated to the employees. Documents that typically are included with the employee communications include the offer document, grant agreement, enrollment form, plan document, prospectus, and tax supplements.

Often, the employee communications are based on a U.S.-model that does not take into account the nuances of a country's legal and practical requirements. Companies even may find that their U.S.-based model documents are in violation of local laws. Companies should consider the following issues:

- Whether local disclosure requirements, employee entitlements, and data protection provisions are addressed in employee communications;
- Whether specific country modifications are necessary to comply with local law or whether a standard global form is acceptable;
- Whether the electronic distribution of plan documents and acceptance of plan terms is permitted under local law; and
- Whether documents must be translated into the local language.

Electronic distribution of plan documents has been gaining popularity, due to its ease and efficiency. However, electronic distribution of plan documents raises a number of issues, including the legal validity and enforceability of electronic contracts under local jurisdiction that differ from country to country.

### Difficulties and Pitfalls in Communication

As we mentioned towards the beginning of this paper, there is an increasing demand for specific cultural specialists who may join the ranks of the advisory team to provide the local knowledge necessary for the successful planning, launch and maintenance of "global" plans.

Creating understanding and clarity around equity programs generates a number of challenges for organizations. The organization is required to provide consistent and engaging messaging across the world—in many languages, various time zones, numerous currencies, multiple cultures, and micro-cultures.

At the same time, the organization needs to develop supporting infrastructure by setting up systems and service partnerships to launch and maintain the program for their employees. This is particularly challenging while each country reviews and revises local positioning, considers legislation, and regularly requires new approaches to tax and legal decisions in order to allow and accept these types of programs for its citizens.

To educate employees about ownership plans, organizations must develop comprehensive programs that use different approaches and provide targeted, straightforward information on a regular and ongoing basis.

Organizations must also beware of the pitfalls they may encounter. For example, whether the organization providing the ownership opportunity is U.S.-based or not, many programs communicate using U.S.-specific terms, which can cause confusion. One also sees companies developing and launching these programs from a central location or corporate office with little or no local country leadership involvement. In an effort to create excitement and push employees to take action, one also sees programs providing communication that creates

unrealistic expectations or over-ambitious financial return. This causes further concern about an audience unprepared for future market and business realities.

## Sending the Right Message

A focus on simplicity and the commitment to answer fundamental design and operational questions provides the most compelling story and the quickest return on your company's communication investment.

> Help employees understand why the organization is providing this opportunity, what the company hopes to accomplish, and what it means to the employee. Tell them what kind of information and support they will have throughout the process and where to go for what. Give them the basics of the plan design and tell them what action is required of them.
>
> Use this opportunity to build employees' business literacy. Help them understand how the pieces fit together—how does the company make money, save money, and increase customer satisfaction? How do their jobs fit into the picture?
>
> Demonstrate what "one company mentality" means, and how it can be manifested throughout the organization. What does mutual success mean?

## Matching the Message and Theme to the Culture

If we assume that each of us act on the basis of our own best interest, how do I decide whether what you are communicating is a good deal for me? How do I decipher what is the truth? Different cultures arrive at truth in different ways.

The information below is based on cultural patterns, not necessarily on each of the individuals you are trying to reach. Look at what this might mean when addressing some fundamental activities of communication development and delivery.

If you want employees to understand how their efforts fit in to the company's success, you might develop messages and themes that are subtly different country to country.

- In the United States:
  - "You can make a difference by working smarter."
  - "The company's success equals your success."
- In Japan:
  - "We can make a difference if we do x, y, and z."
  - "Success is good for everyone."
- In Mexico:
  - "We can make a difference by working together to do x, y, and z."
  - "Success is good for everyone."
- In Germany:
  - "You can make a difference by working harder."
  - "The company's success equals your success."

In the development and design of program training, the documentation and content may be exactly the same. However, the approach to the training and the selection of the delivery team may need to be quite different.

- In the United States, training may be:
  - Conducted by HR and/or direct supervisors
  - Highly interactive, using role-playing opportunities

    - Designed to recognize adult learning methods and approach verbal, visual, and written processes
- In Japan, training may be:
    - Conducted by top executives or authority figures
    - Delivered in a lecture style
    - Designed to avoid emotional statements and excessive circular concepts
- In Mexico, training may be:
    - Conducted by line executives, supplemented with HR
    - Designed to create a more social environment to allow employees to help one another learn
- In Germany, training may be:
    - Conducted by managers, supported by the Works Council
    - Delivered in a "just the facts, please" style
    - Designed to have a heavy written component

If you want to generate enthusiasm to help motivate employees to learn about the program, your approach might:

In the United States:

- Use bright colors
- Deliver a "party-in-a-box"

In Japan:

- Do not use red hats
- Do not use groups of four or the number 4
- Involve a more giving approach

In Mexico:

- Use bright colors
- Create community; include social time to create an atmosphere of trust

In Germany:

- Emphasize punctuality and timeliness
- Use very direct language and media to get to the point as quickly as possible
- Commit to and deliver just the facts, giving the audience time to digest and discuss with others later

## 9 Administration

Most companies consider the administration too late in the process. There are generally two ways to support the plan, with a combination of the two solutions also possible. Companies can (1) outsource the entire plan or (2) handle the plan by administering it in your company, or (3) "co-source" the plan by allowing outside service providers to do some of the work while maintaining responsibility of the data at the company. Each method has its pros and cons.

### Outsourcing

Many large, multinational plans have outsourced the administration of their plan. Companies such as PepsiCo, Bank of America, IBM and The Walt Disney Company have selected an outsourcing vendor (which has been a brokerage firm in each case). Brokerage firms are traditional outsourcing providers because everyone will want to sell his or her stock sometime, and that can generally be done most efficiently by a broker/dealer. Some companies have outsourced to their transfer agents or independent record keepers.

When outsourcing, the primary goal is to have the vendor manage all the data, answer all the phone calls related to the plan, and provide all reporting required to maintain the legal, tax and financial reporting filing requirements. Most outsourcing vendors charge companies a fee annually or a fee per participant to maintain the data. There is also generally an additional fee charged at the time the stock is sold (or exercised).

When selecting an outsourcing provider, companies should look at not only the provider's experience but also its track record in supporting global plans. Because a global plan has so many moving parts, it requires expertise that is beyond the regular outsourcing of a domestic plan. In addition, it is crucial to evaluate the capacity of the provider to take on the implementation and support of your plan. Although many providers will include project management as a key part of their proposal, it is wise to consider hiring an outside project manager or designate someone full time to keep not only your vendor on track, but also your internal team.

Finally, when choosing an outsourcer, make sure to include all departments that will be affected by the selection in your decision making process. Everyone needs to work with this provider, and some team members may have had experiences that are worth sharing with the group.

### Internal Administration

Because some companies are uncomfortable parting with their internal data or feel that the cost of outsourcing does not justify the benefit, many large and small companies have kept their administration in-house. The downside of internal administration is the need to duplicate the infrastructure that outsourcing vendors already have in place. These departments need to be managed by experienced individuals who generally have a large task with generally a small staff.

In addition to a capable and trained staff, companies must select a database/software to help them track the information, set up special phone lines for questions, handle all the transactions with the broker and be available every hour and day the stock market is open. For a company with a small staff, this may become a burden.

## Co-Sourcing

Many companies who handle the administration internally have internal groups to administer the stock plan. However, each has used outside vendors to reduce the “heavy lifting” part of stock administration. Although there are many variations, many companies regularly send a copy of the database they maintain to the broker. This database is then loaded into the broker database, which allows employees to use the interactive voice response (IVR) system, website, and call centers. Every evening, a file containing the transactions for the day is sent to the company. The file is uploaded into the database, and the company reconciles all trades. Although there is still administrative work to be done, the majority of the data entry is done by the broker. The company can offload many of the phone calls to the broker and manage the program instead of administering it.

## 10 Conclusion

Working with international stock plans is an exciting albeit challenging opportunity for any professional. With the variety of disciplines involved, you will become extremely knowledgeable on many subjects, not the least will be meeting many people from different places and different cultures.

Ensuring you have strong advisors is critical to your success – when selecting your advisor, make sure they have worked in the area of international stock plans before and that they have a strong network that will allow them to obtain knowledgeable advice and information for you easily and economically.

There are a variety of organizations located in different countries that can support you with specific information related to the rules and practices in their country. Organizations such as NASPP, Proshare, ESOP Centre, Irish Proshare Association and others all have websites and local events that provide a wealth of information. The Global Equity Organization (GEO) is a non-profit organization developed to support professionals throughout the world with their international stock plan educational and networking needs.

In conclusion, the authors want to remind you that sometimes, during the most difficult moments, you may loose sight of the end goal – providing employees in your company with an opportunity to be a shareholder in your company, to accumulate additional wealth – and to be a part of your company's success. With the right team, you will reach your goal.