



# **Navigating a Perfect Storm**

## **TAX POLICY AND PRACTICE IN THE AGE OF COVID-19**

### **Compensation & Benefits Taxation – TCJA, Cross-border, and M&A Dimensions**

Tuesday, Oct. 27, 2020  
2:45 p.m.–4:00 p.m. (EDT)

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# Navigating a Perfect Storm

## TAX POLICY AND PRACTICE IN THE AGE OF COVID-19

### SPEAKER PANEL



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# Overall Agenda

- ▶ Tax Cuts and Jobs Act Updates
- ▶ Compensatory Tax Issues in M&A
- ▶ Cross-Border Compensation and Benefit Tax Issues

# Tax Cuts and Jobs Act Updates

# Tax Cuts and Jobs Act Updates

- ▶ Section 4960 proposed regulations
- ▶ Section 274 proposed and final regulations
- ▶ Section 162(m) proposed regulations

# Section 4960 Proposed Regulations

# The tax

21% excise tax imposed on

- ▶ Excess remuneration
  - ▶ Remuneration in excess of \$1,000,000
  - ▶ Paid by an applicable tax-exempt organization (ATEO) or related organization
  - ▶ To a covered employee
- ▶ Excess parachute payments
  - ▶ Paid by an ATEO
  - ▶ To a covered employee



# Law and current guidance

- ▶ Section 4960 imposes an excise tax on certain tax-exempt organizations and related taxable, tax-exempt, and government entities
  - ▶ Enacted December 22, 2017 as part of the 2017 Tax Act
- ▶ Notice 2019-09 provides interim guidance as Q&As
  - ▶ Released December 31, 2018
- ▶ Proposed regulations provide interim guidance and address open questions
  - ▶ Published June 11, 2020



# Options

- ▶ Reasonable, good faith interpretation of the statute
- ▶ Notice 2019-09
- ▶ Proposed regulations

Anticipated effective date of final regulations: taxable years beginning on or after the date published in Federal Register

# Significant items in proposed regs

- ▶ Volunteer exceptions
- ▶ Predecessor organizations
- ▶ On regular wages included at payment instead of vesting, no short-term deferral exception as under 457(f)

# Section 274 Proposed and Final Regulations



# TCJA changes for QTF

► Added new §274(a)(4) which says:

“No deduction shall be allowed under this chapter for the expense of any **qualified transportation fringe [QTF]** (as defined in section 132(f)) provided to an employee of the taxpayer.”

► Added new §274(l)(1) which says:

“No deduction shall be allowed under this chapter for any expense incurred for providing any transportation, or any payment or reimbursement, to an employee of the taxpayer in **connection with travel between the employee’s residence and place of employment, except as necessary for ensuring the safety of the employee.**”

► Applies to expenses paid or incurred after Dec. 31, 2017



# Law and current guidance

- ▶ New sections disallow certain transportation expenses
  - ▶ Changes enacted December 22, 2017 as part of the 2017 Tax Act
- ▶ Notice 2018-99 provides interim guidance
  - ▶ Released August 21, 2018
- ▶ Proposed regulations provide interim guidance and simplification methods
  - ▶ Released June 19, 2020

# Options

- ▶ Reasonable, good faith interpretation of the statute
- ▶ Notice 2018-99
- ▶ Proposed regulations after December 31, 2017

Anticipated effective date of final regulations: taxable years beginning on or after the date published in Federal Register

# Significant items in proposed regs

- ▶ Addition of simplified methods
  - ▶ Includes 5% mixed parking expense safe harbor
  - ▶ Can choose any method per facility and per tax year
- ▶ Clarity on general public exception for multi-tenant locations
- ▶ Safety for commuting uses strict 1.132-5(m) definition
- ▶ Aggregation means contiguous tracts or parcels
- ▶ Open questions:
  - ▶ Peak demand for instances like COVID



# TCJA changes for M&E

- Business entertainment was 50% deductible, now not deductible at all
- De minimis fringe benefits were 100% deductible, now 50% limitation applies
  - Food & beverage that was a de minimis fringe was fully deductible
- Applies to expenses paid or incurred after Dec. 31, 2017



# Law and current guidance

- ▶ Changed business entertainment to non-deductible; removed de minimis fringe exception to meals
  - ▶ Changes enacted December 22, 2017 as part of the 2017 Tax Act
- ▶ Notice 2018-76 provides interim guidance
  - ▶ Released October 3, 2018
- ▶ Proposed regulations provide interim guidance
  - ▶ Released February 26, 2020
- ▶ Final regulations issued
  - ▶ Released September 30, 2020 and effective for taxable years beginning on or after publication in the Federal Register

# Significant items in final regulations

- ▶ Confirm exceptions under 274(e) apply and that entertainment does not include food & beverages unless not separately stated
  - ▶ Final regs clarify that separately stated amount must reflect the venue's usual selling cost or reasonable value
- ▶ Clarify that business associate for business meals includes an employee
- ▶ Added examples on business meetings; clarify break rooms do not meet the recreational exception

# Section 162(m) Proposed Regulations

## Key TCJA changes to section 162(m)

Old law	New law
Commissions and performance-based pay could be excepted (and almost always were)	Removal of the commissions and performance-based pay exceptions
CEO and three highest paid officers not including the CFO (using SEC summary compensation table)	CFO is returned to the group of covered employees
Executives lost covered employee status if not employed on the last day of the tax year	“Hotel California” rule - Once an executive is a covered employee in any year (starting January 1, 2017 and after), they are <i>always a covered employee</i> ; also extends to whether or not a proxy is required to be filed (e.g. sale of business during period company is public)
Applied only to companies with publicly-traded stock	Now also applies to companies with only <i>debt securities registered</i> with the SEC or foreign companies with US ADRs (those required to file under section 15(d) of the Securities Act – must be determined by SEC counsel).



# Law and current guidance

- ▶ Section 162(m) limits deductions to covered employees of public companies to \$1M per taxable year
  - ▶ Changes enacted December 22, 2017 as part of the 2017 Tax Act
- ▶ Notice 2018-68 provides interim guidance
  - ▶ Released August 21, 2018
- ▶ Proposed regulations provide interim guidance and clarity
  - ▶ Published December 18, 2019

# Applicability of proposed regulations

- ▶ Some items proposed to apply for tax years ending on or after Sept. 10, 2018 (the date of the Notice)
- ▶ Certain positions considered a departure or new guidance not effective until final regulations are published (2020?)
- ▶ Taxpayers may rely now but only if relied on in their entirety



# Significant items in proposed regs

- ▶ Clarity on expansion of publicly-held corporation
  - ▶ May include S corps, publicly-held subsidiaries, foreign private issuers, publicly-traded partnerships, affiliated group entities, and certain disregarded entities
- ▶ Clarity on three highest-paid executive officers
  - ▶ Must be executive officer and use SEC compensation rules
- ▶ Predecessor rules
  - ▶ 368(a)(1) reorgs, corporate divisions, stock acquisitions or asset acquisition of at least 80% of operating assets
- ▶ Continue to rely on state law for “written binding contract”
- ▶ No transition relief for newly public entities

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# Compensatory Tax Issues in M&A



# Compensatory Tax Issues in M&A

- ▶ Why is it important?
- ▶ Due diligence
- ▶ Section 409A of the IRC
- ▶ Section 280G of the IRC
- ▶ Treatment of incentive equity in M&A transaction

# Compensatory Tax Issues in M&A – Why Important?

- ▶ Taxation of employee compensation and benefits may impact the economics of a transaction
- ▶ Retention, incentive and integration of key executives and employees is often critical to success of a transaction
  - ▶ Employee taxation may impact structure of transaction (e.g., equity incentives in c-corp (ordinary income) vs. partnership (capital gains))
  - ▶ Liabilities determined through due diligence
  - ▶ Treatment of employees' equity incentives – cash out vs. rollover impacts economics and taxation
  - ▶ Treatment of employees' deferred compensation
  - ▶ Section 280G golden parachutes and potential excise tax gross-ups

# Compensatory Tax Issues in M&A – Diligence

- Key arrangements for review
  - ▶ Employment, severance and change in control agreements or programs
  - ▶ Equity and equity-based plans and award agreements, ESPP
  - ▶ Options, SARs, restricted shares and RSUs
  - ▶ LLC/partnership interests – “profits interests”
  - ▶ Deferred compensation plans
  - ▶ Short- and long-term cash incentive plans
- Sampling of tax statutes to consider: Sections 83, 162(m), 409A, 280G, 421, 423
- Recent developments – CARES Act and Payroll Protection Program
  - ▶ Payroll tax deferrals
  - ▶ Postponed 2020 funding for defined benefit plans until January 1, 2021
  - ▶ Retention credit/PPP loan

## Compensatory Tax Issues in M&A – Section 409A

- ▶ Section 409A imposes specific requirements that nonqualified deferred compensation (NQDC) arrangements must satisfy
  - ▶ NQDC is defined broadly and exists if a service provider has a legally binding right to compensation during a tax year and the amount is payable in a later tax year
  - ▶ Service provider is an employee, director, certain independent contractors and can be an entity
- ▶ Strict limitations on the timing of initial and subsequent deferral elections and on the timing and form of payments for NQDC
- ▶ Employers subject to reporting requirements (W-2 or 1099-MISC) for compensation that is deferred

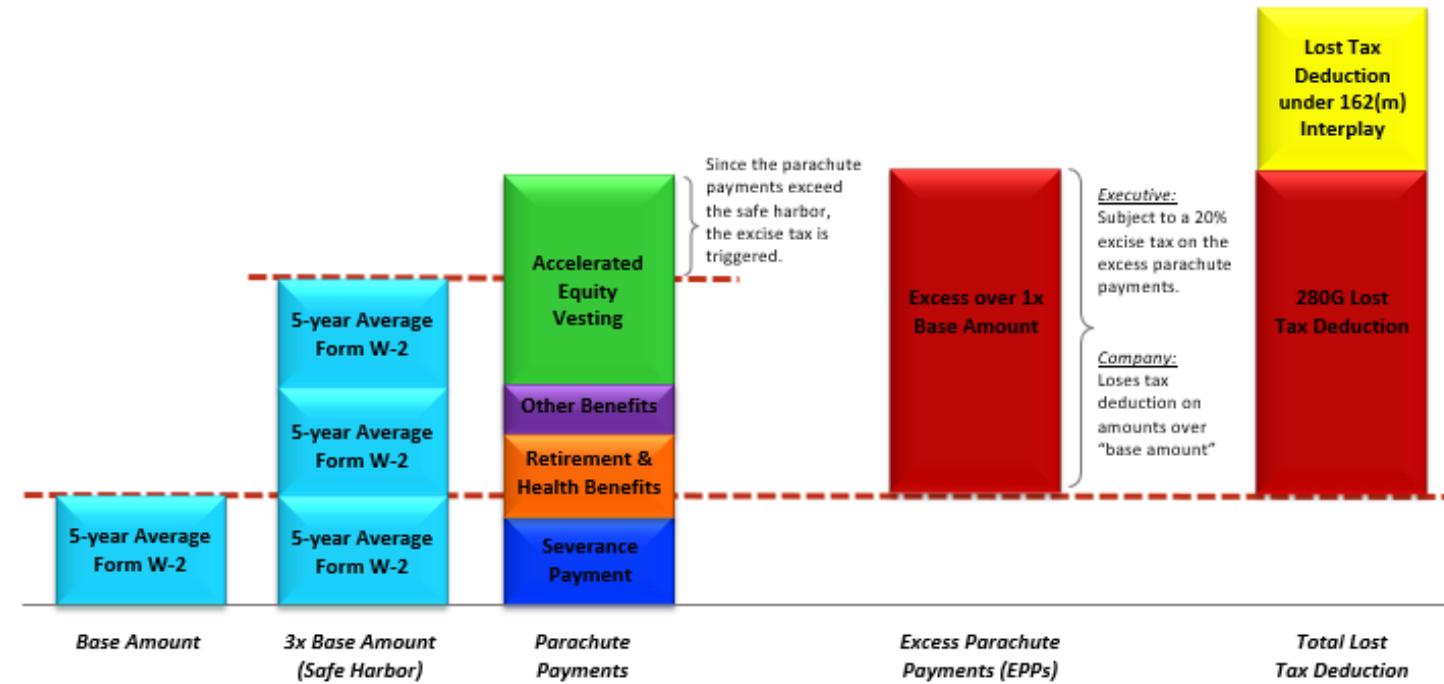
## Compensatory Tax Issues in M&A – Section 409A

- ▶ Penalties for non-compliance are significant; borne by service provider
  - ▶ Immediate taxation unless subject to a substantial risk of forfeiture
  - ▶ 20% additional tax
  - ▶ Interest at underpayment rate plus 1%, based on the later of the year(s) that the amount was first deferred or when no longer subject to a substantial risk of forfeiture
- ▶ Due diligence of potential 409A liabilities in connection with an M&A transaction is important
- ▶ Methods to address noncompliance
  - ▶ Noncompliance may be corrected under IRS corrections notice or self-help methods
  - ▶ Report noncompliance to taxing authorities and pay taxes and penalties; may need to indemnify service providers
  - ▶ Buyer indemnity for future audit

# Compensation Issues in M&A Transactions

## Golden Parachutes – Section 280G

- ▶ Golden parachutes are payments or benefits received by an employee (usually executives and upper management) in connection with a change in control.
- ▶ If golden parachutes are “too big,” the company will lose the corporate tax deduction and certain employees will owe a 20% nondeductible excise tax on “Excess Parachute Payments.”



# Trends in Change in Control Benefits

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## ► Gross-up

- ▶ The company pays the executive the full amount of any excise tax imposed. The Gross-up payment thereby makes the executive “whole” on an after-tax basis.

## ► Modified Gross-up

- ▶ The company will gross-up the executive if the payments exceed the safe harbor limit by a certain amount (e.g. \$50,000) or percentage (e.g. 10 percent). Otherwise, payments are cut back to the safe harbor limit to avoid any excise tax.

## ► Cut Back

- ▶ The company cuts back parachute payments to the safe harbor limit to avoid any excise tax.

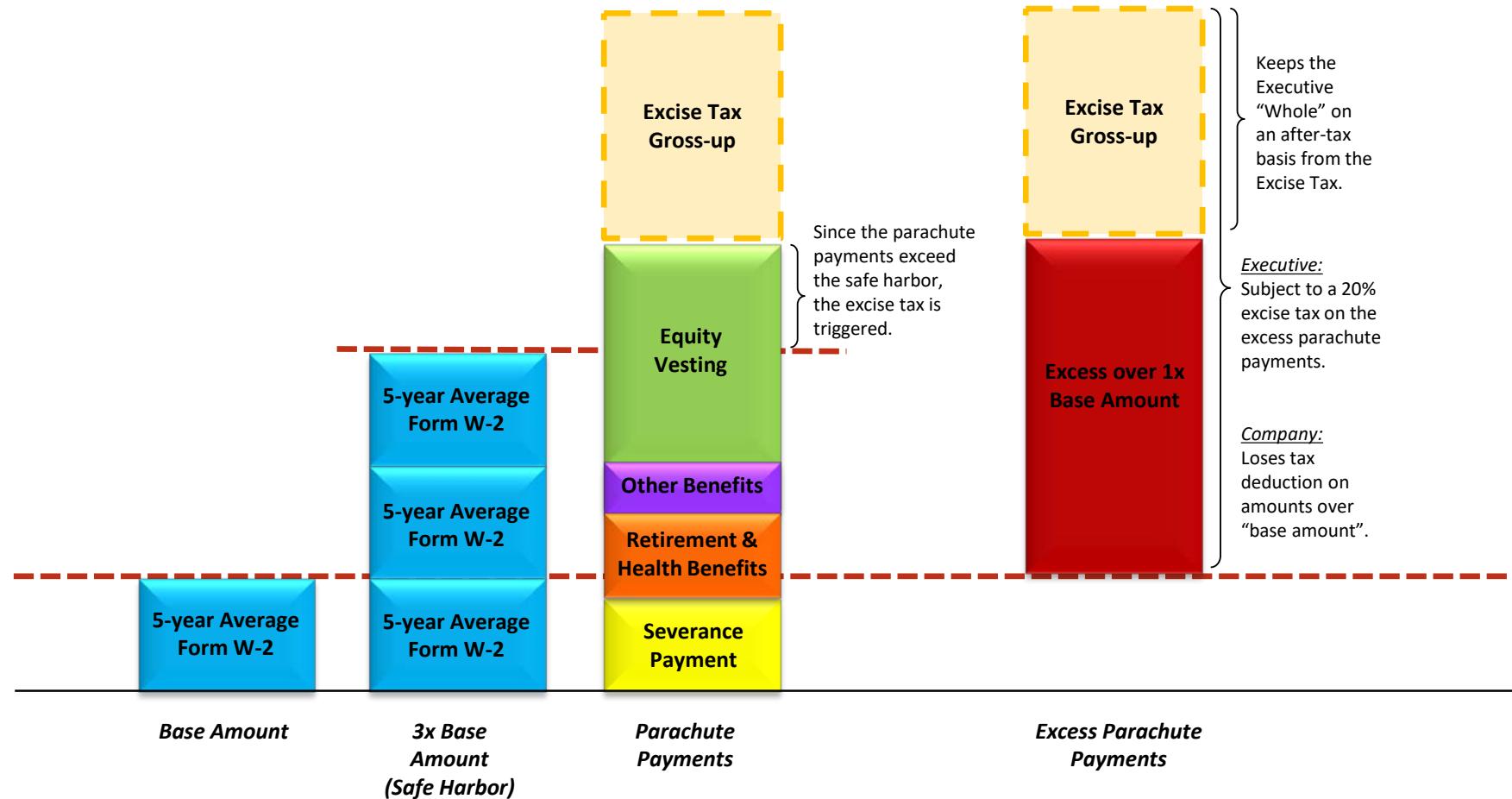
## ► Valley Provision

- ▶ The company cuts back parachute payments to the safe harbor limit if it is more financially advantageous to the executive. Otherwise, the company does not adjust the payments and the executive is responsible for paying the excise tax.

## ► None

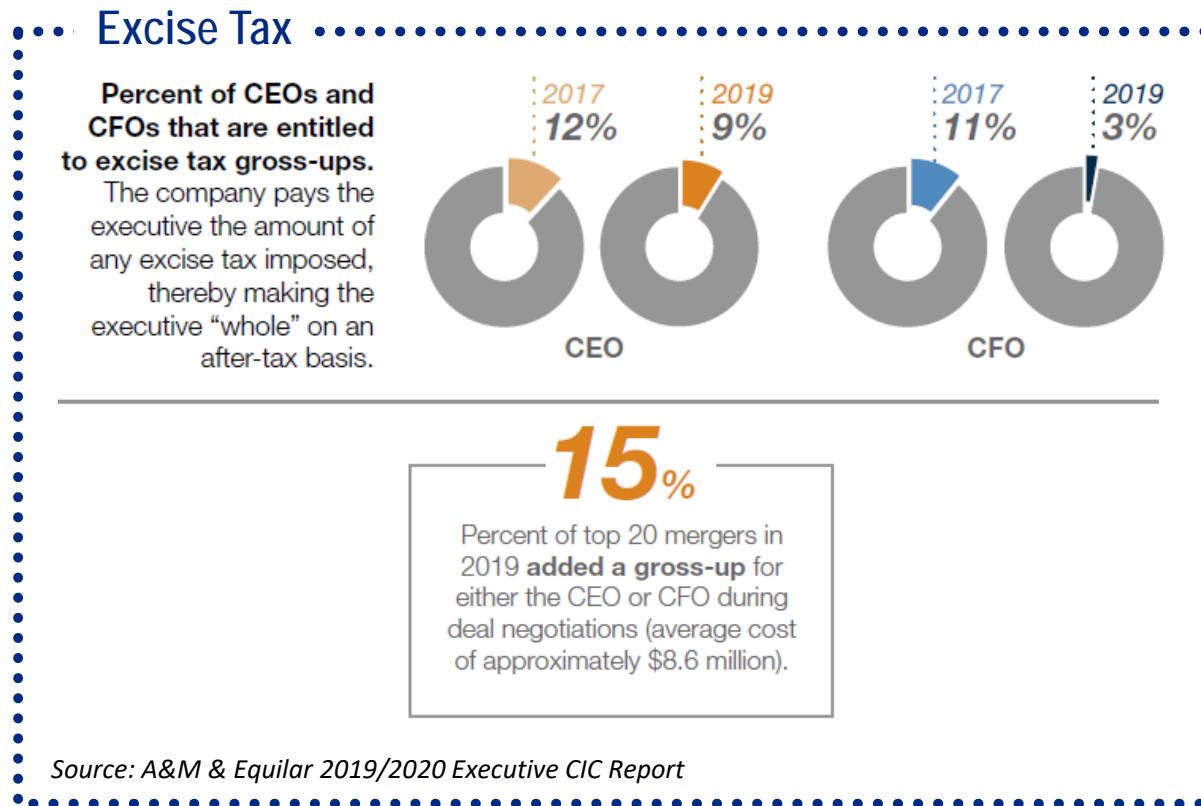
- ▶ Some companies do not address the excise tax; subsequently, executives are solely responsible for the excise tax and the company may or may not lose their related tax deduction.

# Excise Tax Gross-Up



# Compensation Issues in M&A Transactions

## Golden Parachutes – Excise Tax Protection

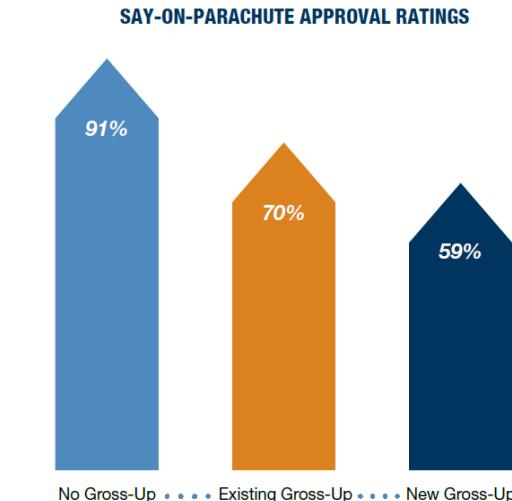


# Compensation Issues in M&A Transactions

## Golden Parachutes – 11<sup>th</sup> Hour Gross-Ups

- ▶ In a study of 150 mergers within the healthcare industry since 2013, 22 companies introduced tax gross-ups to CIC arrangements during merger negotiations.
- ▶ A strong stock market had led to surprises for some boards in payments exceeding the limit, and therefore, the introduction of gross-ups.
- ▶ In response to the addition of these gross-ups, the Say-on-Parachute approval ratings lowered, as shown to the right.

Type of Gross-Up	Average Value	Median Value
New	\$4,363,844	\$2,618,544
Existing	\$3,148,832	\$1,812,454



Source: A&M & Equilar 2019/2020 Executive CIC Report

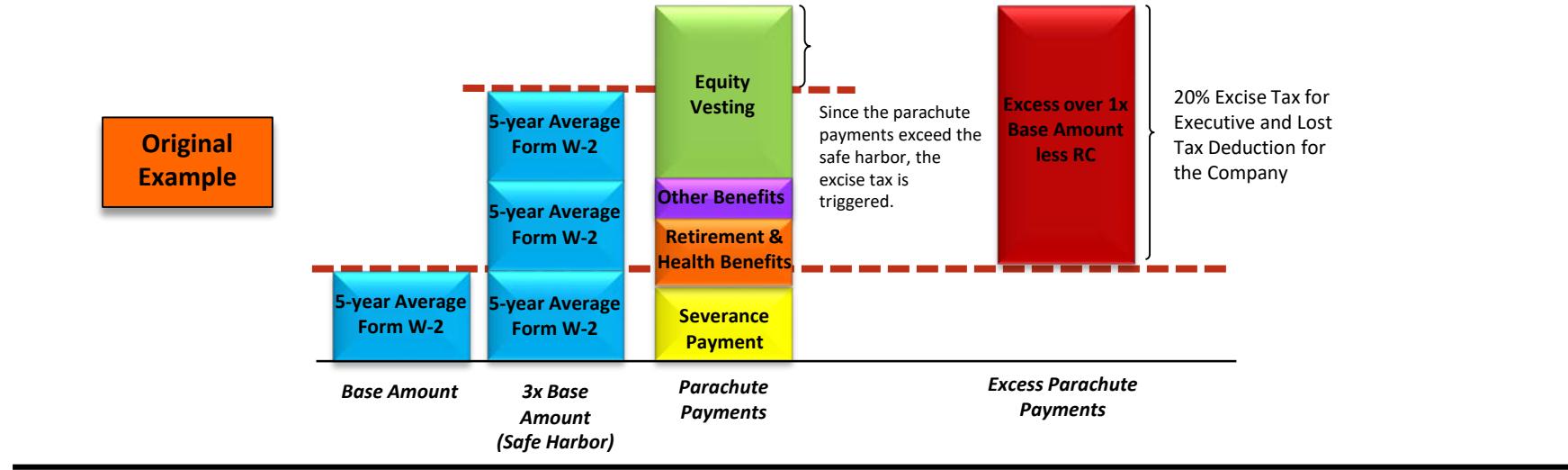
# Reasonable Compensation for Services Rendered Prior to Change in Control

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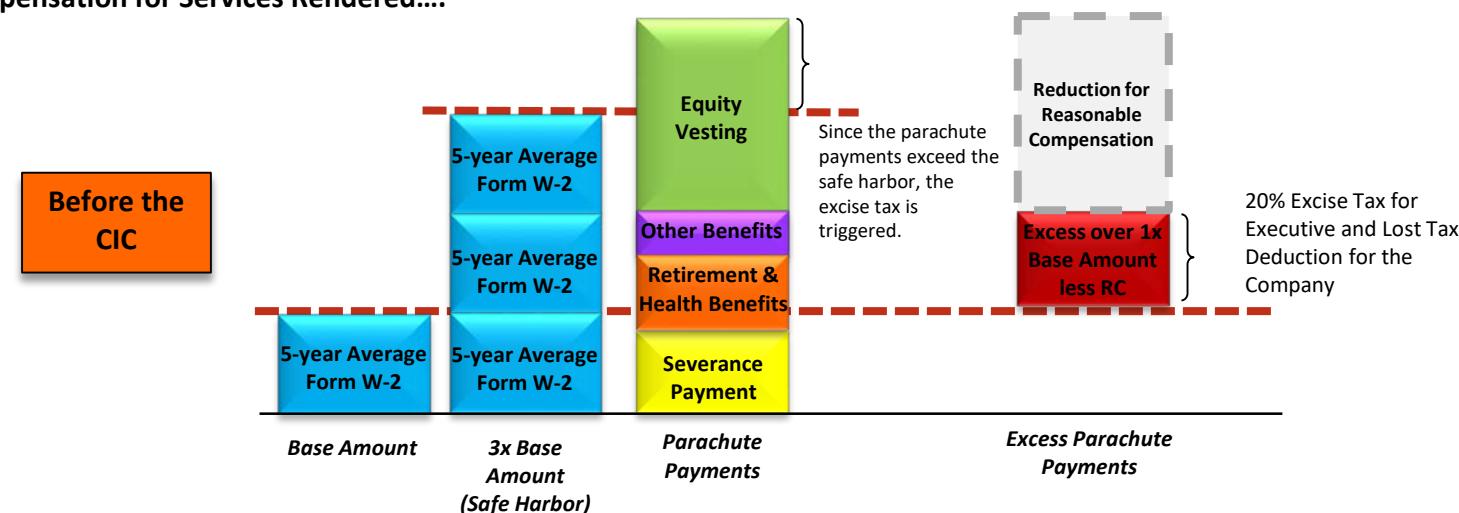


- ▶ **“Reasonable compensation” for services rendered prior to the change in control**
  - ▶ Such payments are still treated as parachute payments
  - ▶ However, in determining the excess parachute payments, the amount of such payment that is for reasonable compensation can be subtracted from the value of the excess parachute payments
  - ▶ Services must actually be rendered and the payment must be reasonable compensation
- ▶ **Reasonable compensation determination**
  - ▶ Facts and circumstances test based on relevant factors including:
    - ▶ Nature of services rendered
    - ▶ Individual’s historic compensation for performing such services
    - ▶ Compensation of individuals performing comparable services in situations where compensation is not contingent on a Change in Control
- ▶ **Application**
  - ▶ Long-Term Incentive Awards
  - ▶ Annual Bonus Arrangements

# Reasonable Compensation for Services Rendered Prior to Change in Control



Assume the Equity Awards were Reasonable Compensation for Services Rendered....

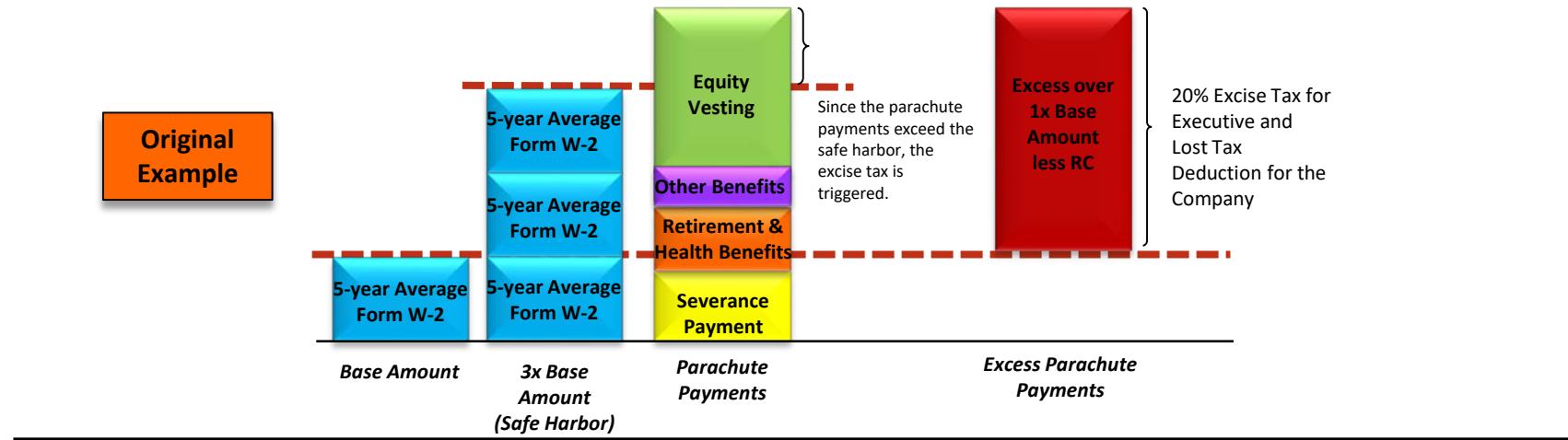


# Reasonable Compensation for Services Performed After Change in Control

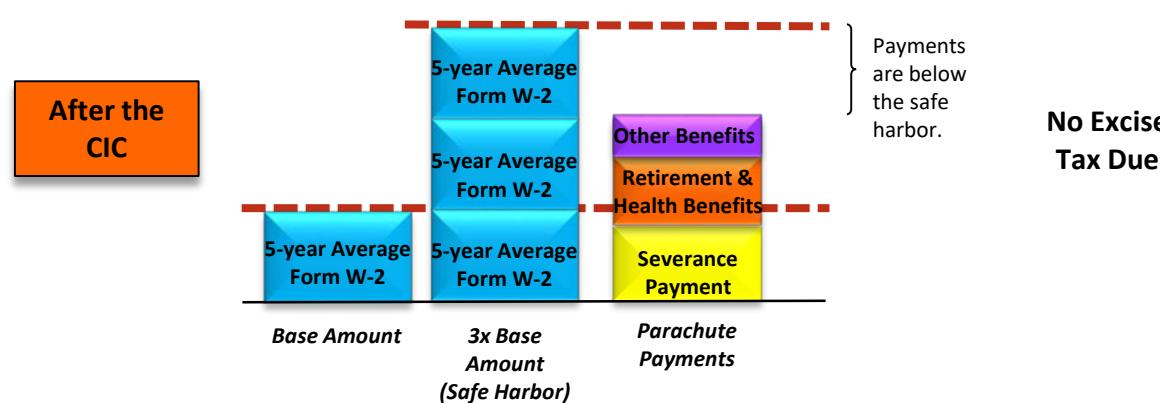
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- ▶ **Payments can be structured so that the amount payable may be considered “reasonable compensation” for services actually performed after a change in control.**
  - ▶ Compensation for agreeing to a covenant not to compete.
    - ▶ Legally Enforceable
    - ▶ IRS Position: Lesser of:
      - ▶ Economic Loss
      - ▶ Reasonable Compensation
    - ▶ Also, consider deduction under section 197
  - ▶ If a “transition period” is required in the agreement, compensation which is reasonable for services performed after change in control is excluded from the calculation.
    - ▶ Stay pay
    - ▶ Retention bonus

# Reasonable Compensation for Services Performed After Change in Control



Assume the Equity Awards were Reasonable Compensation for Services Rendered....



## Compensatory Tax Issues in M&A – Incentive Equity

- ▶ Treatment of equity awards can be a key element of a transaction
  - economics, tax, incentive, morale
- ▶ Due diligence to determine permitted treatment under the relevant documents
  - ▶ Relevant documents may include equity plan and award agreements, employment or change in control agreements, severance arrangements
  - ▶ What types of equity awards are outstanding
  - ▶ To what extent are they vested
  - ▶ Does the contemplated transaction constitute a “change in control”
  - ▶ The required or permissible treatment of outstanding awards upon the contemplated transaction, whether or not a change in control
  - ▶ If desired treatment not expressly permitted, equity plans and award agreements commonly require each holder’s consent if adverse impact of the holder’s award

# Compensatory Tax Issues in M&A – Incentive Equity

- ▶ Common treatment: roll over, cash out and/or accelerated vesting.
- ▶ Rollover of incentive equity
  - ▶ Assumption of seller awards and equity plan or substitution of the awards with substantially the same award under one of purchaser's equity plans
  - ▶ NQSOs and SARs must satisfy Section 409A; Section 424 for ISOs
- ▶ General requirements for adjustment:
  - ▶ Spread test - the spread value (i.e., excess of the fair market value of the shares over the aggregate exercise price) of the new option must not be greater than the spread value of the corresponding old option immediately before the conversion.
  - ▶ Ratio test- For ISOs, on a share-by-share basis, the ratio of the exercise price to the fair market value per share of each new option must not be less than the ratio of the exercise price to the fair market value per share of the corresponding old option immediately before the conversion (i.e., the new option cannot be more in-the-money). For NQSOs, the ratio test will be deemed satisfied if the ratio exercise price to the fair market value of each new option is not greater than such ratio of the old option immediately before the conversion.
  - ▶ The new or assumed option must contain all terms of the old option, except to the extent rendered inoperative by the transaction
  - ▶ The new or assumed option must not give the optionee additional benefits
- ▶ Adjust to reduce dilution and leverage
- ▶ Expiration of term of rollover options

# Compensatory Tax Issues in M&A – Incentive Equity

## ► Cash cancellation

- ▶ Cancel in exchange for the excess (if any) of the per share price in the transaction over the per share purchase/strike price (if any), typically at closing
- ▶ Equity awards that are NQDC pay on settlement date or plan termination
- ▶ Option cash out on original vesting schedule
- ▶ Participation in escrow, earn out
  - ▶ Section 409A considerations

## ► Cancellation of underwater options

- ▶ Clear/unambiguous plan terms vs. holder consent

# Comparison of Equity Compensation

	NQ Stock Option	Stock Appreciation Right (SAR)	Restricted Stock/RSU	Profits Interest
Description	Right to purchase a fixed number of shares at a fixed price during a specified period of exercise	Right to receive, upon exercise, an amount equal to the appreciation in the value of a fixed number of shares over a fixed value	RS: Shares issued subject to vesting conditions  RSU: Notional interest that tracks the value of a designated number of shares	A partnership interest that entitles the holder to participate in operating profits of the partnership
How Settled/Paid	In shares upon exercise once vested after payment of exercise price and taxes	In shares and/or cash upon exercise once vested	RS: N/A  RSU: In shares or cash upon fixed settlement date	No settlement concept; operating agreement governs rights to allocations and distributions
How Taxed	<ul style="list-style-type: none"> <li>▪ No tax on grant or on vesting</li> <li>▪ Upon exercise or cash out in M&amp;A transaction, ordinary income is recognized on the spread (i.e., the excess of the FMV of the shares acquired on exercise over the aggregate exercise price)</li> <li>▪ The Company is entitled to a tax deduction corresponding to the amount of ordinary income recognized upon exercise</li> </ul>	<ul style="list-style-type: none"> <li>▪ No tax on grant or on vesting</li> <li>▪ Upon exercise or cash out in M&amp;A transaction, ordinary income is recognized on the spread</li> <li>▪ The Company is entitled to a tax deduction corresponding to the amount of ordinary income recognized upon exercise</li> </ul>	<p>RS:</p> <ul style="list-style-type: none"> <li>• Tax on vesting date or, if Section 83(b) election filed, at issuance.</li> <li>▪ Tax at ordinary income rate on FMV of share less any amount paid.</li> </ul> <p>RSU</p> <ul style="list-style-type: none"> <li>▪ No tax on date of grant.</li> <li>▪ Tax at ordinary income rate on FMV of amount settled.</li> </ul> <p>The Company is entitled to a tax deduction corresponding to the amount of ordinary income recognized.</p>	<ul style="list-style-type: none"> <li>• No tax at grant</li> <li>• No tax at vesting*</li> <li>• Tax character of any allocations will vary</li> </ul>

# Cross-Border Compensation and Benefit Tax Issues

# Cross-border compensation and benefit tax issues

- ▶ Payroll
- ▶ U.S. tax-qualified plans versus nonqualified plans
- ▶ Nonqualified funded plans (section 402(b)) versus unfunded plans (section 409A)
- ▶ Specific 409A issues in cross-border context
- ▶ Deductions

# U.S. taxation of service providers – generally

- ▶ Worldwide income taxation on U.S. persons (U.S. citizens, Green card holders, tax residents)
- ▶ Taxation of U.S. source income of nonresident aliens (NRAs)
- ▶ Compensation source = location in which services occur to earn compensation

# Payroll

- Employer (including non-U.S. employer) subject to U.S. payroll – reporting and withholding
  - ▶ Certain withholding exemptions from income tax and/or FICA tax may apply
  - ▶ Reporting generally applies regardless
- NRAs with U.S. source income
  - ▶ Certain exemptions
- U.S. persons regardless of source or employer
  - ▶ Certain exemptions

# Payroll exemptions

- ▶ Section 911 foreign earned income exclusion
  - ▶ Applies to U.S. citizens and residents
  - ▶ Requirements are tax home in foreign country, and certain residence/physical presence tests in foreign country – COVID-19 relief in Rev. Proc. 2020-27
  - ▶ Indexed, \$107,600 in 2020
- ▶ Federal income tax withholding exceptions for a U.S. citizen's foreign earned income – if proper substantiation:
  - ▶ If local law requires mandatory income tax withholding on same income
  - ▶ If qualifies under section 911

# Payroll exemptions – continued

- ▶ Bilateral agreement exemptions
  - ▶ Income tax treaties for FIT
  - ▶ Totalization agreements for FICA
- ▶ Other FICA exemptions and rules
  - ▶ American employer
  - ▶ 3121(l) agreements

# Common law employer and section 414 “controlled group” rules

- ▶ Importance of common law employer
  - ▶ U.S. compensation deduction applies to entity which receives the services
    - Section 162, *Young & Rubicam* principles
    - Entity reporting Form W-2/payroll may not be the “employer”
  - ▶ Qualified plans
  - ▶ “Secondment” agreement not dispositive
- ▶ Important of assignment to controlled group member
  - ▶ Qualified plans, health plans (MEPs, MEWA?)
  - ▶ Fringe benefits requiring employment relationship

# Qualified plans for U.S. tax purposes

- ▶ Qualified means US tax requirements are met (e.g., 401(k), defined benefit pension plan)
- ▶ Requirements – e.g., limits, coverage, nondiscrimination, form (documentary) and operational compliance
  - HCE (highly compensated employee) (\$130,000 for 2020)
- ▶ U.S. expatriates and non-U.S. inpatriates
  - ▶ Definitions of “employer,” “employee,” “eligibility”
  - ▶ Distribution on “separation from service”
- ▶ Does a treaty help?
  - ▶ Contributions vs. undistributed earnings vs. distributions

# Nonqualified plans: “funded” plans and section 402(b)

- ▶ Section 402(b) governs “funded” compensation other than U.S. tax-qualified plans
- ▶ These are not just pensions and are often incentive/equity plans
  - ▶ E.g., foreign plans typically in “secular” (non-rabbi) trust
  - ▶ E.g., UK employee benefit trust (e.g. share plans)
- ▶ Contributions taxed when no longer subject to a “substantial risk of forfeiture”
- ▶ If “discriminatory” plan, HCEs taxed (as wages) on annual undistributed earnings under §402(b)(4)
- ▶ All employees taxed on distributions above any “investment in the contract” (generally, basis in what was previously taxed)

# Nonqualified plans: “unfunded” plans and section 409A

- ▶ General corporate assets, subject to claims of creditors
  - ▶ “Rabbi” trust = subject to claims of creditors
- ▶ Subject to section 409A
  - ▶ Applies to unfunded “**nonqualified deferred compensation**”
  - ▶ Form (documentary) and operational compliance
  - ▶ Timing of deferrals, payments, etc.
  - ▶ Noncompliance doesn’t just impact the employee/service provider:
    - Employee has additional 20% income tax and potential interest factor tax when no longer subject to “substantial risk of forfeiture,” and each year until paid out or fixed
    - Employer often has significant payroll tax and penalty exposure

# Nonqualified plans: section 409A

- What is nonqualified deferred compensation under section 409A?
- Various exemptions include:
  - ▶ Short-term deferral
  - ▶ US tax-qualified plans (401(k), defined benefit pension)
  - ▶ Various cross-border exemptions, including amounts exempted under treaty
  - ▶ Option exemption
  - ▶ Restricted stock taxable under section 83
- If not exempt and not compliant, cross-border first year resident election/amendments can help

# Section 402(b) exemption from 409A

- ▶ A plan/arrangement governed by section 402(b) is exempt from section 409A (generally, means no section 409A 20% additional tax but still taxable when vested/on earnings)
- ▶ Most non-U.S. pension plans are 402(b) arrangements
- ▶ Many non-U.S. stock plans are 402(b) arrangements (employee benefit trusts, EBTs)
- ▶ However, section 402(b) only applies once a transfer/contribution to a trust occurs. If there is a legally binding right in years prior to the transfer, until that point, section 409A may apply

# Section 409A(b)

- ▶ Treats transfer to offshore trust as taxable, subject to 20% income tax and potential interest factor tax
- ▶ Exception if substantially all services to which NQDC relates are provided in the non-U.S. jurisdiction
  - ▶ Not clear whether this means the individual's services or all participants in plan (likely means individual)
- ▶ Note that 402(b) exemption applies if secular trust – but could be deferred compensation until funded
- ▶ Offshore rabbi trusts are not good

# 409A stock option exemption – some requirements

- ▶ Exercise price equal to (or greater than) the underlying stock's fair market value (FMV) on the option grant date (no "discounted" exercise price)
  - ▶ Cannot indirectly reduce exercise price below this threshold (e.g., bonus to pay exercise price, dividends only received if exercised)
- ▶ Cannot have additional deferral features
- ▶ Granted on "service recipient stock"
  - ▶ Can be stock of company in chain that ends with employer company, provided each entity in chain is 50% or more owned
  - ▶ Must be common stock

# Option failures that may occur in foreign context

- ▶ Failure is usually discovered in years after vested
- ▶ Corrections guidance does not generally help
- ▶ Main reasons stock options fail:
  - ▶ Exercise price is not equal to FMV on grant date, based on FMV as determined under U.S. rules and section 409A regulations
  - ▶ Not discounted but not on common stock
  - ▶ Not discounted but not on service recipient stock
  - ▶ Discounted stock purchase plan not qualified under section 423

# Fair market value issues in foreign context

## – public companies

### ► Public company

- ▶ Have to set out how exercise price is determined before the grant
  - Determination of “grant date” becomes important (not always clear with foreign stock options)
- ▶ Can be based on average selling price during a specified period that is a maximum of a 30-day window that includes the grant date, but can’t decide this after the period has already begun
  - Regulations indicate that if applicable foreign law requires the stock right to be priced based on a specific averaging method and period, a stock right granted in accordance with such foreign law will be treated as though it meets the requirements “provided the averaging period does not exceed 30 days” **(not much help if foreign law requires more than 30 days!)**

# Fair market value issues in foreign context – private companies

## ► Private company

- ▶ Regulations set out reasonable methods
  - Independent valuation within 12 months before grant date
  - In-house report based on reasonable value used for other company purposes
  - New company (less than 10 years old) valuation by knowledgeable person, written report on value
- ▶ But many non-US valuations are not “FMV” for U.S. purposes, such as:
  - Discount due to service or performance conditions
  - Valuation rules that are not reasonable from standpoint of U.S. valuation rules

# Property transfers subject to section 83

- ▶ Exempt if restricted stock subject to section 83 with no additional deferral feature
- ▶ When employer provides a nonrecourse loan to purchase stock, this may be an option
  - ▶ Section 409A if a discounted option
- ▶ Share subscriptions (common in Europe) with nominal exercise price may be an option or may be a transfer of property
- ▶ Note that just because it is called “restricted stock” doesn’t mean it falls under section 83 – could be deferred compensation or could be in a 402(b) trust

# Various other 409A foreign plan exemptions

- ▶ Plan where contributions/ earnings excludable from U.S. income tax under treaty or other bilateral agreement with United States
- ▶ “Broad-based foreign retirement plans”
- ▶ Certain nonelective deferrals in broad-based foreign retirement plan
- ▶ A social security system of a foreign country if subject to totalization agreement with the United States or if government-mandated

# Various other 409A foreign plan exemptions – continued

- ▶ Compensation that (if it had been paid when vested) would have been excludible from U.S. income under treaty or specific enumerated U.S. Code sections
- ▶ Certain indexed amounts
- ▶ Certain foreign separation pay
- ▶ Tax equalization if specific language and rules are met (otherwise language and rules to comply must be met)

# Deductions

- ▶ Start with section 162 requirements
  - ▶ Employer entitled to reasonable, ordinary, and necessary business expense
- ▶ US tax-qualified plan deductions
- ▶ US nonqualified deferred compensation deductions
  - ▶ Section 404(a)(5)
  - ▶ Section 404A for “qualified foreign deferred compensation plans”
- ▶ Cross-border aspects of 162(m)
- ▶ Cross-border aspects of 280G

# Disclaimer

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