INTELLIGENCE REPORT
Employee share plan trends
Australia

December 2016
Welcome to the third edition of Computershare’s Employee Share Plan Trends intelligence report, designed to provide you with insights into the local and global employee equity landscape.

Over the last 12 months there hasn’t been significant variation in employee share plan activity across Australia and New Zealand. We have seen a slight increase in participation for salary sacrifice plans, and also a small increase in global contribution plans.

Trading activity and volumes were down as employee participants held on to their equity, amidst the uncertainty of the economic and political situation in Australia and abroad, with the lowest Wage Price Index to date, results of the federal election and the Brexit referendum taking a toll. Companies were increasingly impacted by forces of globalisation; we saw a number of regulatory and broader market changes in 2016 that will impact the global equity landscape in the years to come. These are covered in detail within the report with expert commentary from Allens Linklaters and Tapestry.

Employers are faced with the challenge of balancing regulatory changes with the need to engage a more mobile workforce and explore new attraction and retention strategies for the next generation of employees, who are rejecting traditional remuneration models. Along with a drive for more flexible working arrangements, employers are starting to consider changes to plan design and to the communications that attend them. In line with the wider consumer trend for increased digital engagement, employee participants have moved their transactions and interactions online and expect a user experience on par with the offerings of market-leading personal banking services.

HELPING YOU MANAGE YOUR EVOLVING WORKFORCE

According to a recent survey conducted by EY, one in three employers of 100,000 employees or more expect to use 30% or more contingent workers by 2020*. Employing more contingent workers enables organisations to control costs while accelerating change and growth, but to make the model work we need to balance the needs of all stakeholders in the gig economy. Organisations can attract and incentivise the best talent by creating tailored benefits packages, which may include flexible working arrangements, cash incentives and equity. Computershare has been working with our clients to understand if equity should change to accommodate these short term employees and what these plans could look like - potentially offering reduced vesting periods or allowing for vesting of awards post cessation of employment. While the regulatory conditions of most countries currently restrict rapid innovation in this area, we will continue to monitor developments and share our insights with you.

In light of these changes, and the challenges they present not only to our clients, but ourselves as a global employer, we are working on evolving our solution for employees and employers. A brand new digital application has been launched in December 2016 which will give employers improved, streamlined access to plans and participant information.

GIVING YOU DEEPER INSIGHT INTO THE EMPLOYEE SHARE PLAN EXPERIENCE

To derive value from your plans – increasing engagement, retention and productivity, issuers need to maximise participation. We understand that to create attractive plan designs and effective communications, you need greater insight into the behaviour of your employee participants. In addition to this annual intelligence report, we’re working on several projects to deliver these deeper client insights, providing easy access to data analytics for issuers who want to launch a new share plan or make an existing plan more effective. We’re also conducting a comprehensive employee participant survey in early 2017, continuing the work of the survey we carried out in collaboration with London School of Economics in 2014. The results will help you design and promote share plans that resonate with today’s employees. We’ll be in contact with an invitation to participate in the new year.

SHARING GLOBAL TRENDS AND REGULATORY DEVELOPMENTS

While Australia’s regulatory environment was relatively static, there were a number of developments around the world that affected issuers and employee participants. In addition to providing regional overviews from our offices in the US, Canada, Europe, UK and Asia, EY offers an in-depth look at results of the New Zealand Inland Revenue’s review of employee share schemes, while our Head of Client Relations Matthew Reed discusses what resulting changes to withholding and disclosure requirements mean for our New Zealand clients.

I hope you find this year’s report interesting and beneficial in the planning and management of your employee equity strategy. If you have feedback or suggestions for future research, please don’t hesitate to get in touch.

Regards,

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We saw very little change in the make-up of executive plan structures over the course of the year with performance rights plans continuing to be the most common Long Term Incentive (LTI) vehicle. Across our client base, most companies continued with automatic vesting on achievement of performance hurdles rather than allowing employees to choose when they exercise their vested rights. Very few clients have moved to options even though the tax changes from 1 July 2015 make these plans less problematic and while we have one or two clients that operate loan plans, these are still rare in Australia.

Our LTI and STI plan trends align with industry findings

For LTI Plans, the vast majority of our clients have a three year performance period which mirrors the findings in the EY Pay Perspective 2016 Executive and Board Remuneration Report, although EY’s research shows an increase in companies in the ASX 100 with a four-year performance period. EY’s report confirms that a majority of companies’ LTI plans use two performance measures (61%) and, there was a 50% increase in companies using three or more measures in their LTI plans in 2015 – 18% compared to 12% in 2014. There was more standardisation in the performance measures of choice among LTI plans with two performance measures. Of these, the most common combination was relative TSR and EPS growth, at 43% in 2015 compared to 38% in 2014. The increased prevalence is due partly to new entrants into the ASX 100 using this combination, and partly to companies changing their performance measures. Some companies are testing different performance measures like introducing additional strategic or project-based measures, but we have not yet seen these introduced broadly across our clients.

For short-term incentives, shares and rights are the most common vehicles used for STI deferral, and the most popular deferral period is two years. EY’s research tells us that profit/earnings are still the most prevalent financial STI performance measure with people, values, behaviours or culture being a predominant non-financial STI performance measure, used by 79% of the ASX 100. For executives and non-executive directors we have not yet seen significant uptake in plans which enable the sacrifice of salary and fees into vested rights, so it will be interesting to see if more companies implement this structure going forward.

Increased scrutiny on executive remuneration in 2016

Year-on-year there has been significant focus on executive remuneration at Annual General Meetings, with some companies receiving a large percentage of votes against the Remuneration report. You will have access to more 2016 participant voting trends early next year when we release our annual intelligence report Insights from company meetings.
POSITIVE TREND IN ALL EMPLOYEE PLANS CONTINUES

The number of salary sacrifice plans offered in FY16 remained the same.

It's great to see that the upward trend over the last four years for matched plans has continued with average participation up this year to 63%.

Continued low wage growth and reduced discretionary spending do not seem to have had an impact on participation levels with higher participation rates for all contribution plan types. In our 2014 joint survey with London School of Economics on employee share plan behaviour, we found that 44% of the employees surveyed who had never joined a share plan cited affordability as the key reason for their lack of participation but offering a match certainly encourage employees to contribute their hard-earned cash to their company share plan.

Non-matched plans are back up to where they were in 2015 with an average participation rate of 25%. While the average for non-matched plans is very healthy at 25% we see significant variance amongst clients with take-up ranging from 7% to 40%.

Compared to UK Employee Share Purchase Plan statistics, which have an average take-up rate of 36% for a combination of matched and non-matched plans, the Australian and New Zealand average of 41% is still healthy.

*Data from the Australian Bureau of Statistics (ABS) shows just how subdued wage growth was in FY16. The seasonally adjusted Wage Price Index (WPI) for the private sector rose just 19% in the year to September 2016 – a new low for the series.
VESTING PERIOD INFLUENCES TRADING BEHAVIOUR MORE THAN SHARE PRICE

The graphs on this page reaffirm our research over the last few years, which show that trade volumes will predominantly increase around a company’s vesting period as opposed to changes in a company’s share market price. We took a sample set of four ASX 50 clients across a range of industries and tracked their trade price movement vs. total transaction numbers.

The Australian share market rose marginally (0.6%) during the recent financial year and was largely characterised by two distinct periods of volatility in August/September 2015 and January/February 2016. However, as in previous years, there does not appear to be any correlation between how a company’s shares are performing, and the trading behaviour of that company’s employees.

As has been the trend in previous years, our research indicates that trade volumes will predominantly increase around a company’s vesting period as opposed to changes in a company’s share market price. The reasons for this behaviour may vary between employee participants, however based on our research, the main reasons that employee participants will consider selling their shares include:

- to coincide with a significant life event, such as a property purchase, holiday or wedding
- the opportunity to trade during a period where black-out restrictions have been lifted
- where there is a tax obligation on vest
- a need to diversify the investment (specific to executive plan members)

Top four reasons why employee participants sell their shares
Limit vs. market orders

‘Market order’ sales remain steady at 96%. This means that employees prefer to sell at market and immediately receive their proceeds, rather than leaving an order to sell at a target price (limit order). This trend supports findings by the London School of Economics (2014) that participants prefer simplicity. Pursuing limit order transactions requires a certain level of financial sophistication or confidence in executing the transaction.

Limit vs. market orders for transactions >$100,000

On the other hand, limit orders for transactions greater than $100,000 are increasing. As noted in last year’s report, this trend is popular for executive plan participants who value having the choice of sale methods and the ability to nominate a limit, rather than taking the market rate at the time of the transaction. It is also reasonable to assume that these employees have higher financial literacy and therefore a better understanding of the implications of each order type.

Our research also suggests that with a more volatile market, executive plan participants are taking a more conservative approach in achieving an optimal price when choosing to transact.

Web vs. managed transaction sales

In line with the general consumer shift to digital channels, and after several years of promoting the benefit of transacting online to employee participants, web sales now sit at 71%, an increase of 27% since 2012. Despite this surge, there has been minimal change for the last two years. In all likelihood, we have now reached maximum take-up for web-based self-service transactions. We believe managed transaction sales will hover at 30% for the next few years.

While online services are convenient and produce a quicker outcome for employees, managed transaction processing is currently required for event-driven vestings where there is a withholding tax obligation.

In addition, there is always a subsection of employees such as remote workers without internet access and some blue-collar workers with low digital literacy, who will always send in hard copy forms for manual processing.
MOBILE EMPLOYEES AND GREATER
GLOBAL PLAN PARTICIPATION DRIVE WIRE
TRANSFERS AND EMPLOYER PAYMENTS

Over the last three years, we have seen some changes in how employees would like to receive their sale proceeds. Direct credit is still the most popular payment method due to the fact that it is simple and convenient and widely used by business to make payments. However, it has reduced from 76% to 62% over the last three years, due to an overall decrease in transaction volumes.

Payments by AUD and foreign cheque have largely remained steady across the last three years. We are seeing a slight increase in wire payments across the three years, indicating more transactions are being undertaken by international employees.

We have noted a steady rise in employer payments as a result of an increasing global workforce, 43% year-on-year. Straight-through processing has declined as we facilitate more managed transaction sales with withholding tax obligations where we remit these directly to a client’s payroll in the relevant jurisdiction.
Allens & Linklaters

As we reported in last year's update, sensible legislative changes were made to the taxation of employee share schemes (ESS) in Australia for awards granted on or after 1 July 2015. One of the main implications of those changes was to move the taxing time of rights/options from vesting to exercise. As a result of these changes, in the last year we have seen some employers return to granting performance rights, which include an exercise period post vesting of those rights.

Voluntary PAYG withholding for ESS interests

In June 2016 the ATO released an ESS news bulletin in relation to employers' ESS reporting obligations (the Bulletin). The Bulletin confirmed that if an employee has provided their employer with their TFN, the employer is not required to withhold tax in respect of the ESS discount. The Bulletin also stated that “If you and the employee agree, you can withhold extra tax from their salary or wages to offset their end of year tax liability. This is treated as ordinary PAYG withholding and forms part of the amount at W2 on your activity statement.”

While some employees might see voluntary PAYG withholding from salary to cover expected tax on their ESS interests as an administrative benefit, other employees will be reluctant to lose the timing benefit associated with only being required to pay their tax liability on receipt of an income tax assessment for the relevant income year. In the absence of a specific legislative requirement to withhold PAYG amounts from ESS interests, employers would need to obtain express consent from employees in an approved form to implement voluntary PAYG withholding arrangements from salary and wages. It is important to note that this would be voluntary withholding from salary and wages - not from proceeds on the sale of ESS interests at the taxing point. Of course the employer could also arrange sale of ESS interests to replace the voluntary amount withheld from the employee's salary, but that would also generally require express consent from the employee.

Tax rulings in 2016

In the last 12 months the Australian Taxation Office (ATO) has issued six Class Rulings dealing with employee equity awards. All of the Class Rulings related to corporate events affecting shareholders that also had some impact on employee equity awards i.e. Shell's takeover of BG Group (CR 2016/59), eBay's demerger of PayPal (CRs 2016/34 and 2016/35), Qantas' return of capital (CR 2016/9), Google's 'Alphabet' restructure (CR 2015/109) and EQT Group's restructure (CR 2015/107). Very generally, it would appear in those rulings that sensible tax outcomes were able to be achieved for the employee equity award holders. The Qantas Class Ruling demonstrates the complex tax issues that can arise from corporate transactions (in that case, a return of capital) where employees hold beneficial interests in shares through an employee share trust.

Clarification of the indeterminate right rule

The scope of the indeterminate right rule (IRR) has been the subject of contention for the last few years. Broadly, the IRR can, for Australian tax purposes, retrospectively deem a right, which later becomes a right to acquire shares, to be a right to acquire shares from the date the original right was granted. This can potentially be useful where up-front tax applies (if the value of the awards is lower on the earlier date) and also if the right becomes locked-up shares for which tax deferral may not have been available (e.g. where the 75% offer test has not been satisfied or where the shares are not subject to a real risk of forfeiture).

In Davies v Commissioner of Taxation (2015) FCA 773 case, the Federal Court held that a right to have a grant of shares and options put to shareholders for approval was an ‘indeterminate right’. The consequence of this decision is that the acquisition date for ESS tax purposes comes back to before shareholder approval is obtained. This case directly contradicted TD 2014/21, which was subsequently withdrawn by the ATO.

Computershare has not observed many clients gravitating towards an exercise period for performance rights to this date

On 2 November 2016 the ATO released TD 2016/17 (the TD), which attempts to clarify the operation of the IRR rule. Broadly, it appears to take a narrower view of the IRR than may perhaps have been implied by the Davies case. In particular, there is an interesting example in the TD in relation to STI equity awards which implies that there may be no right to which the IRR will apply until after the end of the STI year.

Following the Davies case, we advised companies to be careful not to create ‘rights’ to ESS interests pre-employment, which could render such rights ineligible for tax deferral. One of the examples in the TD helpfully confirms that pre-employment rights to ESS interests that are subject to commencement of employment should not constitute indeterminate rights. In those circumstances, an employee will only acquire an enforceable contractual right that can become a right to acquire shares once they have actually commenced employment.

Regulatory developments

In last year’s update, we reported on the Australian Securities and Investments Commission (ASIC) Class Order CO 14/1000, which provides relief from the disclosure, licensing and hawking provisions of the Corporations Act 2001 (Cth) for certain ESS of companies listed on ASX or particular overseas markets. While over the past year ASIC has continued to extend the operation of the relief in individual instances, overall the market has been satisfied with the greater flexibility that the class order allows for the terms of ESS.
Nevertheless, the Government has recognised that not all ESS operated, or sought to be operated, in the Australian market are accommodated by the ASIC relief. In late October 2016, the Government commenced a consultation process focused on whether corporate regulation of ESS should be further reduced. This process will look at whether the other avenues available to companies operating ESS in Australia — issuing a compliant disclosure document under the Corporations Act 2001 or relying on a specific legislative exemption from disclosure — can be made more ‘user-friendly’ for ESS. Some of the proposals include reducing the information requirements for certain types of disclosure documents, expanding the range of ESS that those disclosure documents can be used for, and increasing the scope of various legislative exemptions such as those for ‘small scale’ offerings or offers to senior managers.

What we expect to see in 2017

a. a new draft tax ruling on employee remuneration trust arrangements (to replace TR 2014/D1 which issued in March 2014) is anticipated sometime in 2017. The new draft ruling is expected to cover whether dividend equivalents payments received from an employee share trust on vesting of awards which are funded from after-tax dividends received by the trust will effectively be double taxed by also being assessable as remuneration income of the employee (i.e. paragraph 40 of CR 2013/15 may be overruled for go-forward arrangements);

b. some guidance from the ATO on its view of fixed remuneration equity arrangements involving locked up shares which may have previously been offered as post-tax shares (e.g. NED Share Plans) being delivered as the grant of rights to shares;

c. in executive share plans:

  i. a continued increase in cash discretions in scheme rules for rights plans as a useful tool to achieve sensible tax outcomes for equity award holders in various circumstances, including on cessation of employment before vesting and where there is a corporate event impacting both shareholders and employee equity awards (e.g. see the eBay Class Ruling CR 2016/34); a review of performance conditions to ensure they continue to be relevant and motivating; and

  ii. continued tweaking of scheme rules to ensure appropriate clawback rules and alignment with termination benefit restrictions.

d. in all employee share plans:

  i. consideration of whether changes to the plan rules are needed, given the rapidly changing workforce (e.g. should the vesting periods be shorter, should the category of employee participants be broader, should there be pausing in vesting for career breaks?); and

  ii. more creative thinking about whether the plans could be used more effectively to meet company goals which require buy-in from the whole workforce (e.g. level of matching awards linked to safety or environmental goals rather than only retention).

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About Allens Head Office and Governance team

Allen’s Head Office and Governance team provides practical and tailored advice on corporate governance and head office advisory matters, bringing together a network of highly skilled lawyers from across the firm with relevant expertise. Specialists in corporate law, employment law and tax law advise on executive remuneration-related developments and emerging practices.
Employee equity plans have been in the headlines over the last year in both Australia and New Zealand. Australian companies regularly review their employee equity plans to ensure they are “fit for purposes” and in 2016, we saw companies contemplate the design in light of tax law changes which took effective from 1 July 2015. 2016 also heralded significant review of the New Zealand employee equity plan tax framework by the New Zealand Inland Revenue.

Australia
The key changes to the taxation of ESS in Australia, which took effect for grants made on or after 1 July 2015, included:

- the taxing point of options and rights (effectively, options with no exercise price) will typically be deferred until the time of exercise (rather than the time of vesting);
- the requirement for options and rights to be subject to a ‘real risk of forfeiture’ to enable deferral of tax has been removed if a disposal restriction applies; and
- the introduction of new tax concessions for eligible “start-up” companies as part of a suite of initiatives to support innovation.

These changes have influenced the manner in which companies are structuring their equity plans and delivering remuneration to directors and employees. We have summarised below the key emerging Australian equity plan design trends since July 2015.

Exercise period
With the introduction of new tax rules, for grants made after 1 July 2015, the deferred taxing point of rights will generally be at exercise (rather than at the time of vesting). As a result of this change, some Australian companies have introduced exercise mechanisms into their rights plans (i.e. participants can choose when to convert vested rights), for example extending for up to two to three years after vesting.

Although an exercise mechanism provides flexibility for employees on when to trigger the taxing point, from the company’s perspective, this has also increased the administration burden. We have seen companies balance the impact of the additional administration by limiting when vested rights can be exercised (e.g. only during trading windows), and/or defining a shorter period for the exercise window (rather than allowing employees the maximum tax deferral period of 15 years from the date of grant of the rights).

Option plans
Although the deferred taxing point for options is now largely aligned to when an employee exercises the options (rather than at vesting), we have not seen any significant movement amongst the large Australian listed companies to reintroduce market-value options (with performance rights remaining the most common award vehicle), unless this is in line with the company’s business and reward strategies.

However, in the high growth and early stage sector, options are back on the agenda, allowing companies to once again consider the use of options to align the interests of key management to the shareholders.

Sacrifice schemes
The new tax rules removed the ‘real risk of forfeiture’ requirement to enable tax deferral for options and rights (where a genuine disposal restriction applies to the options and rights, and appropriate language is incorporated in the documentation). As a result, fully vested options/rights can be granted without triggering upfront tax.

Coupled with the increased prevalence of minimum shareholding requirements for Australian listed companies, and the existing $5,000 limit for share-based sacrifice schemes, we saw a number of listed companies introduce tax-effective sacrifice schemes for directors and executives, allowing them to contribute an uncapped amount of pre-tax remuneration (including fees, salary and short-term incentive bonuses) in consideration for being granted fully vested rights without triggering upfront tax. Rights typically convert to restricted shares allowing tax deferral until disposal restrictions are lifted.

We expect these tax-effective sacrifice schemes to increase in popularity amongst listed companies as they are disclosed and become familiar to the market.

Very few of Computershare’s clients have set up a plan to allow executives and directors to sacrifice fees or bonuses into rights.
Start-up tax concessions
The introduction of tax concessions for “start-up” companies has been universally welcomed, with many eligible companies implementing option plans where under the previous tax rules, such schemes would have been unworkable from a tax perspective.

New Zealand
Employee share schemes have been under the spotlight in New Zealand over the past 12 months driven by an Inland Revenue policy review into employee equity plans. As a result, legislation has been introduced to effect withholding and disclosure requirements and the Inland Revenue is currently proposing changes to the taxation of some employee share schemes.

Summarised below are the key changes that will be affecting employers that are operating, or looking to operate, an employee share scheme in New Zealand. Employers should be conscious how these future and proposed changes may affect their employee share schemes.

Tax reporting changes
At present, employees are required to disclose and pay employee share plan benefits in their New Zealand income tax return. There is currently no reporting obligation for employers, nor is there any specific mechanism which allows withholding on share scheme benefits.

From 1 April 2017, employers can choose to withhold tax under the PAYE rules on employee share scheme benefits. If PAYE is correctly withheld, an employee should have no further tax to pay in respect of their share scheme benefits. Furthermore, employees should not be required to disclose the share plan benefit in their tax return.

Employers will also be required from 1 April 2017 to disclose details of the employee share scheme benefits to the Inland Revenue in their monthly payroll reporting, irrespective of whether the PAYE rules have been applied.

Inland Revenue share scheme proposals
Inland Revenue released an issues paper1 in May 2016 which set out a number of proposals for taxing employee share schemes. Following consultation with taxpayers, the Inland Revenue has now refined their proposals2 as outlined below.

New tax framework
The Inland Revenue’s primary focus in the issues paper is to align the tax treatment of employee share schemes with cash remuneration.

Under the current framework, employees are taxable when they ‘acquire’ shares. The taxable income arising to employees is the difference between the value of the shares at the time they are acquired and the price the employee pays for them, if any.

The Inland Revenue has suggested the introduction of a tax framework that would distinguish between conditional shares schemes, such as those subject to a continued employment requirement and unconditional share schemes, which provide shares to employees free from any further conditions.

Under the proposed framework, employees would be taxable once the employee holds the shares on the same basis as a non-employee shareholder. The Inland Revenue has proposed that this should be where there are no put or call options, and no downside or upside price protections. This would exclude those conditions that would arise in the absence of an employment relationship or do not affect the employees right to economic ownership.

We expect that further clarity is provided once the Bill has been introduced to reflect these proposals.

Grand-parenting provisions
The Inland Revenue has proposed that the new tax framework would not apply to:

- benefits granted within six months after enactment of the new law for employee share schemes that were in existence prior to the date of publication of the Issues Paper (12 May 2016)
- benefits granted within six months after the enactment where the taxing point for the shares under the new rules takes place before 1 April 2022

Like EY, Computershare hasn’t seen companies introducing option plans as a result of the change in legislation nor exercise mechanisms for their rights plans. Most issuers prefer the simplicity and reduced administration burden of automatic exercise on vesting.

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2 http://taxpolicy.ird.govt.nz/publications/2016-ip-employee-share-schemes-up-data/overview
Approved Inland Revenue scheme

The Inland Revenue is currently reviewing the mechanics of the approved Inland Revenue schemes (DC 12 Scheme) as part of their wider policy review.

While it had been originally mooted that the DC 12 Scheme may be repealed, following taxpayer consultation, the Inland Revenue has proposed a number of amendments. In particular, the Inland Revenue has proposed that the employee cost of shares would need to satisfy three requirements, being:

1. no more than $5,000 per year;
2. no less than $2,000 less than market value (i.e. net benefit received by employee can be no more than $2,000); and
3. no more than market value.

This amendment is well overdue considering that the current cost restrictions for employee contributions3 have not been adjusted since 1980.

Other main proposals to the DC 12 Scheme are:

1. if there is a cost to the employee an interest free loan must be provided (currently discretionary);
2. no deemed deduction for employers providing an interest free loan to employees, and no deduction allowable for cost of providing shares; and
3. DC 12 Scheme will be subject to registration, rather than an approval process.

Employer deduction

The Inland Revenue has proposed allowing an automatic deduction to employers providing employee share scheme benefits.

It is proposed that the deduction would arise at the same time the employee derives a taxable benefit under the employee share scheme, and will be of an amount equal to that taxable benefit. Adopting such an approach is consistent with the Inland Revenue’s policy intent to align the tax treatment of employee share schemes with cash remuneration, which is generally deductible.

The Inland Revenue has stated that at present the cost of issuing shares is generally not deductible as issued shares do not give rise to a cost to the employer. Under the Inland Revenue’s proposals, employers would be entitled to a deduction, whether or not an actual cost does not arise.

In the event that employers acquire shares on market, it would appear that the deduction would be restricted to the taxable benefit arising to the employee.

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The better the question.
The better the answer.
The better the world works.

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ED None.

3 Employee restricted to $2,340 over a three-year period.
Equity Trading Notes

Over the past five years, there have been numerous changes to the Australian securities market. Coupled with increased regulatory requirements over the same period, these changes have had some impact on the operation of ESS and related share market transactions.

Ongoing regulatory focus on trading blackouts prior to the announcement of company results or AGMs has meant that companies and their employees are becoming progressively limited in their available trading periods.

The amended tax treatment of ESS and relatively short trading windows, have also resulted in employees trading as soon as possible during open periods, with little flexibility or discretion in relation to timing or price.

In most cases, employee trading behaviour has limited impact on the overall market and specific stock prices, although there have been occasions where it appears that ESS sales have had some impact on the specific company’s share price on the days in question. This has been more evident when executives or founding shareholders with significant holdings, are actively trading in stock with relatively limited liquidity. This can cause negative share price reactions that are often exacerbated by the subsequent director disclosure to the market. Negative price movements can be exacerbated in part because the broader market does not understand why senior management or founders are suddenly selling company stock after releasing results.

While market liquidity can be an issue for some listed companies, recent changes to the Australian securities market have included new trading avenues and functions, such as Chi-X and hidden liquidity in the form of dark pools offered by different market providers. This means that while available market volumes may not always look very large, the underlying potential market depth and liquidity can be larger than expected, thereby allowing trades to be completed with minimal share price impact. Although executed trades become visible to the market once fulfilled, any remaining volume can remain hidden through management of the order across the various venues. The ability to cross an order within the current market price can also achieve a similar outcome on market.

As a market participant, Morgan Stanley Wealth Management is bound by regulatory obligations to execute all orders within our Best Execution Policy. We assist ESS administrators to find available liquidity by engaging with other employee participants including institutions, institutional desks and major equity shareholders. Large orders such as those executed on behalf of ESS can often be completed via the market with very limited impact on the share price using the various trade options available. Thus, while large market transactions on behalf of an ESS initially may appear likely to impact the share price, the many trading avenues available in combination with specific company knowledge allow us to execute trades in a timely manner often with limited impact on the market.

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About Morgan Stanley Wealth Management

Mathew Schurmann and Clinton McBride are Financial Advisers at Morgan Stanley Wealth Management Australia Pty Ltd (ABN 19 009 145 555, AFSL 240813 – a Participant of ASX Group). Mathew and Clinton specialise in providing execution, custodial and wealth management solutions for employee share plans. Their longstanding relationship with Computershare Plan Managers has expanded globally over the last 10 years, which sees them servicing listed companies in Australia and offshore.

Computershare believes best practice is for companies to provide clear explanations around the purpose of director or significant shareholder disposal, via their market announcements, to avoid any adverse effects of market speculation.
Changes and trends in employee equity plans around the globe

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The following pages contain insight from Computershare’s offices in Canada, US, UK, Europe and Asia.

Our colleagues in the UK are seeing an increase in participation in all-employee contribution plans through Sharesave and SIP. The US ESPP take-up levels remain steady and Australia has seen a slight dip over the past year, but we still have on average 41% participation across matched and non-matched plans, which is excellent when compared with our global peers.

Some of our clients have been able to achieve a participation rate of 50% by matching on a one-for-one (and even one-for-two) basis even where the plan does not take advantage of local tax incentives, with a couple of clients achieving an outstanding result of over 80% using Australian exempt and/or deferred plans.

Apart from the level of matching, which generally has the greatest impact on take-up, communication is still key when it comes to improving employee engagement and increasing participation. We see the greatest impact when this communication is backed by strong messages from the Managing Director or CEO.

In last year’s report, I mentioned that Canada was expecting increased taxes on stock option in the February 2016 budget but our colleagues in Canada are pleased to say that these changes didn’t go ahead.

In the US, 50% of companies offer an ESPP which seems to be far in excess of the number of companies in Australia that allow their broad-based employees the opportunity to participate in a share plan.

The US shows a trend towards restricted stock with performance criteria for executive awards with performance shares in the UK. While the 2015 tax change in Australia - to tax on exercise for options and rights rather than vest - has taken away one of the main challenges with offering options, we have not seen companies change to using option plans which is in line with the US, UK and China.

There has been positive support from the UK Government for share schemes. Tax free limit for Share Incentive Plans increased to £1,800, which equates to around AUD 3,000 whereas in Canada the Tax Free Savings Account (TFSA) dollar limit has been lowered from $10,000 to $5,500 but both limits are significantly higher than the $1,000 exempt limit here in Australia. Inland Revenue in New Zealand is reviewing the DC12 scheme with a view to increasing the benefit available.

For employee stock purchase plans (either salary-sacrifice or post-tax plans), Australian companies tend to offer a company match, like the UK and China, rather than a discount which is only popular in the US.

For the most part, governments seem to be supportive of employee ownership with an improved regulatory environment in mainland China, increased limits in the UK and the proposed Prospectus Regulation in the EU. However other legislation such as the new EU General Data Protection Regulation and Market Abuse Regulation means that broad legislation continues to heavily impact this area.

AUSTRALIA AND NEW ZEALAND ISSUERS SLOW TO IMPLEMENT CHANGE OFFERED BY REGULATORY DEVELOPMENTS

In Australia we haven’t seen a move to options following the change in deferred taxing point from vesting to exercise and most of our clients still have a cliff vesting for their rights plans rather than allowing employees to exercise when they choose. As noted in EY’s insights, sacrifice into fully vested rights is now possible but we have only seen one or two clients make this available for their directors or executives.

Hot off the press in New Zealand, from 1 December all share plans must comply with the Financial Markets Conduct Act (FMCA) following two years of transitional arrangements. There is also new legislation for disclosure and withholding requirements for share schemes which will apply from April 2017. This legislation requires employers to disclose details of ESS benefits to Inland Revenue in New Zealand and provides employers with the ability to elect to withhold tax on employee share scheme benefits. Despite the fact that it’s the norm in many jurisdictions throughout the world, at the time of going to press none of our clients with share schemes in New Zealand have indicated that they are planning to withhold.
2017 and beyond

We are waiting to see what the DC12 in New Zealand will look like, how the new reporting regime in New Zealand works and whether more companies will elect to withhold.

Employee Ownership Australia and New Zealand continue to lobby for change and we fully support their suggestion that cessation of employment should no longer be a taxing point and also that the $1,000 exempt plan limit should be increased as it hasn’t changed for over two decades.

As the update from Allens in this report outlines, in Australia, if the company and the employee agree, you can withhold extra tax from salary or wages to offset end-of-year tax liability.

We are aware of some companies considering this but we do support the introduction of compulsory withholding in Australia. Employees find our current taxation rules confusing and get a surprise when they receive their ESS statement or tax bill, long after an ESS taxing point. We therefore believe that, as in many other countries, tax should be withheld at the time of the taxing event. This puts the payment of tax in the hands of the company with the withholding managed by Computershare, rather than it being a burden on the employees.
Stock option plans keep their attractive tax rate
In Canada, the regulatory and tax landscape around equity plan administration was expected to change following the election of Liberal leader Justin Trudeau. During the election campaign, the Liberal party had pledged to eliminate the employee stock option deduction in a number of situations and also to raise the top marginal tax rate by 4%. These changes would raise the top tax rate on stock options from approximately 25% to 54%. The Canadian federal government’s proposed changes to stock options and awards are no longer being pursued, following significant pushback by the private sector, especially technology companies. Start-up companies, which rely on stock option plans to offer competitive salaries and to attract and retain key employees were also part of the opponents of these amendments.

Limited hedging in place
We have witnessed a modest continuation of new clients (two) purchasing shares on the market in advance of future vesting dates. However, we have not returned to the days where a significant portion of new clients hedge their plans.

The reduction of the final tax free threshold to $5,500 means Canada is now more aligned with other countries’ limits, except for Australia which still has a very restrictive limit of $1,000

Cash awards an option in more flexible settlement arrangements
We are continuing to see clients structuring their plans to permit settlements of awards in combinations of cash and shares, with some clients choosing to settle all of their awards exclusively in cash or shares. The general trend is that companies are designing their plans to allow for full flexibility in methods of settlement, but allowing their boards and/or overseeing committees the ability to determine the desirable methods of settlement from the suite permitted under the plan texts on a grant by grant basis.

Alternative post-vest holding periods becoming more dynamic
The practice of implementing a post-vesting hold period, where an award is not sellable until a certain amount of post-vesting time has passed, has remained steady over the past year. We are seeing more clients engaging us in the management of senior executive share ownership guidelines. While we have not seen more clients establishing hold periods, more are requiring us to provide exercise/redemption alternatives and vesting share accounts for senior executives subject to share ownership guidelines.

Employee Stock Purchase Plans – ups and downs in the TFSA contribution limit
During the Canadian federal election campaign in 2015, Liberal leader Justin Trudeau pledged that, if elected, he would lower the Tax-Free Savings Account (TFSA) contribution limit back to $5,500, from the $10,000 limit put in place by the incumbent Conservative Party earlier in 2015. He had based this campaign promise on the analyses from the Parliamentary Budget Office, the Broadbent Institute and other think tanks that had indicated that high-income older households benefit most from the higher TFSA contribution limit.

Following the Liberal victory, a number of online petitions were launched demanding the Liberals keep the annual contribution limit at $10,000. There were worries that lowering the contribution limits for 2015 would negatively impact on people who had already maxed-out their TFSA contributions, while also creating problems for the Canadian Revenue Agency to track and tax this over-contribution.

The Liberals have compromised on some of these concerns; they lowered the TFSA dollar limit to $5,500 effective January 1, 2016, and have agreed to allow future increases to the contribution limits based on inflation index. The lowered TFSA dollar limit would lower the overall assets accumulated in this type of account over the future years. However, it is not expected to lower the number of TFSA accounts.

David Nugent
Senior Vice President, Equity Services, Computershare Canada
Global insights - United States

Employee Stock Purchase Plans - tax-qualified ESPPs continue to dominate

Employee Stock Purchase Plans (ESPP) continue to be a stable and valued offering for US companies, with roughly 50% of publicly traded companies offering an ESPP. Tax-qualified ESPPs continue to be heavily favoured over non-qualified ESPPs. Most research shows that 80% of companies offer a tax-qualified ESPP. However, that number may actually be on the rise. A recent survey of 239 stock plan administrators at US companies of varying sizes across a host of industries was conducted by the National Center for Employee Ownership (NCEO), the National Association of Stock Plan Professionals (NASPP) and the Certified Equity Professionals Institute (CEPI). This study showed that 92% of companies offer a tax-qualified ESPP. The likeliest reason for favouring the tax-qualified ESPP is the tax advantage offered to employees as well as the reduced tax withholding requirements for companies.

The CEPI/NASPP/NCEO study also reinforced that certain plan features are most favoured by companies:

- 70% of companies offer a 15% discount on the stock purchase price
- 50% have a six-month offering period
- 59% have a look back feature, which bases the purchase price on the lower of the price at the beginning or end of the offering period
- 79% do not have a required holding period after purchase

These results are consistent with previous research. There is also a strong correlation between these plan features and higher employee participation in the plans.

Despite efforts by companies to offer ESPPs with tax advantages and favourable plan features, participation in ESPPs continues to be a challenge. According to the CEPI/NASPP/NCEO study, roughly half of companies report participation below 40%. A review of our US client participation rate shows that the overall average participation in tax-qualified ESPPs is 24%, and for non-qualified ESPPs, only 11%.

The CEPI/NASPP/NCEO study notes that the primary reason employees do not participate is they do not feel they can afford it. While many likely cannot afford it, some of this effect may also be due to a lack of understanding of the plan. Computershare’s own research conducted with the London School of Economics noted lack of understanding as a top reason why employees do not participate. The CEPI/NASPP/NCEO study also found this to be the case.

Our internal research has identified a strong correlation between enhanced communication and and increased participation. We recently executed an education campaign for Indivior PLC, which was a great success with 43% enrolment – nearly double the industry average participation rate of 24%. We will continue to analyse how plan communications drive participation in the years to come.

Tax challenges - improving processes to track retirement eligibility and mobility

Two of the hotter tax topics in the US right now are retirement eligibility and participant mobility taxation.

Retirement eligibility - the US Internal Revenue Service (IRS) mandates that when there is no longer a substantial risk of forfeiture for a non-performance restricted grant, certain taxes must be assessed and remitted. In this case, it is the employee’s retirement eligibility date regardless of the vesting dates of the grant. This IRS rule places a burden on the participant to fund the taxes in advance and for the company to continually assess taxes on participant grants, collect and remit the funds. We have developed functionality to monitor this information and calculate the taxes, the client then works with their employees to collect the taxes. The administrative functionality has been well received and our next research initiative will be to look at how we can leverage the actual shares in the unvested grant to fund the taxes owed by the participant.

Participant mobility - a key issue for our clients with a global workforce such as short-term transfers, formal expatriate assignees, permanent transfers and even the US business travellers and state-to-state work commuters. As tax jurisdictions at all levels (countries, states, municipalities, etc.) grow more vigilant with collecting taxes on mobile employees, tracking employees’ movements becomes more vital. Recently we worked with a large global client and their tax advisors to create a process that provides us with precise tax rates for our client’s mobile and cross-border employees at the time of exercise, based on the employee’s specific mobility history. In the coming months we will be researching other ways to support clients in staying up to date with this incredibly complex issue.

Equity awards - introducing mandatory withholding and alternatives to TSR

Year-on-year, trends show a decline in the granting of simple time vested option awards and an increase in the issuance of restricted stock with performance criteria. For Long Term Incentive Plans, market-related metrics such as Total Shareholder Return (TSR) have been the preferred method for measuring performance grants. Though we have not seen a shift away from using TSR as the primary metric, a report by Pearl Meyer, an executive compensation advisory firm, provides some insight into why TSR may not be enough and what additional measurements companies may want to start including such as, targeted financial, operational and other leading indicators that more accurately assess management’s strategy execution.

We have also noticed an increase in the number of clients mandating share withholding, instead of selling shares for payment of taxes. This could be partly attributed to the recent US accounting update by the Financial Accounting Standards Board (FASB), Accounting Standards Update 2017-03 (ASU 2017-03).

6 Re-Evaluating Total Shareholder Return as an Incentive (2016)
(ASU) 2016-09, issued in March 2016, which simplified aspects of the Accounting Standards Codification (ASC) 718 for share-based compensation accounting. One of the updates allows companies to withhold shares for taxes up to the maximum withholding rate in a relevant jurisdiction and still maintain the award’s equity classification. This is a significant change from the prior guidance that classified the entire award as a liability if the value of shares withheld exceeded the minimum statutory rate. We will be better able to assess the trend after the mandatory adoption date of 15 December 2016.

Sheila Frierson
CEP, President,
Computershare Plan Managers USA

Strategic communication campaigns help Indivior PLC double the average participation rate

“We are impressed with the innovative suite of communication materials developed for us by Computershare. The video and on-site training sessions were particularly useful as they enabled our team to experience first hand how the ESPP would work.”

Laura Crossley
CEBS, Global Benefits Manager, Indivior
UK approved plans thrive under increased contribution limits

Employee ownership is still seen by the UK government as an important tool in driving economic prosperity. Over the past three years, Save-As-You-Earn (SAYE) and Share Incentive Plan (SIP), the two most popular forms of approved all-employee plans, benefited from rule changes which increased the maximum monthly contribution limits. In the case of SAYE, where employees save in order to acquire company shares at a discounted option price – the monthly contribution limit doubled from £250 to £500. For SIP, a share purchase plan typically offered with free matching shares, the annual limit was raised from £1,500 to £1,800.

Companies see SAYE and SIP as crucial components of their employee engagement and employee benefits strategies. Across our client base, most companies offer one or the other, choosing the plan which best meets their objectives. This observation is borne out across the wider market. Only one in four companies offer employees the opportunity of joining both plans*, according to analysis from ProShare, the UK’s foremost industry body advocating employee share ownership.

With an experienced base of share plan professionals, advisors and providers in the UK, the challenges with SAYE and SIP no longer lie in streamlining administration. Instead, we see a growing trend in issuers investing in enhanced employee communications as they look to build employee understanding and engagement to drive increased value from their plans.

It is therefore pleasing to see that participation in both SAYE and SIP is on the up. In 2015, average monthly participation sat at just under 36% for SAYE and just under 31% for SIP with monthly contributions at £156 and £89 respectively*, with both plan types recovering well following a global financial crash-induced hangover.

*ProShare SAYE and SIP Report 2015

Employee Share Purchase Plans – ever popular as new jurisdictions beckon

Employee Share Purchase Plans (ESPPs) continue to grow across the UK and Europe, both in terms of new plans and the expansion of existing plans into new jurisdictions.

Design-wise, the use of matching shares is by far the most common way to incentivise participation in Europe. Only 1 in 10 ESPPs we administer utilise a discount, and almost exclusively this is where the issuer stock is US listed. Looking at plans with a match, a 1:1 ratio is most popular (featuring in 56% of plans), followed by 1:2 (28%) and 1:3 (16%).

While average participation in ESPPs tends to be lower than local approved plans, there is an increasing trend of extending ESPP to as many jurisdictions as is practical, including offers in emerging markets where employee share ownership is less common and/or logistically challenging. Companies which actively communicate the ESPP to their employees and select an appropriate minimum contribution amount, tend to have the highest take-ups.

Long Term Incentives – still the domain of senior management

The UK and Europe stand firmly with the rest of the world in favouring full-price share awards over options. In Europe, we see LTI design favouring performance shares instead of restricted stock and their use is predominantly saved for executives and senior management. Only 41% of European firms extend the use of LTIPs to middle management, versus 82% in North America**.

Looking at performance, total shareholder return (TSR) is the measurement of choice. Although seldom used in the US, share price remains favoured in Europe where the final number of performance shares is linked to external measures to explicitly emphasise the incentive effect**.

Following the binding say on pay introduced in the UK in 2013, 2014 saw influential investor Fidelity International set out its intention to vote against issuers that do not implement minimum retention periods of five years across LTIPs. When looking at voting data for unique resolutions relating to remuneration, we see a 14% increase in the number of votes cast against during the 2015-16 AGM season compared with 2014-15. While LTIPs still most commonly vest at three years, we expect to see a big increase in the use of post-vest holding periods and a corresponding rise in demand for compliant post-vest services.

**Global Equity Insights Survey 2016

** Re-Evaluating Total Shareholder Return as an Incentive (2016)
Market trends – a year of two halves

The most notable trend for the first half of the year was the continued depression in global equity markets, driven by market sentiment towards mining, minerals and energy stocks. As a result, trading levels from employee and executive plans were significantly lower than previous years, as more participants opted to hold on to shares during Q1 vestings.

Unsurprisingly, the second half of the year succumbed to Brexit rhetoric, as the UK voted to leave the European Union in June. A round of quantitative easing was swiftly followed by a drop in the Bank of England base rate to 0.25%. With several European central banks adopting negative interest rates over recent years, the reality of this policy being adopted in the UK is now being drawn sharply into focus. This would pose challenges for administrators, plan issuers and participants alike, particularly in relation to UK Save-As-You-Earn (SAYE) plans, where the bonus rate applied at the end of savings contracts looks set to remain flat-lined at zero for the foreseeable future.

As we head towards the end of the year, a harder line from both UK and European ministers contributed to a huge drop in sterling. This saw the FTSE100 rise to record levels, as multinationals’ overseas earnings were effectively boosted when converted back into sterling. For UK-based employees with shares in overseas stock, the opportunity to dispose of shares for a potentially higher return will be attractive for many, so we will monitor this with interest.

Regulatory issues – business as usual (for now)

With the events of June throwing the longer term picture for the UK regulatory landscape into uncertainty, for now it remains business as usual. Here’s some regulatory highlights from the past year:

July saw the introduction of new Market Abuse Regulation (MAR). As a piece of EU primary legislation, MAR applies in all 28 EU member states, in many cases introducing more stringent regulation and significant new procedural requirements. A number of areas are impacted, including market soundings, disclosures, insider dealing, closed periods and insider lists. For issuers, the ramifications are wide-ranging and include the need to review internal dealing codes, check vesting timetables and ensure historic versions of insider lists are maintained for five years. In the UK, helpful exemptions (e.g. allowing PDMRs to participate in all-employee plans and the ability to grant awards in prohibited periods subject to certain conditions) that existed in the UK Model Code have been removed, leaving a degree of uncertainty that remains unclarified by regulators.

Years in the making, the European General Data Protection Regulation (GDPR) has finally been adopted and comes into effect in May 2018. A potential fine of 4% of annual group turnover has propelled the topic up the Board agenda. Among many changes, the most significant is its expanded territorial reach: if an activity relates to EU citizens, GDPR will apply to data controllers and processors regardless of where they are in the world. A myriad of regulatory compliance issues result, not least for multinationals with global share plan arrangements.

Jay Foley
Managing Director,
Computershare Plan Managers Europe
Global insights – Asia

An encouraging year with strong enrolment rates and State support

The previous trends of employee share plans in the Hong Kong/China market have continued, particularly where companies are moving from Stock Appreciation Rights and Stock Option Plans towards Restricted Share Awards (Executive) and broad-based Employee Share Purchase Plans (ESPPs). Of the companies offering ESPPs, the majority offer a share match incentive (versus discount). As these share plans provide many Chinese employees with the opportunity to hold overseas listed shares, we have witnessed strong enrolment rates within China compared to other global jurisdictions. This is obviously dependent on the development of effective communications strategies for these plans that are tailored to local languages.

From a regulatory perspective, the China Securities and Regulatory Commission (CSRC), the Ministry of Finance (MoF) and the State Administration of Tax (SAT) have published circulars that further clarify the treatment of employee equity as well as promote the use of employee equity incentives in the China domestic A-shares market.

Equity Incentive Plan – new regulations reduce the administration burden for issuers

In July 2016, the CSRC released Measures for the Administration of Equity Incentive Plans of Listed Companies which replaced the previous 2005 ruling and all other relevant rules concerning equity incentive plans.

The 2016 Rule outlines an improved regulatory environment for equity incentive plans in mainland China. The CSRC is no longer required to provide an onerous review for implementation of equity incentive plans. Furthermore, it allows foreign employees to participate in equity incentive plans of domestically listed A-shares issuers. The 2016 Rule also removes the financial performance requirements for listed companies to be eligible for adopting the equity incentive plans, provides more flexibility in determining the option/RSU strike price and increasing the % of share capital reserved for equity incentive plans from 10% to 20%. With the implementation of the 2016 Rule, Computershare expects equity incentive plans to increase in the A-shares market.

Employee Stock Purchase Plan – education is driving ownership

On 2 August 2016, the State-owned Assets Supervision and Administration Commission (SASAC), the Ministry of Finance (MOF) and the CSRC have jointly issued Opinions on Implementing the Pilot Program of Shareholding by Employees in State-controlled Mixed Ownership Enterprises (‘the Opinion’) to encourage the adoption of employee stock purchase plans in state-owned enterprises.

The Opinion stipulates the conditions to be eligible for the pilot program and various requirements for employees’ participation. According to the Opinion, employees participating in the ESPP shall primarily use cash to purchase shares at a price not lower than the net asset value per share.

Pilot enterprises and state-owned shareholders are not able to transfer shares to employees for free or provide any kind of financial aid. 10 subsidiaries of centrally administered state-owned enterprises, as well as another 5-10 local state-owned enterprises will be included in the pilot program. The pilot program will be implemented within 2016 and concluded by the end of 2018, when the scope of the pilot program may be expanded according to the actual situations.

Tax changes to encourage growth in new industries

In September 2016, the Ministry of Finance and the State Administration of Taxation (SAT) jointly issued a circular regarding the preferential tax treatment of equity incentive plans. The circular adjusts the income tax policies relating to equity incentive plans that meet the required criterion.

For stock options, restricted shares and equity rewards granted by an unlisted company, where certain requirements are met and filing has been completed with the relevant tax authorities, the employees are eligible to defer the tax payment from the time when the incentives are received to the time when the equity is transferred. When transferring equity, employees are charged individual income tax, at the rate of 20% on the balance, after deducting the cost of acquiring the equity and reasonable taxes and dues from the equity transfer proceeds, which is classified as ‘income from property transfer’.

For stock options, restricted shares and equity rewards granted by a listed company, where filing has been completed with the local tax authorities, the individuals are eligible to pay individual income tax within 12 months from the date when the stock options are exercised, or the restricted shares are vested, or the equity rewards are awarded. As such, qualified plans provide employees with reduced tax obligations. This circular reflects the Chinese government’s intention to utilise equity compensation to encourage the growth and future development of promising small-medium enterprises in high-tech (or other new industries).

Seth Bohart
Managing Director,
Computershare Plan Managers Asia
Global regulatory environment review

Global review

In 2016 we continued to see changes to regulatory, legal and tax rules which, whether intentionally or indirectly, affect equity incentive plans. Further developments in data protection, tax reporting, remuneration regulations and securities filing have impacted on the global legal and tax environment for employee share plans and executive compensation.

Companies are focusing their legal and tax due diligence to keep up, aiming to balance the need for compliance with cost-effective and practical country reviews and plan processes. Increasingly companies are looking at how to provide information for employees to ensure that compliance is encouraged at all levels within the company. There is an increased use of compliance and knowhow databases, but also more targeted due diligence reports. The drive toward globally consistent, streamlined and user-friendly plan documents also continues.

Some of the developments affecting international share plans are discussed below, with brief examples of what 2016 brought us and what we are anticipating in 2017.

Securities law exemptions

Several securities law developments globally indicated a growing trend for regulators to ease restrictions and exemption requirements for employee share plans. When market practice is specifically addressed in consultations and legislation, there is a recognition that even large employee offers should not be treated in the same way as public offers, balanced with an ongoing need to have some safeguards in place for employee investors.

Key examples:

New Zealand: New Zealand’s revised securities law, the Financial Markets Conduct Act (FMCA), in 2014 came fully into force on 1 December 2016 and all share plan issuers must now comply with the new law. The FMCA provides a specific exclusion from filing obligations for employee share plans which comply with the FMCA. Companies which already offer financial products in New Zealand under an exemption granted under the previous Securities Act, may be able to reply on a separate exemption which gives relief to issuers even though the old Securities Act exemptions are no longer available.

European Union (EU): The Prospectus Regulation (which will replace the Prospectus Directive) is currently before the European Parliament. The Regulation expands the scope of the exemptions and exclusions from the requirement to issue a prospectus in EU member states and seeks to limit the ability of states to impose local requirements. There is no further progress on the ‘equivalence’ rules for non-EU stock exchanges although it is anticipated that third-country issuers will be covered by the employee shares scheme exemption without any further equivalence decision requirement.

Philippines: Clarifying rather than easing up filing obligations, the Securities and Exchange Commission has confirmed that it will no longer accept a Notice of Exemption (from the prospectus rules) in relation to offers to fewer than 20 employees. All offers now require the employer to file a Confirmation of Exemption.

Foreign exchange

Foreign exchange controls can limit the opportunity for employees to purchase and hold shares under an incentive plan and add additional layers of administration for employers. 2016 saw a welcome relaxation of restrictions in some jurisdictions:

Argentina: At the end of 2015, the Argentinian government eased the restrictions on foreign exchange rules, reversing the tight controls imposed on residents’ access to the foreign exchange market to purchase foreign currency and remit funds out of Argentina. Under the old rules, employee share plans had to be structured so that there was no inflow or outflow of funds and no obligations on local employees or the local employing company to make payments abroad. These restrictions are now mostly removed and individuals and companies have access to foreign exchange.

Russia: Under changes coming into effect on 1 January 2018, Russian residents will be permitted to receive funds from the sale of securities directly into foreign accounts without first repatriating the funds to Russia.

Vietnam: The State Bank of Vietnam (SBV) eased rules which prevented Vietnamese citizens from participating in employee incentive plans offered by a foreign employer. Previously the SBV would not approve any plan which involved an outward flow of funds and usually required employees to sell any shares received under a share plan and repatriate the proceeds. Detailed rules apply for any application for approval from the SBV.
Data protection

The global trend towards stronger data protection laws and enforcement continued in 2016, highlighting the need for companies to check that their data protection policies and practices comply on a country by country basis rather than relying on a ‘one size fits all’ global policy. Key examples:

EU: The new EU General Data Protection Regulation (GDPR) was adopted in May 2016 and will automatically be binding on all EU member states in May 2018. Considered the most stringent data protection rules in the world, the territorial reach of the GDPR means that companies operating global share plans will be required to comply with the EU data protection rules if they or any of their employees are in the EU. The penalties for non-compliance are severe and companies should take steps to ensure that they identify how GDPR affects their business and start to implement any relevant changes.

EU/US: The ‘Privacy Shield’ data transfer agreement, which replaces the defunct ‘Safe Harbour’ arrangement, came into force in August this year. The aim of the new arrangement is to allow companies in the EU to transfer personal data to the US without breaching the EU’s strict privacy rules. These rules restrict the transfer of personal data from the EU to a country which does not provide similar privacy safeguards to the EU. Although welcomed by some commentators, there is uncertainty over whether Privacy Shield will suffer from the same flaws as Safe Harbour – and meet the same fate – and there has been limited take up by US companies.

Turkey: Coming into effect in April 2016 (subject to transitional periods), the Data Protection Law represents Turkey’s first dedicated privacy and data protection legislation. Based on the EU’s Data Protection Directive, one of the key requirements of the new law is the obligation to obtain ‘explicit consent’ prior to the processing of personal data. This is particularly relevant if the data is to be exported outside Turkey.

Tax

Tax authorities continue to move tax filing and reporting online. This is generally more efficient although the initial introduction of a new system can cause difficulties, as seen in the UK when the online reporting of tax plans crashed the system in 2015. In 2016, the process proved much smoother. There have also been developments in the tax treatment of incentive plans (although not always positive) and good news for tax favourable plans in some countries. Key examples:

Online tax filings: The Australian Tax Office (ATO) will no longer accept ESS annual reports in paper-based format, filing must either be through the ATO’s webpage portal or by using the ATO’s software for online filing. In addition to the new filing system, employers will be required to provide additional information, in particular in relation to mobile employees. France is to bring in a system of compulsory electronic filing of individual annual tax returns and the payment of income tax. The system will be phased in over a four-year period so that by 2019 it will apply to all taxpayers.

Employer withholding: Plans proposed last year by the New Zealand tax authority to require employers to report their employees’ share benefits, and allow them to elect to apply withholding tax on the income, were adopted in 2016 and will apply from April 2017. South Korean tax authorities announced new withholding tax rules for expatriate employees working in Korea on assignment from a foreign parent company. The new rules came into force on 1 July 2016.

Employer reporting: New filing obligations for all share plans operating in Luxembourg were introduced at the start of 2016. The obligations apply to new plans and to existing plans and require employers to file a copy of the share plan rules and a list of the plan participants with the local withholding tax office. The introduction of tax withholding in NZ and tax favourable plans in Denmark, also impose additional reporting obligations on employers.

Tax favourable plans: Denmark re-introduced tax favourable rules for equity based awards from July 2016, permitting income to be taxed at the lower capital gains tax rate. Additional reporting obligations for employers were also introduced. In Romania, the moment of tax for stock option plans was moved to sale, so there is no withholding or social security on the plan income. Plans by the Canadian government to impose an annual cap on the 50% tax deduction applicable to stock option income were abandoned following pressure from employers.

Taxation of share plans: Turkey and Chile have both announced the introduction of specific rules for the taxation of employee share plans. The Turkish rules are still under review but seem likely to clarify the current practice, so, for example, for option plans, the employee will be liable for tax on the exercise date. The new rules in Chile represent more of an upheaval as they will tax share options at grant as well as on exercise. The Chilean rules are due to come into effect in January 2017.
About Computershare Limited (CPU)
Computershare (ASX: CPU) is a global market leader in transfer agency and share registration, employee equity plans, mortgage servicing, proxy solicitation and stakeholder communications. We also specialise in corporate trust, bankruptcy, class action and a range of other diversified financial and governance services.
Founded in 1978, Computershare is renowned for its expertise in high integrity data management, high volume transaction processing and reconciliations, payments and stakeholder engagement. Many of the world’s leading organisations use us to streamline and maximise the value of relationships with their investors, employees, creditors and customers.
Computershare is represented in all major financial markets and has over 16,000 employees worldwide.
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