

DEALING WITH EQUITY  
AWARDS WHEN EMPLOYEE  
STATUS CHANGES

June 13, 2019

CERTAINTY | INGENUITY | ADVANTAGE

Computershare

# Upcoming Events

## Webinar Series

- All Things ESPP @ [www.computershare.com/allthingsespp](http://www.computershare.com/allthingsespp)
- All Things Equity Plans @ [www.computershare.com/allthingsequityplans](http://www.computershare.com/allthingsequityplans)

## ESPP Day 2019

- November 7, 2019 | Dallas, TX
- [www.computershare.com/esppday](http://www.computershare.com/esppday)

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# Housekeeping

Presentation is being recorded

- Email will be sent to all attendees with link to recording and presentation

Presentation qualifies for one CEP credit

Please take our survey!

# GEO Board of Directors Elections

[www.globalequity.org/geo/elections](http://www.globalequity.org/geo/elections)

## Place Your Votes!

GEO's Annual Board of Directors election is now open. Have your say - vote by 5pmPT on 15 June to make a difference.

### How to Vote

Visit the [GEO Website](#) to review each candidate's profile and register your vote(s). Your GEO username and password are required for voting.



**Sheila Frierson**  
*President*  
*Computershare*  
*United States*  
*New Candidate*

# Introductions



Andrew  
Schwartz, CPA,  
CEP  
  
Vice President  
  
Computershare,  
Inc.

Andrew has more than 15 years of experience with the administration and taxation of equity compensation.

Andrew manages the Executive Services team, responsible for all Rule 144/Section 16 equity sales and 10b5-1 plans for the employee plan and investment plan business. In addition, he serves as a lead advisor to Computershare's U.S. Plan Managers business, as well as the equity compensation industry, on tax and regulatory issues. He is a frequent speaker at industry events and on webinars.

Andrew earned an M.B.A. in Taxation from the Stern School of Business at New York University, and a B.A. from the University of California at Davis. He is a Certified Public Accountant, CEP (Certified Equity Professional), and holds FINRA series 7, 24, 27, and 63 securities licenses.

# Introductions



Nicole Calabro

Partner

Baker &  
McKenzie LLP

Nicole Calabro is a partner in Baker McKenzie's Employment & Compensation Practice, with a focus on global equity services. She advises multinational companies on all facets of employee equity plans. She regularly assists public and private companies in offering their employee equity plans around the world.

Nicole is currently a member of the National Association of Stock Plan Professionals and the Global Equity Organization.

Prior to joining the Firm, Nicole was a senior associate in the Global Equity Group at Mercer Human Resource Consulting LLC. Previously, she was a manager in the New York office of Deloitte Tax LLP.



# Introductions



Victor Flores  
Partner  
Baker &  
McKenzie LLP

Victor Flores is a partner in Baker McKenzie's Compensation Sub Practice Group and focuses in the area of executive compensation and employee benefits. He advises global U.S. and non-U.S. companies – both public and private – on all aspects of executive compensation and benefits matters, including the corporate, securities and tax law, and ERISA issues arising in the implementation and administration of compensation programs.

Victor also has extensive experience advising on compensation and benefits issues in mergers and acquisitions, corporate reorganizations, spin-offs, private equity and other corporate transactions. He also represents companies in the negotiation of executive employment, termination, and change in control and severance arrangements.

Victor has been recognized as a ranked practitioner by Legal 500 USA 2018. He is a frequent author and founding member of the [Compensation Connection](#) blog.

Victor is admitted to practice in California and New York.

# Topics

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- Termination of Employment
  - Types of Termination
  - Impact on Equity Compensation
  - Best Practices
- Divorce
- Leaves of Absence
  - Types of Leave
  - Impact on Equity Compensation
  - Best Practices



# Types of Terminations

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- Employee-Initiated
  - Resignation
  - Retirement
  - Disability
  - Death
- Employer-Initiated
  - Redundancy
  - Cause (Unusual Outside US)



# Impact of Termination on Equity Compensation

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- Notice Period
  - Outstanding Awards
  - Entitlements to Additional Awards
- Vested Rights/Termination Indemnities
  - Entitlement Determination (Works Councils, Employment Agreement, Grant Document, Repeated Nature of Grant)
  - Calculation of Severance Pay
- ISO Considerations
  - Change of status – 3 months to maintain ISO status
    - Employee to consultant
    - Terminations
    - After 3 months, convert to NQSOs

# Special Issues for Retirement

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- No longer risk of forfeiture upon meeting Retirement definition (even if not termination of employment)
  - Accelerated expense
  - Accelerated taxation / FICA
    - Rule of Administrative Convenience
  - 409A Considerations
  - Age discrimination issues
- Special treatment upon termination due to Retirement (extended exercisability period)
  - Age discrimination issues



# Special Issues for Disability

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- Use appropriate definition for global plans
  - Avoid references to U.S. benefit plans or U.S. tax code
  - Special definition for ISO and awards subject to 409A
- Extended exercise period (12 months)
- Proper documentation if awards transferred to representative of disabled employee
- Special rules for French-qualified awards and UK – approved options



# Special Issues for Termination Due to Death

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- Local Inheritance Considerations
- U.S. Tax and Securities Law Considerations



# Local Inheritance Law Considerations

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- Consider omitting beneficiary designations, especially for non-U.S. participants
- When a participant dies, obtain certified copy of death certificate
- Letters of Administration from executor/administrator of estate
- Ascertain marital status of participant at death



# Local Inheritance Law Considerations (cont'd)

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- Did participant reside in a community property state?
- If plan or agreement provide for beneficiary designation, determine if there is a beneficiary designation on file
  - Shareholdings held by the Company
  - Outstanding Awards
- Only distribute shares or permit exercise through beneficiary designation, instructions from executor/administrator, or small estate affidavit

# Inheritance Considerations: Administration

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- Does vendor system allow beneficiary designations?
  - Primary (multiple?)
  - Contingent (multiple?)
- Can participants enter information themselves?
- Who is responsible for collecting documents and making legal determinations?
- Can beneficiaries exercise or sell on their own, on-line?

# Inheritance Considerations: Administration (cont'd)

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- Watch out for
  - Expiring options
  - Change in vesting schedule or terms
  - Escheatment of uncashed checks and company stock
  - Medallion Guarantee process
- Educate beneficiaries in clearest, most sensitive manner
  - Potential cost basis adjustments

# U.S. Federal Tax and Securities Law Considerations

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- FICA applies to employee where option exercise/RSU vesting occurs in year of death; report on Final W-2
- No income tax withholding from beneficiary; issue Form 1099-MISC to beneficiary
  - May require adding beneficiary to payroll system
  - Beneficiaries should be informed about income increase with no withholding
- Deliver S-8 prospectus documents to new award holder

# U.S. Federal Tax and Securities Law Considerations

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- ISOs – Unexercised at death:
  - Step up in basis to Black-Scholes value
  - When exercised, cost basis = exercise price + B-S value
  - Must hold stock one year to receive LT capital gain treatment
- ISO-qualified shares at death:
  - Immediately qualify for LT capital gain treatment
  - Cost basis = FMV at date of death

# U.S. Federal Tax and Securities Law Considerations

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- ESPP shares – purchased before death
  - Employee recognizes ordinary income in W-2 in year of death
  - Similar to qualifying disposition – lesser of:
    - FMV at beginning of the offering period \* discount %
    - **FMV at death** – original purchase price
  - Immediately qualify for LT capital gain treatment
  - Cost basis = FMV at date of death
  - Upon sale, no ordinary income reported

# U.S. Federal Tax and Securities Law Considerations

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- ESPP shares – purchased by estate
  - Sale of shares always a qualified disposition
  - Same as qualifying disposition – lesser of:
    - FMV at beginning of the offering period \* discount %
    - Sales proceeds– original purchase price
  - Ordinary income to estate, eligible for estate tax deduction

# Termination of Employment: Best Practices

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- Award Agreement – “Exclusion of Benefits”
  - No notice period – “When active employment ends”
  - 3rd Party Award (not from employer)
  - Not salary and not included in severance
  - Plan discretionary
  - Awards discretionary
  - Fixed term of plan
  - Alternative pay outs in cash?





# Termination of Employment: Best Practices

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- State that U.S. Law is Governing Law in Plan/Agreement
- Specify U.S. Forum
- Include Non-423 Component to 423 Plan to Provide Greater Flexibility if Terminated Employee Must Participate or Cash Alternatives

# Termination of Employment: Best Practices

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- Equity Compensation Awards Separate from New Hire Letters or Employment Agreements
- Avoidance of Pattern of Awards
- Remove Beneficiary Designation Forms and Provide for Special Death Terms
- Take Out Claw Back or Forfeiture Provisions (or Do Not Enforce Absent Legal Advice)
- Consider Obtaining Release Upon Termination

# Divorce: What to Consider

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- U.S. Tax Issues
- U.S. Securities Law Issues
- Best Practices



# Divorce: U.S. Federal Tax Considerations

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- Withhold income tax and FICA from proceeds of exercise of transferred NQSOs and non-qualified deferred compensation (Rev. Rul. 2004-60)
  - Different results may apply if DRO does not provide for transfer of award to ex-spouse or if transfer not permitted under plan
- Report income on non-employee ex-spouse's 1099-MISC; may withhold as supplemental wages and apply flat rate withholding
  - Rare exception where payroll tax withholding appears on a 1099-MISC

# Divorce: U.S. Federal Tax Considerations (cont'd)

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- FICA obligation determined on the basis of employee's tax status and earnings level
  - Report FICA withheld from non-employee's ex-spouse on employee's W-2
- Incentive Stock Options
  - When unexercised ISO transferred to the ex-spouse, tax-qualified status is lost
  - Exception to holding period requirement for shares acquired by employee under ISOs (but not ESPPs) and transferred pursuant to DROs

# Divorce: U.S. Federal Securities Law Considerations

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- Deliver S-8 prospectus documents to non-employee spouse if award is transferred
- Consider whether non-employee spouse is subject to the company's insider trading policy; inform brokers if non-employee spouse is subject to black-out periods
- Form 4 – report transfers in footnote

# Divorce: Best Practices

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- Legal review of DROs for clarity, problematic provisions, e.g., provisions that contradict plan provisions, tax laws or impose onerous obligations on the company
  - does plan permit transfer of awards?
- Respond only to a business records requests or other subpoena and only after notifying employee so any objection can be filed
- Document any informal request to disclose by employee



# Divorce: Best Practices

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- Establish procedures for recording divorce settlements in the stock plan database
- Track any transferred award separately



# Types of Leave

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- Paid vs. Unpaid
- Statutory vs. Discretionary/Common Law
- Maternity/Paternity
- Parental/Adoption
- Sickness/Medical
- Disability
- Military
- Educational/Sabbaticals



# Which of the below countries has the Most Generous Maternity Leave Policy?

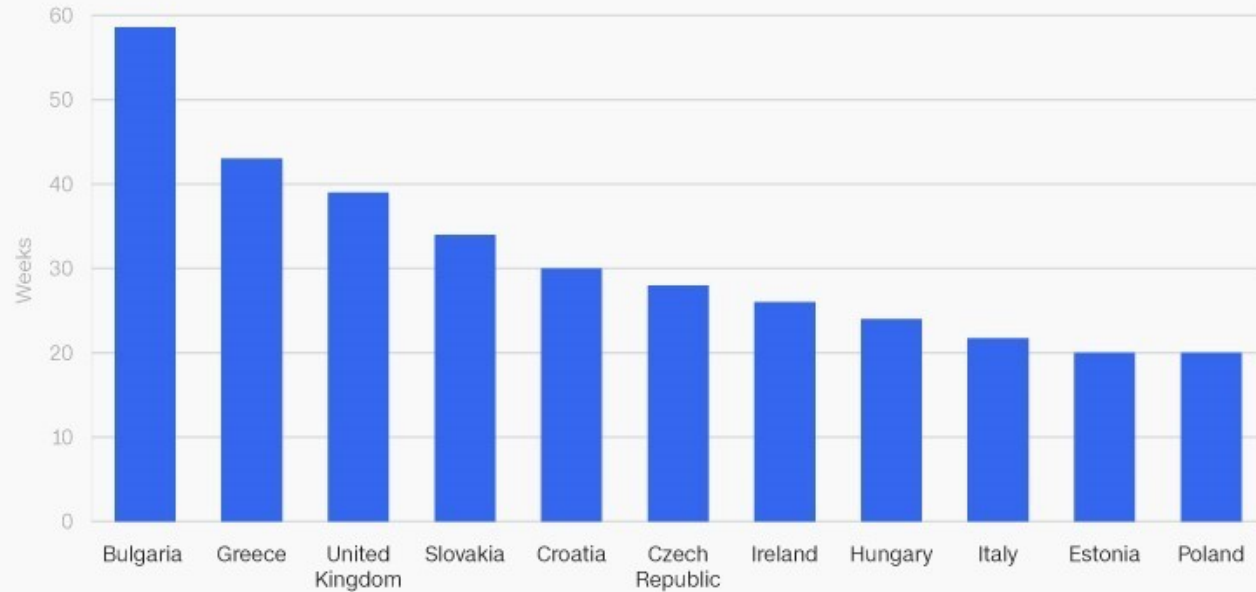
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- a) United States
- b) New Zealand
- c) Mexico
- d) United Kingdom



<https://money.cnn.com/2018/01/19/news/economy/countries-most-maternity-leave/index.html>

## Paid maternity leave around the world



SOURCE: OECD



# Impact of Leaves on Equity Compensation

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- Vesting
- Exercisability
- Continued Participation in Elective Plans (ESPPs)
- Potential for ISO disqualification
- Entitlement to Awards made to Active Employees



# Tax Effects of Leaves on Equity Compensation

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- Depends on type of leave, award, and timing of exercise
- If no guaranteed right to return to position:
  - Unvested ISOs – 1<sup>st</sup> day after 3-month leave - become NQSOs
  - Vested ISOs – 1<sup>st</sup> day after 6-month leave – become NQSOs
  - ESPPs – usually forfeit benefit to participate
  - “Tolling” vesting periods

# Leaves of Absence: Best Practices

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- Statutory Leaves
  - Continued Vesting/Exercisability
  - Pro-Rata Awards
- Non-Statutory Leaves
  - Discretionary
  - Pursuant to Provisions in Award Agreement/Plan
- Best Practice to Address Leaves in Award Documentation

# Panelists

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Questions?