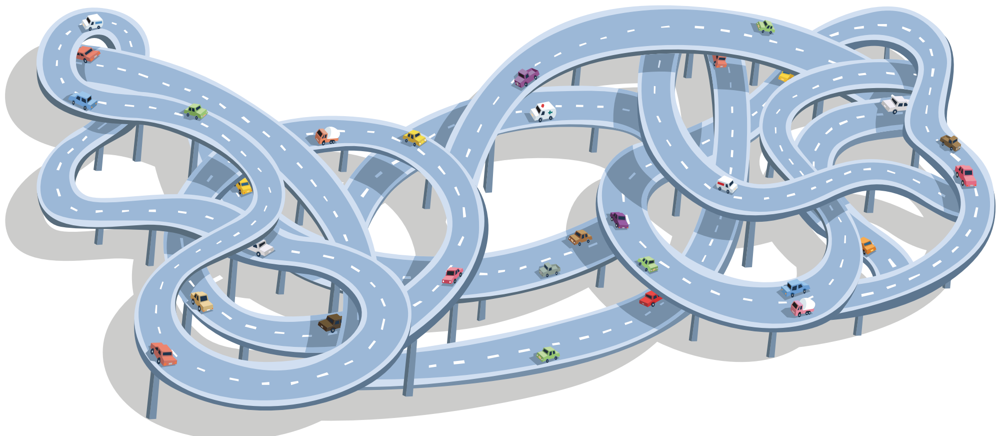


Building a Road Map to a Global Employee Stock Purchase Plan

The head of human resources comes into your office one day and says, "The compensation committee has decided to adopt an employee stock purchase plan. They want to include all employees worldwide, and they'd like the plan to be up and running within six months. And oh yeah, YOU'VE got to make this happen." What would you do? If you were like most people who've been faced with this situation, you'd probably step back, take a deep breath and reply, "What do I need to KNOW to make this a success?"

It is easy to be overwhelmed when faced with the task of establishing a global employee stock purchase plan (ESPP). However, identifying and understanding the key issues at the outset of the project is the first step toward achieving your goal. To this end, ISP Advisors has prepared the following document, which should be viewed as a road map taking you through some of the more significant considerations associated with implementing a global employee stock purchase plan.

This document is divided into two sections. Section I deals with the fundamentals of an ESPP, including:
> A broad description of ESPPs.
> The strategic driver behind these plans.
> The major design considerations that will maximize the competitive value of the ESPP.

Section II frames the key issues associated with extending an ESPP outside the United States.

Section I: ESPP Fundamentals

I. WHAT IS AN ESPP?

An ESPP is an employee benefit plan that allows employees to purchase company stock, often at a discount. Usually this stock is bought through accumulated payroll deductions. It is almost always available to all employees (although some types of ESPPs can limit participation to a certain group of employees).

Under virtually all ESPPs, employees authorize the company to deduct a specified percentage of their salary each month for a specified number of months, called the "accumulation period" or "offering period." The deduction percentage chosen is based on the employee's gross pay, but is deducted from their after-tax pay (i.e., shares are purchased with after-tax dollars). These funds collected during the offering period are then used to purchase stock at a predetermined date, which is typically at the end of the offering period.

One of the most attractive characteristics of ESPPs from the employee's perspective is that they allow employees to buy shares at a discount. That is, the price paid by the employee is less than what an investor would pay on the open market on the same date. The amount of the discount will depend on the method by which the company determines the purchase price. Most US-style plans allow employees to purchase shares for a set percentage lower than the fair market value of the company stock at the time of purchase, while many European-style plans deliver the "benefit" through an employer-match concept. Another popular feature for US-style plans is a "lookback." This feature allows employees to apply the discount to the value of the company shares at either the beginning or the end of the offering period, whichever is more advantageous to the employees.

As an example, assume that the company's stock sold for $15 per share at the beginning of a six-month offering period. At the end of the offering period, assume that the stock was selling for $20 per share. Also assume that the plan allows for a 15% discount when purchasing the shares. If the plan doesn't allow for a lookback, the purchase price would be $17 per share (85% x $20). However, a plan with a lookback provision would allow the employee to purchase the stock for $12.75 a share (85% x $15).

ESPPs can be divided into two types: those that are qualified under Section 423 of the Internal Revenue Code (also referred to as "423 plans") and those that are not (i.e., non-qualified ESPPs). Although most companies choose to offer a 423 plan to deliver stock in a tax-favorable way, doing so requires the company to adhere to certain conditions with respect to plan design and maintenance.

These include, but are not limited to:

> Virtually all employees must be able to participate (part-timers can be excluded).
> All participants must be given the same rights and privileges.
> The plan must be approved by the shareholders.
> Employees cannot purchase more than $25,000 worth of stock in a calendar year.
> If the plan has a lookback feature, the offering period (i.e., accumulation period) can be no longer than 27 months (5 years without a lookback).

II. WHY AN ESPP? >

Although many times the decision to roll out an ESPP is initiated by the Board without advance exploration, it is important to understand the rationale behind creating such plans. Historically, reasons for creating an ESPP include:

> Increase the company's ability to attract, recruit, and retain talent.
> Align the interests of employees with those of the shareholders.

However, in practice the driving force behind establishing ESPPs is often based on competitive pressure. According to a 2014 industry-wide survey conducted by the National Association of Stock Plan Professionals (NASPP survey), 52% of the 487 companies polled had implemented an ESPP, and this is an increasing trend. So when faced with the daunting task of positioning one's company in the marketplace, not having an ESPP can prove to be a major disadvantage. Of course, the fact that ESPPs align the interest of employees with those of the company's shareholders is an added benefit, making these programs a golden child of the shareholder advisory firms such as ISS and Glass Lewis. As a result, securing shareholder approval for ESPPs is relatively easy.

ESPPs can also have a very tangible, positive impact on a company's bottom line. Recent academic research from Rutgers University Professors Blasi and Kruse has shown that companies offering broad-based equity programs experience improved productivity (17% increase) and return on assets (2.3% increase).

III. TO QUALIFY OR NOT TO QUALIFY? >

There are two types of ESPPs: 423 plans and non-qualified ESPPs. The majority of US companies have chosen to operate a 423 plan. In fact, of the companies participating in the NASPP survey, 80% of those operating an ESPP did so under a qualified arrangement, up from 56% in 1996. The main tax differences are listed below.

423 PLANS

> No income and/or social security tax is levied at the time of purchase.

> Employees pay tax at the time of sale, and a significant portion of the taxable amount can be treated as a capital gain, assuming certain holding periods were met.* Should the employee sell prior to satisfying the holding periods, they will pay ordinary income tax on the discount at the time they purchased the shares (much like a non-qualified ESPP). Any post-purchase stock price increase is a capital gain.

> No corresponding corporate tax deduction is allowed unless a "disqualifying disposition" occurs, in which case a deduction equal to the discount at purchase can be taken.

> Special reporting requirements (under IRC 6039) apply.

* The stock must not be disposed of within two years from the date that the option is granted or within one year after the transfer of the stock to the individual (so-called "disqualifying dispositions").

NON-QUALIFIED ESPPs

> Ordinary income and social security tax is levied on the discount at the time of purchase.

> Company can obtain a corporate tax deduction for the discount at the time of purchase.

You are probably wondering why companies would choose to operate a non-qualified ESPP if the benefits of a 423 plan are greater. Again, the most common reason for selecting a non-qualified ESPP is to avoid the design constraints imposed by Section 423.

IV. ACCOUNTING IMPLICATIONS OF ESPPs

The relevant accounting standard (ASC 718) details two types of ESPPs: compensatory and non-compensatory. To be considered non-compensatory, the plan cannot offer (i) a discount that exceeds 5% or (ii) option-like features (e.g., lookback). Though non-compensatory programs do exist, their use remains an infrequent practice (<20% prevalence per the 2015 NASPP Survey).

The majority of ESPPs offer discounts exceeding 5% and, as a result, are treated as compensatory. This requires the recognition of a plan-related expense. Like other stock-settled awards, the expense is generally fixed and involves a grant date valuation. This valuation includes three components: value of any discount, value of a call option, and value of a put option. Each of these components is described in more detail below.

PLAN FEATURE	DESCRIPTION	FAIR VALUE OF COMPONENT
Discount	% of Discount	Typically the largest component of the expense. This is the % reduction in the purchase price per share.
Lookback	Ability to purchase at LOWER market value between beginning of offering period market value and purchase date market value. Ability to benefit from increase in stock price.	Call Black-Scholes Option
No Beginning Price Limit	Ability to purchase MORE shares if price declines (number of shares to be purchased not limited by beginning price). Ability to benefity from decrease in stock price. May not apply to plans without a lookback.	Put Black-Scholes Option

Participation rate is the primary driver of expense since the initial charge is based on the anticipated number of shares to be purchased—a figure that is derived from the anticipated employee contributions for the period. As a result, ESPPs are often viewed favorably from an accounting perspective, since these programs arguably offer the most realistic expense of any equity vehicle. That is, the company only pays for the value actually delivered to its employees, as opposed to a moment-in-time "best guess" of what will be delivered in the future.

V. PLAN DESIGN >

Since participation rates are often viewed as the key measure of a plan's "success," competitive plan design is crucial. Implementing an ESPP with non-competitive design features can be a costly mistake, as participation levels are likely to be quite low while the administrative cost associated with establishing the plan is fixed. Therefore, the goal of any ESPP should be to maximize participation. We have provided some best practices surrounding the most significant ESPP plan design considerations.

BEST PRACTICES: QUALIFIED OR NON-QUALIFIED?

The overwhelming majority (82%) of companies operating an ESPP are doing so under a qualified arrangement (i.e., an IRC 423 plan). This is mainly due to the preferential tax treatment afforded under such plans.

BEST PRACTICES: DETERMINATION OF DISCOUNT

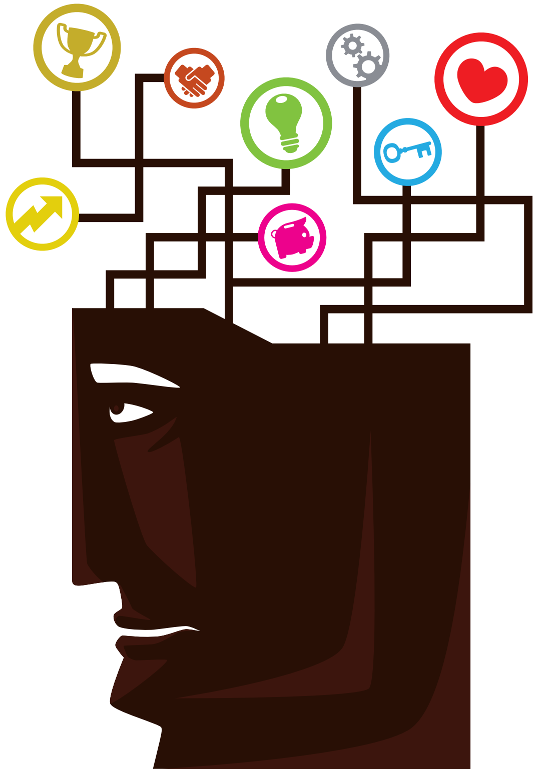
According to the 2015 NASPP survey, over 70% of the companies with 423 plans offered an automatic discount of 15% applied to the purchase price, which is the maximum discount allowed under a qualified plan.

BEST PRACTICES: LOOKBACK FEATURE

When the plan applies the discount to the lesser price of either the first day of the offering period or the purchase date (i.e., last day of the offering period), this is called the lookback feature. Lookback features greatly enhance the benefits of an ESPP and have become the industry practice with over 60% of 423 plans containing such a provision.

BEST PRACTICES: OFFERING PERIOD

Employee contributions accumulate during the length of time known as the "offering period." Under section 423, companies have the ability to extend the offering period up to 27 months. The longer the offering period, the greater the potential benefit is to employees where the plan has a lookback feature. But this benefit comes at a cost to the company—namely, in the form of a larger accounting expense. Most plans, however, continue to provide a six-month offering period (approximately 50% according to the most recent NASPP survey).



Section II: Major Considerations for a Global Plan

While there are a range of technical and strategic issues associated with extending ESPP participation to a global population, some of the more significant considerations include:

1) What are the local HR administrative and compliance requirements?
2) Are we taking advantage of tax optimization opportunities such as delivering the benefit through a local "qualified" plan mechanism or recharging plan costs to the local affiliates?
3) How are we going to communicate the plan and its impact to employees?

These questions, including our recommended courses of action, are addressed in detail on the following pages.

I. COMPLIANCE + REGULATION >

The global regulatory environment governing equity compensation varies widely. So, we strongly encourage companies to recognize the importance of understanding the intricacies of local regulations (e.g., local payroll tax withholding and reporting obligations, securities filings, foreign exchange restrictions, payroll deduction limitations, etc.). Following are examples of the types of questions that need to be addressed to ensure global compliance:

> Do you need to file the plan with a regulatory body such as a local securities board or national bank?
> Are payroll deductions allowed in the countries in which you would like to offer ESPP participation?
> Are there any payroll withholding or reporting obligations for either the employee or the employer that result from the program?
> Is there a requirement to set aside the employee contributions in a separate corporate account?

ISP ADVISORS RECOMMEND...

A typical first step in understanding the relevant compliance considerations is to conduct a due diligence review of the countries in which you are contemplating extending participation. The review should cover—at a minimum—the following:

> An overview of the labor law considerations such as acquired rights laws, data protection, etc.
> Regulatory filing and notification requirements (e.g., with the local securities commission, tax authorities, etc.).
> Points of taxation for income tax, social tax, and any other applicable taxes.
> Tax withholding and reporting requirements and responsibilities for the local employer and the employee.
> Payroll deduction parameters.

II. TAX OPTIMIZATION >

LOCAL QUALIFIED PLANS

Numerous analogs to a section 423 plan exist throughout the globe. Some of these vehicles include France's Plan d'Epargne d'Entreprise (PEE), Spain's 12,000 EUR broad-based stock plan exemption, and the UK's Share Incentive Plan (SIP). While some of these benefits can be realized through minor plan design adjustments, others require extensive changes to a 423 plan's fundamental design and administration.

ISP ADVISORS RECOMMEND...

Companies should perform a cost/benefit analysis for each country with qualified plan opportunities. ISP Advisors can define the modifications necessary to implement, summarize the benefits available to the employer/employee, and address local barriers to implementation including the impact on plan administration. This analysis is critical in validating the employer's rollout decisions, determining if local customization should be considered, and identifying areas for improvement in program efficiency.

CORPORATE CHARGEBACKS

One of the drawbacks of a 423 plan is that a US corporate tax deduction is not allowed for the costs associated with the ESPP (i.e., the discount at purchase). An exception to this, however, occurs when employees trigger a disqualifying disposition. For costs associated with employees of the company's foreign subsidiaries, it is possible to obtain a corresponding deduction. However, this deduction cannot be taken at the US parent level, as the US parent cannot take a corporate tax deduction for the costs associated with employees of its foreign subsidiaries. Obtaining corporate tax deductions for such employees requires a chargeback agreement (also referred to as a recharge agreement) under which the foreign subsidiary agrees to bear the local cost associated with the plan. This arrangement could offer significant tax savings (assuming the local affiliate is profitable) for the company's foreign affiliates as well as make the use of Foreign Tax Credits more efficient from a US corporate tax standpoint, especially where an excess foreign tax credit position exists.

ISP ADVISORS RECOMMEND...

When implementing a chargeback, the company should enter into the agreement PRIOR to the grant of any award to ensure an arms-length transaction (although one should try, wherever possible, to capture previous equity-based compensation grants as well). ISP Advisors can assist with the drafting of chargeback agreements and work with your tax department to determine the most appropriate use of the funds repatriated through chargebacks.

III. EMPLOYEE COMMUNICATIONS >

Our experience has shown that employee communications are often the catalyst to successful equity compensation arrangements. However, since ESPPs contain many layers of complexity (i.e. administrative rules, tax rules, investment considerations, etc.), it can prove challenging to generate a sense of excitement around the plan. To maximize participation, it is important to ensure that employees—many of whom may be new to share ownership and investment markets—have a solid understanding of the plan's implications. Employees will also want to know why the company is providing this benefit as well as the benefits of long-term stock ownership. Sending out messages like, "Team, we're going to offer you a benefit that provides a guaranteed return on your investment," can really make a difference.

Some countries (e.g., Belgium) will require the company to provide the employee with appropriate local language communications. In other countries such as Japan, the failure of companies to communicate the personal tax responsibilities to their employees has resulted in embarrassing publicity when it was later determined by the authorities that the employees had failed to report such income. Therefore, communications will be required for countries in which the employee is responsible to settle their outstanding tax liability (i.e., where no local employer reporting/withholding is required).

ISP ADVISORS RECOMMEND...

Global implementations raise unique employee communication issues not found in a typical US communication program. Works councils, translations, varying cultural norms and traditions, different levels of employee awareness, and multiple personal tax implications all require global experience and leadership. Best-practice communication builds on the opportunity to further engage employees in corporate brand values, reinforce the link between job performance and reward, and provide employees with a stake in the company's overall future. To benefit from the outstanding opportunities and avoid high-risk pitfalls, we believe the approach needed to communicate your ESPP during every stage of the process should be as disciplined and sophisticated as an external marketing or public relations campaign.

Frequently Asked Questions

I. GENERAL >

Q: Are there any international issues to consider when implementing a 423 plan in the United States?

A: Yes. One of the conditions that must be met in order to establish a 423 plan is that the plan is extended to all employees. This would include employees of a foreign entity if the foreign affiliate were a branch of the US parent. This is because a branch entity of a US parent is regarded (for US purposes) as being the same legal entity. As such, it would be required that participation was offered to such employees at the same time that participation was offered to the US employees. Employees of foreign subsidiaries, however, can be excluded from the plan.

Q: Is there any way to determine whether the benefit of extending ESPP participation to international employees would outweigh the costs?

A: Yes. This is extremely valuable when looking at countries with low employee populations. We can help companies perform a cost/benefit analysis that measures the total projected benefit recognized by employees (factoring in local population, estimated participation, etc.) against the cost of implementation on a per-country basis. If the cost to extend participation outweighs the benefit, we recommend providing a replacement plan benefit to avoid internal equity issues and employee dissatisfaction.

Q: Is there any performance measure that I can use to determine the "success" of an ESPP?

A: Yes. When it comes to ESPPs, success typically is measured in terms of participation. While historical figures show participation averaging around 25%, we believe in setting a target of 40%. Competitive plan design, coupled with a robust communications campaign, will be the driving force behind employee participation.

Q: How long would it take to roll out an ESPP to international employees?

A: This would depend on the number of international locales in which the company would like to extend participation. For companies with more than 20 jurisdictions intended for ESPP rollout, you may wish to use a phased-in approach. This is because it is easier to roll out an ESPP in what we refer to as "green light" countries (e.g., Canada) than in those countries in which filing requirements could apply (e.g., Japan). Note, however, that to ensure high participation, ample time must be given to developing and rolling out the communications strategy before the first plan enrollment date.

ISP ADVISORS RECOMMEND...

Look at the countries in which you would like to offer ESPP participation. Based on local headcount figures and the relative ease of implementation, develop a phased-in approach.

II. PLAN DESIGN

Q: What is a lookback feature?

A: This is a feature used in conjunction with determining the purchase price of the company shares at the end of the offering period (or, if the offering period is greater than six months, the interim purchase period). It greatly enhances the plan's potential benefits by allowing the purchase price to be determined by applying the discount (typically 15%) to the lower of the fair market value of company shares at either the beginning or end of the offering period (should the shares depreciate over the offering period). As such, it often allows for employees to purchase company shares at a discount well in excess of 15%.

Q: Do companies typically require a holding period after shares are purchased via an ESPP?

A: Some companies have required shares purchased through an ESPP to be restricted from subsequent sale until the holding provisions of section 423 are satisfied. While this plan feature is welcomed by shareholders, it often serves as a deterrent for would-be plan participants. Moreover, with respect to international participants (where tax is typically levied at the time of purchase), such provisions may place undue cash-flow hardship on the plan participant, as they would be required to pay the required taxes out of pocket.

Q: What is an offering period?

A: It is the period of time during which employees accumulate funds via payroll deductions. The offering period begins with the first payroll deduction and ends at the time the shares are purchased. This is also referred to as the accumulation period.

Q: Do I pay interest on the employee fund accumulated via payroll deductions?

A: Usually not. Most plans do not pay interest on the payroll deductions. However, some countries may require that the company pay interest for plan participants in that jurisdiction.

III. PARTICIPATION LEVELS >

Q: What is the average participation level for US companies operating global ESPPs?

A: According to the latest NASPP survey, the average participation was approximately 25%.*
But we believe it can go much higher, since certain design features can significantly influence participation. For example, one would expect greater participation in a 15% discount, six-month lookback plan than in a 5% discount, no lookback plan.

* Note, however, that this average should not be viewed as a goal against which to measure a plan's success. Participation levels have been known to reach as high as 80%.

ISP ADVISORS RECOMMEND...

Pay special attention to plan design and communications to ensure that participation is maximized.

Q: My company has already implemented a 423 plan in the US and has extended participation to our international employees. However, participation levels have historically been quite low at around 10%. Why?

A: There are a number of reasons why participation could be low: non-competitive plan design, lack of effective communications, lack of confidence in the company or market as a whole, etc. Therefore, it is important to make sure that you have identified the root cause behind the lack of participation before choosing to redesign the plan.

Q: Is there any way to increase participation in an ESPP?

A: Absolutely. The first step toward increasing participation is identifying the root cause behind the lack of employee interest. Only once this cause has been identified can one take the necessary steps to resolve it.

IV. COMPLIANCE >

Q: Are there any securities filing requirements that I need to be aware of when extending my ESPP to employees of our international affiliates?

A: Potentially. In certain countries, you might be required to file your plan with the local Securities and Exchange Commission or similar authority. Failure to comply with such regulations could have severe repercussions.

Q: Do I need to translate my plan documents (including the communications)?

A: Potentially. In certain jurisdictions such as Belgium, for instance, all plan and plan-related documents need to be translated into either French or Dutch. Again, this information should be researched prior to rollout.

Q: Due to employee turnover in our local offices, it is difficult to maintain compliance: when the current plan champion leaves, they often take the administrative knowledge with them leaving the new plan champion unaware of the administrative requirements (e.g., withholding and reporting). Is there any way to ensure continued compliance?

A: This situation underscores the importance of documenting administrative procedures. By preparing a manual that captures (i) the local compliance requirements and (ii) the internal policies and procedures that support the plan, continued compliance can be achieved with ease.

V. TAX ISSUES >

Q: Can international participants benefit from the same tax advantages afforded 423 plans in the United States?

A: No. Section 423 is only applicable in the US.

Q: Are there any countries that offer similar tax-preferred treatment as the 423 plan?

A: Yes. Like the US IRC 423 plan, the UK SIP and the French PEE receive favorable tax treatment.

Q: When are employees typically taxed outside of the United States?

A: Most countries impose tax on the discount at the time of purchase. However, the risk of tax at grant and/or sale does exist in some jurisdictions.

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