AMERICAN COALITION OF STOCK PLAN ADMINISTRATORS

MOBILITY TAXATION

A GUIDE FOR ISSUERS

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The American Coalition of Stock Plan Administrators (ACSPA)

Mobility Taxation Guide

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The American Coalition of Stock Plan Administrators (ACSPA) is an industry trade organization focused on improving the administration of U.S. based employee equity plans. It is comprised of the leading administration and technology firms who provide services to U.S.-based employers who offer employee stock plans. Collectively, ACSPA members administer the interests of thousands of plan sponsors and millions of participants worldwide.

ACSPA's mission is to facilitate:

- **Awareness** among regulators, law-makers and key industry constituencies to the needs and challenges of plan sponsors and the impact of potential changes in policy, laws or regulations.
- **Collaboration** among the industry-leading firms to improve processes and communication.
- **Communication** of best practices within the industry that promotes greater effectiveness and value of stock plans for both participants and corporations.
- **Promotion** of equity plans to non-participating corporations within the U.S.
- **Administration** efficiencies through proactive and open dialogue with key constituents including industry group plan designers and consultants.

The purpose of this Guide is to educate key stake-holders of the administrative considerations of tracking and collecting tax information for the mobile employee. This document is not designed to be seen as legal, tax or accounting advice, but rather a guide to the general issues in the area of employee stock plan taxation and mobility.

If you would like to learn more about ACSPA and its member firms please visit **www.acspa.org** or email **info@acspa.org**.

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Executive Summary

A Mobile Employee is an employee who works in more than one Tax Jurisdiction between the grant of an Equity Award and when the Equity Award is taxable under local law. A Tax Jurisdiction can be a country, state, city, or region. Each Tax Jurisdiction that the Mobile Employee has worked in may tax some or all of the income associated with that Equity Award.

Rules in Tax Jurisdictions regarding the taxation of Equity Awards vary. Equity Awards may be taxed at grant, vest, exercise, sale, or at the point that an employee permanently leaves that location. When an employee moves from one Tax Jurisdiction to another, each Jurisdiction may have the right to tax the employee on the income from the Equity Award and the employee may pay tax in more than one location. The Mobile Employee may even be subject to tax in a Tax Jurisdiction where (s)he no longer lives or works. This is known as a Trailing Tax Liability.

This Guide is intended to assist a company with the information it might need to gather before complying with its income reporting and tax withholding obligations for Mobile Employees. It is intended to address mobility compliance for employees only; some, but not all, of the concepts may be applicable to other individuals, such as contractors, self-employed individuals, beneficiaries, etc.

Glossary of Terms

Types of Mobility

Assignee (also known as an expatriate, inpatriate, or third-country national): an employee who is on a company-sponsored assignment to another Tax Jurisdiction for a pre-defined period of time, usually three to five years. Assignees are usually tax-equalized to their home country.

Business Traveler: an employee who remains on one payroll and resides in a single Tax Jurisdiction, but travels for short periods of time to work in other Tax Jurisdictions.

Commuter: an employee who is assigned to work in another Tax Jurisdiction for a period of time, but does not relocate to that location. A commuter would typically work in a non-resident location from Monday to Thursday and return to their home location for Friday and the weekend. For the purposes of this document, a Commuter is included in the term Business Traveler.

Localized Employee: often refers to a Permanent Transfer or an Assignee who has decided to stay in their Host location and has been phased out of receiving assignment benefits, essentially becoming a Permanent Transfer.

Mobile Employee (also known as an Assignee, Business Traveler, or Permanent Transferee): an individual may be (or has been) all three types of Mobile Employee over time.

Permanent Transfer: an employee who moves from one Tax Jurisdiction to another Tax Jurisdiction. The move encompasses both work location and residence.

Telecommuter: an employee who works from his/her residence in one Tax Jurisdiction for an employer in another Tax Jurisdiction. While this definition is included in this Guide for completeness, Telecommuters are not necessarily Mobile Employees.

Tax Terms

Certificate of Coverage: a document issued by the social security administration of an Assignee's Home country under a Totalization Agreement with the Assignee's Host country, so that social security taxes only need to be paid to the Home country.

Double Income Tax Treaty: an agreement between two countries that explains how individuals and companies doing business in both will be treated for tax purposes. The provisions within a Double Income Tax Treaty may determine which country is deemed to be the country of residence, and how to deal with situations where both countries would otherwise subject an element of income to taxation.

Gross-up: where the company pays the taxes for an individual, as is common under Tax Equalization, the taxes paid are a taxable benefit and so is the tax on tax. A gross-up calculation determines the final amount of tax owed by the company.

Home: the initial work and residence Tax Jurisdiction for a Mobile Employee.

Host: the Tax Jurisdiction in which a Mobile Employee works.

Hypothetical Tax (hypo-tax): the amount an individual pays to the company under Tax Equalization. As hypo-tax is not a real tax, it is typically treated as negative income with the company picking up the actual tax liabilities in the Home and Host locations.

Reciprocal Agreement: an agreement, typically between neighboring Tax Jurisdictions, which dictates how residents of one Tax Jurisdiction will be taxed when working in the other.

Shadow Payroll: a payroll in a Host location that reports taxable income and pays taxes to the relevant tax authority, but from which the individual receives no pay.

Tax Equalization: an agreement between a company and an employee, usually an Assignee, that the employee will pay no more tax than (s)he would have done if (s)he remained working in the Home location. The amount of equity subject to Tax Equalization is sometimes limited to a cap, e.g., $50,000 a year, and any tax implications of income over that cap are the employee's responsibility.

Tax Protection: similar to Tax Equalization, but the company only pays for any taxes over and above what the individual would have paid if (s)he stayed in the Home location.

Tax Jurisdiction: a country, state, or province.

Totalization Agreement: an agreement between two countries, similar to a Double Income Tax Treaty, that covers social security taxes only. A Totalization Agreement typically provides for Certificates of Coverage to document continued participation in the Home country social security scheme.

Trailing Tax Liability: the liability an individual has to a Tax Jurisdiction after leaving. It is typically associated with income earned in that Tax Jurisdiction but paid/received at a later date.

Equity Awards

Employee Stock Purchase Plan (ESPP): a plan that permits employees to purchase company stock, often at a discount, generally through payroll deductions. A §423 plan is an example of a U.S. tax qualified ESPP.

Equity Award: an Incentive Stock Option, Non-qualifying Stock Option, Performance Award, Restricted Stock grant (Award or Unit), Stock Appreciation Right or an award under the Employee Stock Purchase Plan.

Incentive Stock Option (ISO): a Stock Option that qualifies under IRC §422.

Non-qualifying Stock Option (NQSO): a Stock Option that does not qualify for favorable tax treatment under IRC §422.

Performance Award: an Equity Award whose vesting is conditioned upon the achievement of specific performance criteria. Performance Awards can be structured as Stock Options or as Restricted Stock.

Restricted Stock Award (RSA): an offer of shares that confers shareholder rights from the time of grant, but which the employee cannot sell or transfer until vested. Typically if the employee terminates employment prior to vest, the award is forfeited.

Restricted Stock Unit (RSU): the right to receive shares after the vesting period.

Stock Appreciation Right (SAR): a right to receive a bonus equal to the appreciation in the company's stock over a specified period, similar to Stock Options, SARs may be paid in cash or shares.

Stock Option: the right to purchase shares in the future at a fixed price. Stock Options may be ISOs or NQSOs.

Transaction: for the purposes of this document, Transaction refers to the taxable event of an Equity Award, usually exercise for stock options, vest for restricted stock awards, vest and release for restricted stock units.

Getting Started

Often companies find getting started the hardest step. There is no one correct way to get started. However, the main steps that companies may consider include

- ► Gather the team of stakeholders to discuss the issue, gather input and assist throughout the project. A list of potential stakeholders is listed in the section entitled *Stakeholders*.
- ► Determine the company's mobility compliance exposure areas. These vary by company and may be related to types of Mobile Employee, types of Equity Awards, related to a certain division within the company and/or certain jurisdictions. For example, a company may have a professional services division that sends a large number of Business Travelers to work temporarily on client sites; another company may be relocating employees from one subsidiary to another in a different Tax Jurisdictions.
- ► Once the risk is understood, determine whether and how the company will phase-in compliance processes; for example, starting with the higher risk Mobile Employees or Tax Jurisdictions before expanding compliance processes to lesser risk areas.
- ► Determine the company's ideal mobility process; compliance processes may be done in-house, outsourced, or automated.
- ► Assess the company's existing systems to establish whether the ideal process can be achieved using current systems, whether any manual workarounds are required and/or whether a system upgrade is required. See *Assessing System Capabilities*.
- ► The company should also evaluate whether it has all the demographic data needed for compliance and if any further data needs to be gathered. See *Demographic Data*.
- ► Other sections of this Guide may help with implementation decisions such as *Tax Position Review, Risk Management Decisions* and *Employee Policies*.

Stakeholders

In order to properly implement a mobile employee equity compliance project, several stakeholders are likely to be involved. This may vary by company and its type of Mobile Employees.

One of the challenges of a mobility compliance project is to get the right stakeholder(s) to take ownership. Ownership varies by company and sometimes by type of Mobile Employee. The owner of the process can be any of the internal stakeholders noted below, although typically it is Stock Administration, Global Mobility, or HR. If a large number of the Mobile Employees are Business Travelers, the ownership may fall to the Payroll department.

Internal Stakeholders

Finance and Accounting ensures proper accounting for actual tax authority payments, hypo-tax retention, corporate tax deductions, and deferred tax assets. This group also is responsible for recording all accounting entries in the company financial records.

Global Mobility, depending on the company, the Global Mobility department may be involved by:

- Providing mobility data.
- Developing employee policies.
- Communicating with employees.
- Managing the company sponsored tax return preparers.

Human Resources may play several roles in a mobility compliance process:

- Providing mobility data.
- Developing employee policies.
- Communicating with employees.

IT plays a role where the tax solution is automated. In many cases, they can also be involved in the automation of data exchange between systems.

Legal ensures that any communications with the employees are appropriate and do not expose the company to liabilities.

Payroll processes the tax withholdings and deposits the actual tax payments with the Tax Authorities, as prescribed under local payroll regulations. Depending on the types of mobility, U.S. payroll, local payroll in each country, or both need to be involved in reporting the correct amounts under local law.

Stock Administration, as owner of the administration of Equity Awards processes the Transactions.

Tax Department (corporate) may be involved in several ways:

- Making tax position decisions.
- Assessing the impact of mobility on chargebacks.
- Ensuring Mobile Employee activity does not create an unwanted taxable presence for the corporation (nexus).

Other departments may have an adjunct role to play in the mobility compliance process, such as internal audit and Sarbanes-Oxley Act (SOX) compliance.

External Stakeholders

Broker may calculate the tax withholding due, undertake the transaction, calculate the accounting entries and remit funds to the employee, depending on the way the company has set up its system(s).

Stock Plan Service Providers may calculate the tax withholding due, undertake the transaction, and calculate the accounting entries, depending on the way the company has set up its system(s).

Tax Consultants provide tax advice on the tax treatment of Equity Awards for Mobile Employees. These providers may also work in conjunction with Stock Plan Service Providers, Payroll, HRIS, and other technology systems to calculate the tax withholding due at the time of the taxable event.

Tax Return Providers may prepare tax returns for Assignees and potentially other types of Mobile Employees. If the Tax Return Provider is a different firm than the Tax Consultant, the company should make sure that both vendors agree on the tax positions taken, or that the Tax Return Provider will accept the tax positions taken by the Tax Consultant. Otherwise, the withholding taxes may be calculated on one basis and the Tax Return Provider will recalculate the taxes due on the Mobile Employee’s tax return.

General Tax Principles

In general, a resident of a Tax Jurisdiction is taxed on worldwide income by the Tax Jurisdiction, but a non-resident is taxed on sourced income. Worldwide income means the total income of an individual in a particular tax year regardless of where it is earned or paid. Sourced income means the income of an individual which is deemed to arise from a source in that Tax Jurisdiction. The rules for determining sourced income are complex and vary by the type of income. Common methods of sourcing income from Equity Awards include:

- Applying the ratio of work days in that Tax Jurisdiction between date of grant and date of vest as compared to total work days from date of grant and date of vest to the full income; and
- Applying the ratio of work days in that Tax Jurisdiction between date of grant and date of exercise as compared to total work days from date of grant and date of exercise to the full income.

As different Tax Jurisdictions may have different sourcing rules, it is possible to pay tax in more than one Tax Jurisdiction since each has the right to tax the income. There are various ways to avoid double taxation. Some Tax Jurisdictions tax only a portion of the income. Some tax 100% of the income, but allow a tax credit for tax paid to another jurisdiction (i.e., tax credits). Tax credits provide an offset for income that is double taxed by reducing actual tax by tax paid in another Tax Jurisdiction.

Some countries assess an exit tax when the employee leaves the country. To avoid future compliance and collection problems, the individual is taxed as though the Equity Award was taxable when the employee moves. An exit tax can create problems for the employee. Tax may be due even though the Equity Award has not vested. The exit tax may not be adjusted to reflect subsequent decreases in the value of the award. An exit tax may also complicate the foreign tax credit calculation when a taxable Transaction occurs while the Mobile Employee is resident in another country.

The reader should note that a U.S. citizen or green card holder is taxed on worldwide income regardless of where the individual is working.[1] Therefore, a U.S. citizen will always be taxable in the U.S. on 100% of the equity compensation, even though the person is working in another country. Certain exemptions, exclusions, and tax credits may apply to reduce the amount of U.S. tax payable.[2]

1 IRC §61 (a), IRC §7701 (a) (30).
2 IRC §901, IRC §911; Publication 525.

A person who moves to the U.S. for more than 12 months usually becomes a U.S. tax resident upon arrival in the U.S.[3] The determination of U.S. tax residency is very complicated and beyond the scope of this publication. A U.S. tax resident is taxed on worldwide income, including 100% of the income from an Equity Award even though the award was fully vested prior to establishing U.S. residency.

When a U.S. tax resident (who is not a U.S. citizen or green card holder) leaves the U.S. holding an Equity Award that has not been taxed, U.S. law provides that when the taxable event occurs, the employee is subject to U.S. tax on the portion of the income earned in the U.S. The Internal Revenue Service has issued regulations regarding the sourcing of income for purposes of where income is deemed earned. These regulations are effective January 1, 2006, for U.S. tax purposes. The regulations address multi-year compensation arrangements, including stock plans, transfers of restricted property, and other deferred compensation arrangements that generally relate to services performed over a period of more than one year. The sourcing is based on time apportionment and the applicable facts and circumstances. In the case of stock options, income is generally sourced based on the work location between the date of grant and the date of vest.

3 IRC §7701 (b) (3).

Risk of Non-Compliance

The rules surrounding Mobile Employees are very complicated. Compliance with the income reporting and tax withholding requirements in multiple Tax Jurisdictions and in multiple payroll systems is challenging. Historically, tax authorities have not focused on compliance for Equity Awards of Mobile Employees; however, this is changing. Some countries are targeting Mobile Employees for audits. Employees and companies that are not compliant may be subject to interest, monetary penalties, negative publicity, and, in some cases, civil penalties.

Penalties and enforcement actions vary by Tax Jurisdiction. In general, these would include failure to withhold, for Tax Jurisdictions with a withholding requirement on equity awards, and failure to report. Some Tax Jurisdictions target Mobile Employee compliance with their tax return filing requirements.

Under U.S. law, employers can be assessed the following penalties for failure to comply with the withholding and reporting requirements on W-2: [1]

- Failing to file on time.
- Failing to include all required information.
- Failing to meet electronic filing requirements.
- Failing to file compliant paper forms.
- Failing to include correct information.

1 IRC §6721.

Types of Equity Awards and Associated Taxation

While there are many different types of Equity Awards, this Guide covers those that are typically granted by U.S. based companies, namely Stock Options (both Incentive Stock Options and Non-qualifying), RSAs, RSUs, and ESPP. A brief description of these types of awards is provided in the Glossary of Terms section of this Guide.

Local law controls how the awards are taxed. The local law may provide that equity compensation is fully taxed or only a percentage is taxed. However, there are some common themes:

1. Not all countries tax awards in the same way. For example, at the time of publication, Australia will generally tax stock options at vest.[1]
2. Most U.S. states follow the Federal taxation of equity awards with a few notable exceptions:
   - Pennsylvania does not recognize the tax qualifying status of ISOs and ESPP.[2]
   - Some states, such as Hawaii, provide state level tax exemptions for certain plans that meet their requirements.[3]
3. Most countries tax RSAs at grant as the employee becomes the shareholder of record on the date of grant and there is deemed to be a transfer of property. Some countries, however, allow a discount on the taxable amount, as the shares are non-transferable at the time of grant.
4. Some countries have tax-favorable treatment for equity awards that meet certain conditions. These are common for France (stock options and/or RSUs),[4] Israel (stock options, RSAs and RSUs)[5] and the U.K.[6] Many other countries offer tax favorable plans, too. However, the tax-favorable treatment typically only applies in one country so that a tax preferred award in one country will not be treated as such in another. This can be especially problematic for a Mobile Employee who has received a tax favorable award in one country and then relocates to another before the Transaction occurs. In particular, some tax favorable awards, for example, those from France or Israel, mandate a holding period so a Mobile Employee with such Equity Awards will not be able to sell shares in order to pay tax in another country.

1 Division 83A of the Income Tax Assessment Act 1997.
2 61 Pa Code §101.6 (f).
3 HI Rev Stat § 235-9.5 (2013).
4 Article L. 225-197-1 of the French Commercial Code.
5 Section 102 of the Israeli Income Tax Ordinance [New Version] 1961.
6 Section 521 Income Tax (Earnings and Pensions) Act 2003.

Demographic Data

In order to calculate the income reporting and tax withholding required for Mobile Employees, companies should collect the information listed below. While all items of information are necessary for an accurate determination, most companies cannot collect every data element noted below. Those data elements that are generally necessary for a payroll tax withholding or reporting calculation which can be deemed reasonable upon audit by a tax authority are noted:

- Home country and state, if applicable (necessary).
- Host country and state, if applicable (necessary).
- Dates of work/relocation (necessary).
- Residence status in Host location.
- Residence status in Home location.
- Country, state, province, or canton, if applicable, of residence (both at the time of the event and also throughout the life of the award).
- Payroll country.
- Employer in Home location (e.g., U.S. corporation, branch of U.S. corporation, non-U.S. corporation, branch of non-U.S. corporation, etc.).
- Employer Host location (e.g., U.S. corporation, branch of U.S. corporation, non-U.S. corporation, branch of non-U.S. corporation, etc.).
- Tax equalization agreement.
- Hypothetical tax rate.
- Certificate of coverage.
- Citizenship.
- Visa status.
- Green card status.
- Marital status.
- Special tax treatment (e.g., expatriate agreements).
- Intended duration of stay.
- Applicability of income tax treaty.
- Conditions of grant (e.g., grant made on the transfer to the new country).
- Previous international travel for work.

In addition to the above details, the following information on the Equity Award (which should be readily available) is required:

- ► Date of grant.
- ► Type of award.
- ► Vesting dates.
- ► Service period.
- ► Date of transaction.
- ► Taxes paid prior to settlement (e.g., any taxes paid at grant, vest, exit).
- ► Prior options exercised from the same award (stock options and SARs).
- ► Whether the Equity Award has tax favorable status in any Tax Jurisdiction.
- ► Whether the Equity Award will be charged to an entity in any Tax Jurisdiction.

Mobility Compliance Challenges

In addition to the challenges of calculating the correct amount of income to be reported or tax withholding for Mobile Employees as outlined previously, there are several other challenges that sometimes are more complex and problematic for companies.

The first is gathering the data about the individual that would be required for the calculation. A typical list is outlined in the section on Demographic Data on page 14. Although this sounds very simple, many companies do not retain this type of information for their employees. Simply gathering work locations and dates can be an overwhelming task if the company has not kept clear historical records.

In addition, the data has to be kept in a way that can easily be accessed in the event of a transaction. If the HRIS is the system of record for mobility, it may not be feasible to run daily reports from HRIS to compare against stock transactions. There are several ways to address this issue depending on the solution chosen by a company and the capabilities of its systems. (See *System Capabilities.*) Possible methods include:

1. The grant number of each award can contain a reference to the employee's location at grant. At the time of the transaction, the administrator can compare the grant number with the employee's address record to determine if there is a difference. This method is very manual and the administrator would have to retain mobility data elsewhere in order to be able to calculate the tax withholdings due. In addition, this method would fail to capture situations where the Mobile Employee returned to his Home location.

2. A company can simply flag Mobile Employees in a user defined field. Some stock administration systems have the ability to run reports by user defined fields. This method is also manual and the administrator would have to retain mobility data elsewhere in order to be able to calculate the tax withholdings due.

3. Some stock administration systems have the ability to record address change fields, making it easier for the company to track Mobile Employees, run reports, and even calculate rudimentary taxes due.

4. Mobility data can be sent to a tax provider who can retain the data and use it when a calculation is required.

Another challenge is the payroll processing of the tax withholding made by the stock administration system. The following challenges (among others) can arise:

- Reporting an income amount greater than or less than the amount of the equity awards.
- Reporting for multiple jurisdictions.
- Reopening payroll for employees terminated from a local payroll system.

Some of these challenges may be mitigated by assessing systems capabilities upfront, and either developing a process around a limitation or by upgrading the current software. (See *System Capabilities* section.) However, some of these challenges need to be addressed through change management and communication with the payroll providers. Payroll compliance is the key reason to address mobility; therefore, companies should not fall short of the communication required with payroll providers to make mobility compliance a success.

Assessing System Capabilities

Depending on the type of mobility solution chosen, a company may need to assess the capabilities of its systems. This Guide does not address the capabilities of a system purchased or licensed solely to address mobility compliance; rather it focuses on the assessment of a company's existing systems. Moreover, this Guide does not suggest any specific minimum requirement.

HRIS

- Is there a global HRIS system?
- How much mobility data can be stored?
- Can historical data (former locations, etc.) be retained?
- Can reports of mobility data be run?
- Can an interface be built between historical data and other systems?
- How far back do records in the HRIS system go?
- Are all Mobile Employees in the HRIS system?

Payroll

- Can the payroll system report accept tax calculations from another system?
- Can the payroll system report income in more than one U.S. state?
- Can the payroll system handle a combined taxable income in two (or more) states that is greater than or less than the total income from the transaction?
- Can the payroll system report taxable income that is less than the full income from a transaction?
- Can the payroll system report an amount of taxable income for income tax that is different than the amount of taxable income for social security?
- Can the payroll system handle state taxable income when there is no Federal taxable income?

Stock Administration/Broker System

- Which system holds the tax rates data?
- How many different rates are allowed for each transaction?
- How are tax rates assigned? By Tax Jurisdiction? Employee? At the grant level? At the tranche level?
- Can the stock administration system hold employee demographic data?
- How many tax rate fields are available?
- Can the system produce taxable income and taxes withheld reports by Tax Jurisdiction?

- Will the financial accounting be impacted by the mobility information? For example, when the income for an individual employee is sourced over Tax Jurisdictions, the corporate tax deduction and consequently the DTA should be adjusted accordingly.
- Can the system allow for tax withholding based on different fair market values by jurisdictions (e.g., an employee moving between India and the U.S. will likely require two different fair market values)?

Employee Policies

A company should consider the following policy questions:

- ► Will there be pre-assignment communications?
- ► Will the income from Equity Awards be tax equalized?
- ► If so, will there be a cap on the amount subject to Tax Equalization?
- ► Will the company provide or assist with the costs for tax return preparation?
- ► Will the company include compliance for employees who have been mobile in the past or start fresh with new Mobile Employees?

A clear policy communicated upfront will avoid individual negotiations at a later date and will allow the company to make realistic cost estimates.

Tax Position Review

There are several ways for companies to approach the tax calculations:

- Internally, with prior advice from a tax professional.
- Outsourced to a tax provider, with the tax calculation done manually.
- Outsourced to a tax provider and automated.
- Utilizing an equity compensation provider that has full mobility taxation capabilities.

Although an outsourced automated calculation is ideal, it may not be feasible for all companies. Many considerations should go into the chosen approach, including:

- Number of Mobile Employees concerned and scalability.
- Amount of equity concerned. A company with 5,000 Mobile Employees with $1,000 in equity each may have different priorities than a company with 100 employees with $1,000,000 of equity each.
- Complication of mobility patterns. For example, a company whose Mobile Employees travel mainly within a few key Tax Jurisdictions would handle mobility differently than a company whose mobility patterns are more complex.
- Internal resources and their capabilities.
- Budget.

Regardless of who does the calculations or how they are done, an appropriate individual from the company should review the tax positions being taken by the Tax Consulant and approve them. Even in Tax Jurisdictions with a well-developed tax regime for Mobile Employees, there are different positions that can be taken by Tax Consulants. In particular the tax positions should be checked against:

- Any tax information provided to employees such as through a prospectus supplement.
- Positions taken on tax returns by company sponsored Tax Return Providers (usually for expatriates).

Tax positions should be reviewed at least annually and preferably more frequently, such as quarterly or prior to each major vest.

Communicating the Transaction

In an ideal world, a Mobile Employee should know about and understand the concept of the Trailing Tax Liability prior to becoming mobile. This is not always possible.

Once a transaction occurs, an employee should be able to review and understand the transaction statement, be able to provide it to their tax return preparer for inclusion in their tax return, and reconcile the statement with the funds received. Ideally the statement should include:

- Taxable income by Tax Jurisdiction.
- Taxes withheld by Tax Jurisdiction.
- FX rate used, if applicable.

Some systems can go further by providing the taxable income that would need to be reported in each Tax Jurisdiction even where no withholding has been required, e.g., for Australia or Japan.

Risk Management Decisions

While the goal is to be 100% compliant, many companies cannot reach that goal in one phase. Instead they need to start with their largest exposure areas and expand compliance to the full compliance goal. The largest exposure areas may be determined by reviewing the following:

- Types of Mobile Employees: do Business Travelers create more exposure than Permanent Transfers?
- Types of Equity Awards: many companies exclude ESPP from the compliance process, as the exposure may not be significant.
- Job type or grade: do employees in one division travel more than others? Is the income from awards for executives much greater than the income from other employees' Equity Awards?
- Key or high enforcement locations.

Once the company has assessed the exposures and determined initial steps, a few other policy issues must be addressed:

- Will there be a *de minimis* amount under which the company will not address mobility taxation? A de minimis amount represents a minimal risk. Each company should decide what represents a de minimis amount based on its risk tolerance.
- How far back should the company go?
- Is there a policy on the minimum number of days a Business Traveler must spend in a Tax Jurisdiction before the company starts to comply? Note that some Tax Jurisdictions, such as California, have a one-day compliance minimum that may not be administratively feasible for most companies.

Compliance needs to be an evolving process. If a company determines that full compliance is not their goal, they should review their largest exposures and reassess over time. Changes in company structure, numbers of employees, key locations, and types of stock plans can reposition those large exposures.

Illustrative Examples

The following examples are illustrative only. Many assumptions are inherent in these examples, including the demographic data outlined on page 14 that would be impractical to state for each example below. A company should not rely on these examples for application to actual circumstances.

International expatriate employee (tax equalized)

John, a U.S. citizen, is assigned by his employer from Texas, U.S. to Canada for a period of two years starting January 1, 2014. He is tax equalized and has a Certificate of Coverage to the U.S. He was granted a stock option on January 1, 2013, when resident in Texas. He exercises the stock option on February 1, 2014, during his assignment recognizing income of $10,000.

As John is tax equalized, he will pay hypo-tax on the income as follows:

> $10,000 x 25% = $2,500[1]

As John is under a Certificate of Coverage to the U.S., he will pay social tax on the income as follows:

> $10,000 x 1.45% = $145 (Assume he has earned over the FICA limit but not enough for additional Medicare tax)[2]

The company should treat the hypo-tax as negative income and pay grossed-up taxes on the net income to both the U.S. and Canada according to its sourcing and gross-up policies. John's final income and social tax liability for the year will be computed based on the company's tax equalization policy.

International permanent transfer

Anne, a German national, transferred from Germany to California, U.S. on July 1, 2013. She was granted an RSU on July 1, 2012. The RSU vests on July 1, 2014 recognizing income of $10,000.

Germany taxes equity income of non-residents based on German workdays from grant to vest over total workdays in the same period[3]; in this case that equates to 50% of the RSU gain.

German taxable income = $10,000 x 50% = $5,000.

1 In this example, the company used a hypo-tax rate of 25%.
2 SSA Publication No. 05-10198, January 2004, ICN 480199.
3 German Federal Tax Gazette (BStBI) I 2006 September 14, 2006.

Note that if the company is using net share withholding, they would likely have to agree with their auditors on the method for determining this individual's German tax rate. Determining the tax rate for a non-resident could be challenging as it is likely that Anne has no other income in Germany.[4]

The U.S taxes residents on worldwide income and the individual could take foreign tax credits for taxes paid to Germany on non-U.S. sourced income. However, using the non-discrimination clause of the German:U.S. Double Tax Treaty the company withholds U.S. Federal tax on U.S. sourced income only.

U.S Federal tax = $10,000 x 50% @ 25% = $1,250

California taxes residents on worldwide income and does not recognize Double Tax Treaties.[5]

California income tax = $10,000 x 10.23% = $1,023

SDI is due on $10,000 to the extent the individual has not reached the earnings cap.

The company has taken the position that social tax is due on income allocated in the same way as income tax. Some companies have taken the position that social tax is only due for the country of current employment if a Totalization Agreement exists between the two countries. Social tax withholding is required and would therefore be withheld based on the company sourcing policy.

International permanent transfer with difference in the taxation of awards

Simon, a French national, transferred from France to New York, U.S. on July 1, 2012. He was granted a French qualifying RSU on January 1, 2012. This RSU vests on January 1, 2014 but, as a result of the conditions for French qualification, the individual cannot sell the shares until January 1, 2016.

French taxes are not due until the shares are sold.[6]

U.S taxes residents on worldwide income. As there are no other taxes due at vest, the full income is subject to U.S. Federal, state and social taxes at vest.[7]

4 ASC 718 -10-25-18.
5 CA Publication 1001.
6 Article L. 225-209 of the French Commercial Code.
7 IRC §61 (a), IRC §7701 (a) (30).

Domestic permanent transfer with ISOs

Tammy, a U.S. employee, transfers from Minnesota to Georgia on April 1, 2012. She is granted an ISO while resident in Minnesota on April 1, 2011. The ISO vests on April 1, 2013, she exercises the ISO and immediately sells the shares.

The disqualifying disposition income reported on Tammy's W-2 for state wage reporting in respect of the ISO should be allocated as follows:

ISO income to be reported x 50%

For both Minnesota[8] and Georgia.[9]

Domestic permanent transfer with RSUs and non-qualifying options

Peter, a U.S. employee, transfers from Kentucky to New York on October 1, 2013. He was granted a restricted stock unit (RSU) and a non-qualifying stock option on October 1, 2012, when resident and employed in Kentucky. The RSU vests on October 1, 2014. The stock option vests in four equal annual instalments on October 1, 2013, October 1, 2014, October 1, 2015 and October 1, 2016.

The 2014 state income from the RSU is allocated as follows:

Kentucky – 50%[10]

New York – 50% plus the differential between the New York tax rate and the Kentucky tax rate on the 50% sourced to Kentucky.[11]

The state income from the stock option is allocated as follows:

Kentucky – full gain from the first vesting tranche when it is exercised
– fifty percent of the gain from the second vesting tranche when it is exercised
– one-third of the gain from the third vesting tranche when it is exercised
– one-fourth of the gain from the fourth vesting tranche when it is exercised

8 §290.17 and Department of Revenue Notice #8-10.

9 Rules of Department of Revenue Income Tax Division Chapter 560-7-4 describe the allocation of non-statutory stock options for non-residents. The author has extrapolated this treatment for statutory stock options.

10 103 KAR 18:010. Section 2.

11 N.Y. TAX. LAW § 671.

New York – will tax the remaining amounts plus the differential between the New York tax rate and the Kentucky tax rate on the Kentucky sourced income.

International business traveler

Claire is resident and employed in New Jersey, U.S. She travels frequently on business. In 2012 she travels to Denmark for 120 days starting in July 2012. In 2013 she travels to Denmark for another 90 days in the period January to June 2013. As Claire has worked in Denmark for more than 183 days in a twelve-month period, July 2012 to June 2013, she is not exempt from Danish tax under the Danish-U.S Double Tax Treaty.

Claire is granted a performance share unit (PSU) on July 1, 2012 and it vests on June 30, 2014. Claire works a total of 20 days a month (240 workdays in each year). The percentage subject to Danish tax is:[12]

$$\frac{(120+90)}{(240+240)} = 43.75\%$$

Domestic business traveler

Nathan is resident and employed in Texas, U.S. He travels to California to visit customers one week of every month. Nathan has been granted a restricted stock award (RSA) on which he did not make a 83(b) election. When the RSA vests, 25% of the income is subject to California income tax.[13]

12 Section 28 of the Danish Tax Assessment Act.
13 CA Publication 1100.