



Sourcing of Equity Compensation

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Agenda

Background

Sourcing and Multi-Jurisdictional Taxation 101

Taxation and Payroll Compliance for Equity Compensation

Examples

Administrative Issues

Best Practices

Questions

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Definitions

Assignees – including expatriates, inpatriates, third-party nationals

Permanent transfers

Business travelers – including commuters

Telecommuters

Tax Jurisdiction – a region capable of imposing tax, e.g. state or country

International Migrant – someone living in a country they are not born in

Equity compensation – an award of employer stock, e.g. stock option, restricted stock unit (RSU) etc.



Is the World Getting Smaller?

UN International Migration Report published December 2017 key findings:

- The number of international migrants worldwide has grown faster than the world's population
- The share of international migrants in the total world population increased from 2.8% in 2000 to 3.4% in 2017

2019 International Migration and Displacement Trends and Policies Report to the G20 key findings:

- More than 10 million people migrate permanently or temporarily to and within G20 countries in 2018 (this figure includes students and refugees)

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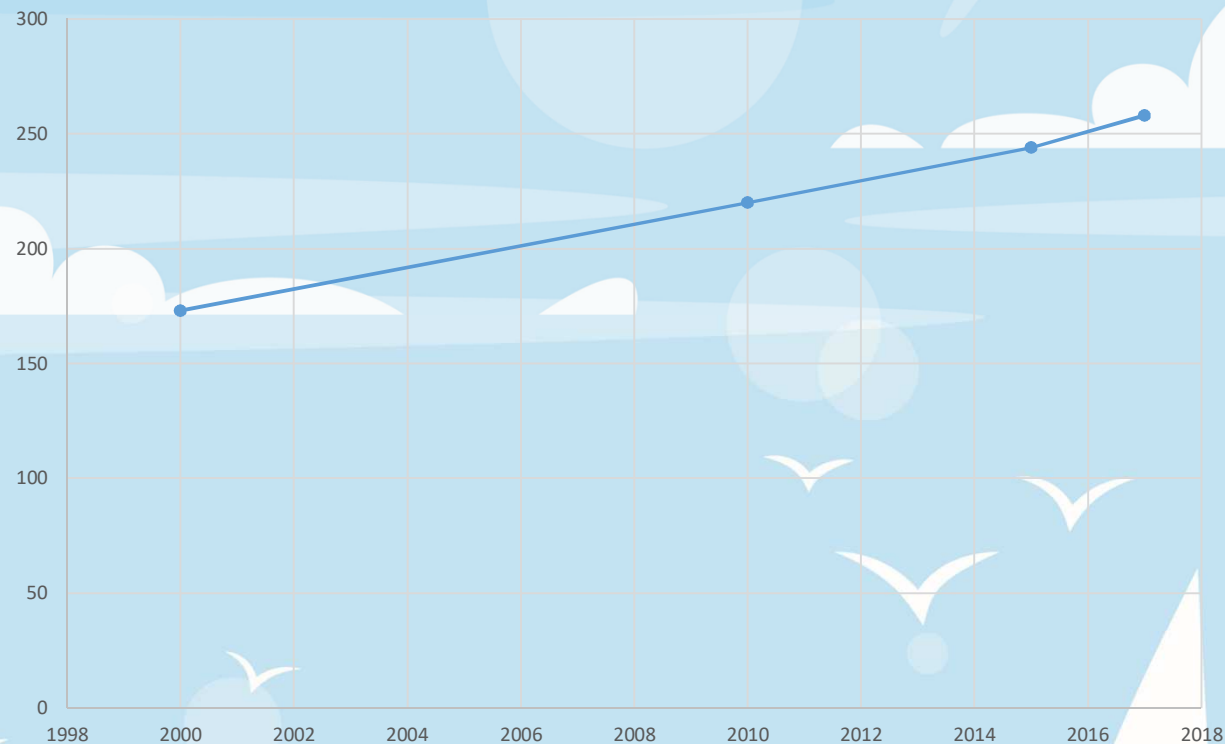




Number of International Migrants Over Time

In millions

Number of International Migrants



Note: From a 2016 report, the number of worldwide refugees was 25.9M

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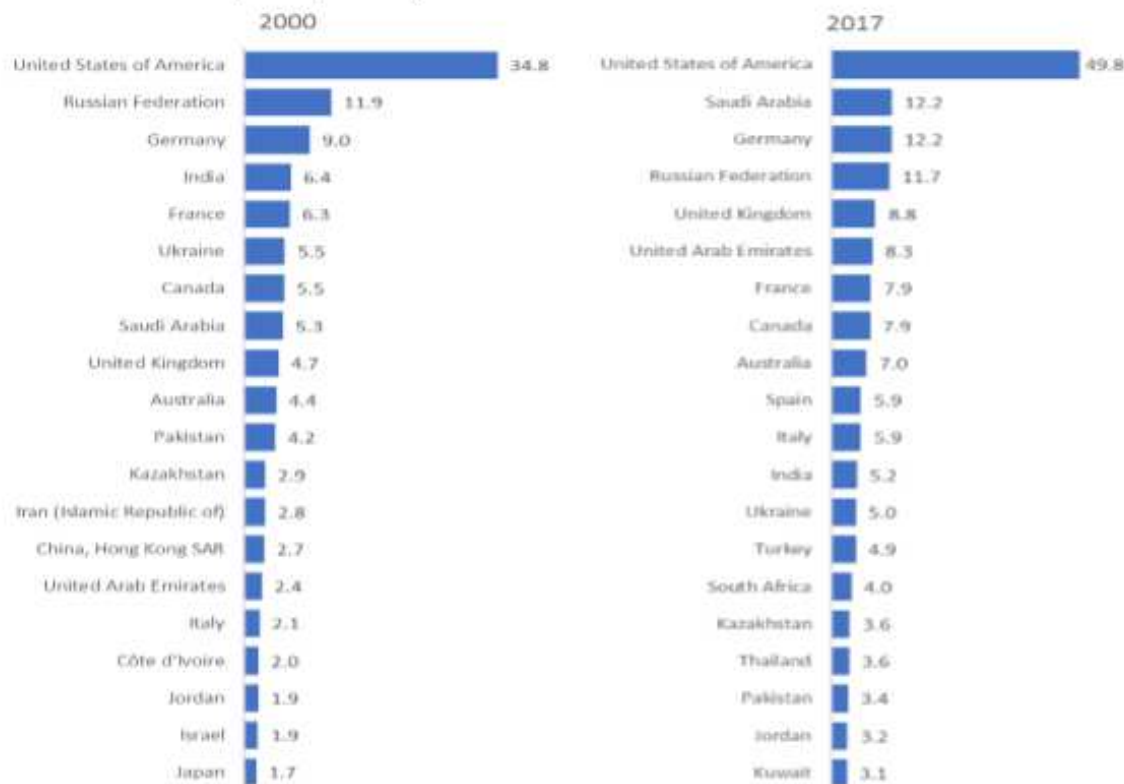
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Countries Hosting Migrants

Twenty countries or areas hosting the largest numbers of international migrants, 2000 and 2017, number of migrants (millions)



Source: United Nations (2017a)

Notes: "China, Hong Kong SAR" refers to China, Hong Kong Special Administrative Region

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Reasons Why Employees Move

Career

- Company needs
- Career opportunity

Family Needs

- Partner assignment
- Sick/elderly parent
- Better environment for family

Lifestyle Choice

- “I bought a beach house in Spain”



Corporate Concerns

Corporate nexus

Business licenses

Immigration & work visas

Labor law issues

- E.g., termination, severance pay, maternity leave

Statutory benefits

Payroll taxes & compliance

Focus of today's presentation

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Review: Multi-Jurisdictional Taxation 101

In general:

- Individuals are resident in one tax jurisdiction
- They may also have income from other tax jurisdictions where they
 - Are no longer resident
 - Were never resident
- Most jurisdictions tax:
 - Residents on worldwide income
 - Nonresidents on sourced income



Sourcing Principles

The general rule is that income is sourced where it is earned
If earned over time, the sourcing is over the “earnings period”
Each tax jurisdiction may have a different determination of

- Sourcing
- Earnings period

Sourcing ≠ taxability

Sourcing is important to determine:

- Amount subject to tax in nonresident jurisdiction
- Amount allowable for tax credits



Sourcing Examples

	Earned	Taxable*
Base salary	Daily	When paid
Bonus	Over bonus performance period or related to the achievement of a goal	When paid
Commission	Related to a sale	When paid
Pension	Daily	When paid – special rules may apply
Stock options	From grant to vest/exercise	When exercised
Restricted stock units	From grant to vest/release	When vested/released

* Assumes compliance with deferred compensation rules



U.S. Income Tax Sourcing Rules - Equity Compensation

Since January 1, 2006 'default' Federal sourcing is based on U.S. workdays from grant to vest

Some treaties state otherwise:

- U.S.: Canada
- U.S.: Japan
- U.S.: U.K.

Specific grants may require different sourcing

- E.g., an award granted for a project undertaken in a particular location

State sourcing may differ

- E.g., Arizona, California



California Income Tax Sourcing Rules - Equity Compensation

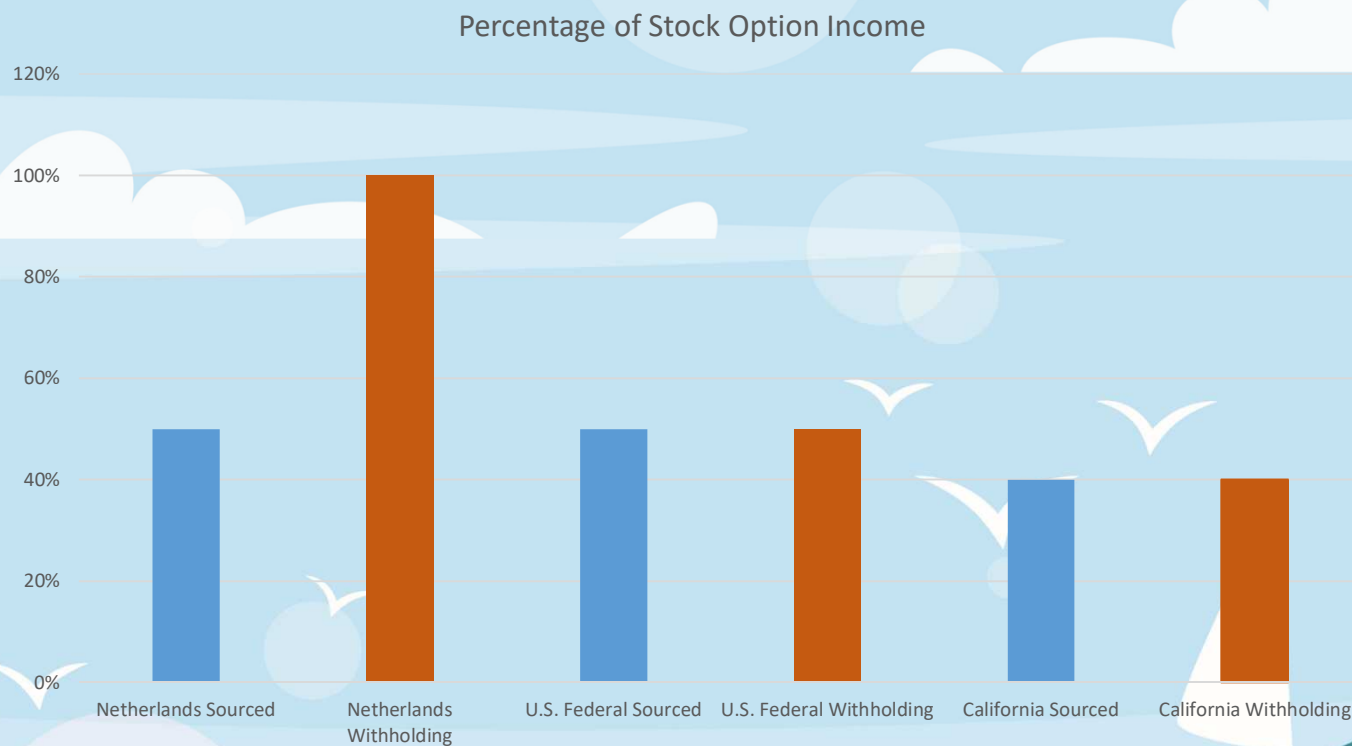
Income taxable to the extent earned in California

- Title 18 17951-2 Income from Sources Within This State includes *“compensation for personal services performed within this State”*
- Sourcing depends on percentage of workdays. 17951-5: *“...portion of the total compensation for personal services which the total number of working days employed within the State bears to the total number of working days both within and without the State..”*
- Non-qualifying stock option examples and audit manual use time between date of grant to date of exercise
- RSU guidance is to use time between date of grant to date of vest



Example 1: Sourcing For Equity Compensation

Anne, a resident of California, is granted a nonqualifying stock option which vests 100% on the 4th anniversary. She relocates to the Netherlands 2 years after the grant and exercises on the 5th anniversary of grant.





Income Tax Sourcing For Statutory Plans

Incentive stock options and employee stock purchase plans under §423 are not taxable until sale

Ordinary income should be sourced

	Ordinary income amount
ISO*	If disqualifying disposition – source W-2 reportable amount: <u>In jurisdiction workdays from grant to vest date (exercise for certain states)</u> Total workdays from grant to vest date (exercise for certain states) Calculation should be done separately for each vesting tranche
ESPP*	Source W-2 reportable amount: <u>In jurisdiction workdays from first date of offering period to purchase date</u> Total workdays from first date of offering period to purchase date



U.S. Payroll Compliance

U.S. citizen

- Report full income
- Withhold on
 - U.S. source income if other country withholding
 - Full income if no withholding in other country

U.S. resident (not citizen)

- Report full income
- Withhold on
 - U.S. source income if other country withholding and non-discrimination language in treaty
 - Full income if no withholding in other country or no non-discrimination language

U.S. non-resident (not citizen)

- U.S. sourced portion only



California Payroll Compliance

CA resident

- Report full income
- Withhold on full income less other state withholding

CA non-resident

- CA sourced portion only



Example 2: Inbound Employee

Bob, an U.K. resident is granted an RSU on January 1, 2015. He moves to California on January 1, 2018 and moves to U.S. payroll. The RSU vests and shares are delivered on January 1, 2019. The RSU income is \$8,000. Bob is not tax equalized.

U.K. reporting and withholding: $\$8,000 \times \frac{3}{4} = \$6,000$

U.S. reporting: \$8,000

U.S. withholding: $\$8,000 - \$6,000 = \$2,000$

CA withholding and reporting: \$8,000



Example 3: Outbound Employee

Carol, a CA resident and U.S. citizen, is granted an RSU on January 1, 2015. She moves to Australia on January 1, 2018. The RSU vests and shares are delivered on January 1, 2019. The RSU income is \$8,000.

Australia reporting: \$8,000

Australia withholding: None

U.S. reporting: \$8,000

U.S. withholding: \$8,000

CA withholding and reporting: $\$8,000 \times \frac{3}{4} = \$6,000$



Example 4: Outbound Employee

Debbie, a CA resident and U.S. citizen, is granted an RSU on January 1, 2015. She moves to India on January 1, 2018. The RSU vests and shares are delivered on January 1, 2019. The RSU income is \$8,000.

India reporting: \$8,000

India withholding: $\$8,000 \times 1/4 = \$2,000$

U.S. reporting: \$8,000

U.S. withholding: $\$8,000 - \$2,000 = \$6,000$

CA withholding and reporting: $\$8,000 \times 3/4 = \$6,000$



Example 5: Outbound Employee

Eric, a CA resident and German citizen, is granted an RSU on January 1, 2015. He moves back to Germany on January 1, 2018. The RSU vests and shares are delivered on January 1, 2019. The RSU income is \$8,000.

Germany reporting: \$8,000

Germany withholding: $\$8,000 \times \frac{1}{4} = \$2,000$
(participation exemption claimed)

U.S. reporting: $\$8,000 \times \frac{3}{4} = \$6,000$

U.S. withholding: $\$8,000 \times \frac{3}{4} = \$6,000$

CA withholding and reporting: $\$8,000 \times \frac{3}{4} = \$6,000$



Example 6: State Transfer

Frances, a CA resident, is granted an RSU on January 1, 2015. She moves to Oregon on January 1, 2018. The RSU vests and shares are delivered on January 1, 2019. The RSU income is \$8,000.

Oregon reporting: \$8,000

Oregon withholding: \$8,000

Oregon transit tax: \$8,000

CA withholding and reporting: $\$8,000 \times \frac{3}{4} = \$6,000$

CA SDI = \$0(?)



International Assignees

Tax equalization process requires special treatment

- Assignee pays tax only to same extent they would have paid in their home country
 - Hypo-tax
- Company pays host country and home country actual taxes
 - Hypo-tax treated as negative income
 - Gross-up may be required
- If there is a certificate of coverage, individual may pay social tax only to the home country



Double Tax Treaties

Each double tax treaty is different

U.S has double tax treaties with almost 70 countries

BUT generally an individual is tax exempt if :

- The employee is present in the host country for 183 days or less,
 - In the taxable year concerned or rolling 12-month period
 - Referred to as 183-day rule
- The employee compensation is paid by or on behalf of an employer which is not a resident of the host country, and
- The compensation is not borne by a Permanent Establishment (PE) or fixed base which the employer has in the host country
- Economic employer



Totalization Agreements

Similar to double tax treaties but focus is social security

U.S. has totalization agreements with 30 countries

Generally, individual can be covered in "Home Country" for up to 5 years

May mean that income tax and social tax are sourced differently for the same income



Example 7: Impact of a Certificate of Coverage

Greg, an employee of ACME Inc. in the U.S. is assigned to work in Germany for 3 years starting July 1, 2017. ACME obtains a Certificate of Coverage to retain Greg in the U.S. social security system during his assignment. On July 1, 2015, Greg is granted an RSU which fully vests on July 1, 2019. What taxes should be withheld?

U.S. income tax on \$10,000 x 50%*

U.S. social tax on \$10,000 x 100%

German income tax on \$10,000 x 50%

Does the payer matter?

* Assuming a U.S. citizen and the company takes a position that U.S. withholding is not required on foreign sourced income as the individual is subject to foreign withholding



Administrative Issues

Shadow payroll for international assignees

- Exchange rates
- Actual or hypo tax

For short term mobile employees from nontreaty countries, report and withhold income tax on U.S sourced income

- Form W-7 – Individual Taxpayer Identification Number
 - Timing and processing issues

For short term mobile employees from non totalization countries report and withhold social tax on U.S sourced income

State tax compliance where no Federal compliance required



Administrative Issues (ctd)

Company may need to withhold in a tax year when the individual is no longer an employee

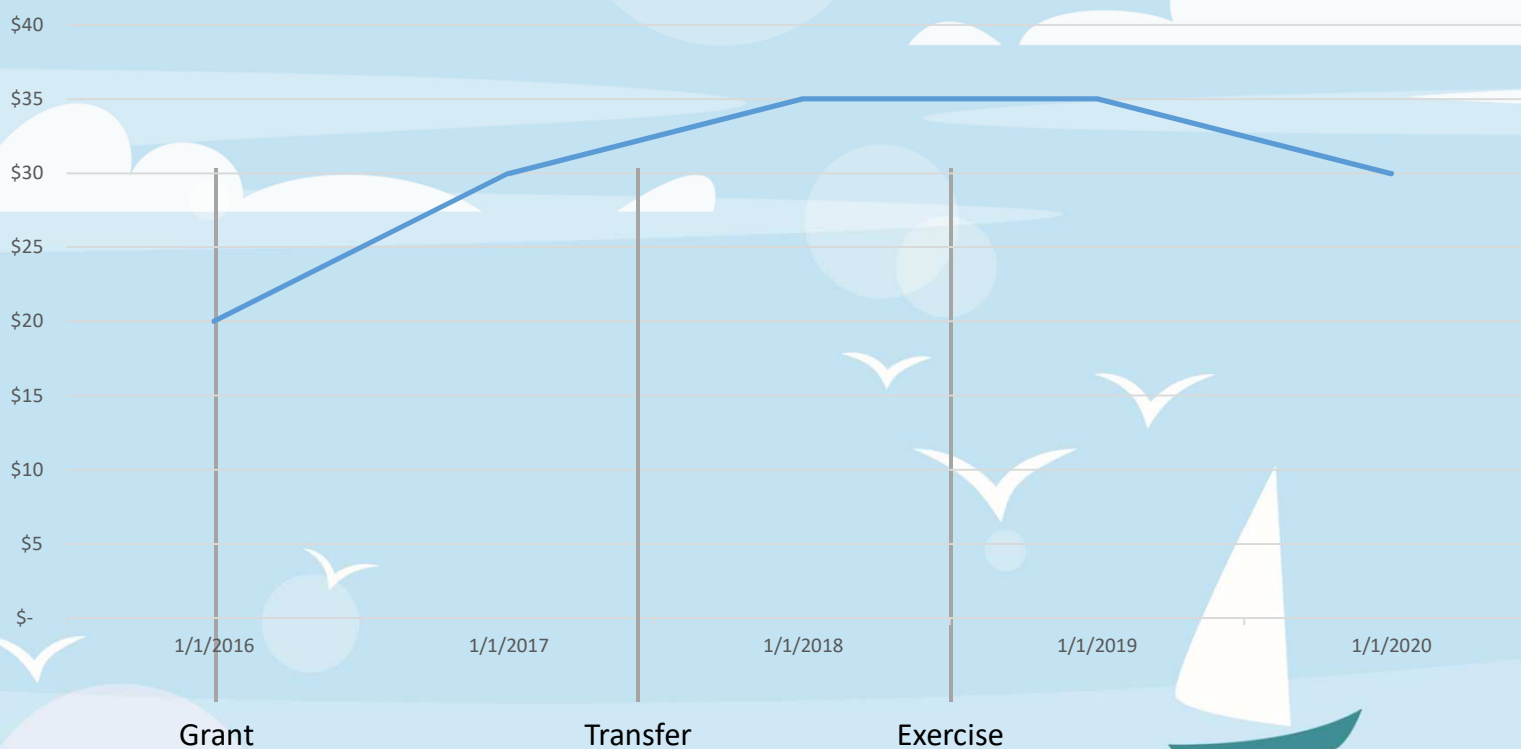
Supplemental income tax rate is not available for former employees who receive payments in the second calendar year after termination

- Must withhold at the former employee's W-4 rate



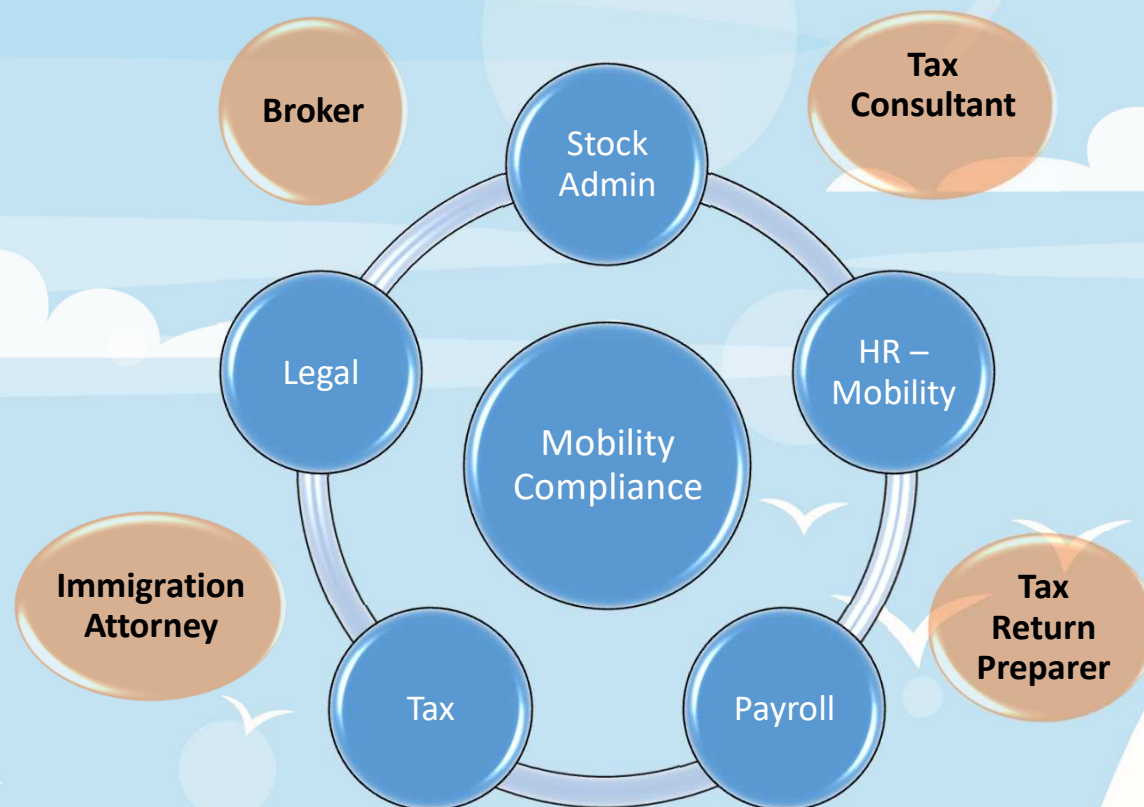
Example 8

Hannah is granted a stock option on January 1, 2016 and transfers overseas as a local transfer on January 1, 2017. She is terminated from the U.S. company payroll. She exercises the stock option on July 1, 2018.





Best Practices 1 - Gather the Team



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Best Practices 2 - Create A Mobility Policy

Checklist of departments that must sign off before an employee can move

- Corporate tax – nexus
- Legal/HR – immigration visas
- HR – employment laws
- Finance – costs
- Business unit manager
- Payroll/ stock – compliance requirements

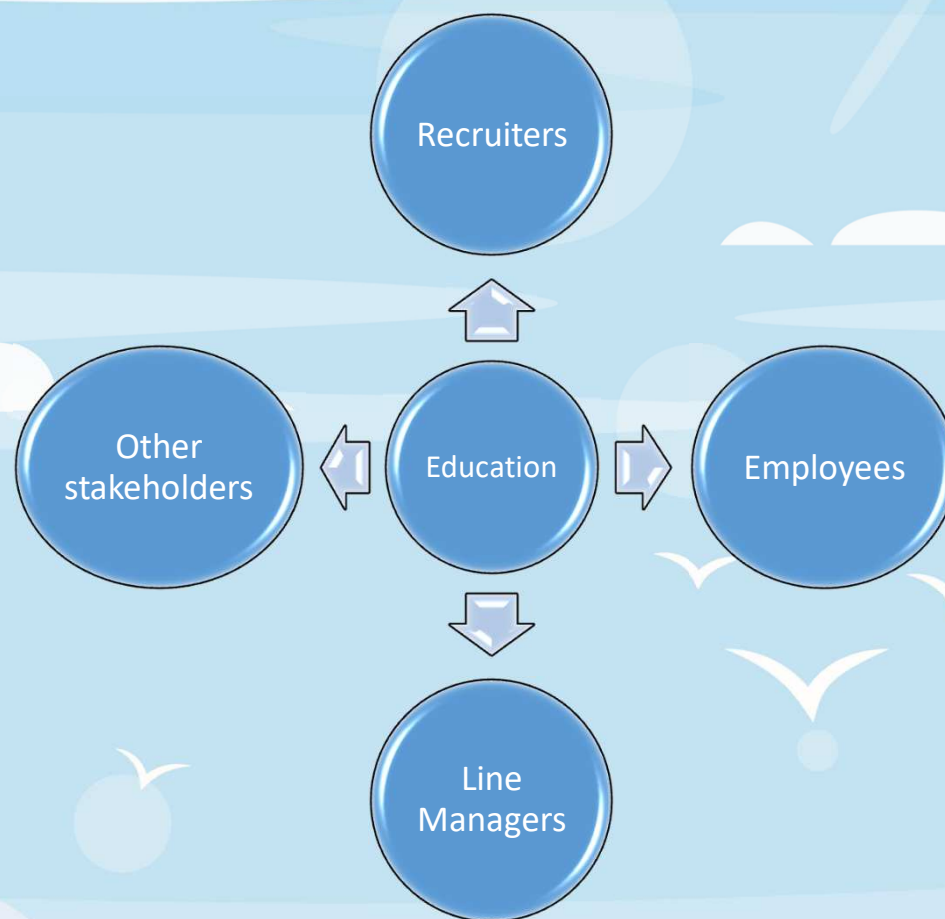
Cost allocation

Employee support that the company will /may provide

- Relocation expenses
- Cost of visa
- Tax support



Best Practices 3 - Educate





Education For Mobility/ Stock

Mobility memo

- Post online
- Distribute to prospective mobile employees

Importance of timely HRIS updates

Impact of timing of moves:

- After stock grant
- Before award vesting
- Before stock option exercise

W-8 BEN vs W-9 requirements



Best Practices 4 - Collect & Clean Data

Collect/Audit mobile employee list

- Periodic review

Review use of work or home addresses

Understand system capabilities

Understand system limitations

Develop and document policies and tax positions taken

Comply!



Best Practices 5 - Plan For Ongoing Evaluation



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Best Practices

Team with stock admin and HR mobility

Understand the limitations of your systems

Determine jointly the compliance strategy to be used

Consult with global equity adviser in case there are limitations/ issues in certain countries

High level employee communications

Detailed payroll communications / process guides

Sign up for alerts or updates from global equity adviser



Questions?

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Thank you!