

Insight

Global Equity-Based Compensation

New Arrival Strengthens European Regulatory Expertise

We are pleased to announce that Ruth Walters has recently joined our Brussels office. Ruth most recently worked at the European Commission where she was closely involved in the implementation of the Markets in Financial Instruments Directive (MiFID).

Ruth was also involved in representations made to the Committee of European Securities Regulators (CESR) about the impact of the EU Prospectus Directive on employee share plans and the discussions in the CESR working group that resulted in the very useful Q&As referred to in previous editions of Insight. Her arrival strengthens the Firm's expertise in the European financial services regulatory field, which is of considerable importance to clients of our Global Equity-based Compensation group.

Prospectus Directive and Employee Share Plans—Committee of European Securities Regulators (“CESR”) Commences Work on ‘Light-Touch Approach’.

In our Spring 2007 issue of Insight, we reported on the submission made by White & Case (acting on behalf of IAFFP (International Association for Financial Participation) and GEO (Global Equity Organisation)) to CESR on the application of the EU Prospectus Directive (the “Directive”) to employee share plans. This submission focussed on the lack of clarity of the Directive as to whether companies wishing to implement employee share plans for their employees will be required to go to the considerable effort and expense of publishing a prospectus in relation to the operation of the plan in the EU.

It was originally envisaged that the Directive would contain a comprehensive exemption for employee share plans;



Our global equity-based compensation practice is a key part of the Global Executive Compensation Benefits and Employment Law group which numbers more than 100 lawyers worldwide. We offer extensive expertise in dealing with the key issues involved in operating international equity-based compensation plans. Our work includes:

- Implementing global employee stock plans
- Advising companies on the effects of major M&A transactions on their equity incentive plans.
- Implementing equity incentive plans for companies preparing for an IPO.
- Establishing offshore trusts for the benefit of employees
- Implementing global re-pricing and exchange programs for underwater options.
- Implementing global stock appreciation rights plans.
- Implementing global profit-sharing plans.
- Advising non-US companies on offering equity-based compensation in the US.
- Advising companies regarding equity-based plans with respect to the spin-off of divisions.

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however, in its final form, this exemption only applied to employee share plans of those companies which are listed on a regulated market in the EU. This means that companies listed outside the EU, companies listed on AIM and unlisted companies face considerable uncertainty, and must attempt instead to rely on another of the exemptions to the requirement to publish a prospectus. As we emphasized in our submission to CESR, this creates an inevitable deterrent to many such companies, who are unable to offer their employee share plans to employees within the EU without the need to seek legal advice across the EU for fear of falling foul of the relevant requirement in each member state.

We are pleased to report that on December 13, 2007, CESR made a public statement, publishing a letter from Commissioner Charlie McCreevy to CESR's Chairs which requested CESR's assistance on the issue of employee share plans, and announced the European Commission's intention to request regulators to adopt a 'common light-touch approach' under the Directive for offers to employees. In this letter, the Commissioner acknowledges the negative impact that the Directive appears to be having on equity participation schemes in the EU, and asks CESR to submit proposals for a light-touch application of the Directive regime to employee share plans. The Commission would encourage regulators to apply this light-touch approach pending the likely amendment to the Directive which it anticipates will be proposed in the wake of its review in 2008.

The Commissioner also expresses the view that there is sufficient legal basis for the adoption of such an approach under the standards set out in the Directive. He specifically mentions the provisions of Article 5 of the Directive, which states that a prospectus should

contain all the information which is necessary to enable investors to make an informed assessment of the issuer and the securities. Article 7 provides that the level of information required should depend upon, inter alia, the various types and characteristics of offers. Further, Article 23(4) of the implementing Regulation allows for the omission of certain information if it is not pertinent to the issuer, the offer or the securities.

The FSA (the UK Financial Services Authority) is already using Article 23(4) to allow certain details about intermediaries to be omitted from retail debt prospectuses and some local regulators, such as the AMF (France) and the CBFA (Belgium), already allow short-form disclosure for employee share plan prospectuses, and would presumably refer to their powers under Article 23(4) if challenged. One of the main objectives of the Commissioner's request to CESR is to ensure a common approach by all regulators.

The above analysis suggests that different disclosure may be appropriate for different kinds of offers; and in particular, indicates that it may be possible to omit a significant amount of information that would normally be required in a prospectus provided it is not pertinent to an employee share plan. These provisions would seem to support a short-form disclosure regime for offers to employees, especially in light of the fact that participants in an employee share plan will almost certainly receive information about the plan from a source other than the prospectus and are therefore unlikely to require the same level of information as normal investors.

In its statement, CESR welcomes this letter and mentions the high priority it has been giving to this issue following the receipt of comments from market participants (such as ourselves) on the need to remove existing obstacles

for companies wishing to implement employee share plans within the EU. CESR now intends to follow a fast-track procedure to review this issue and is likely to publish its views in a 'questions and answers' format. No formal consultation process will take place given the urgency of the European Commission's request.

As a key contributor to the debate surrounding this issue, White & Case welcomes the urgency with which CESR is reacting to the European Commission's request. We shall update you further upon publication of CESR's views.

Pre-Budget Report 2007: Proposed Capital Gains Tax Reform

In the Pre-Budget Report 2007, which was published on October 9 last year, a number of changes to the capital gains tax ("CGT") regime were proposed, to take effect from April 6, 2008. The proposals have prompted mixed reactions; and are viewed by some as making significant changes to the environment for employee share plans. We outline the major changes detailed in the Pre-Budget Report below.

Current Law

CGT Rates

Currently, section 4 of the Taxation of Chargeable Gains Act 1992 ("TCGA") provides that individuals are chargeable to CGT at the rates for income tax on savings income (currently 10%, 20% or 40%), and net chargeable gains are treated as the top slice of income. Trustees and personal representatives are generally chargeable at the rate applicable to trusts (40%).

Taper Relief

Taper relief is currently available to reduce the amount of the gain chargeable to CGT according to how long an asset is held after April 5, 1998 (which in turn reduces the effective rate of tax payable on the gain). The amount of relief available depends on how long an asset has been held since April 5, 1998, and whether the asset is classed as a business or a non-business asset for taper relief purposes. For business assets, the effective rate of CGT paid by a higher rate tax payer is reduced from 40% to 10% where the business asset has been held for a qualifying period of two years. For non-business assets, taper relief reduces the rate of CGT paid by a higher rate tax payer from 40% to 24% after ten years of ownership. Where an employee holds shares in his or her employer, these shares normally automatically qualify as business assets.

In addition, the charge to CGT is reduced by the annual CGT exemption (which is currently £9,200 for individuals and £4,600 for some trustees).

Proposed Revisions

The proposal is that, for disposals made on or after April 6, 2008, there will be a single flat rate of CGT set at 18%. This rate will apply to individuals, trustees and personal representatives. In addition, a number of other changes, intended to simplify the CGT regime, will be made. These include the abolition of taper relief.

For disposals on or after April 6, 2008 and held over gains which fall to charge on or after April 6, 2008, taper relief will no longer be available, even if assets were held before this date.

Practical Implications

Individuals who are currently considering selling shares, including employees who hold shares under employee share plans, will need to be advised of the rates of CGT payable under both the

old and the new regime, as this may have an impact on their decision as to the right moment to sell. By way of example, for an employee selling shares held for less than two years, a disposal prior to April 6, 2008 would give rise to a CGT charge of 40%, instead of 18% should the disposal occur after April 6, 2008. However, if the shares had been held for longer than two years, a disposal before April 6, 2008 would be taxed at 10% rather than 18%.

Critics of the proposals claim that the abolition of taper relief will impact on efforts to build up long-term employee share ownership in the UK (something which Gordon Brown, in his former role as Chancellor, had been keen to encourage). Subject to the limited exception explained below, employees who choose to retain shares acquired through employee share plans would no longer benefit from any reduction in the effective rate of CGT once taper relief is withdrawn (although they will continue to benefit from the annual exemption—the amount of which is yet to be announced for the new tax year).

The proposed changes were due to be confirmed before Christmas but after extensive lobbying, confirmation was delayed until 24 January 2008, when the Government announced a concession in the form of the “entrepreneurs’ relief”. This relief will offer a 10 per cent CGT rate on lifetime gains up to £1m and will apply to people who own a stake of at least 5 per cent in a trading company and are also an employee, director or other officer of that company. Because of the 5 per cent requirement, employee shareholders other than those in very small companies are unlikely to benefit from this relief in most cases.

The impact on the operation of share plans may not, we would suggest, be as dramatic as some critics seem to fear. Employees will continue to benefit from the individual annual exemption,

and the single flat rate of 18% is substantially (22%) lower than the standard rate of 40%. This represents a significant cut for disposals in the first year of ownership. Furthermore, on many employee share plans, there is no CGT payable in any event, as shares are generally sold immediately after income tax is charged. Where this does not apply, plans are often approved for tax purposes and subject to such low limits that much or all of any gain is likely to be extinguished by the individual exemption. A notable exception is EMI options, which benefit from relatively high limits, and so may be affected by the changes. However, these options are only available to small UK companies and are subject to a number of conditions that mean that they are not generally available to our clients. The public outcry against the proposed changes to the CGT reforms may yet turn out to have been a storm in a teacup—at least as far as employee share plans are concerned.

Changes to Social Security Contributions Due Under Qualified French Stock Option and Free Share Awards

Recently enacted amendments to the 2008 Bill on the financing of the State Social Security in France mean that local companies will now have to pay social security contributions on the grant of qualified stock options and free share awards whereas employers were previously exempt from such payments provided certain conditions were met. Essentially, for grants made on or after October 16, 2007, flat-rate employer social security of 10% is payable on the grant date of stock options and the award date of free shares under French qualified plans. Additionally, employees will be required to pay up to 2.5% of the acquisition gain on the exercise of options or the vesting of free shares.

Impact on Employers

Qualified stock options: The taxable basis of the contribution is equal, at the employer's discretion, to either the fair value of the options (as defined under IFRS 2) or to 25% of the value of the underlying shares on the date of grant. Employers should take care, however, because the choice between either basis cannot be changed for all of the awards granted under the same plan during the tax year of the grant.

Free share awards: The taxable basis of the contribution will again be at the employer's discretion but will either be equal to the fair value of the options (as defined under IFRS 2) or to the value of the shares on the date that the Board decide to grant the shares. Similarly, the choice is irrevocable for all awards granted under the same plan during the tax year of the grant.

For both options and free share awards, contributions will be due in the month following the grant date and for all options/shares granted by a French or foreign grantor as from October 16, 2007.

Impact on Employees

The proposed contribution rate for employees is 2.5%, assessed on (i) the exercise gain income arising from the difference between the market value of the shares upon exercise and the exercise price for the options and (ii) the market value of the shares on the acquisition date (i.e. transfer date) for the free shares.

The contribution will be levied on the employee upon issuance of the tax bill corresponding to the personal income tax return to be filed during the year following the sale date.

This document is prepared for the general information of our clients and other interested persons. It is not, and does not attempt to be, comprehensive in nature. Due to the general nature of its content, it should not be regarded as legal advice.

White & Case (Europe) LLP
5 Old Broad Street
London EC2N 1DW
United Kingdom
Phone +44 (0)20 7532 1000
Fax +44 (0)20 7532 1001

www.whitecase.com

London



Oliver Brettle
+44 (0)20 7532 2103
obrettle@whitecase.com



Nicholas Greenacre
+44 (0)20 7532 2141
ngreenacre@whitecase.com



Ben Crompton
+44 (0)20 7532 2179
bcrompton@whitecase.com



Fahim Rahman
+44 (0)20 7532 2161
fraham@whitecase.com



Chris Weaver
+44 (0)20 7532 2174
cweaver@whitecase.com



Simon Burlinson
+44 (0)20 7532 2515
sburlinson@whitecase.com

New York



Ken Raskin
+1 212 819 8508
kraskin@whitecase.com



Mark Hamilton
+1 212 819 8262
mhamilton@whitecase.com

ABU DHABI ALMATY ANKARA BANGKOK BEIJING BERLIN BRATISLAVA BRUSSELS BUDAPEST DRESDEN DÜSSELDORF FRANKFURT
HAMBURG HELSINKI HONG KONG ISTANBUL JOHANNESBURG LONDON LOS ANGELES MEXICO CITY MIAMI MILAN MOSCOW MUNICH
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