香港信託人公會
Hong Kong Trustees' Association

HONG KONG TRUSTEES' ASSOCIATION WEBINAR SERIES ON

OVERVIEW OF EQUITY COMPENSATION FOR EMPLOYEES WITH US/HK/PRC TAX IMPLICATIONS AND THE USE OF EMPLOYEE BENEFIT TRUSTS

(26 APRIL 2021)

The session will start at

5:00pm

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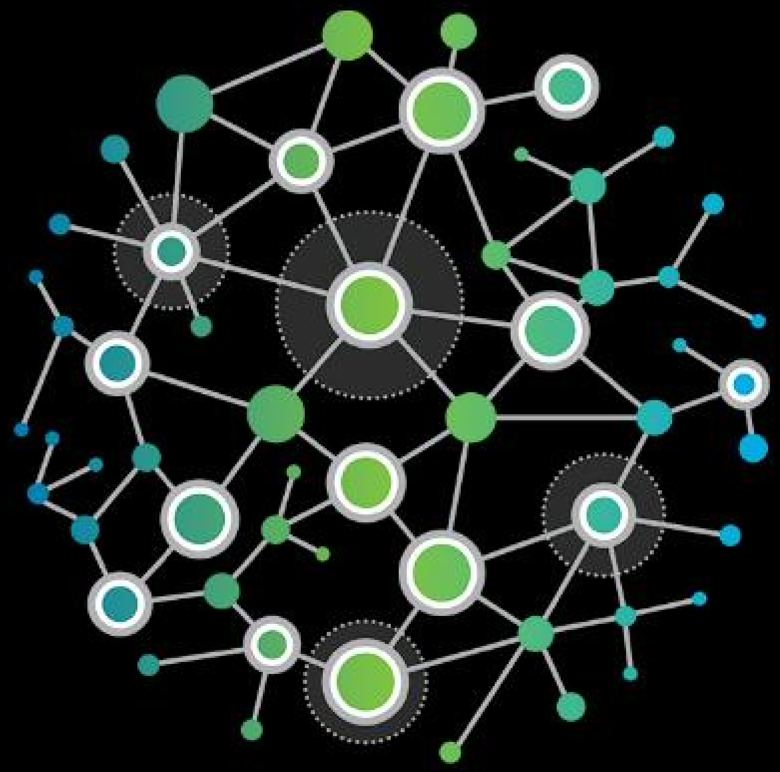

Hong Kong Trustees' Association Webinar - US/PRC/HK Equity Compensation Planning: Tax & Legal Aspects

26 April 2021, Hong Kong and China

175 MAKING AN IMPACT THAT MATTERS since 1845

Agenda

Time	Topics	Speaker(s)
5:05 – 5:20 p.m.	Employee Benefit Trusts in Hong Kong	Winnie Chiu
5:20 – 5:35 p.m.	U.S. Tax Considerations on Equity Awards	Ellen Tong
5:35 – 5:50 p.m.	China Tax Considerations	Tiffany Li
5:50 – 6:05 p.m.	Hong Kong Salaries Tax – Stock Option, RSAs and RSUs	Esti Chui
6:05 – 6:20 p.m.	Employee Incentive Plan – Design Considerations	Peter Chen
6:20 p.m. – 6:30 p.m.	Q&A session	All Speakers

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Employee Benefit Trusts in Hong Kong

Winnie Chiu

Partner, Yang Chan & Jamison LLP

Information Classification: External

Use of Equity Compensation

Objectives:

- Attract and Retain talents
- Provide Incentives to Employees
- Create a Sense of Belonging
- Risk Management
- Cash Flow Management
- Tax Planning
- Long Term Development

Popular for Particular Companies

'Mature'
start-up companies

Pre-IPO

Companies
with employees from high
tax jurisdictions

Listed companies

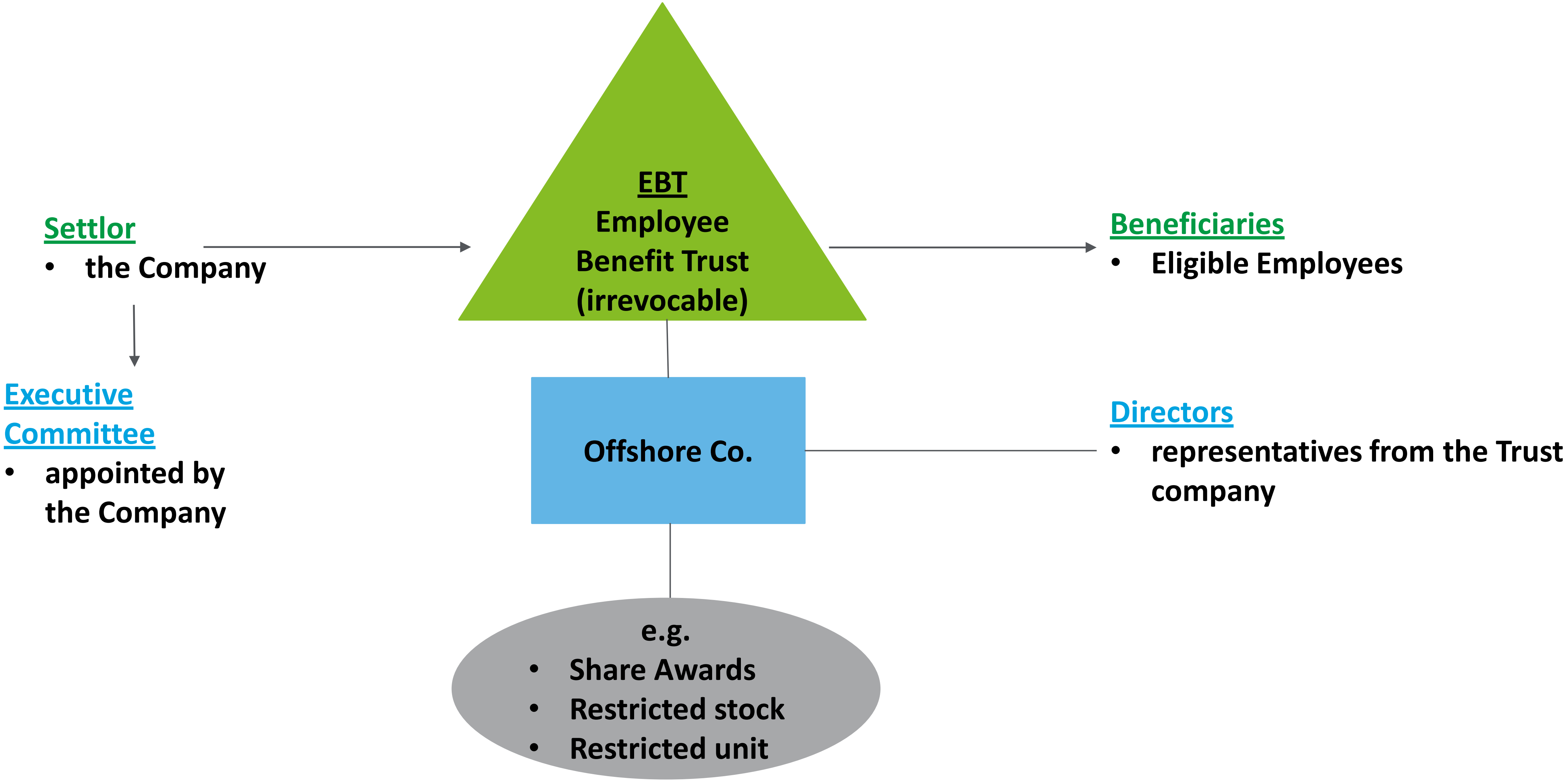
Major Legal Issues

- Relevant provisions in the Employment Contract
- Share Award Schemes
- Share Option Schemes
- Conditions for the grant of RSA & RSU
- Compliance of the Listing Rules (if applicable)
- Assessment of performance (objective and proper mechanism)
- Lawful Termination of Employment
- Incapacity or death of employees
- Mergers & Acquisitions

Implementation & Operation

- Appointment of corporate trustee
- Formation of Executive/Supervising Committee
- Administrator for the operation of the scheme

Employee Benefit Trust Structure



Speaker

Winnie Chiu
Partner
Yang Chan & Jamison LLP

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Direct: +852 2852 1953
Mobile: +852 9768 3607

Education:

- Diploma in International Trust Management (Distinction), Society of Trust & Estate Practitioners (STEP)
- Postgraduate Certificate in Laws (PCLL), University of Hong Kong
- Bachelor of Laws (Hons), University of Birmingham, United Kingdom
- Bachelor of Arts (Hons), University of Hong Kong

Qualification:

- Admitted as Solicitor of the High Court of Hong Kong
- Admitted as Solicitor of the Supreme Court of England and Wales (non-practising)
- Member of the Society of Trust & Estate Practitioners (STEP)

Winnie has extensive experience in Succession Planning, Will, Trust and Probate related matters. She also handles disputes between beneficiaries; beneficiaries and the executor/administrator/trustee.

Winnie is a frequent speaker at seminars in Hong Kong, PRC and overseas in relation to succession planning for trustee companies, bankers, investment advisors, accountants, lawyers and high net worth individuals.

Winnie also has solid experience in handling contentious and non-contentious employment matters as well as anti-discriminations, sexual harassment and personal data privacy related issues arising from recruitment, merger & acquisition, restructuring and/or post-termination restrictive covenants. She regularly conducts seminars and training sessions for HR directors, professionals and management of international companies.

Prior to joining Yang Chan & Jamison LLP, Winnie had acted as a partner of various leading law firms, and she had also worked as an in-house lawyer for an international trustee company in Hong Kong.

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U.S. Tax Considerations on Equity Awards

Ellen Tong
Director, Global Employer Services, Deloitte China

Information Classification: External

U.S. Tax Considerations on Equity Awards

Employee Stock Options

Nonqualified Stock Options (ordinary income (up to 37%)) .vs. **Qualified Stock Options (long-term capital gain (up to 20%))**

Nonqualified Stock Options

- *Readily Ascertainable Value*
- *No readily Ascertainable Value*

Qualified Stock Options

- Incentive Stock Options ("ISO")
- Employee Stock Purchase Plans ("ESPP")

U.S. Tax Considerations on Equity Awards

Nonqualified stock options: *Readily Ascertainable Value .vs. No Readily Ascertainable Value*

Employee Taxation:

	Readily Ascertainable Value (on an established market)	**No Readily Ascertainable Value**
Recognize as ordinary income	Grant date	Exercise date
Taxable amount	FMV of the stock share at grant date less any amount paid; taxed at ordinary income rates	FMV of the stock share at exercise date less any exercise price paid; taxed at ordinary income rates
Cost basis/Holding Period	Cost basis – FMV of the stock share at grant date Holding period – Begins from the grant date	Cost basis – FMV of the stock share at exercise date Holding period – Begins from the exercise date

* Employer can deduct the value of the nonqualified stock options as a business expenses in the same year that the employee is required to recognize the option as ordinary income

U.S. Tax Considerations on Equity Awards

Qualified stock options: Incentive Stock Options ("ISO")

Taxation	ISO
Employee	• No taxation when the option is granted or exercised • Taxation arises at the time of sale • Long-term capital gain/loss will be realized when selling the shares if the required conditions are met • Long-term capital gain = FMV at sale date less any exercise price plus any amount paid • **Stock must be held <u>at least 2 years</u> after the grant date & 1 year after exercise date** • Remain employment from grant date until 3 months before the option is exercised • If the holding period requirements are not satisfied, any gain is ordinary, up to the amount (FMV at exercise date – option price) – same treatment as nonqualified options • If the options lapse, only amount was paid for option is deductible • Only exercise <u>up to US$100,000</u> of ISOs in a year, any excess will be treated as nonqualified option • Favorable tax treatment does <u>not</u> apply to Alternative Minimum Tax ("AMT")

U.S. Tax Considerations on Equity Awards

Qualified stock options: Incentive Stock Options ("ISO")

Taxation	ISO
Employer	• The option costs are not tax deductible • Must be granted under a plan & approved by shareholder • Must be granted within 10 years of the earlier of the date when the plan was adopted or approved • Must be exercisable within 10 years of the grant date • Exercise price may not be less than FMV at the date of the grant • Employee may not own > 10% of the combined voting power

U.S. Tax Considerations on Equity Awards

Case Study

Date of grant: January 1, 2019

Date of vest: January 1, 2020

Date of exercise: June 1, 2020

Date of sale: August 1, 2021

Options granted: 1,000

Options exercised: 1,000

Exercise price: US$5

FMV at date of exercise: US$10

FMV at date of sale: US$20

Effective tax rate for ordinary income – 35%

Long-term capital gain – 20% + 3.8% net investment income tax

U.S. Tax Considerations on Equity Awards

Qualified Stock Options (ISO the certain requirements are met)	Nonqualified Stock Options (with no readily ascertainable value)
• Date of grant: No taxation • Date of vest: No taxation • Date of exercise: No taxation • Date of sale: Long-term capital gain • Long-term capital gain = (US$20 – US$5) x 1,000 = US$15,000 • Tax liability – US$15,000 x 23.8% = US$3,570 • ***Tax savings – US$560*** ***Cash Flow for Paying Alternative Minimum Tax***	• Date of grant: No taxation • Date of vest: No taxation • Date of exercise: Ordinary income = FMV of stock share less exercise price • Ordinary taxable income = (US$10 – US$5) X 1,000 = US$5,000 • Tax liability – US$5,000 x 35% = US$1,750 (i) • Date of sale – Long-term capital gain/loss • Long-term capital gain = (US$20 – US$10) x 1,000 = US$10,000 • Long-term capital gain tax liability = US$10,000 x 23.8% = US$2,380 (ii) • Total tax liabilities (i) + (ii) = US$4,130

U.S. Tax Considerations on Equity Awards

Restricted Share Award (RSA)	Restricted Share Unit (RSU)
• **Shares issued at grant date and held until vested/risk of forfeiture (employment conditions)** • Taxation at vested as ordinary income if no Section 83(b) election is made • Taxation cannot be deferred beyond vesting • **Section 83(b) election – taxation at grant** • Company repurchases unvested shares at termination	• **Shares are not issued until vesting complete/risk of forfeiture (employment conditions)** • Taxation generally at vest as ordinary income • Taxation can be deferred beyond vesting if distribution of underlying shares deferred • **Section 83(b) election NOT allowed** • Unvested shares are forfeited at termination

U.S. Tax Considerations on Equity Awards

<u>Section 83(b) election</u>
The 83(b) election allows an individual to accelerate the timing of income recognition

Available for RSAs but not for RSUs

Generally a lower amount of tax is paid due to lower stock price at grant and no additional tax liability at vest

There is a <u>30-day deadline</u> from the grant date to file an 83(b) election and no late election is allowed

Speaker

Ellen Tong
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Ellen has worked for Deloitte in the U.S. and Hong Kong. As a Tax Director in the Hong Kong office, Ellen leads the U.S. Individual tax practice. Ellen is also a specialist in China individual income tax, Hong Kong individual income tax and mobility management. She has extensive experience in providing personal tax advisory and compliance services, advising on remuneration structure, equity rewards, tax equalization/ employee's tax assistance programs, retirement benefits planning, policy design, implementation, review, mobility management and immigration solutions to clients in different industries with a widespread and diversified workforce. Ellen is experienced in handling cross-border issues and providing practical solutions in the deployment of resources for risk and control management.

Ellen has in-depth experience in advising private and public companies on reward strategy and executive remuneration from design, implement, manage to employee communications.

Ellen also provides high-touch personal tax advice to senior executives and high net-worth individuals, and acts a trusted tax and business advisor to their family offices.

Ellen is a Certified Public Account in U.S. She is a member of both American Institute of Certified Public Accountants and California Board of Accountancy. Ellen has a Bachelor of Science degree from University of California, Berkeley.

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China Tax Considerations

Tiffany Li
Director, Global Employer Services, Deloitte China

Information Classification: External

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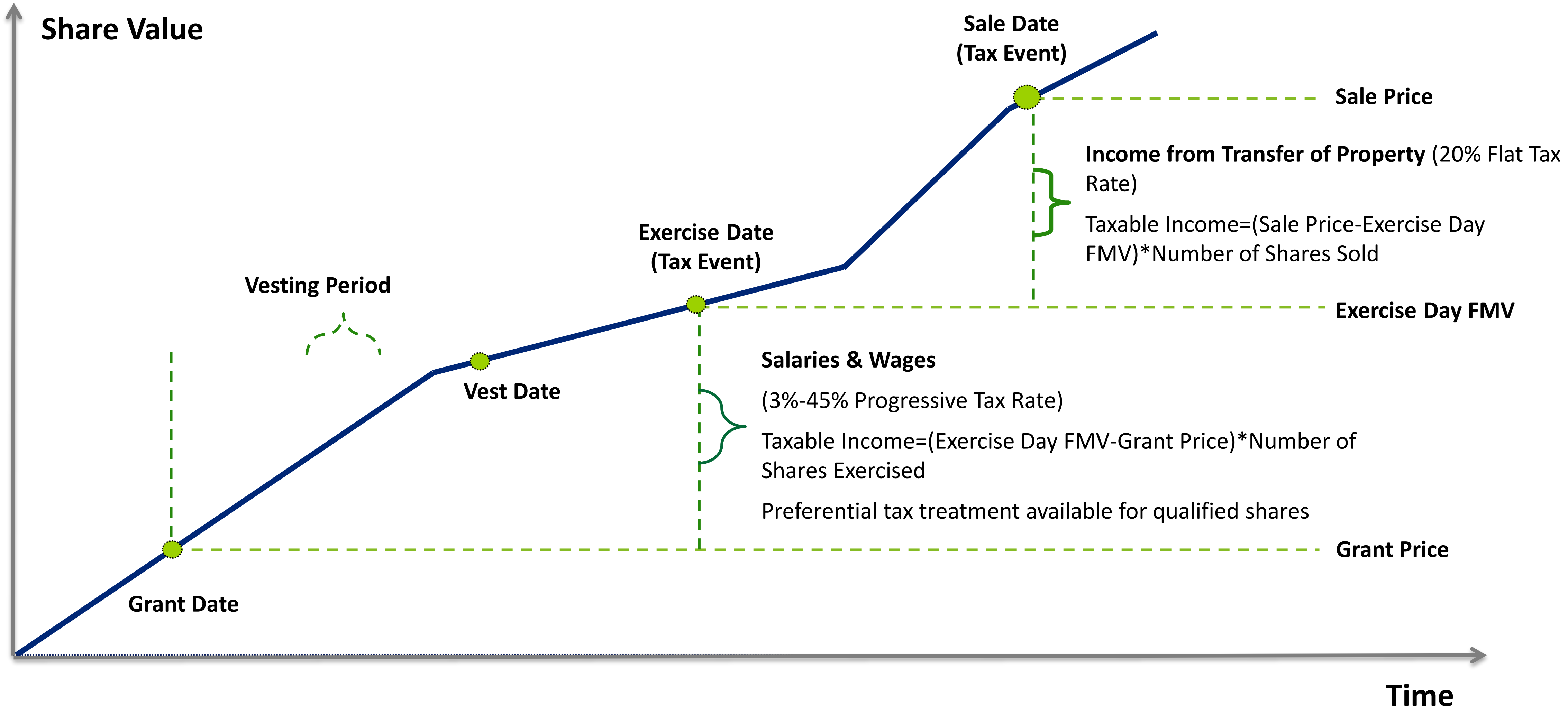
General China Tax Rule of Equity Compensation

An Example – Stock Option Issued by Listed Company



Compliance Requirement for MNCs Implementing Equity Plan in China

Comply with Registration Requirements in China

Overseas listed companies

- Circular 35 tax registration
- Circular 7 SAFE registration for PRC national participants

Practical Considerations

Reporting or withholding obligations on equity gains

- Preferential tax treatment on equity income
- Uncertainty under coming PRC IIT reform

Ongoing compliance requirement in SAFE and Tax

Involvement of global team in plan administration

Additional Considerations for China MNCs

Comply with Registration Requirements in China

Company type	Registration requirement
China domestic listed companies	Circular 35 tax registration
China unlisted companies	Circular 101 & Bulletin 62 tax registration
Pre-IPO China companies with overseas structure	Circular 37 SAFE registration for PRC national participants??

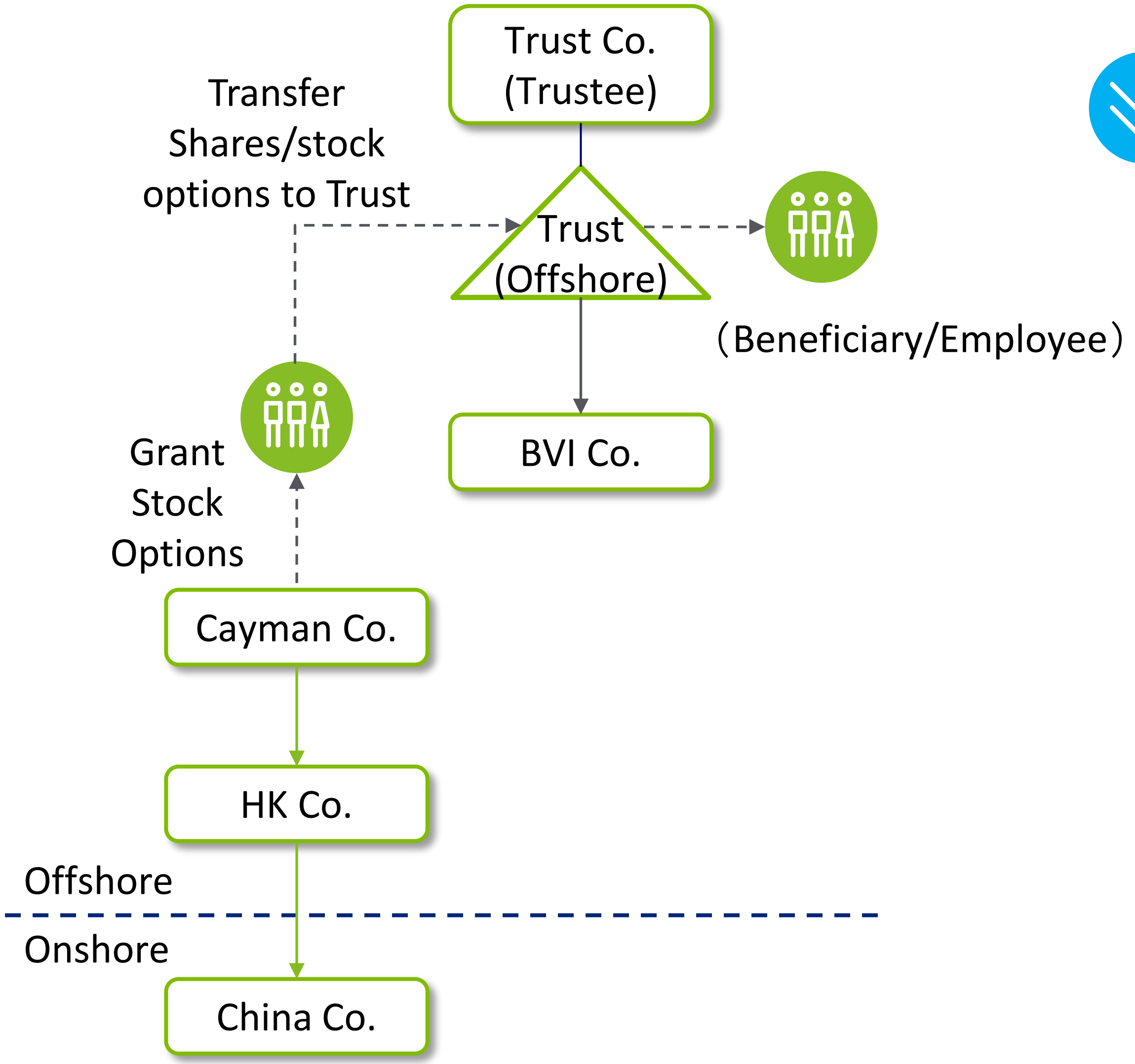
Practical Considerations

China stock market (A share) is open to more non-China investors. China domestic listed companies can offer equity incentives to foreign employees in overseas subsidiaries

Conditions to apply preferential tax treatment under Circular 101

- SAFE compliance and China individual income tax exposure
- Proper management of equity plans under overseas structure

China Tax Considerations of Equity Based Trust



China Tax Considerations

Uncertainty exists in the below areas hence proactive communications with the competent China tax authority is needed:

- Tax treatment of transferring stock options or shares
- Applicable share value to assess taxable income;
- Whether Circular 35 preferential tax treatment is applicable;
- Tax treatment of income distributed by offshore trust.

The prevailing China tax law is silent on tax treatment of offshore trust. Hence practically it is usually subject to the in-charge tax authority's assessment.

Speaker

Tiffany Li
Director
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- Tel: +86 21 6141 1335

Tiffany is a Tax Director based in Deloitte Shanghai. She is a core team member of Global Employer Services ("GES") team, with 16 years of professional experience in tax and mobility areas.

Tiffany has delivered services to a wide range of multinational companies and high growth Chinese companies covering industries including financial institutions, large manufacturing companies, Bio companies, bio-pharmaceutical companies, automotive companies, etc.

Tiffany has extensive experience in managing large mobility engagements for both MNCs and China headquartered company and has provided wide scopes of services covering inbound/outbound international assignment structuring, individual income tax compliance and consulting, compensation and benefits structuring, global equity consulting, foreign exchange consulting and tax advisory for high net worth individuals.

Tiffany is a China specialist on global equity and rewards advisory. She is the core team member of China Eastern Region Equity Champion providing comprehensive equity/rewards consulting services throughout a plan design to roll out for many multinational companies and China domestic companies. She is experienced in offering practical support for MNC clients on implementing their global equity plans in China, or helping China clients with their outbound equity strategies.

Tiffany has a Master Degree of Law from Xiamen University and an International MBA Degree from Hong Kong University.

Tiffany has PRC lawyer qualification.

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Hong Kong Salaries Tax – Stock Option, RSAs and RSUs

Esti Chui
Director, Global Employer Services, Deloitte China

Information Classification: External

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Hong Kong tax – Stock Option, RSAs and RSUs

Taxability of Share Awards and Share Options (DIPN 38)

You have to pay salaries tax on any benefits associated with stock-based awards arising from your employment.

Stock option

If you are granted the right to acquire shares within a period of time in the future (ie. a share option), you will be assessed under section 9(1)(d) of the Inland Revenue Ordinance (IRO) on a notional gain. This is assessed not when the option is granted to you but when you exercise, assign or release that option.

Stock option income: The realized gain is calculated as the amount which a person might reasonably expect to obtain from a sale of the shares acquired in the open market, less any consideration paid at the time of exercise of the option. The HK Inland Revenue Department would adopt the closing price of the day of exercise as the open market value of the shares.

Hong Kong tax – Stock Option, RSAs and RSUs

Taxability of Share Awards and Share Options (DIPN 38)

You have to pay salaries tax on any benefits associated with stock-based awards arising from your employment.

Share awards

Shares awarded to you not in the form of options, you will be assessed in the year you are fully entitled to the ownership of the shares.

Share award income: The gain is calculated as the open market value of the shares at vesting

Sale of shares

However, any gain or loss you realize from the subsequent sale of the shares is usually non-taxable or non-deductible.

Hong Kong tax – Stock Option, RSAs and RSUs (Cont'd)

How the stock option/RSA/RSU are taxed?

<u>Employer</u>

There are no withholding requirements in general. Stock Options, RSA and RSU benefits must be reported annually with the employee's other employment income. Failure to do so may result in penalties.

<u>Employee and directors</u>

Stock Options are taxable upon exercise, assign or release.

RSA and RSU are taxable upon vesting. If RSA/RSUs are not subject to future vesting, then they will be taxed upon grant.

Shares obtained from Stock Options/RSA/RSU are not subject to tax upon subsequent sale.

Hong Kong tax – Stock Option, RSAs and RSUs (Cont'd)

Hong Kong Salaries Tax reporting requirements

Employer

Benefits must be reported as the employee's income:

	Stock options	RSA/RSU (no vesting)	RSA/RSU (with vesting)
At grant	Disclose details of grant of Stock Options on the relevant employer's return	Report as income in the relevant employer's return Form IR56B/F/G	Disclose details of grant of RSA/RSU on the relevant employer's return
At vesting/exercise	Report as income on the relevant employer's return	N/A	Report as income on the relevant employer's return Form
At sale	N/A	N/A	N/A

Employees and directors

Benefits derived from Stock Option/RSA/RSU must be reported in Part 4.1 of the Tax Return – Individuals (BIR60).

Speaker

Esti specializes in Hong Kong Salaries Tax, PRC Individual Income tax and cross-border individual income tax matters. Esti has many years of professional tax experience including working with another Big Four accounting firm and the Inland Revenue Department.

Esti has been dealing with complex tax-related issues and mobility management, and has rich experience in handling clients from financial industry including banks, insurance company, private equity and assessment management. She also has onsite experience as mobility professional in client office.

Esti is a member of the Association of Chartered Certified Accountants ("ACCA"). She is an experienced speaker in seminars and was facilitator of advanced diploma program in tax for HKICPA.

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Employee Incentive Plan – Design Considerations

Peter Chen

Partner, International Tax Services, Deloitte China

Information Classification: External

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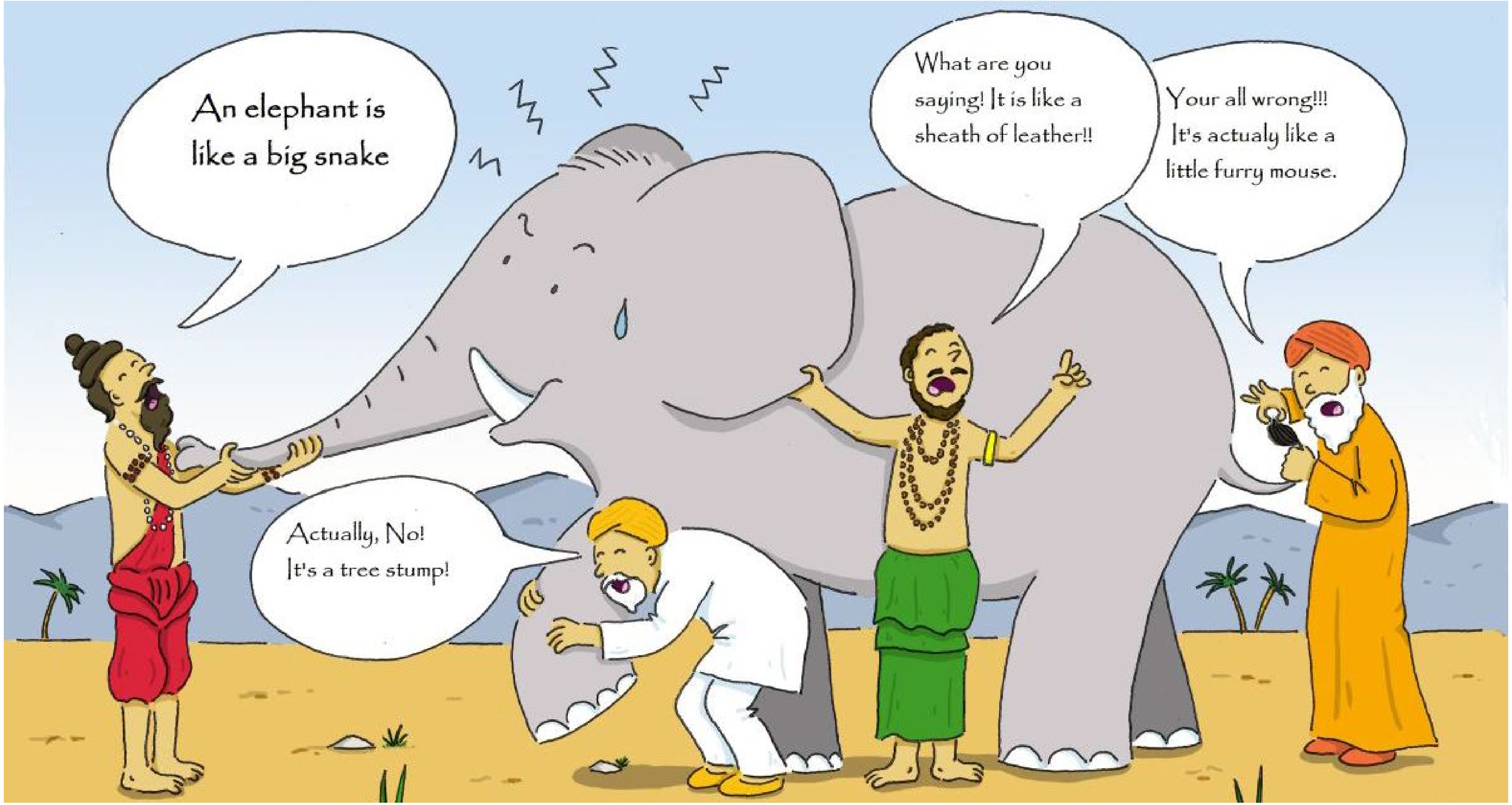
Equity Compensation Planning - Design Considerations



An elephant is like: a big snake, a tree stump, a furry mouse, a sheath of leather - it's like all of these things

Equity Compensation Planning - Design Considerations

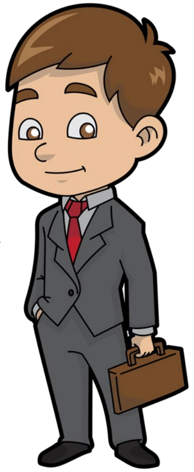
It is to incentivize our executives, so our company can have a great IPO listing !

Equity Incentive Plan (Employee Benefit Plan)

(RSA, RSU, Stock Options (ISO, ESPP)

It is a Trust !

It is a way for the company to pay me with stocks, and let me pay less Tax!



Equity Compensation Planning - Design Considerations

The plan design needs to accommodate objectives of multiple Stakeholder.

Stakeholders:

- The Company (the Shareholders, including the founder(s))
- the Investors
- the Executives (plan participants)

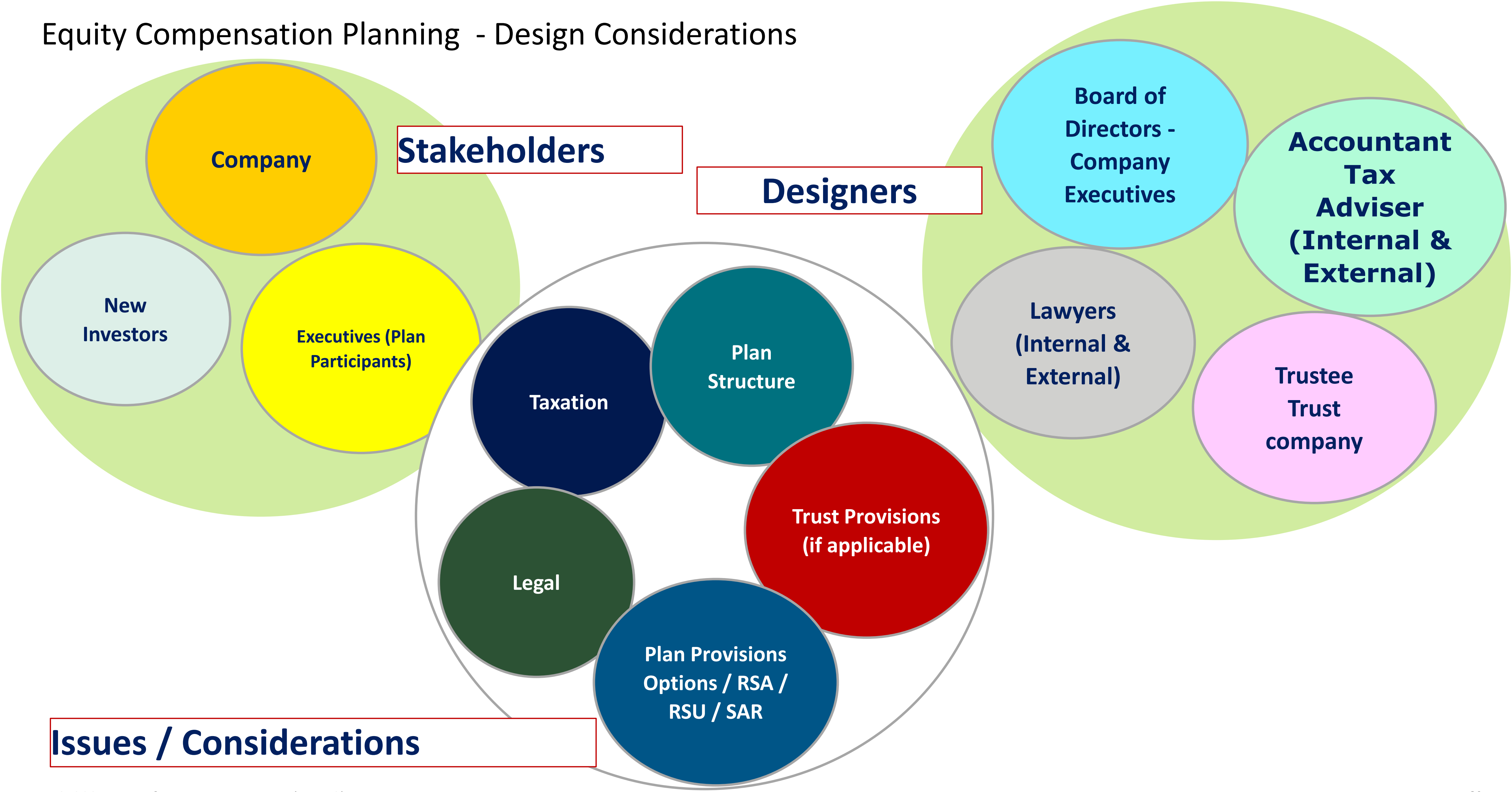
Plan designers:

- Company's Board of Directors
- Company Executives (President, CFO, Chief Legal Officer, etc)
- Lawyers (internal and external)
- Accountants (internal and external)
- Trust company (external)

Design Issues (partial list of selected issues)

- Company Level: effect on financial statements, effect on IPO, effect on new investors, company level tax considerations
- Plan substance: options, RSA (Restricted Share Awards), RSU (Restricted Share Units), SAR (Share Appreciation Rights)
    - Single plan versus Multiple plans
- Tax Considerations of the Employees / Key Executives / Founders | Tax jurisdictions of plan participants
- Trust platform vs no Trust platform

Equity Compensation Planning - Design Considerations



Equity Compensation Planning - Design Considerations

- Design process should begin early – with involvement of all stakeholders
- Tax Planning for Plan Participants can be complex due to various factors, including:
  - Tax residence of Plan Participants
  - Tension / conflict between Tax effect versus Economics

Equity Compensation Planning - Design Considerations

Example (composite of 3 client cases)

- Bio-medical technology companies based in Eastern China (Shanghai / Hangzhou)
- Helped designed / implemented Companies Stock incentive plan
  - Company used Employee Benefit Trust structure
    - Participants from Multiple tax jurisdictions: China, U.S., Canada, Hong Kong
    - Company / founder wishes to retain high degree of control prior to IPO, and require right to “call back” of shares awarded under Company’s stock incentive plan ?
    - IRC 409A complication - complex U.S. provision with “long arm” reaching an employee benefit plan of China company, with U.S. employee/participant in employee benefit plan – should company plan to avoid IRC 409A ?
  - CEO/Founder of Company – given stock options under Company’s Stock Incentive Plan. Plan also allows RSAs (Restricted Share Awards). Tax planning achieved minimization of US taxation.
  - CFO of Company – one of Company executives who help design Equity Incentive Plan. Helped negotiation with Company on plan features. Tax planning for CFO’s tax costs on share awards.

Design process is a balancing act, negotiations and compromises of objectives of stakeholders!

Speaker

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Peter Chen is both a certified public accountant and an attorney with more than 20 years of experience in tax advisory and planning. He has advised China, Hong Kong and the US, and other multinational corporations and high net worth individuals on their inbound and outbound transactions, China and international tax issues, investment structuring, regulatory, and business issues; mergers, acquisitions; and the reorganizations of multinationals in China and the Asia Pacific region; structuring of trusts, foundations, estate planning and asset preservation for individuals. He has represented companies and individuals to resolve tax disputes with tax authorities in China and the US.

Recently, Chen has been engaged by the Ministry of Finance of a Southeast Asian nation to draft the country's tax regulations and to provide consulting on international tax matters.

Previously, Chen was with a major economic consulting firm and also was a tax partner at Deloitte US, where he was responsible for the China Desk in New York, and served as China leader at the firm's International Centre of Excellence.

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