

Morgan Lewis

GLOBAL PUBLIC COMPANY ACADEMY ISSUES CONCERNING CROSS-BORDER EMPLOYEES

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OVERVIEW

- I. Cross Border Employment and Data Privacy**
- II. Equity-Based Compensation**
- III. US Taxation**

CROSS BORDER EMPLOYMENT AND DATA PRIVACY

Choice of law

- Restrictions on choice of law and jurisdiction
 - In Europe under the Rome Convention, employers usually have the choice of governing law
 - But employers cannot deprive individuals of their mandatory rights
- With respect to jurisdiction, employees usually have the right to sue and be sued by the employer in the country in which that employee is usually domiciled under the Recast Brussels Regulations
- Local Courts may not enforce foreign law if that contravenes public policy
- It may not always be clear whether employees have the right to bring claims in particular countries
- It may be possible for an employee to claim that his/her contract of employment is broad enough to include the provisions of a foreign equity plan. This may be useful for example when challenging the enforceability of restrictive covenants

Territorial jurisdiction of English employment law

- Generally, employees must be ordinarily working in the UK to have UK employment rights
- Peripatetic employees (such as airline pilots or sales persons) will normally have UK employment rights if their base is in the UK (where the commute begins and ends is often the decisive factor)
- Expatriate employees who live and work mostly abroad will not usually have UK employment rights
 - Unless, those employees can show they have a sufficiently strong connection with the UK

Sufficiently strong connection

- Even if the place of work and employing entity is not in the UK, UK law can still apply if there is a sufficiently strong connection with Great Britain
- Various factors taken into account, including:
 - Where the employee is recruited
 - Where the work is done
 - Where the employee is based
 - Where the employment relationship has been managed from a HR perspective
 - Where the employee gets paid and in what currency
 - Where the employee pays taxes and makes social security contributions
 - Choice of governing law clause

European Works Councils

- Automatic transfer principle- employees might transfer automatically from one employer to another as a matter of law and be subject to certain restrictions
- European works council
 - May be established in all groups of businesses with
 - At least 1,000 employees in the EU/EEA
 - At least 2 businesses in different EU/EEA countries with at least 150 employees each
- Information and consultation
 - Tailor-made EWC – review EWC agreement for matters subject to information and consultation
 - Standard EWC – Matters subject to information and consultation include inter alia
 - Cut-backs or closures of undertakings, establishments or important parts thereof, and collective redundancies

Consultation

- Automatic Transfer Laws- there may be an obligation to inform and consult with elected representatives
- Works Councils- in many countries, there may be a need to consult with works councils about certain “business changes”
- Large scale redundancies- across Europe, there are obligations to inform and consult with elected representatives in relation to large scale redundancies
- Significant liabilities and implications for failing to comply with these obligations

The EU General Data Protection Regulation

- The GDPR replaced the EU Data Protection Directive on 25 May 2018
- “Personal Data” means any information relating to an identified or identifiable natural person (“data subject”); an identifiable person is one who can be identified, directly or indirectly, in particular by reference to an identifier such as a name, an identification number, location data, online identifier or to one or more factors specific to the physical, physiological, genetic, mental, economic, cultural or social identity of that person
- Personal data must be processed fairly and lawfully
- Expanded application of the EU data privacy obligations
- The GDPR applies to processing of personal data in the context of the activities of a controller or processor in the EU
- The GDPR applies to controllers and processors based outside the EU territory where the processing of personal data regarding EU data subjects relates to:
 - the offering of goods or services (regardless of payment); or
 - the monitoring of data subjects’ behaviour within the EU

The EU General Data Protection Regulation

- Pseudonymisation/anonymisation distinction
- Lawful processing grounds include:
 - Contractual obligations
 - Legal obligations
 - Legitimate interest
 - Consent (which must be explicit, freely given and fully informed)
- For employee data, consent is unlikely to be valid
- Privacy Notice is a key document for data subjects:
 - Lawful basis for processing data
 - Description of data being processed and source of data
 - Data sharing e.g. benefit plan administrators or providers
 - Data transfers e.g. to US
 - Data security
 - Data privacy rights
 - Right to make a complaint

The EU General Data Protection Regulation

- International transfers: Binding Corporate Rules, model clauses, transfers to a certified organization, consent, transfer is “necessary” for performance of contract, establish, exercise or defend legal claims or for legitimate interests of controller (one-off and limited data subjects involved)
- Schrems II- EU-US Privacy Shield invalid and greater scrutiny of cross-border transfers
- Data Protection Officer: for controllers/processors processing substantial sensitive personal data or who have core activity of monitoring individuals on a large scale or public body
- Right to request to be forgotten, have data restricted, have data rectified or access to data
- Privacy by design: privacy safeguarding technology built-in from the start
- Actively factor privacy considerations into the design and upgrade of all systems, policies, settings which process personal data
- Privacy by default: privacy-friendly default settings until user chooses otherwise

The EU General Data Protection Regulation

- Data protection impact assessment: prior to processing if high risk for individuals
- Notify data breach to supervisory authority without undue delay/within 72 hours unless unlikely to be a risk to individuals' rights
- Notify data breach to individuals without undue delay if there is likely to be high risk to individuals
- Penalties for breach of GDPR - up to higher of 4% global turnover or €20,000,000
- Individual rights to bring claims against controllers and processors

EQUITY-BASED COMPENSATION

Equity-Based Compensation

- Equity Plan
- ESPP

Implementation

- Plan Design
 - Global Plan
 - Discretion to modify for local compliance
- Compliance with U.S. Law
- Country Specific Analysis of Local Compliance
- Administration

Compliance Issues

- Tax
- Securities Law
- Exchange Control
- Employment Law
- Data Privacy
- Additional Issues for ESPP

Tax Consequences

- Taxation Event
 - Options: generally, tax at exercise
 - RSUs: generally, tax at vesting
 - Restricted Shares: may be tax at grant
 - Characterization of Income
 - May be unclear

Tax Consequences

- Withholding and reporting
 - Who withholds and reports
 - Effect of recharge
- Social insurance
 - Employer and employee contributions
- Mobile employees
 - Tax in multiple jurisdictions
 - Tracking issues

Securities Law Compliance

- Vary by country
 - Registration/Prospectus
 - Exemptions for employee offerings or small offerings
 - Notice filing requirements
- Change type of award

Exchange Control

- Regulates foreign currency flows
- Approval
 - China
 - SAFE approval
 - Requires repatriation
 - Cash alternative
- Reporting requirement
 - By employer
 - By employee

Employment Laws

- Plan entitlement/acquired rights
 - Clauses to protect employer
- Discrimination
 - Age
 - Part-time

Employment Laws

- Clawback/Penalty clauses
 - Enforceability
 - Effect on taxation
- Restrictive Covenants
 - Enforceability
 - Effect on taxation

Employment Laws

- Governing law
- Translation

Data Privacy

- Data privacy laws restrict processing and transfer of personal data
 - Consent
 - Third party administrator

Additional ESPP Issues

- Conversion of Payroll
- Deductions
- Securities Exemptions
- Approval for Payroll Deductions
- Impact of Holding Period

Plan Documents

- Global Plan
 - Sub-plans
- Form Agreements
 - Country specific provisions
- Supplements to Prospectus

Year-End Reporting

- Annual/periodic reporting

Practical Tips

- Review local compliance
- Prepare securities filing if necessary
- Prepare form agreements
- Analyze tax withholding/reporting
 - Establish process
 - Tracking mobile employees

U.S. TAXATION

Federal Income Taxation for U.S. Citizens/Residents

- U.S. Federal Income Tax Withholding
 - U.S. citizens, permanent residents, and resident aliens are taxed on their worldwide income, regardless of where services are performed
 - Withholding generally is required for all U.S. citizens and residents, with several exceptions:
 - A treaty provides relief and the taxpayer claims treaty relief on the appropriate forms
 - At the time of payment, it is reasonable to believe that the payment will be excluded from gross income under Code section 911 (US citizens only)
 - The payment is subject to foreign income tax withholding in a foreign country or U.S. possession (US citizens only)
 - Additional exceptions apply for services performed in U.S. possessions

Federal Income Taxation for Nonresident Aliens

- Nonresident aliens are taxed on U.S. source income – i.e., payment for services performed in the U.S.
 - Compensation generally allocated on the basis of workdays spent within and without the U.S.
 - Stock option income generally allocated on the basis of workdays between the grant and vesting dates.
- Absent treaty relief, withholding rules for nonresident aliens are as follows:
 - For employees, withhold at graduated rates under Code section 3402 (subject to flat-rate withholding rules for certain supplemental wages)
 - Non-employees generally are subject to 30% FDAP withholding under Code section 1441, even though the individual may be subject to tax at graduated rates

Federal Income Taxation for Nonresident Aliens

- Treaties may provide relief for individuals who are present in the U.S. for less than 183 days during the year, if the compensation is paid by a non-U.S. employer and may not be deducted by a permanent establishment that the employer maintains in the United States.
- Under a few treaties, an additional limited exception is available for work done by the treaty country resident in the U.S., where total salary for the year does not exceed a prescribed dollar minimum
- Section 861(a)(3) exception applies if all three of the following apply:
 - (i) the employer is foreign person not engaged in trade/business in U.S. or foreign office of U.S. entity;
 - (ii) the nonresident alien spends no more than 90 days in the United States in the calendar year; and
 - (iii) compensation for all work in the United States does not exceed \$3,000.

Social Security Taxation

- U.S. FICA Tax Withholding
 - Generally required for wages paid by any employer for services within the U.S., regardless of the employee's citizenship or residency status
 - Exception for nonresident aliens temporarily present in the U.S. under certain types of visas
 - Exception for certain temporary foreign agricultural workers
 - Generally required for services performed outside the U.S. by U.S. citizens and residents, but only for wages paid by an American employer
 - The term "American employer" includes U.S. corporations, the U.S. government, U.S. residents, and partnerships where 2/3 of the partners are U.S. residents
 - Also includes service under a U.S. government contract for a foreign member of a U.S.-based controlled group
 - Not required for employment with a foreign affiliate of a U.S. employer, except as provided by a totalization agreement or a 3121(I) agreement

Social Security Taxation

- Totalization Agreements (more common)
 - Prevent double taxation where both countries provide for coverage
 - Permits social security credits in both countries to be added together
 - Especially useful for temporary assignments, where a minimum period of service is required for social security benefits
 - Not available for local hires
 - Only available in about 25 countries
- Section 3121(I) Agreements (less common)
 - American employer must have at least a 10% interest in the foreign affiliate
 - Agreement is irrevocable
 - Must apply to all U.S. citizens employed by the foreign affiliate, including local hires
 - American employer is responsible for withholding and paying the employer and employee share of FICA taxes
- Income tax treaties rarely address social security taxes

U.S. Citizens/Residents in Foreign Retirement Plans

- Foreign funded arrangements taxed under Section 402(b)
 - Benefits become taxable when they vest
 - HCEs taxed on trust earnings in discriminatory plans
 - Funded arrangements are not subject to Section 409A
- Unfunded arrangements may be subject to Section 409A
 - Must comply or qualify for an exemption
 - Exemptions cover broad-based foreign retirement plans, and amounts excludable by treaty or pursuant to Code section 911
 - If exempt from or compliant with Section 409A, taxation is deferred until distribution or funding, whichever comes first
 - If plan violates Section 409A, vested benefits (using a different definition of vesting than Section 402(b)) are subject to immediate income taxation, plus a 20% penalty tax and premium interest tax retroactive to the vesting date
- Common mistakes: Failure to file forms required for treaty protection

Non-Resident Aliens in U.S. Retirement Plans

- Many plans will exclude “non-resident aliens with no US source income” from participation
 - These employees may be excluded from non-discrimination testing
 - Employers may want to exclude from participation employees who receive benefits under the retirement plans of other countries
 - Plans often limit eligibility to employees paid from a U.S. payroll
- Taxation issues may arise when non-resident aliens employed in the US participate in a U.S. qualified plan
 - Distributions are subject to 30% withholding to the extent attributable to income generated in the U.S.
 - Distributions to non-resident aliens are reported on IRS Forms 1042 and 1042-S

QUESTIONS?

Biography



Lee Harding

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Lee has a broad and versatile practice that goes beyond the provision of traditional legal services. Lee's practice is focused on the myriad legal implications arising out of a rapidly changing workplace: flexible working, five generations in the workplace, giving workers a voice, and the crossover between employment and the regulatory environment, to name but a few. The nontraditional legal services that Lee offers require a proactive approach to managing workplace issues before they escalate. He engages with a wide range of stakeholders to deliver sophisticated and actionable solutions that resonate across the entire business.

Biography



Erin Randolph-Williams

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Erin is part of a team that helps clients find solutions to their employee benefits–related problems. She counsels clients on employee benefits matters, including design, implementation, and administration of cash or deferred compensation arrangements, nonqualified deferred compensation plans, and executive and equity compensation arrangements. Erin negotiates employment agreements and severance arrangements for senior executives, and advises clients on all employee benefits and compensation-related aspects of mergers, acquisitions, sales and spin-offs.

Biography



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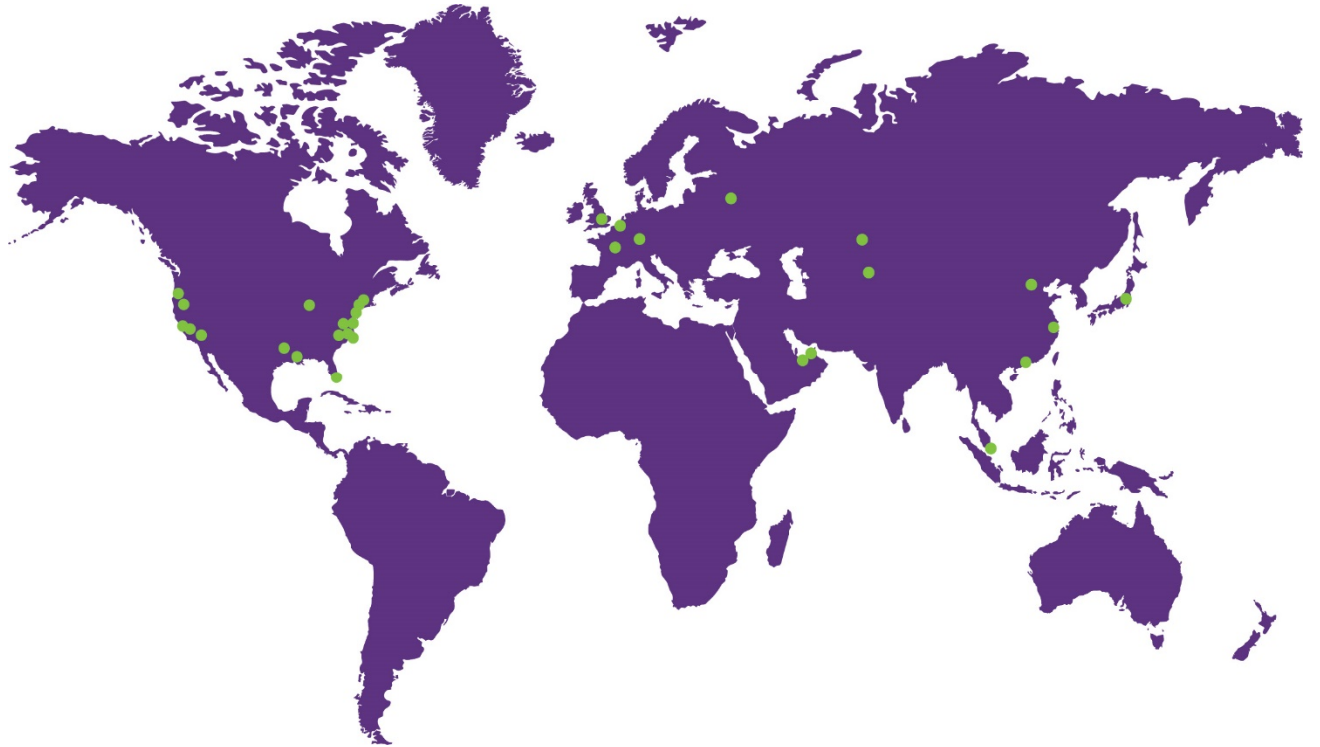
Jonathan helps clients design and maintain all types of employee benefit plans and programs. His practice focuses on Internal Revenue Code and Employee Retirement Income Security Act (ERISA) compliance for retirement, health and welfare, and executive compensation plans. He has particular experience with Code Sections 409A, 162(m), and 280G, and with taxes and fees arising under the Affordable Care Act (ACA). Jonathan also devotes a large part of his practice to payroll, withholding, and fringe benefits matters. He works with clients of all sizes and routinely handles matters ranging from large transactions to day-to-day administrative questions.

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