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Recent Developments for the Third Quarter 2007

Baker & McKenzie

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Abstract
[Excerpt] This letter summarizes developments around the world that affect global stock plans and that, for the most part, occurred between July and September 2007. In some cases, we expand on topics mentioned in previous updates.

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BAKER & MCKENZIE

Baker & McKenzie LLP
Two Embarcadero Center, 11th Floor
San Francisco, CA 94111-3802, USA

Tel: +1 415 576 3000
Fax: +1 415 576 3099
www.bakernet.com

TO: Clients & Friends

FROM: Global Equity Services Group

DATE: December 4, 2007

RE: Recent Developments for the Third Quarter 2007

This letter is from the Global Equity Services ("GES") group in San Francisco, Chicago and New York. Attorneys in the GES practice group work extensively with multinational employers to design, implement, and maintain equity-based compensation programs, including stock option, stock appreciation rights, restricted stock, restricted stock unit and stock purchase plans for their employees, consultants and directors. Within this context, we provide advice regarding U.S. and non-U.S. tax, securities, labor, exchange control, data privacy and other legal requirements. We design equity-based compensation programs to take into account a client's overall international tax structure and its accounting requirements. We also offer sophisticated and experienced perspectives on option repricing/exchange programs and ways to preserve the equity incentives in transactions such as spin-offs, mergers and acquisitions. In addition to legal services, we deliver project management services and prepare employee communications. To complement our equity-based compensation practice, we furnish guidance in connection with global and domestic benefit plans to document fiduciary decisions, compare benefit programs and attain compliance. This letter summarizes developments around the world that affect global stock plans and that, for the most part, occurred between July and September 2007. In some cases, we expand on topics mentioned in previous updates.

Table of Contents

THIRD QUARTER 2007 — THE TRENDS ... 1

AUSTRALIA ... 2

Payroll Tax Due on Equity Incentives in Victoria ... 2
Tax Office Clarifies Taxing Rights Upon Sale of Shares ... 2

CANADA ... 2

New U.S.-Canada Income Sourcing Rules for Stock Options ... 2

CHINA ... 3

Applicability of Notice 35 and Tax Circular 902 to Different Types of Equity Awards ... 3
Method for Calculating Taxable Income from Equity Awards ... 4
Update on New Exchange Control Regulations in China ... 4

CZECH REPUBLIC ... 5

Pending Changes to Capital Gains and Dividend Taxation ... 5

DENMARK ... 6

Danish Tax Ruling Confirming RSUs Are Not Subject to Tax at Grant ... 6

EUROPEAN UNION ... 7

Prospectus Directive Updates ... 7

FRANCE ... 8

Gift of Shares Changes to Tax-Qualified Stock Option Regime ... 8
French Parliament Approves Tax Changes to Tax-Qualified Awards ... 8

GERMANY ... 9

Update on Draft Tax Reform to Eliminate Capital Gains Tax Exemption for Individuals ... 9

INDIA ... 9

Guidelines for the Calculation of the Value of Publicly-Traded Shares for FBT Purposes Issued ... 9
Net Share Withholding for RSUs May be Acceptable Under India's Exchange Control Laws ... 10
Further Liberalization of Exchange Control Laws ... 11

JAPAN ... 11

New Securities Law Changes Affect Filing Requirements in Japan ... 11

MALAYSIA ... 12

New Securities Legislation Introduced in Malaysia ... 12

NEW ZEALAND ... 12

Extension of the Overseas Issuer Exemption ... 12

UNITED KINGDOM ... 12

Capital Gains Reform Proposed for April 2008 Tax Year ... 12
New Forms for Annual Share Scheme Reports in 2008 ... 13

UNITED STATES ... 14

IRS Extends Most Transition Relief Under Code Section 409A until December 31, 2008 ... 14

THIRD QUARTER 2007 — THE TRENDS

We expect that many of you are taking a bit of a breather at the moment, having gone through one or two cycles of FAS123R, proxies with new CD&A disclosure and of course the ever present SOX requirements. Nevertheless, having survived these issues, you probably have taken a pretty close look at your plan design and have implemented changes in that regard.

A design trend we are seeing is the introduction of "choice" plans. Under these plans, employees (sometimes only senior executives) are given a choice as to the form of awards within certain parameters. For example, an employee might be offered the opportunity to receive options over 10,000 shares, or restricted stock units over 3,000 shares, or some combination of the two within specified parameters. In some cases, a current cash award is in the mix as well, or the executive is given the ability to determine that part of his or her annual bonus is converted to an equity award of one type or another, again in specified ratios. There are of course complicated U.S. tax and accounting issues in connection with this plan design, but we want to point out that there are substantial non-U.S. aspects to this as well, including the perhaps more obvious tax issue of constructive receipt on an international basis, but perhaps the less obvious securities law implications of giving the employees a choice. In some countries, the offer of the choice is in and of itself the securities offering for which a filing or exemption is required. We are currently involved in at least three of these projects, and are uncovering significant international issues which should be addressed before implementing these programs.

Two other items are cropping up a bit more and will likely continue over the near future at least. The first, to which we have previously alluded, is the ongoing analysis of the interplay of the accounting rules as they relate to income taxes, the availability of local tax deductions and the impact of intercompany pricing analysis on these issues. As more countries adopt IFRS2 for local statutory accounting, and as the tax regulators around the world focus more on equity in connection with transfer pricing, we can expect continued attention to this issue and complexity of designing appropriate structures to optimize tax/accounting results.

One final comment. As matters settle down somewhat in connection with the accounting and plan design issues, it may be a good time to review your programs for international compliance, as a focus on the latter may have suffered a bit given the attention required for certain other (domestic) aspects of your programs.

AUSTRALIA

Payroll Tax Due on Equity Incentives in Victoria

As you are probably aware, employer-paid payroll tax is due on total wages, which has been determined to include the value of employee equity incentives in New South Wales, Western Australia, the Northern Territory, the Australian Capital Territory and Queensland. Under the new Payroll Tax Act 2007, effective as of July 1, 2007, employee equity incentives are now also subject to payroll tax in Victoria. In Victoria, the rate of payroll tax is 5.05% if the value of the employer's total annual wage payments to all Victoria employees exceeds AUD550,000. The taxable amount is the market value (as defined under Australian tax law) of the equity award less any consideration paid by the employee to receive the award and will apply to grants of equity incentives made on or after July 1, 2007. As in New South Wales, employers in Victoria may elect payroll taxation on the options at the time the options "vest" (which probably means exercise for a U.S. multinational stock option pursuant to the odd definition of "vest") or at the time of grant. If you would like information on whether you are able to defer payroll tax until exercise and how to make that election, please contact the GES attorney with whom you usually work.

Tax Office Clarifies Taxing Rights Upon Sale of Shares

On August 28, 2007, the Australian Tax Office ruled on a capital gain tax issue for a mobile employee with stock options. In that ruling, an employee who was a U.S. tax resident at the time of the grant and exercise of stock options (and taxed on the spread at exercise in the U.S.), subsequently became a tax resident in Australia. When the shares were sold, the employee was subject to capital gains tax on the entire gain at sale (*i.e.*, the sales proceeds less the cost basis of the option). In Australia, a capital gain may be reduced for tax purposes by the amount of exempt income (such as foreign earnings) that has been included in the gain. However, in the August ruling, the Australian Tax Office determined that capital gains realized in Australia from stock options, which were granted and vested in the U.S., were not considered foreign earnings. Furthermore, the Australian Tax Office ruled that neither the relevant tax treaty with the U.S. (under which the employee had already been subject to tax in the U.S.) nor the principles of international tax law barred Australia from considering the entire amount of the capital gain from the sale of stock (*i.e.*, the sales proceeds less the cost basis of the option) in assessing the employee's taxable capital gains. However, it is possible that double taxation may be able to be avoided by the residence country (in this case, Australia) providing appropriate credit relief.

CANADA

New U.S.-Canada Income Sourcing Rules for Stock Options

On September 21, 2007, the U.S. and Canada signed the Fifth Protocol to the current U.S.-Canada Income Tax Treaty (the "Protocol"), which has yet to be ratified into law in either country. In the Exchange of Diplomatic Notes accompanying the Protocol, specific rules are provided to address the income tax consequences of stock options where an employee has worked at a "principal place of employment" in both the U.S. and Canada between the date of grant and date of exercise. In such case, the stock option income sourced to the U.S. is based on a ratio of (A) workdays between the date of grant and exercise that the individual's principal place of employment for the employer was situated in the U.S. over (B) the total workdays between the date of grant and exercise. Similar to the treatment provided under the 2001 Notes to the U.S.-U.K. Income Tax Treaty, this approach looks to the period between grant and exercise, rather than to the vesting period (which is the applicable period specified in the OECD Model Treaty guidance, as well as U.S. Treasury Regulations on sourcing stock option compensation). However, unlike the U.S.-U.K. approach, the sourcing is based on where the individual's "principal place of employment" is situated, and not the country where the individual actually performs the services. Consequently, where an individual frequently works in both countries, the tax treatment will still be determined by the location of the individual's principal place of employment and this sourcing provision will be available only to individuals who had a principal place of employment in one country and a subsequent principal place of employment in the other country before the option is exercised.

There is additional language providing that the competent authorities of both countries may agree to use a different approach in cases where the grant of options would be more appropriately treated as a transfer of ownership of securities. The language suggests that this may be the case where the options were granted at a discount or where the options are not subject to a substantial vesting period.

For example, an employee of a U.S. company is granted a stock option on January 1, 2009. On January 1, 2010, the employee is transferred from the company's U.S. office to its Canadian subsidiary. On December 31, 2011, the employee exercises the option, giving rise to an income inclusion. Unless the competent authorities agree that the circumstances warrant departing from the usual rule, one third of the income will be treated as having arisen in the U.S., and two thirds in Canada.

This provision enters into force on the same date that the Protocol takes effect. As mentioned above, the Protocol needs to be ratified according to the applicable procedures in both Canada and the U.S. in order to become effective. We will monitor further developments on the ratification process and the interpretation of these provisions.

CHINA

Applicability of Notice 35 and Tax Circular 902 to Different Types of Equity Awards

As we reported in prior Clients & Friends newsletters, companies offering stock options and other forms of equity compensation to employees in the PRC are required to withhold and report income taxes on awards and to satisfy certain reporting obligations to the local provincial tax authorities pursuant to Circular Caishui [2005] No. 35 (“Notice 35”), issued by the Ministry of Finance and the State Administration of Taxes (the “SAT”). We then reported in our first quarter 2007 Clients & Friends newsletter that the SAT issued Tax Circular 902 as a follow-up implementation rule to Notice 35.

Tax Circular 902 stipulates that gains from employee stock option and purchase plans should be taxed as a separate month’s salary with no allowance for a standard deduction and sets forth a formula for calculating the taxable income realized from equity awards. Tax Circular 902 also amends Notice 9, which was issued by the SAT in 1998 regarding the PRC Individual

Income Tax ("IIT") implications of income received by employees from equity incentive plans. Although both Notice 9 and Notice 35 provide that income from stock options (and other types of equity awards) is employment income and should be taxed when employees actually acquire the shares, they provide different methods for calculating the tax due on equity awards. Notice 35 provides that if there is any inconsistency between Notice 35 and Notice 9, Notice 35 shall prevail.

However, because Notice 35 only explicitly covers stock options, there has been some debate as to whether Notice 35 or Notice 9 applies to ESPPs and other types of equity awards (other than options). The language of Notice 9 seems to be broad enough to cover other types of equity incentive plans. Nevertheless, most tax practitioners believe that the method of calculating tax and the withholding and reporting requirements in Notice 35 regarding stock options should apply to other types of equity awards because of the similarities between equity awards. This is the majority view held by officials according to no-names discussions with the SAT, the Beijing Local Tax Bureau and the Shanghai Local Tax Bureau, and our actual experiences in dealing with tax officials in Notice 35 filings. The SAT official contacted by our PRC colleagues opined that Notice 35 should apply to all types of equity awards over listed shares, and Notice 9 should apply only to equity awards over non-listed shares. (Tax Circular 902 states that Notice 35 does not apply to equity awards granted by private companies.)

Therefore, Notice 35 (and consequently Tax Circular 902) should apply to the taxation of income received by employees from ESPPs and RSUs in addition to stock options.

Method for Calculating Taxable Income from Equity Awards

As we reported in our first quarter 2007 Clients & Friends newsletter and reiterated in the discussion of Notice 35 above, there are complicated formulas for determining the taxable income from equity awards granted to employees in the PRC. These formulas vary for each acquisition of shares during the year, and, generally speaking, a company cannot compute taxable income by simply looking to the spread at exercise (or discount at purchase (ESPP)/fair market value of shares at vesting (RSUs)) and multiplying this amount by the employee's progressive tax rate. If you would like information on the correct formula to be used, please contact your GES attorney.

Update on New Exchange Control Regulations in China

As reported in prior Clients & Friends newsletters and most recently in our second quarter Clients & Friends newsletter, the Central Bank and State Administration of Foreign Exchange (the "Central SAFE") issued new "Implementation Rules Regarding Individual Foreign Exchange Administration," effective as of February 1, 2007. Under the new rules, it is possible to apply for permission from Central SAFE to transfer funds to and from China to purchase foreign shares offered under an equity plan. Furthermore, pursuant to an internal circular issued by the Central SAFE to the various local SAFEs on April 6, 2007, entitled "Operational Guidelines on Foreign Exchange Administration Concerning Domestic Individuals Participating in Stock Purchase Plans and Stock Option Plans of Overseas Listed Companies (Hui Zong Fa [2007] No. 78" ("Circular 78"), approval is required for both ESPPs and for stock option plans (including those limited to cashless exercise). Approval will likely also be required for RSU programs where no funds are remitted out of China and employees simply receive the proceeds remitted to China from the sale of the shares.

The application procedure (as described in Circular 78) requires that a company seeking SAFE approval for its equity plans appoint one of its subsidiaries or affiliates in China as the "Domestic Agent" for the participating employees in China. The application for exchange control approval will be filed by this Domestic Agent. As part of the application, the Domestic Agent will be required to apply to the local SAFE office to open a special foreign exchange bank account (the "Onshore Account") through which all funds have to be remitted out of or into China in connection with the stock plans. If the company needs to apply for the outward remittance of funds (*i.e.*, for cash exercises of options and share purchases under an ESPP) as well as for inward remittances, the application will be more complicated because it will be necessary to get approval at both the local and Central SAFE level (rather than solely at the local SAFE level, as is the case for cashless option and RSU offerings). Circular 78 also requires that Chinese employees immediately repatriate all proceeds earned from participation in an equity plan to China through the Onshore Account. Circular 78 further provides that the company apply for an "annual quota" representing the amount of funds that will be converted into foreign currency and remitted abroad for the purchase of shares under an ESPP.

We were recently informed by Shanghai SAFE during the initial stages of an exchange control application for a client's cashless stock option program, that the client must apply for an annual quota for the conversion funds that are both repatriated into and remitted out of China under an option plan as well (and likely RSU programs). Therefore, clients applying for approval for equity award programs in China must request approval for a maximum amount of aggregate funds that can be converted into foreign currency and remitted for the purchase of shares, together with funds converted into Renminbi and received into the Onshore Account annually. However, SAFE will generally allow companies to establish as high an amount as they wish for the annual quota of converted funds funneled through the Onshore Account, as there does not appear to be any fee required in connection with the annual quota approval.

In addition, SAFE stated that PRC employees should be permitted to use only one broker, and not be given a choice between two or more brokers. The rationale suggested by the SAFE officer we spoke with is that it would be more difficult for SAFE to oversee compliance with exchange control requirements if there is more than one broker available to employees participating in an equity award plan in China.

We will continue to monitor any new developments regarding the requirements for exchange control approval.

CZECH REPUBLIC

Pending Changes to Capital Gains and Dividend Taxation

A draft tax reform bill adopted by the lower house of the Czech Parliament introduces changes to the taxation of dividends and capital gains realized on the sale of shares. This bill still needs to be approved by the upper house of the Parliament, the Czech Senate and the President to become law. A summary of the proposed changes follows.

Capital Gains Taxation

Under current law, when an individual holds shares for a period exceeding six months, any gain realized from the sale of the shares is exempt from taxation. If the shares are sold prior to six months, the gain is subject to personal income tax. Under the proposed new law, upon the sale of transferable securities (*i.e.*, shares traded on the NYSE or the NASDAQ), the six-month tax exemption rule continues to apply, provided that the individual did not hold more than 5% of the registered capital or voting rights of the relevant company for a period of 24 months or more prior to the sale. Under the new bill, a tax exemption is available upon the sale of "other securities", which generally would include private company shares, only if the individual has held the shares for a period exceeding five years prior to sale. The five year tax exemption rule also would apply in the event the individual held more than a 5% interest in the company for a period of 24 months or more prior to the sale.

If adopted, this change will apply to all securities acquired on or after January 1, 2008. The change will not impact the employees of our clients whose shares are publicly traded unless an employee holds more than a 5% interest in the company. However, the extended holding period is something our private company clients granting equity in the Czech Republic may wish to make their employees aware of.

Dividend Taxation

With respect to dividends paid by non-Czech issuers to Czech individuals, under current law, individuals may elect either to have the dividends taxed separately from their other income at a flat rate of 15%, or included as part of their total income, in which case tax applies at the individual's marginal tax rate (current rates range from 12% to 32%). Under the proposed change, the flat rate at which individuals may elect dividends to be taxed will be reduced to 12.5%. If adopted, this change will apply to dividends issued on or after January 1, 2009.

DENMARK

Danish Tax Ruling Confirming RSUs Are Not Subject to Tax at Grant

As many of you know, there is uncertainty in Denmark regarding the timing of taxation of RSUs with time-based vesting because, pursuant to the Stock Options Act, it is difficult to cancel unvested RSUs at the time of termination of employment (regardless of the forfeiture provisions of the award agreement) unless the termination is voluntary on the employee's part. Given the extremely limited circumstances under which an employer may cancel outstanding RSUs, our Danish tax advisors have raised a concern that the Danish tax authorities may seek to tax RSUs with time-based vesting schedules at the time of grant. However, one of our clients recently obtained a favorable private tax ruling in Denmark stating that RSUs (with normal time-based vesting and no performance criteria) will be subject to tax at vesting and not at grant. (Please note that there have always been arguments that RSUs subject to performance vesting criteria would not be subject to tax until vesting because the employee had to meet certain other vesting conditions in addition to remaining in employment.) This ruling is very encouraging for other companies granting RSUs that are subject to time-based vesting requirements. However, as a private ruling, it may not be relied on by other companies. To obtain certainty regarding the timing of taxation of RSUs with time-based vesting, each company will need to obtain its own tax ruling.

In addition, the ruling confirmed that the "7H exemption" available under the Tax Assessment Act may apply to RSUs, options and stock purchase rights, provided that the requirements are met. The requirements of the "7H exemption" (as applied to stock options) are as follows: (i) the employee and the company agree to opt for the regime; (ii) either the value of the shares, options, and warrants does not exceed 10% of the employee's annual salary, or the exercise price for the options and warrants is at least 85% of the market value of the underlying shares and the value of any shares received does not exceed 10% of the employee's salary; (iii) the employee's employer or a group company offers the shares, options, or warrants; (iv) the offered options or the underlying shares to be acquired upon exercise of the options or warrants are shares in the employer or a group company; (v) no special share classes are created for the shares; (vi) the employee or the employer (or company within the employer's group) has a right to receive or issue shares, respectively (*i.e.*, instruments that can only be settled in cash do not qualify); (vii) the company's external legal counsel or accountant must certify that the above conditions are met; and a copy of this attestation and of the agreement regarding the application must be filed with the tax authorities; and (viii) generally, the options may not be transferred. If these requirements are met, tax will be deferred until the sale of shares. Further, the local subsidiary will be able to claim a local tax deduction if it reimburses the U.S. parent company for the cost of the awards.

If you think that these 7H exemption requirements may be met for equity rights offered by your company and the exemption is of interest to you, we would recommend speaking with your GES attorney.

EUROPEAN UNION

Prospectus Directive Updates

As discussed in our second quarter 2006 Clients & Friends newsletter, on July 18, 2006, the Committee of European Securities Regulators (the "CESR") issued a Question and Answer publication (Ref. CESR/06-296d) (the "CESR Q&As") which revealed that the majority of CESR members take the view that an offer of non-transferable employee stock options (and the subsequent exercise of the options) is not a public offering of securities subject to the EU Prospectus Directive. We are finding that more and more of the competent authorities in the EU member states are taking up CESR's view on this issue.

1. <u>Options as Securities</u>

The Norwegian Prospectus Authority has now adopted the view communicated by CESR that a grant of a non-transferable option to subscribe or purchase a transferable security does not constitute an offer of transferable securities and does thereby not trigger the need to produce and publish a prospectus. Further, the Norwegian Prospectus Authority has also adopted the view that the exercise of a non-transferable option for a transferable security does not constitute an offer and does not trigger the need to produce and publish a prospectus.

2. <u>ESPPs as Securities</u>

In our fourth quarter 2006 Clients & Friends newsletter, we reported that the Spanish securities regulator (the "CMNV") was one of the few securities regulators in the EU to take the view that a U.S.-style Section 423 ESPP is not subject to the EU Prospectus Directive, because the rights offered to employees are not freely transferable (despite the fact that shares purchased under an ESPP are generally freely transferable). It appears that the Portuguese securities regulator (the "CMVM") is taking a similar view that a U.S.-style Section 423 ESPP is not subject to the EU Prospectus Directive. (These countries also take the view that options and RSUs are not subject to the EU Prospectus Directive, assuming the rights offered are not freely transferable.) Thus, currently, a U.S. issuer may offer its U.S.-style Section 423 ESPP to employees of its subsidiaries in Portugal without filing an EU prospectus, even if the 100-person exception or the EUR 2.5 million exclusion are not available. Nonetheless, because there continues to be much development in this area, we recommend that companies check with a GES attorney prior to offering an ESPP to 100 or more employees in either of these countries.

3. Stock-Settled SARs as Securities

It appears that, under Swedish securities legislation, stock-settled stock appreciation rights ("SARs") are not considered subject to the EU Prospectus Directive in Sweden provided the SARs are not transferable and employees do not pay any consideration for the SARs or for the shares issued upon exercise of SARs.

FRANCE

Gift of Shares Changes to Tax-Qualified Stock Option Regime

Prior to August of this year, if shares acquired pursuant to the exercise of French tax-qualified options were gifted to a third-party donee after the four-year holding period was met, then the gain on sale of shares was taxable in the hands of the donee (not the original optionee) as capital gains. This tax result was more favorable than if the optionee had sold the shares, in which case, only the portion of the gain attributable to appreciation over the fair market value of shares at exercise would have been taxable as capital gains, and the spread at exercise may be taxable at a higher rate. However, for French tax-qualified options granted after June 20, 2007, this tax-favored treatment is no longer available. Under recent guidance from the French tax authorities, if shares are gifted after the four-year holding period is up, the spread at exercise will be taxed under the normal rules for French tax-qualified options, not as capital gains.

French Parliament Approves Tax Changes to Tax-Qualified Awards

A proposal has been adopted by the French Assembly and Senate to impose a new form of employer social insurance contributions on French tax-qualified awards. As proposed, there would be new contributions payable by both the employer and the employee on French tax-qualified RSUs and options. We are waiting for publication of the new law before it becomes effective.

Specifically, the proposal would require an employer to pay a social insurance contribution charge on the grant of a French tax-qualified option. The amount is 2.5% of the value of shares subject to an option grant. An employer has the alternative of paying 10% of the IFRS2 "fair value" of the option, but most U.S. multinationals will not necessarily have determined that value, and if the fair value of the option is 25% or more of the underlying share value, the 2.5% of share value rule will be more favorable in any event. For RSUs, the tax will be 10% of the underlying share value at the time of the RSU grant.

A second social insurance contribution charge may be imposed on the employee, although this part of the proposed law is more controversial. It appears that the amount of employee social insurance contribution is 2.5% of the spread at the exercise of the option or 2.5% of the value of RSU shares at vesting. However, the employee would pay this tax at sale. The employer is not responsible for collecting this tax; it is collected by the tax authorities at the same time as the collection of the 11% social taxes ordinarily due by the employee at the sale of French tax-qualified awards.

The proposed effective date for the new employer and employee social insurance contributions is October 16, 2007 for grants made on or after that date. For the employer, the due date of the employer payment obligation is the month after the taxable event, and because the law may not be enacted before the end of November, the first due date (for tax-qualified awards granted in October) may not be until December 2007.

We understand that the current text of the law likely will be implemented as written and will not change. We anticipate the publication of the law to be within the next few weeks. We will continue to monitor this proposed legislation.

GERMANY

Update on Draft Tax Reform to Eliminate Capital Gains Tax Exemption for Individuals

Germany has enacted legislation that abolishes the capital gains tax exemption for shares held by individuals for more than one year. The new law affects the disposition of shares on or after January 1, 2009.

INDIA

Guidelines for the Calculation of the Value of Publicly-Traded Shares for FBT Purposes Issued

On October 23, 2007, the India Finance Minister issued long-awaited guidelines regarding the determination of the fair market value ("FMV") of shares for purposes of the fringe benefit tax ("FBT") applicable to stock awards. (If you have missed our prior alerts on the new FBT, please let us know and we would be pleased to forward them to you.) Prior to issuance of the guidelines, it had been unclear how the FMV of shares should be calculated for FBT purposes. The guidelines provide that for companies whose shares are publicly-traded on a recognized exchange (which the guidelines limit to stock exchanges in India), FMV will be determined on the vesting date as the average of the opening and closing prices of the shares on the applicable stock exchange.

For unlisted companies and for publicly-traded companies whose shares are not listed on a recognized Indian exchange, FMV of the shares must be determined by a Class 1 Merchant Banker in India ("Merchant Banker"). Therefore, U.S. multinational companies that are publicly traded in the U.S., but not in India, must hire a Merchant Banker to obtain a valuation of their shares for each vesting date. There are no rules or guidance for Merchant Bankers with respect to how they should determine FMV for non-Indian listed companies, and therefore, each Merchant Banker is free to use its own valuation method. Hopefully, some Merchant Bankers will be agreeable to using the same valuation method as for Indian publicly-traded companies because the valuation would be relatively easy to do (and hopefully not very expensive). However, other Merchant Bankers may ask to review financial statements and other financial information and apply some type of formula to the valuation of a U.S. publicly-traded company (which would be tedious and costly). This outcome is uncertain, however, and a company will have to contact a Merchant Banker to see if the banker will agree to value the company's shares based on the company's trading price (whether it be the closing price, average of opening and closing prices, etc.).

In addition, the guidelines appear to provide that the same valuation may be used for a period of 180 days. As a result, once a valuation is done, the company does not have to get another valuation for 180 days. However, it may be advisable to have the Merchant Banker prepare a letter on each vesting date stating the valuation amount.

Upon receipt of the valuation report from the Merchant Banker, the company will need to provide a copy of the report to the Indian tax authorities when paying the FBT, as well as a copy to the employees.

There have been rumors that the Indian Finance Minister will grant companies that are publicly traded on certain exchanges (hopefully, NYSE and NASDAQ at a minimum) waivers from the requirement to obtain valuations from Merchant Bankers. We will continue to monitor this issue.

Net Share Withholding for RSUs May be Acceptable Under India's Exchange Control Laws

Fairly stringent exchange controls affect offering equity incentives to employees in India. One of the exchange control restrictions requires employees to repatriate the proceeds from the sale of shares back to India within a certain period of time after sale. As many of you may know, under a conservative interpretation of these repatriation requirements, cashless sell to cover option exercises are problematic because all the proceeds are not being repatriated back to India (*i.e.*, some portion of the proceeds is used to pay the option price and, previously, tax withholding for non-qualified plans). Likewise, net share issuances for RSUs could be problematic under exchange control laws in India.

Under the old income tax regime, the employer was legally obligated to withhold the income tax from the RSU income, and as such, the Reserve Bank of India (the "RBI") did not view the employees as being entitled to the full number of shares at vesting (meaning that the employer/issuer could withhold a sufficient number of shares to pay the tax). Under the new FBT regime, however, even if the employer FBT is contractually transferred to the employee, the employer/issuer is not *legally* entitled to withhold the income tax. Therefore, concern arose that the RBI would not permit withholding of shares because the employee is technically entitled to the full number of shares at vesting.

We have asked Indian counsel to clarify this issue on a no-names basis with the RBI. Fortunately, the RBI confirmed that it does not view withholding in shares (even if done to satisfy the transferred employer FBT liability) as a violation of the Indian repatriation requirement, provided the withholding method is expressly permitted in the issuer's plan or award agreement signed by employees. However, we recommend that an issuer confirm this view with an official ruling if it wants to withhold FBT by means of net share withholding.

Further Liberalization of Exchange Control Laws

On September 26, 2007, the RBI issued a notice (RBI/2007-08/146 A.P. (DIR Series) Circular No. 9) entitled “Liberalised Remittance Scheme for Resident Individuals – Enhancement of limit from USD 100,000 to USD 200,000” whereby the previous foreign remittance limit of US$100,000 per person per financial year (*i.e.*, April to March) has been increased to US$200,000 per person per financial year.

Generally, if employees purchase shares in a foreign company under an employee stock plan, any funds remitted out of India for the purchase of shares would not have to be included for purposes of the US$200,000 remittance limit, provided the conditions of the “general permission” are met. The general permission conditions are as follows: (i) the foreign company issuing the equity awards must own at least 51% of the local Indian company; (ii) the shares under the employee stock plan are offered by the company globally on a uniform basis; and (iii) an annual return is submitted by the company to the RBI through an authorized dealer (*i.e.*, a bank authorized to deal in foreign currency) stating, among other things, details of the remittances, beneficiaries and number of shares allotted according to the prescribed format. Most U.S. issuers granting equity awards to employees in India will be able to satisfy the conditions of the general permission. If, however, the requirements of the general permission cannot be met, the employees could still remit funds out of India for the purchase of shares under an employee stock plan, provided the funds do not exceed US$200,000 in the aggregate per person per financial year.

If no funds are remitted to acquire shares (*e.g.*, if the employee acquires the shares through a cashless option exercise, or if no consideration is paid to receive the shares), nothing will have to be counted towards the US$200,000 limit.

JAPAN

New Securities Law Changes Affect Filing Requirements in Japan

As of September 30, 2007, the Financial Instruments and Exchange Law (“FIEL”) replaced the former Securities and Exchange Law (“SEL”) as the governing legislation regulating securities in Japan. Unfortunately, the entire text of the new law and the implementing ordinances have not yet been released to the public and are expected to be published soon. The implementation of the FIEL has impacted some filing requirements for foreign companies who offer employee stock plans in Japan. The most significant development so far has been the abolition of the requirement to prepare a Company Information Statement for issuers who want to take advantage of the Employee Plan Exemption from filing a Form 7 or Form 7-2 and who only make grants of equity awards to employees of Japanese subsidiaries that are directly and wholly-owned by the U.S. parent company. Now, under the FIEL, issuers can rely on the Employee Plan Exemption without having to prepare and distribute a Company Information Statement or making any additional filings.

Again, there has been more discussion that all types of Japanese securities filings may soon be able to be filed in English with short summaries translated into Japanese. Please note that this change is not certain and, in any event, is not expected to occur prior to March 31, 2009.

MALAYSIA

New Securities Legislation Introduced in Malaysia

On September 28th, the Malaysian government introduced the Malaysian Capital Markets and Services Act (2007) ("CMSA") which replaces provisions of the Malaysian Securities Commission Act regulating excluded offerings of securities pursuant to an employee share or employee stock option plan. As you may recall, excluded offerings of securities to employees in Malaysia do not require prospectus registration; however, such offerings require an information memoranda be prepared and lodged with the Malaysian Securities Commission.

The new legislation does not change the securities requirements applicable to the grant of stock options, RSUs and other awards under an equity compensation plan to employees in Malaysia, including the obligation to submit an information memorandum to the Malaysian Securities Commission within seven days of distributing grant materials. Therefore, the same securities requirements will continue to apply with respect to the grant of equity awards to employees in Malaysia. However, the information memoranda will need to be updated to include references to the relevant sections of the CMSA.

NEW ZEALAND

Extension of the Overseas Issuer Exemption

Under the Securities Act (Overseas Employee Share Purchase Schemes) Exemption Notice 2002 ("Overseas Issuer Exemption"), many U.S. companies offering securities under an employee stock plan have been exempt from compliance with certain provisions of the New Zealand Securities Act, including the prospectus filing requirement, provided certain conditions are met. The availability of the Overseas Issuer Exemption was recently extended through September 30, 2012. Additionally, one of the conditions for the Overseas Issuer Exemption included the filing of annual reports to the New Zealand Securities Commission reporting the details of shares issued/awards made each year. This condition has been eliminated. However, this requirement is not to be confused with the financial reporting obligations to the Registrar of Companies which the overseas issuer has to meet under the Financial Reporting Act, as discussed in the second quarter 2007 Clients & Friends newsletter. These financial reporting obligations have not changed.

UNITED KINGDOM

Capital Gains Reform Proposed for April 2008 Tax Year

In its 2007 Pre-Budget Report, the U.K. government has announced a significant reform to the U.K. tax regime that applies to capital gains, including those realized upon the sale of shares under employee equity plans.

Under current law, U.K. capital gains tax applies to most sales of shares acquired under an employee stock plan at rates ranging from 10% to 20% (but could be as high as 40%) on the amount of a capital gain after application of taper relief and an individual's annual exempt amount (currently £9,200). Introduced in April 1998, taper relief reduces the amount of a gain that is subject to capital gains tax according to the number of complete years an asset is held between the dates of its acquisition and its sale and whether the asset is a "business asset" or "non-business asset", with business assets receiving more favorable treatment. Shares acquired by an employee of his or her employer or a related company are considered to be business assets if, at the time of sale, the employee is employed within the same group of companies. Since April 2002, the effect of taper relief is that upon the sale of shares held as business assets for more than one year, only 50% of any capital gain is taxable. If the shares are held for more than two years before sale, only 25% of the gain is subject to tax, which effectively reduces a top-rate taxpayer's rate of capital gains tax from 40% to 10%.

Under the proposed reform, which would apply to any sale of shares on or after April 6, 2008, taper relief would be eliminated and the full amount of any capital gain would be taxed at a new flat rate of 18%, after application of an individual's annual exempt amount (there is no proposal to eliminate the annual exempt amount). Other forms of capital gains tax relief, including the indexation allowance (the pre-taper relief allowance based on inflation over the period of ownership) and certain special rules for assets held on March 31, 1982 will also be abolished under the new tax regime.

Current proposals do not provide any transitional relief for shares acquired prior to April 6, 2008. However, since the announcement of the Pre-Budget Report, there has been extensive lobbying against the proposed changes from the Confederation of British Industry, the Trades Union Congress and others. As a result, it remains possible that the U.K. government will consider modifying the proposed rules for certain types of investments or assets or introducing some form of transitional relief or grandfathering for shares acquired prior to April 6, 1998.

In the meantime, assuming changes to the proposed new regime are not forthcoming between now and April 2008, our clients may consider notifying their U.K. employees who may qualify for taper relief on the sale of any shares held for more than one or two years of the potential tax advantage in selling those shares prior to April 6, 2008. Please contact your usual GES attorney for more information and assistance with this process.

New Forms for Annual Share Scheme Reports in 2008

On November 15, 2007, the U.K. HM Revenue & Customs ("HMRC") issued new versions of the annual share scheme reports that companies must use to report grant, exercise and other activity under HMRC approved and non-approved stock plans during the 2007/2008 U.K. tax year, *i.e.*, from April 6, 2007 to April 5, 2008. The reports must be filed with the HMRC no later than July 6, 2008 and significant penalties can apply for failure to file. New versions of the the forms can be found on the HMRC's website at http://www.hmrc.gov.uk/shareschemes.

UNITED STATES

IRS Extends Most Transition Relief Under Code Section 409A until December 31, 2008

On October 22, 2007, the Internal Revenue Service issued Notice 2007-86 which extended through December 31, 2008 substantially all of the transitional relief under Internal Revenue Code Section 409A that was due to expire at the end of 2007. As a result, employers have until December 31, 2008 to structure their nonqualified deferred compensation arrangements in full compliance with Section 409A. In essence, the transitional relief (the text of which may be accessed at http://www.irs.gov/pub/irs-drop/n-07-86.pdf), extends the compliance deadlines for a full year and provides the following notable changes:

- The effective date of the final regulations has been delayed to January 1, 2009;
- The deadline for amending nonqualified deferred compensation plans to comply with all documentary requirements under Section 409A (including the time and form of payment) has been delayed to December 31, 2008;
- The transitional rule permitting new elections with respect to the timing and form of payment has been extended until December 31, 2008;
- The period during which non-discounted stock options and SARs may be substituted for certain unexercised discounted stock options and SARs has been extended until December 31, 2008 (this transitional relief does not apply to discounted options or SARs granted to the Section 16 officers of a public company that has not timely reported the financial expense associated with a discounted stock right);
- Payment elections under a tax-qualified plan (and other specified plans) may continue to govern the time and form of payment under certain nonqualified deferred compensation plans through December 31, 2008; and
- Certain good reason provisions (typically found in employment, severance and change in control agreements) may be amended through December 31, 2008 to qualify for exemptive relief available to involuntary termination arrangements.

Even though many of the Section 409A deadlines have been extended, employers must continue to operate their plans in reasonable, good faith with Section 409A through the effective date of the final regulations. (The notice explains what constitutes reasonable, good-faith operational compliance.) Additionally, the IRS anticipates providing guidance soon relating to a Section 409A voluntary corrections program.

In a separate announcement, Notice 2007-89 (the text of which may be accessed at http://www.IRS.gov/irb/2007_41_IRB/ar16.html), the IRS also provided additional guidance on reporting obligations and wage withholding requirements for 2007 with respect to nonqualified deferred compensation. Basically, reporting and withholding is required for non-qualified deferred compensation that does not comply with Section 409A, but employers do not have an additional withholding obligation with respect to the 20% penalty tax. In addition, for 2007, reporting is not required for nonqualified deferred compensation that complies with Code Section 409A.

Despite the extended transitional relief made available under this notice, the review and analysis of compensation arrangements should continue in light of the complex administrative and corporate governance considerations presented by the implementation of the required amendments. This is particularly true for companies with discounted options or SARs because once discounted options and SARs are exercised they may not, in all likelihood, be brought into compliance with Section 409A. Further, the correction of discounted options and SARs may be time intensive and involve numerous considerations, including but not limited to (i) calculating the fair market value on the date of grant, (ii) conducting a tender offer, (iii) seeking board and/or compensation approval and (iv) seeking the consent of the affected holders of stock rights.

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For more information, please contact your usual GES attorney contact or you may contact one of the following partners in the GES group:

Narendra Acharya	**(312) 861-2840**	**narendra.acharya@bakernet.com**
June Anne Burke	**(212) 626-4371**	**june.anne.burke@bakernet.com**
Ed Burmeister	**(415) 576-3029**	**eburmeister@bakernet.com**
Kate Clancy	**(212) 626-4379**	**kate.clancy@bakernet.com**
Valerie Diamond	**(415) 576-3086**	**vdiamond@bakernet.com**
David Ellis	**(312) 861-3072**	**david.w.ellis@bakernet.com**
Jennifer George	**(415) 984-3848**	**jennifer.b.george@bakernet.com**
Jennifer Kirk	**(415) 591-3232**	**jennifer.f.kirk@bakernet.com**
Barbara Klementz	**(415) 591-3211**	**barbara.klementz@bakernet.com**
Bonnie Levitt	**(415) 984-3833**	**blevitt@bakernet.com**
Rob Marshall	**(415) 984-3822**	**robert.marshall@bakernet.com**
Brian Wydajewski	**(312) 861-8286**	**brian.k.wydajewksi@bakernet.com**

You may also visit our website at: www.bakernet.com. Once in the site, click on Practice, then on Employment and then click on Global Equity Services.

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