Equity Awards Granted to U.S. Participants by Non-U.S. Entities Can Lead to Unintended Consequences

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Because of the various benefits, securities, and tax laws that apply to equity awards, what may be permissible (and even commonplace) in one jurisdiction, may be problematic in another. Accordingly, whenever an issuer desires to issue equity awards to service providers (*e.g.*, employees or contractors) in a different jurisdiction, the issuer should engage benefits, securities, and tax counsel in all relevant jurisdictions early in the process to avoid any unanticipated issues that could negatively impact the value or purpose of the awards.

For example, a common issue occurs when the issuer is an entity outside of the United States, but equity awards will also be made to service providers in the United States. Under U.S. tax law, there are specific requirements for determining the exercise price of stock options and stock appreciation rights (under Section 409A of the U.S. Internal Revenue Code (***Section 409A***) that require the exercise price to be at least equal to the underlying stock's fair market value on the date of grant for the awards to be exempt from Section 409A. Other non-U.S. jurisdictions may permit the exercise price to be determined in ways that would result in the exercise price being lower than the stock's fair market value on the date of grant, which would cause a participant who is subject to U.S. taxation (a ***U.S. Participant***) to be taxed on the awards as they vest (regardless of whether the award is exercised) and to substantial additional taxes and penalties if those awards do not comply with Section 409A. In the event awards to U.S. Participants must be granted with a higher exercise price than options granted to non-U.S. Participants in order to comply with Section 409A, the awards granted to U.S. Participants may have less value or be more restrictive than the awards granted to non-U.S. Participants. Identifying these types of issues early in the process can allow for the proposed grants to be adjusted to prevent such adverse consequences.

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