Morgan Stanley

global equity ORGANIZATION

Workforce Mobility

Insights and Strategies to Address Challenges of Workforce Mobility for Global Equity Plans

We live in an increasingly mobile world, where the boundaries of today's workplace are constantly expanding.

Employees cross both state and international borders to perform their jobs on a regular basis. Yet, a mobile workforce continues to test the demands of all types of enterprises—from startups to the largest multinationals, both public and private.

As a result of greater scrutiny by U.S. state and global tax authorities of equity awards and the complexity that mobility adds to the equation, there is a critical need for employee data collection and well-defined processes across the organization in order to be compliant.

Having a clear, established tax mobility tracking strategy is critical in today's mobile environment. A well-crafted strategy, one that includes third-party guidance and expertise, can support a successful tax policy, ensuring compliance for both the corporate issuer and its employees.

This paper tackles the challenges that organizations continue to face over workforce mobility and identifies strategies to address the multifaceted challenges of tax compliance for global equity plan administration.

OUR RESEARCHERS

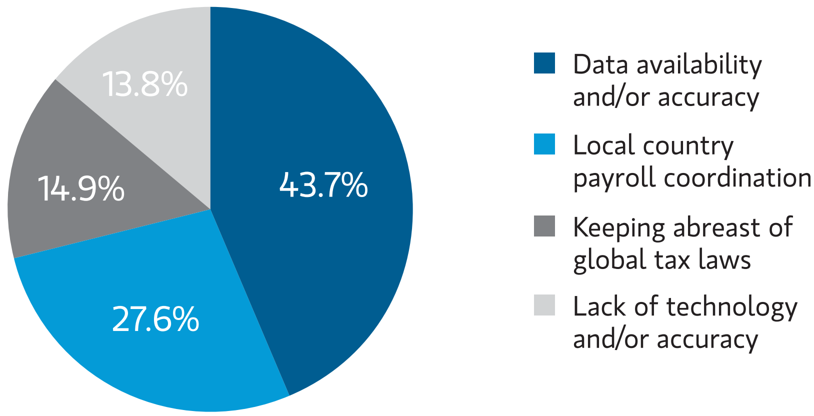
LEANN BALBONA

KPMG LLP, Managing Director
Global Reward Services

Mobility Remains a Top Concern

At the 2018 Global Equity Organization (GEO) Conference held in Orlando, Morgan Stanley conducted a short survey that focused on the challenges of workforce mobility. In attendance were 400 equity compensation professionals, whose main responsibilities include managing the equity administration function or Total Rewards* program for multinational companies, as well as industry professionals.

According to those who completed the survey,[1] 73 percent of issuer respondents confirmed that mobility is one of the top three priorities for their company's equity program. Survey findings also indicated that the major challenges for meeting tax reporting obligations when providing equity awards to their mobile employees focused on data availability and accuracy, as well as payroll coordination among the local country's administration team.



The Expansion of 'Mobility'

The definition of workforce mobility was also confirmed to be broadening by those who completed the survey. Beyond traditional expatriates who are abroad on a temporary international work assignment, the definition of "mobile" now includes internationally mobile employees, short-term business travelers and U.S. state-to-state employees.

Michael Bussa, National Partner of KPMG's Global Reward Services, agrees with the findings of the Morgan Stanley survey. As organizations grapple with the tax and payroll compliance requirements associated with this broadening group of mobile employees, many are considering enhanced tracking and data collection processes, along with robust tax and payroll applications to calculate and collect applicable taxes across all equity compensation transactions in real-time.

Collecting tax from mobile employees when the transactions occur can potentially reduce or eliminate tax adjustments later and eliminate excessive balances due on the employee's tax return or equalization. Further automating the mobility process allows for more timely payroll tax deposits and reporting in each country involved in the transactions with the taxing authorities. A timely approach can improve the experience for all stakeholders, and potentially improve compliance reporting, tax settlement and overall employee experience.

"A timely approach can improve the experience for all stakeholders, and potentially improve compliance reporting, tax settlement and overall employee experience."

*Total Rewards is another name for Compensation and Benefits department.
[1] Source: Morgan Stanley Mobility survey results from 61 attendees at GEO Conference Orlando 2018.

Solutions for Tracking Mobility

One of the critical components in developing a comprehensive workplace mobility program is the ability to efficiently track and record the work locations of each employee. Tracking employee personal data including mobility is a topic that has received much attention from corporate leaders, particularly in light of the recently passed Global Data Privacy Regulations (GDPR) in the European Union. Most employers and employees prefer that their company not track an employee's whereabouts via mobile devices 24/7, even though GPS is widely available on most smartphones and tablets.

So What Are Companies Doing to Track Workforce Mobility?
The 2017 KPMG Global Assignments Policies and Procedures (GAPP) annual survey studied this question and discovered that 82 percent of companies are doing some form of tracking for equity participants on an international assignment.

According to Michael Bussa, "Data is key to solving the mobility puzzle, and more broadly, for telling the story about a company's equity program. We are seeing organizations take steps to enhance processes and controls. As they begin to rely on a broader set of data sources to identify and track mobile employees, they can drive global tax compliance and mitigate risks for both the organization and affected employees. The data accumulated from these efforts can also be leveraged to identify process efficiencies and cost savings opportunities, which can be a substantial incremental benefit to the organization."

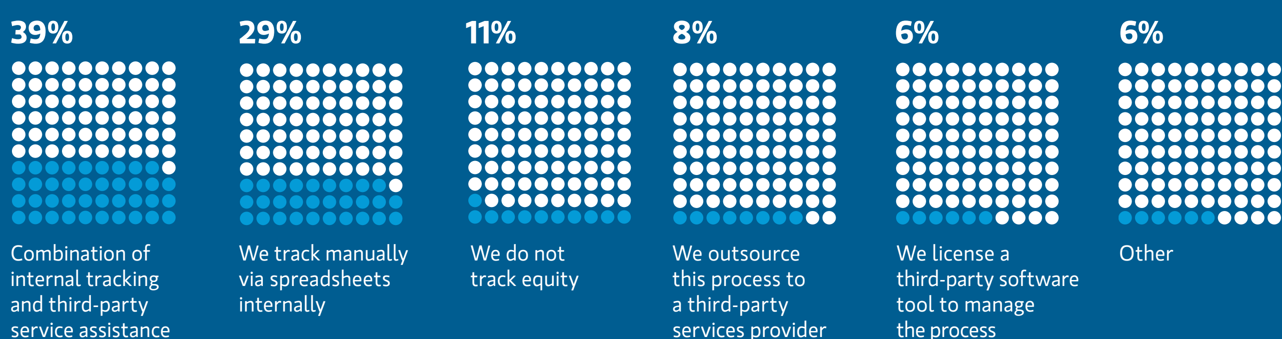
While Tracking Can Solve One Issue, It May Cause Others
Once a company has mobility tracking data, something needs to be done with it to avoid compliance issues. Not only can there be tax settlement issues, there can be immigration, legal and corporate tax implications, when employees are not tracked properly as they cross borders to work for the company.

"The last thing any company wants is to be banned from doing business in a country," Michael explains. "This can happen when employees don't have proper immigration or work visas in place. We also see companies can also lose corporate benefits because their recharge process was not considered in light of mobility or properly implemented to either afford corporate tax deductions or repatriate cash."

This type of issue can also occur domestically. "We've seen cases where companies have triggered U.S. state franchise tax when they began tracking state mobility for business travel," adds Scott Schapiro, National Principal for KPMG's Employment Tax practice. ▶

82% of companies surveyed are tracking data and doing some form of reporting

How do you track assignee equity awards and associated transactions during and following the international assignment?



Note: Total may not add to 100% due to rounding.
Source: KPMG International, GAPP Survey 2017.

"The companies, in good conscience, begin to report employee earnings through payroll and remitted taxes. However, because the company has yet to register to do business in the state, they find themselves opening a "Pandora's box" at the corporate tax level. These experiences serve as a good reminder to always check state and international implications with your Corporate Tax and Legal departments before starting a mobility payroll reporting function."

Complying With Tax Obligations

When tracking mobility tax obligations, companies need to think about end-to-end processing. From an equity perspective, we see many companies hiring third-party tax professionals to guide them in setting up their process. Workplace mobility is complex and generally outside of the U.S., the notion of supplemental wage tax withholding and rates does not exist.

For those who are not seeking professional assistance, we see companies either using a mean or top tax rate to settle awards, or sourcing only a percentage to report in each jurisdiction. While administratively these approaches seem much easier, they can result in some unintended consequences, which were highlighted in a recent GEO webcast:[2]

- Employees can receive less cash or shares than earned.
- If a company uses shares for taxes, this can result in legal issues in certain countries.
- If a refund is required, the easier approach may result in the employee waiting over a year to obtain the appropriate cash back, if taxes were overfunded.
- If a company is funding the taxes on behalf of the employee, it can have a similar result. Tax returns must be filed, tax equalization must be completed and then the company must play "collection agent" with the employee to secure the amount due back to the company as a result of the over-withholding at the time of vest or exercise.
- Further, there are certain countries where the withholding is the final tax, with no mechanism available for refund of the overfunded taxes (i.e., no amended payroll or income tax return can be filed) resulting in lost funds.

Generally, a company's objective is twofold: i) to create minimal administrative burden on its mobility team and other stakeholders, including the payroll department, and ii) to generate good will among the mobile employees and plan participants.

Outsourcing to a professional third-party organization can help track and calculate taxes for mobile employees, while providing additional expertise on other important tax challenges:

- The timing of a tax event for exercising options is controlled by the participant, not the company.
- Frequent vesting of share-based awards can complicate planning and necessitate automated processes.
- Companies can run the risk of over- or under-withholding for "Sell to Cover" transactions.
- Tax details must be explained to participants; efficient and understandable communication can often be difficult to deliver.
- The mobile population is expected to continue to grow and expand.

"Generally, a company's objective is twofold: i) to create minimal administrative burden on its mobility team and other stakeholders, including the payroll department , and ii) to generate good will among the mobile employees and plan participants."

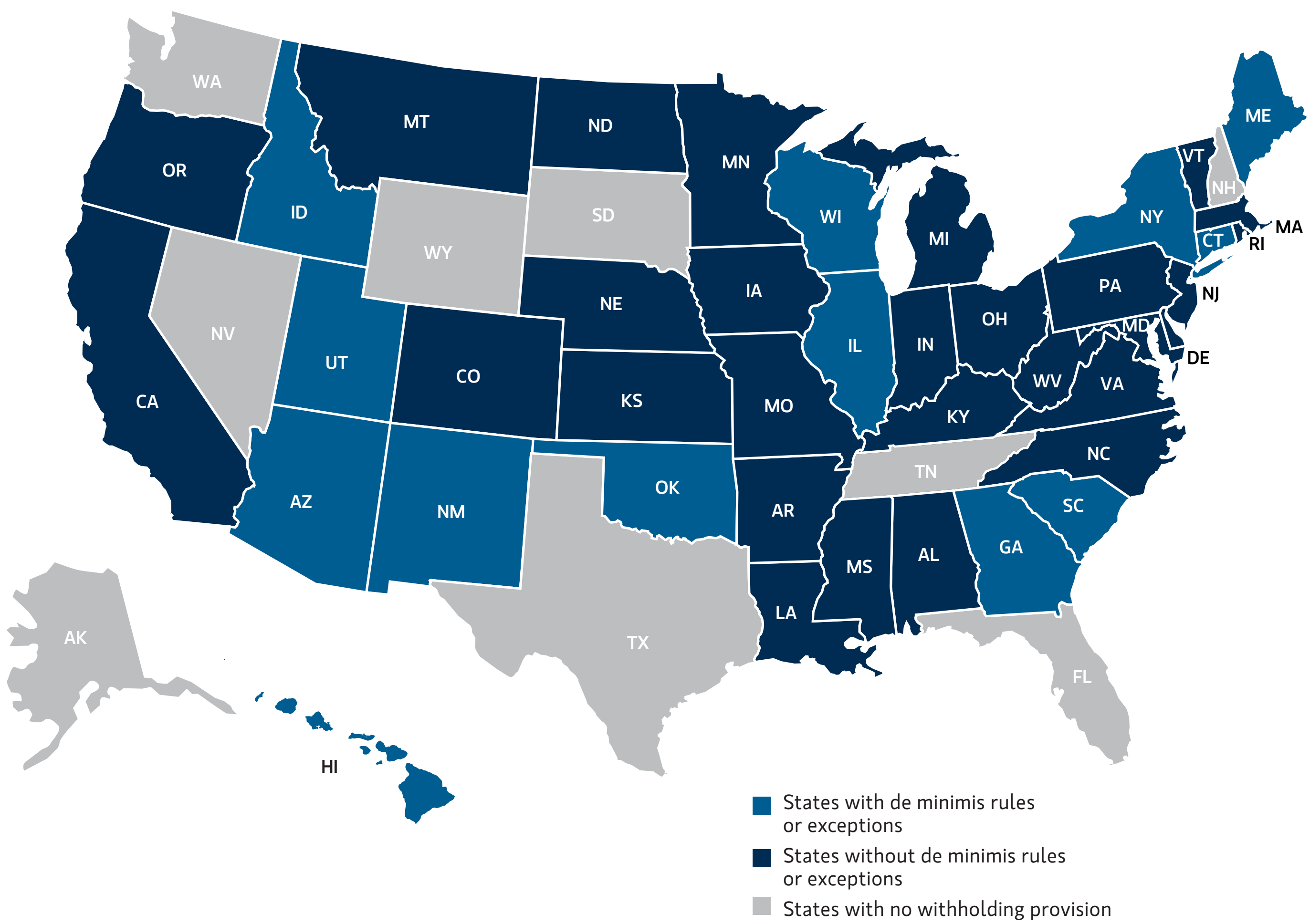
[2] Source: GEO Webcast, April 10, 2018: https://www.globalequity.org/geo/Webcast-10April2018

Workforce Mobility: Not Just an Issue for International Employees

Currently, 41 states impose an income tax that subjects equity awards to reporting and withholding for residents and generally for nonresidents. Some states also have localities where reporting is required and taxes are due. The map below highlights states that impose state income taxes and where de minimis rules or exceptions apply (e.g., number of workdays in any given state can vary by location or over a certain wage amount).

"Both California and New York have very sophisticated nonresident audit procedures and regularly audit companies to investigate whether employers should have been withholding tax for employees working in these states," noted Scott Schapiro. "Other states are ramping up their payroll audit activity," he added. It is good to check with your Payroll and Tax teams on this point because turning on multistate withholding for business travel should be a total compensation approach rather than equity-only approach.

State Income Tax Withholding



Source: KPMG LLP Global Mobility Services as of June 2018

Challenges With Tax Equalization

Many companies today continue to use a form of tax equalization to address traditional expatriates and other mobile employees. Typically, a hypothetical tax is withheld—usually at a predetermined rate or at a rate equal to a supplemental wage rate—to avoid accounting issues. Hypothetical tax is withheld from the employee at settlement and then the company funds the actual withholding tax due. This mechanism allows for an "as if the employee stayed at home" tax approach.

Once tax returns are filed for an expatriate, a tax equalization calculation is typically prepared. If actual tax withholding was overfunded, then the equalization calculation requires the employee to file a return, collect the refund from the taxing authorities and then turn these funds back over to the company. As noted earlier, this is a "collection agent game" that most companies prefer to avoid, in addition to a cash management headache. The best option is to seek professional help.

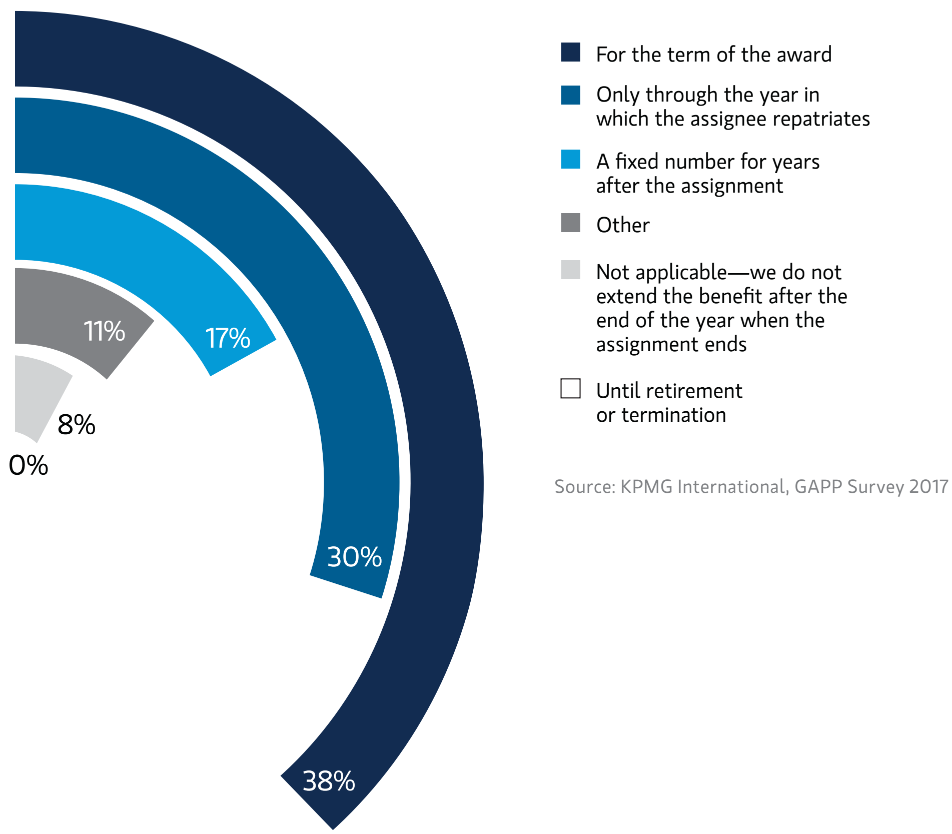
From KPMG's GAPP survey, we found that companies are equalizing equity payments as follows: 8 percent until termination from the company; 38 percent over the life of the award and 30 percent only through repatriation.

It should be noted that for companies which choose to tax equalize equity payments for a fixed number of years or only through the year in which the employee repatriates, we have seen employees come back to the company and want to be tax equalized.

A better practice is to equalize the entire award (hypo tax 100 percent of the award) and then sort out the non-expatriate assignment period when the tax equalization is prepared. Your Global Mobility and Payroll teams will thank you for using an "all-in" method and not having to play "collection agent."

Tax Equalization

If you tax equalize or tax protect equity compensation, for how long after the end of the assignment do you extend the benefit to the assignee? (select all that apply)



Source: KPMG International, GAPP Survey 2017

Technology: An Important Component of the Solution

Delivering awards in multinational corporations is complex — from deciding what type of plan to offer in each country and determining how to settle the award in cash or shares, to registrations (both legal and tax) and recharge of the costs associated with the award.

The good news is that share plan administrators are working with their clients to automate and simplify the mobility process. Morgan Stanley and KPMG have made significant investments in commercial interfaces between their IT platforms. What this means for the business is that implementation of an automated mobility process can be easier and less costly than a full solution built internally. The operating models on the market today can scale and support the various definitions of mobility for each organization's equity program.

Joe Vaccarino, Morgan Stanley's Managing Director of Corporate Equity Solutions, agrees: "Yes, mobility is still very much on the agenda and if your company is not addressing the challenge in some form or fashion, then you are likely falling behind the curve. We have seen greater success in operating models when service providers play to their core competencies to better serve their clients. By using this approach, we have achieved levels of automation that address tracking, modeling and settlement, along with enhancing the employee experience and helping our clients achieve global compliance."

Taking Action

Ignoring the tax requirements of a mobile workforce can be perilous for a company, putting your brand's reputation at risk and gambling on potential and sizable monetary fines. Lack of compliance can also put an organization at risk of losing foreign tax credits and corporate deductions, of overpaying liabilities and of attracting penalties. An enterprise must work proactively, assessing its vulnerabilities before issues arise.

Having a clear, established mobility program is critical in today's mobile environment. Addressing current mobility tax concerns are necessary, but a well-drafted strategy can help companies solve nonmobility tax challenges as well. Unifying tax issues—from state and local requirements to global demands—can create a single source for taxation of all forms of compensation, including both cash and deferred compensation.

As your mobile workforce continues to grow, the burden to comply with mobility tax demands will only increase. Putting an effective program in place today can help address these challenges, easing additional tax concerns along the way. A comprehensive approach—one that includes third-party expertise in mobility tracking, taxation and reporting techniques and technology—can support a successful equity program, ensuring compliance for both the corporate issuer and its employees now and in the long term.

"Having a clear, established mobility strategy is critical in today's current environment."

Contact Information

For more information, please contact your local tax advisor.

Morgan Stanley

Joe Vaccarino
Managing Director
Corporate Equity Solutions
646-536-0441/MAIN
Joe.Vaccarino@morganstanley.com

Allan Golotko
Executive Director
Corporate Equity Solutions
646-536-0327/MAIN
Allan.Golotko@morganstanley.com

Mike Myers
Vice President
Corporate Equity Solutions
646-536-0540/MAIN
Michael.P.Myers@morganstanley.com

KPMG LLP

Michael Bussa
Partner
Global Reward Services Leader
212-954-1811/MAIN
mbussa@kpmg.com

Scott Schapiro
Principal
Employment Tax Services Leader
703-286 8267/MAIN
sschapiro@kpmg.com

Leann Balbona
Managing Director
Global Reward Services
212-872-3671/MAIN
lbalbona@kpmg.com

CES9325606 CRC 2204024 09/18 CS 9325606 10/18