



FUEL INNOVATION, DRIVE PERFORMANCE, AND IGNITE A CULTURE OF OWNERSHIP WITH END-TO-END EQUITY SOLUTIONS

Beyond the Basics: Navigating the Hidden Complexities of ESPPs

Speakers



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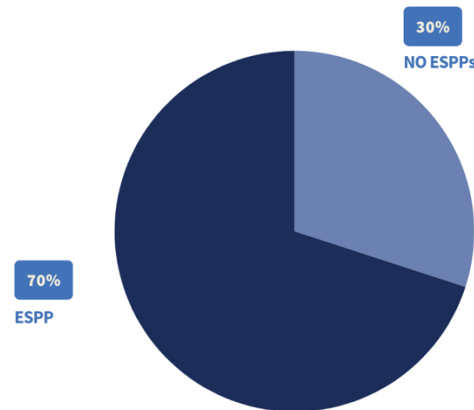


ESPPs: What & Why

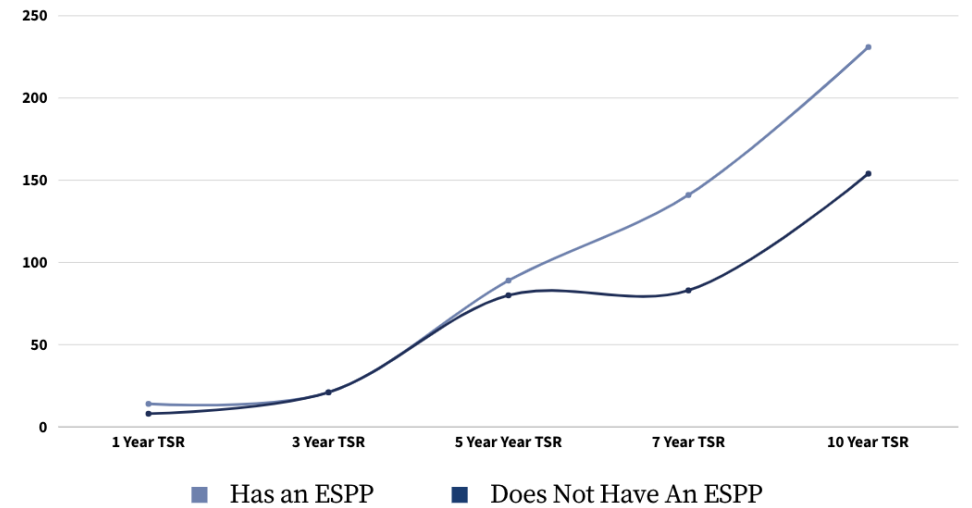
ESPPs: What & Why?

- An Employee Stock Purchase Plan (“ESPP”) provides a broad-based mechanism for employees to become owners.
- ESPPs typically offer a discount (or match) which serves as a great attraction and retention tool in a company’s equity and benefits offerings.
- ESPPs have been shown to increase company performance and employees’ attitudes according to a recent Deloitte analysis of S&P 500 companies.

Prevalence of Best Places to Work Awards



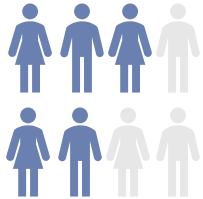
S&P 500 Cumulative TSR (Median)



S&P 500	# of Orgs.	1 Year TSR	3 Year TSR	5 Year TSR	7 Year TSR	10 Year TSR
Has an ESPP	250	14%	21%	89%	141%	231%
No ESPP	250	8%	30%	80%	83%	154%

ESPPs: What & Why?

Motivate



73% of participants **work overtime**, compared to 54% of non-participants



Participants **take fewer unplanned absences**: 2.1 compared to 2.7 days



32% of participants **check the stock price daily**, compared to 8% of non-participants

Attract



Share plan is 2nd most valued benefit after a pension plan; 42% responded it was top 2



55% of participants said the share plan made it more likely they would **recommend the company to others**, compared to 34% of non-participants

Retain



51% of participants said **share plan reduced desire to quit** to some or a great extent, compared to 26% of non-participants



Participants experience **greater loyalty, motivation, and job satisfaction**

Source: Computershare Share Plan Survey (London School of Economics, 2014)

Strategic Plan Design









Types of ESPPs

ESPP Type	Features	Pros	Cons
Safe Harbor Plan	<ul style="list-style-type: none"> • Qualified plan with 5% discount • No look-back feature 	<ul style="list-style-type: none"> • No compensation expense • Administrative ease 	<ul style="list-style-type: none"> • Poor participation rates • Tax treatment may be overly complex for limited benefits
Standard Qualified Plan	<ul style="list-style-type: none"> • 15% discount with lookback most common • 3 or 6-month purchase periods 	<ul style="list-style-type: none"> • Most common ESPP so some employees will have familiarity with design • Administrative ease with common design • Accounting impact is straight-forward • Favorable tax treatment for employees 	<ul style="list-style-type: none"> • Average participation rates can be boosted with communications strategy • 6039 reporting and disposition tracking required • More complicated tax treatment for employees
“Cadillac” Qualified Plan	<ul style="list-style-type: none"> • 15% discount and lookback • 24-month offering with four 6-month purchase periods • Typically have automatic reset or rollover if stock price declines 	<ul style="list-style-type: none"> • Highest participation rates • Participants have maximum possible benefits with long look-back, maximum allowable discount, and reset/rollover provision • Favorable tax treatment for employees 	<ul style="list-style-type: none"> • Same reporting and tracking challenges as above • Administrative and accounting complexities due to multiple outstanding offerings and modifications • Complex design will require more education
Matching Non-Qualified Plan	<ul style="list-style-type: none"> • Greater flexibility and creativity in design than qualified ESPPs • Match up to 25% of employee contributions under ISS limits 	<ul style="list-style-type: none"> • Simple benefit to communicate to employees • Simpler tax treatment for employees and company • Simpler accounting treatment • No 6039 reporting or tracking disqualified dispositions • Globally unified benefit 	<ul style="list-style-type: none"> • Less favorable tax treatment for employees • Not as prevalent as qualified designs historically as pre-FAS 123(R) Section 423 plans did not incur compensation expense

Design Features That Impact Administration

ESPP Feature	Considerations
Eligible Compensation (in addition to base salary)	Consider the demographics of your workforce when selecting variable compensation. Bonuses are the most complicated, whereas overtime and shift differentials for an hourly workforce may be meaningful and simpler to administer.
Contribution Election Type	Allowing multiple types of contributions elections is more complicated for payroll.
Intra-Period Contribution Changes ²	<ul style="list-style-type: none"> Increases in contributions trigger modification accounting. Decreases and withdrawals are ignored, which can be complex. Best practice is to limit changes and have deadlines for changes within a period (i.e., no changes during last two weeks of period).
Purchase Limitation	Per person purchase limitation is necessary to start the grant date for tax purposes. Typically, it's expressed as a share limit, which is more complex because actual contribution limit will fluctuate with the stock price, resulting in contribution refunds.
Fractional Shares	Fractional shares limits amounts to refund or carry forward. Administrative platforms have varying functionality around fractional shares.
Transfer Restriction	Without a transfer restriction for the qualification period, companies must track dispositions, such as through surveys, and risk losing tax deductions due to self reporting by employees and former employees.

ESPP Financial Impact

Financial Impact	Non-Compensatory Plan	Qualified Plan	Non-Qualified Plan
Description	<ul style="list-style-type: none"> • 5% Discount, No Look-Back • Treasury Shares 	<ul style="list-style-type: none"> • 15% Discount, Look-Back • Treasury Shares 	<ul style="list-style-type: none"> • 25% Match • Open Market Purchases
Compensation Expense	None	\$\$\$	\$\$\$
Dilution			-
Cash Flow / APIC (Inflow / Outflow)			
Tax Deduction			
Other Costs	<ul style="list-style-type: none"> • Qualified plans require 6039 filing • Disposition tracking • Purchase frequency affects administrative cost 	<ul style="list-style-type: none"> • Qualified plans require 6039 filing • Disposition tracking 	<ul style="list-style-type: none"> • Tax withholding required at purchase • Purchase frequency affects administrative cost

Payroll & Administrative Efficiencies

Payroll & Administrative Efficiencies

- Payroll team responsibilities
 - Payroll platform capabilities/limitations
 - Weekly monitoring for election changes and withdrawals
 - Reconciling after purchases
 - Are fractional amounts rolled forward or refunded?
 - Refunds for withdrawals, terminations, over \$25K limit
 - Percentage vs. fixed dollar
 - Mechanics of withholding at purchase (if applicable)

Payroll & Administrative Efficiencies

- Equity platform capabilities/limitations
 - Cost basis reporting
 - 6039 reporting
 - \$25K tracking & compliance
 - Disqualifying Disposition/Qualifying Disposition tracking & reporting
 - Approach to transfers –
 - Allowed without restriction
 - Prohibited until Disqualifying Disposition period is past
 - Prohibited completely

Payroll & Administrative Efficiencies

What is The \$25k Limit?



What is the rule?

IRS Section 423 imposes a \$25,000 limit on the maximum value of shares that an employee can purchase under a qualified ESPP in a single calendar year.

The limit is applied for each calendar year that an offering is outstanding. The \$25K per year accrues as an offering crosses calendar years; it cannot be accelerated.



How Is It Calculated?

Value is calculated at the grant date's market price, not purchase price.

Example: If the fair market value at grant is \$100/share, the employee can purchase up to 250 shares ($\$25,000/\100).



What about plans that cross calendar years?

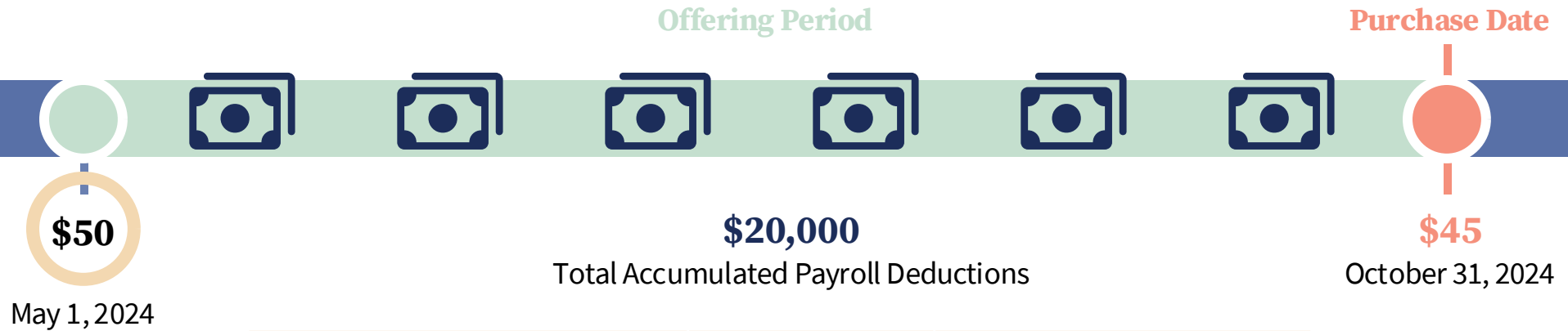
ESPPs have a growing prevalence of purchases that do not fall on 6/30 and 12/31 for administrative ease, so even 6-month plans are impacted

Example: an offering beginning on May 1, 2024 and ending on April 30, 2026 spans 3 calendar years. The \$25K limit accrues up to \$75K worth of stock:

- October 31, 2024 Purchase: \$25K
- April 30, 2025 Purchase: \$50K
- October 31, 2025 Purchase: \$50K
- April 30, 2026 Purchase: \$75K

Payroll & Administrative Efficiencies

25K Limit Example



Description	Amount	Calculation
Purchase Price	\$38.25	$\$45 \times 85\%$
Preliminary Shares Purchased	522 Shares	$\$20,000 \div \38.25
Preliminary \$25K Limit Value	\$26,100	$522 \text{ Shares} \times \50
Actual Shares Purchased	500	Lesser of $\$25,000 \div \50 and $\$20,000 \div \38.25
\$25K Limit Value	\$25,000	$500 \text{ Shares} \times \50
Refund	\$875	$\$20,000 - (500 \times \$38.25)$

Payroll & Administrative Efficiencies

\$25K Limit Example | Multiple Purchases



Description	Purchase Period 1	Purchase Period 2	Calculation
Purchase Price	\$42.50	\$34.00	$\$50 \times 85\% \mid \$40 \times 85\%$
Preliminary Shares Purchased	470 Shares	588 Shares	$\$20,000 \div \text{Purchase Price}$
Preliminary \$25K Limit Value	\$23,500	\$29,400	Shares Purchased x \$50
Actual Shares Purchased	470 Shares	530 Shares	Lesser of \$25K Limit \div \$50 and $\$20,000 \div$ Purchase Price
Starting \$25K Limit Value	\$25,000	\$26,500	2025 Limit: $\$1,500 + \$25,000$
\$25K Limit Value Used	\$23,500	\$26,500	Shares Purchased x \$50
Ending \$25K Limit Value	\$1,500	\$0	
Refund	\$0	\$1,980	$\$20,000 - (\text{Shares Purchased} \times \text{Purchase Price})$

Accounting & Tax Considerations

Accounting Considerations

ESPP compensation expense is based on the plan features, not the tax qualification status

Step 1: Compensatory or non-compensatory	<ul style="list-style-type: none"> Plans with a discount > 5% and/or with a lookback are compensatory under ASC 718
Step 2: Equity or liability classified	<ul style="list-style-type: none"> Plans with a look-back are equity classified Plans with a discount and no look-back or match plans are liability classified
Step 3: Expense Recognition	<ul style="list-style-type: none"> Equity classification: expense based on grant date fair value estimates Liability classification: expense is initially estimated based on grant date estimates
Step 4: Reconcile Expense at end of Purchase Period	<ul style="list-style-type: none"> Equity classification: Limited adjustments permitted to contribution changes like terminations and salary changes; increases in contributions and rollovers/resets trigger modifications; decreases and withdrawals ignored Liability classification: Expense is trued up to actual benefit delivered

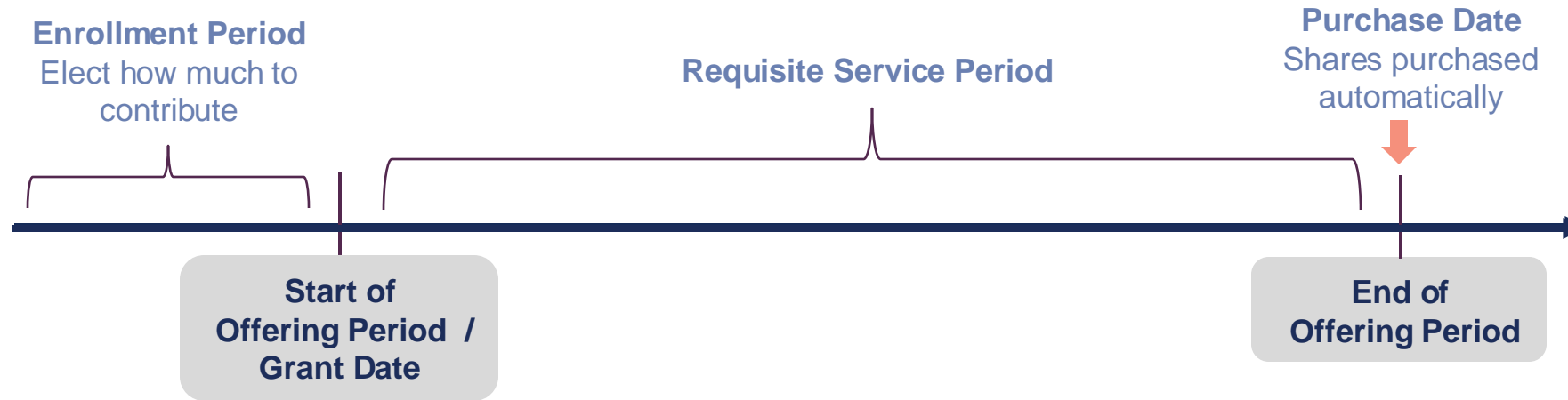
ESPP Valuation

Based on features of ESPP

- Match plan expense based solely on match amount (fixed amount)
- Discount plan valued on up to four components:

Component	Formula	Description	Purchase Price Basis		
			Ending Price	Beginning Price	Lookback Price
Discount	Discount % x Stock Price	Reflects value of discount	Ending Price	Beginning Price	Lookback Price
Interest Foregone	Discount % x Stock Price x Risk-Free Rate x Term x PV Factor	Reflects value lost from not receiving interest on contributions during purchase period			
Call Option	[1 - Discount %] x Call Option	Reflects potential benefit of stock price increases			
Put Option	Discount % x Put Option	Reflects potential benefit of purchasing additional shares if stock price decreases			

Timing of Expense Recognition



- Begins at accounting Grant Date = typically first day of Offering Period
 - All terms and conditions must be known
- Allocated over the Requisite Service Period = Purchase Period
- If multiple purchase periods in one offering, amortization is consistent with policy for other graded vested awards:
 - Straight-line: allocating all expense evenly throughout the offering period, **or**
 - Graded: Treating each purchase period separately, from grant date to the individual purchase dates

Diluted Earnings Per Share

Different methodologies for ESPP shares:

- › Contributions are non-refundable → total expected shares to be purchased included for both basic and diluted EPS
- › Contributions are refundable → treated as options granted on offering date and use treasury stock method to calculate incremental shares
 - › All expected contributions are used
 - › 2 methods for determining number of shares post adoption of ASU 2020-06
 - › Average market price approach
 - › Contingently issuable shares approach (historical approach)
 - › Weighted for time outstanding in period

Diluted EPS Treasury Stock Method

Treasury stock method

- > Assume the company buys back stock with the funds received
- > Reduces shares outstanding
→ increases EPS

Potential treasury shares repurchased	
ESPP shares expected to be purchased	20,000
x Exercise price (discounted purchase price)	\$8.50
Total assumed proceeds	\$170,000
+ Avg unrecognized compensation expense	\$15,000
Total assumed proceeds	\$185,000
Divided by avg market price of stock	\$11.00
Potential treasury shares repurchased	16,818
Incremental shares (20,000 - 16,818)	3,182

Tax Considerations

		Qualified Plans	Nonqualified Plans
Company Impact		<ul style="list-style-type: none"> No tax effect recorded during purchase period No withholding at purchase Upon a disqualifying disposition, record tax deduction to company and report income for employees Company must track qualified and disqualified dispositions 	<ul style="list-style-type: none"> Similar to NQ option or RSU Recognize deferred tax asset over purchase period and reduce current tax expense Company must withhold taxes at purchase in applicable jurisdictions
Employee Impact	At Purchase	<ul style="list-style-type: none"> For US employees, no taxable income at purchase, so no tax withholding Exceptions for PA and international jurisdictions 	<ul style="list-style-type: none"> Similar to RSUs In applicable jurisdictions, income tax withheld at purchase
	At Sale	<ul style="list-style-type: none"> For US, split between ordinary income and capital gain/loss tax depends on whether the sale is qualified or disqualified Employees need to be aware of how cost basis* is reported for accurate tax calculations 	<ul style="list-style-type: none"> Shares held more than one year are subject to long term capital gain/loss applies, otherwise short term capital gain/lost applies

*Cost basis is the original purchase price for an asset. This is reported on a supplemental form, and may need to be adjusted on Form 1099-B for calculating capital gain/loss. Typically, the unadjusted cost basis doesn't include amounts attributed to ordinary income, which can result in double taxation.

Global Expansion Strategies

Global Expansion Strategies

Strategy	Pros	Cons
US: Qualified Plan Global: Nonqualified Plan	<ul style="list-style-type: none"> • Preferential tax treatment in US • Mirror nonqualified plans similar to US • Main features of program are the same globally • Common approach for US headquartered companies 	<ul style="list-style-type: none"> • Plan is US centric • Global jurisdictions may see lower participation rates due to tax treatment
Where Available: Qualified Plan Elsewhere: Nonqualified Plan	<ul style="list-style-type: none"> • Preferential tax treatment everywhere available, not just US • Mirror nonqualified plans similar to US • Approach taken by larger multi-national companies 	<ul style="list-style-type: none"> • Main features of the plan may be materially different in some jurisdictions (i.e., UK SAYE plan) • Administratively the most challenging approach because of different plans
Nonqualified Plan Everywhere	<ul style="list-style-type: none"> • Globally unified benefit • Features of the program are as similar as possible globally • Ideal for a match style plan, which is simpler • Simplest approach administratively because of similarity of plans and tax treatment 	<ul style="list-style-type: none"> • Less common approach, though companies should evaluate based on their own goals and not just prevalence • Less favorable tax treatment for US employees (but simpler) • Administrative platforms have more functionality for NQ plans than they once did, but there could be system limitations

Global Expansion Strategies

Tax

- Discount or match is generally taxable at purchase
- Subject to tax withholding in many countries
- Tax preferred opportunities exist

Regulatory

- Governance – ISS / Glass Lewis
- US Securities law – Shareholder approval & S-8 generally required
- EU securities law – after July 2019, EU Prospectus requirement no longer a concern
- EU labor law – Non-discrimination legislation may limit exclusions
- Foreign exchange restrictions – i.e., China SAFE
- Payroll deduction limitations
- Acquired rights – is ESPP benefit included in severance calculations in various jurisdictions?

Global Expansion Strategies

Administrative – HRIS

- Payroll - foreign payrolls
- Contribution management with HRIS system
- Establish currency conversion procedures

Administrative – Recordkeeping

- Equity vendors offer standard-industry ESPP administrative services
 - Often US-centric
 - Can plans like UK SIP be accommodated?

Operational Excellence – Communication & Education

Addressing Common Questions throughout an ESPP Lifecycle

Pre-Enrollment

- Launch multi-channel strategy – email/ letter/ postcards/ posters/ microsite
- ESPP basics – What is an ESPP and why should employees participate?
- Timeline and next steps – Call to action

Enrollment Window

- Live and virtual webinars to educate employees
- Reminders that employees must opt-in to participate
- Emphasize equity ownership as reward for employees because of their value & work

Purchase Date

- What happens at purchase?
- What can employees do with their shares?
- More detailed tax FAQs

Ongoing

- What are the tax implications at sale?
- How to enroll/change
- Identify employee managers who are ESPP ambassadors
- Measure participation and contribution levels by range of demographics to identify gaps

Operational Excellence

- Thoughtful design
 - Balancing the benefits of a generous plan with the impact on administration, expense, and employee understanding.
 - Do your research, learn from others, and be open minded.
- Administrative efficiencies
 - Platform/service provider optimization
 - Practicality/scalability
 - Automatic data feeds
- Establishing best practices
 - Contribution audits
 - Refund handling
- Working collaboratively with impacted teams
 - Payroll, payroll, payroll
 - Accounting & tax
- Comprehensive communication & education
 - Ownership & budget
 - Approach & measuring success

Questions?

