Project	**IFRS 2 *Share-based Payment***
Topic	**Share-based payment awards settled net of tax withholdings**

Objective and introduction

1. The objective of this agenda paper is to examine the classification of an equity-settled share-based payment (SBP) transaction that is accompanied by the arrangement in which the entity should withhold a specified portion of the shares to be delivered upon exercise (or vesting) to the employee in order to settle the employee's tax obligation.

2. This Agenda Paper includes:

    (a) background;

    (b) staff analysis;

    (c) agenda criteria assessment for the Committee;

    (d) staff recommendation; and

    (e) questions for the Committee.

3. Appendix A provides draft wording for the *IFRIC Update* prepared on a consistent basis with the staff recommendations.

4. The original request is reproduced in Appendix B

Background

5. In March 2010, the staff received a request to add to the Committee's agenda a project to clarify whether an entity's withholding of a portion of a share-based payment transaction for the purpose of satisfying the entity's tax withholding requirements (to satisfy the counterparty's tax liability) should be separately identified as a cash-settled share-based payment transaction. That is, what impact, if any, is there on the classification of the share-based payment transaction from a feature that permits or requires the counterparty in a share-based payment transaction to receive equity instruments net of tax rather than gross shares upon exercise (or vesting).

6. More specifically, the issue included in the agenda request is a share-based payment arrangement (or multiple related/ linked arrangements that have the net effect) in which:

   (a) the entity is required to:

      (i) withhold (by reducing the number of shares issued to the employee) from an employee's compensation an amount to satisfy the employee's tax liability incurred as a result of the share-based payment transaction, and

      (ii) pay to the tax authority in cash the amount withheld from the employee's compensation;

   (b) the employee will receive shares net of the number of shares equal to the employee's tax liability (that will be satisfied by the entity in (a)(ii) above) upon exercise (or vesting); and

   (c) for ease of analysis of the relevant feature, it is assumed that the entire award would be classified as an equity-settled share-based payment transaction, provided the feature creating (a) and (b) did not exist.

7. That is, the relevant feature of the share-based payment transaction that is being analysed in this paper is the net settlement provision for the purpose of satisfying withholding tax requirements.

Staff analysis

Distinction between cash-settled and equity-settled share-based transactions

8. Appendix A *Defined terms* to IFRS 2 states [emphasis added]:

> **cash-settled share-based payment transaction**
>
> A share-based payment transaction in which the entity acquires goods or services by incurring a liability to transfer cash or other assets to the supplier of those goods or services for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the entity or another group entity.
>
> **equity-settled share-based payment transaction**
>
> A share-based payment transaction in which the entity
>
> (a) receives goods or services as consideration for its own equity instruments (including shares or share options), or
>
> (b) receives goods or services but has no obligation to settle the transaction with the supplier.

Diverse views

View A – Separate accounting for each component of the SBP transaction

9. In View A, each component of the single SBP transaction is accounted for consistent with the manner of its settlement. Therefore, since the SBP transaction provides for both the payment of equity instruments and payment of cash (or other assets):

   (a) the portion to which the entity has incurred a liability to pay cash is accounted for as a cash-settled SBP transaction, and

   (b) the portion to which the entity settles the compensation obligation by the issue of equity instruments is accounted for as an equity-classified SBP transaction.

10. View A supporters think that the definition of a cash-settled share-based payment transaction should be comprehensively interpreted and includes the entity assuming a liability to pay cash to a third-party (the tax authority) on

behalf of the counterparty. They believe that 'the entity assuming a liability to pay cash on behalf of the counterparty' should have the same accounting treatment as 'the entity incurring a liability to pay cash to the counterparty'. It is because the entity ends up transferring cash or other assets (for the benefit of the counterparty) in exchange for acquiring goods or services from the counterparty regardless of who receives the cash or other assets.

11. View A supporters also believe that the shares delivered to the employee, should be accounted for as an equity-settled share-based payment transaction.

View B – Part of the entire equity-settled share-based payment transaction

12. Supporters of View B note that the issue of this paper can be seen as the net impact of two different transactions:

    (a) the equity-settled share-based payment transaction that is satisfied in its entirety through the issue of equity instruments, and

    (b) the repurchase by the entity of a portion of the equity instruments just issued in (a).

13. Supporters of View B believe that the portion of the equity instruments withheld by the entity (for the purpose of satisfying the entity's tax withholding requirements to extinguish the employee's tax liability) should be viewed to be a subsequent transaction when the portion is actually withheld. In their view, the 'subsequent transaction' is not a share-based payment transaction because it is not for the purpose of paying the counterparty for the goods or services received by the entity.

14. View B supporters believe the 'subsequent transaction' should be viewed as the entity's repurchase of a portion of the vested shares. In doing so, View B supporters reference paragraph 29 of IFRS 2, which states [emphasis added]:

> <u>If an entity repurchases vested equity instruments, the payment made to the employee shall be accounted for as a deduction from equity</u>, except to the extent that the payment exceeds the fair value of the equity instruments repurchased, measured at the repurchase date. Any such excess shall be recognised as an expense.

15. View B supporters believe that although the entity remits to the tax authority the cash or other assets that would otherwise be paid to the employee as consideration for the repurchase, the transmission directly to the tax authority should be considered to be equivalent to the payment to the employee. The rationale is that the entity is acting as an agent for the employee to discharge the employee's tax liability. View B supporters believe the entity's withholding of cash or other assets is the net result of the issue of equity instruments and the instant repurchase by the entity of a portion of those equity instruments at the same moment.

16. Additionally, View B supporters think that the definition of a cash-settled share-based payment transaction should be narrowly interpreted so that it may be limited to the entity incurring a liability to transfer cash or other assets directly to the counterparty. Therefore, the portion of the equity instruments withheld by the entity to satisfy the tax withholding requirements should not be separately identified as a cash-settled share-based payment transaction and should be regarded as a part of the whole equity-settled share-based payment transaction.

US GAAP

US GAAP relevant literature

17. The staff notes that US GAAP includes guidance on this topic. FASB ASC Topic 718 *Compensation – Stock Compensation* (formerly FAS 123R *Share-based Payment*) sets out specific guidance on the entity's withholding in association with broker-assisted cashless exercises and <u>minimum statutory tax withholding requirements</u> as follows [emphasis added]:

> 10-25-16 A provision that permits employees to effect a broker-assisted cashless exercise of part or all of an award of share options through a broker does not result in liability classification for instruments that otherwise would be classified as equity if both of the following criteria are satisfied:
>
> a. The cashless exercise requires a valid exercise of the share options.
>
> b. The employee is the legal owner of the shares subject to the option (even though the employee has not paid the exercise price before the sale of the shares subject to the option).

> 10-25-17 A broker that is a related party of the entity must sell the shares in the open market within a normal settlement period, which generally is three days, for the award to qualify as equity.
>
> 10-25-18 Similarly, a provision for either direct or indirect (through a net-settlement feature) repurchase of shares issued upon exercise of options (or the vesting of nonvested shares), with any payment due employees withheld to meet the employer's minimum statutory withholding requirements resulting from the exercise, does not, by itself, result in liability classification of instruments that otherwise would be classified as equity**.** However, if an amount in excess of the minimum statutory requirement is withheld, or may be withheld at the employee's discretion, the entire award shall be classified and accounted for as a liability.
>
> 10-25-19 Minimum statutory withholding requirements are to be based on the applicable minimum statutory withholding rates required by the relevant tax authority (or authorities, for example, federal, state, and local), including the employee's share of payroll taxes that are applicable to such supplemental taxable income.

18. Paragraphs B125-B126 of FAS 123R provides the basis for conclusion on that guidance as follows [emphasis added]:

> B125. Paragraph 35 of this Statement also indicates that a provision for direct or indirect (by means of a net-settlement feature) repurchase of shares issued upon exercise of options (or vesting of shares) to meet the employer's minimum statutory withholding requirements does not, by itself, result in liability classification of instruments that otherwise would be classified as equity. Interpretation 44 also provided that exception for accounting under Opinion 25. In concept, the Board considers a provision for repurchase of shares at, or shortly thereafter, the exercise of options, for whatever reason, to result in the employer's incurrence of a liability. However, the Board decided for pragmatic reasons to continue the exception for direct or indirect repurchases to meet the employer's minimum statutory withholding requirements.
>
> B126. Certain respondents to the Exposure Draft asked that the exception for minimum statutory withholding requirements be extended to encompass amounts in excess of the minimum statutory withholding requirements. As noted in paragraph B125, the Board included the exception for minimum statutory requirements for pragmatic rather than conceptual reasons. The Board therefore declined to extend the exception beyond the minimum statutory requirements to which the related exception in Opinion 25 and Interpretation 44 applied.

19. The staff notes that the Basis for Conclusion to FAS 123R does not provide additional insight or further explain what the FASB Board meant by 'pragmatic reasons' for bringing forward the exception from prior versions of US GAAP guidance on share-based payment transactions.

20. The staff notes that if the entity has no ‘statutory withholding obligation’ but opts to withhold the tax amount by means of net settlement under the agreement with the employee or if an amount is withheld in excess of the statutory minimum requirements, the exceptional accounting permitting the entire SBP award to be classified as equity-settled is not available in US GAAP.

Staff analysis of US GAAP rationale

21. The staff notes that the FASB acknowledged that there is a conceptual difference that ordinarily would result in different classifications between the situations in which:

    (a) an entity permits the employee to exercise the equity-settled share-based award, the entity issues all related equity instruments and simultaneously the employee sells the shares through a broker (ie broker-assisted cashless exercise) and requests the broker to withhold some of the proceeds and forward those proceeds to the entity to satisfy the entity’s minimum statutory withholding requirements (which should not result in cash-settled classification); and

    (b) an entity promises to ‘automatically repurchase’ (through the payment of cash or other assets) some of shares to be delivered upon exercise to the employee (ie net settlement) to satisfy the entity’s minimum statutory withholding requirements (which should result in cash-settled classification).

22. Despite acknowledging the conceptual differences, the FASB brought forward a previously existing exception in US GAAP so that net settlement from the exercise of the SBP award to meet the entity’s minimum statutory withholding requirements does not, by itself, result in liability classification.

Broker-assisted cashless exercise vs. net settlement for tax withholding requirements

23. The following paragraphs show the comparison between broker-assisted cashless exercise and net settlement with an analysis of the conceptual rationale.

Comparative example

24. The following example is provided to facilitate a comparison between a broker-assisted cashless exercise and a net settlement to meet tax withholding requirements. General facts for the example include:

(a) At the beginning of year 1,

(i) the entity holds 100 treasury shares and CU30 cash; and

(ii) the entity grants awards of 100 shares to the employee that will cliff vest at the end of 3 years of service (and will be delivered to the counterparty upon vesting).

(b) At the end of year 3,

(i) 100 shares vest and are to be delivered to the employee;

(ii) the entity is obliged to withhold CU20 to satisfy the income tax imposed on the employee and immediately remit the CU20 to the tax authority;

(iii) the fair value of the share is CU2; and

(iv) the withholding is worth 10 shares.

Situation 1. Broker-assisted cashless exercise

25. If there is a provision in which the entity is supposed to direct a broker to sell 10 shares in the market and remit the cash proceeds to the entity to satisfy the entity's tax withholding requirements at the end of year 3, the ultimate change to the financial position of the entity is as follows, as of the end of year 3:

(a) all 100 of the treasury shares have been issued for the benefit of the counterparty:

(i) 90 shares have been actually transferred to the counterparty , and

(ii) 10 shares had been legally transferred to the counterparty but were instantly dedicated for sale on behalf of the employee); and

(b) there is no change to the entity's cash account (with a beginning and ending balance of CU30).

Situation 2. Net settlement

26. If there is a provision in which the entity automatically 'repurchases' (ie 'net settles) 10 shares to satisfy the entity's tax withholdings with the value of the 10 shares of CU20 being paid to the tax authority, the ultimate change to the financial position of the entity is as follows, as of the end of year 3:

(a) some of the treasury shares have not been issued for the benefit of the counterparty; and

(b) there is a decrease in the entity's cash account (of CU20).

27. Appendix D provides an illustrative chart showing in graphical format the changes to the financial position of the entity and why the changes are contrasting with each other.

Staff analysis of example

28. All of the shares granted are issued and there is no net cash outflow from the entity in the case of broker-assisted cashless exercise. Conversely, some of the shares granted are not issued and there is net cash outflow from the entity in the case of net settlement. The staff thinks that the difference in these two fact patterns is substantial and these two situations should not be similarly treated. Therefore, in the staff's opinion,

(a) Share-based payment transactions that involve a broker-assisted cashless exercise should result in the entire share-based payment (including the withholding) being classified as an equity-settled share-based payment transaction.

(b) Share-based payment transactions that involve net settlement should result in the portion of the award that is 'net settled' to satisfy tax withholding requirements of the entity being classified as a cash-settled share-based payment transaction (with the remainder of the award classified as an equity-settled share-based payment transaction).

Staff view

29. In the staff's opinion, if a portion of a SBP transaction is settled net for the purpose of satisfying the entity's tax withholding requirements to pay a tax authority for tax obligations of the employee:

    (a) the portion of the SBP transaction that is 'net settled' (ie withheld) should be classified as a cash-settled share-based payment, and

    (b) the physically settled portion of the SBP transaction should be classified as a equity-settled share-based payment.

30. Also, the staff notes that such an exception as has been carried forward for pragmatic reasons in US GAAP does not have the same historical accommodation in IFRS 2. The basis for conclusion of IFRS 2 already makes clear that giving a favourable treatment to particular transactions is not the role of IFRSs. The paragraph BC60 of IFRS 2 states [emphasis added]:

> <u>In any event, the Board noted that the role of accounting is to report transactions and events in a neutral manner, not to give 'favourable' treatment to particular transactions to encourage entities to engage in those transactions.</u> To do so would impair the quality of financial reporting. The omission of expenses from the financial statements does not change the fact that those expenses have been incurred. Hence, if expenses are omitted from the income statement, reported profits are overstated. The financial statements are not neutral, are less transparent and are potentially misleading to users. Comparability is impaired, given that expenses arising from employee share-based payment transactions vary from entity to entity, from sector to sector, and from year to year. More fundamentally, accountability is impaired, because the entities are not accounting for transactions they have entered into and the consequences of those transactions.

Agenda criteria assessment for the Committee

31. The staff's assessment of the agenda criteria for addition to the <u>Committee's Interpretation agenda</u> is as follows:

(a) *The issue is widespread and has practical relevance.*

Yes. The staff notes that tax withholding is common in jurisdictions applying IFRSs.

(b) *The issue indicates that there are significantly divergent interpretations (either emerging or already existing in practice). The Committee will not add an item to its agenda if IFRSs are clear, with the result that divergent interpretations are not expected in practice.*

No. There is a prevalent view in practice (as noted in the large international accounting firm guidance included in Appendix C) that it should be assessed whether the entity is acting as an agent for the employee or as a principle as far as tax withholding is concerned:

(i) If the entity is acting as an agent, the entity will have issued all of the equity instruments (and not repurchased any of those equity instruments in a linked/ related transaction) and the entire share-based award should be classified as an equity-settled share-based payment transaction.

(ii) If the entity is acting as a principle, the portion of equity instruments that are net settled to compensate for the amount of the tax withholding should be classified as a cash-settled share-based payment transaction. The remainder of the award that is paid by the issue of equity instruments remains eligible for classification as an equity-settled share-based payment transaction.

(c) *Financial reporting would be improved through elimination of the diverse reporting methods.*

n/a. There is a prevalent view in practice.

(d) *The issue can be resolved efficiently within the confines of existing IFRSs and the Framework, and the demands of the interpretation process.*

n/a. The issue may be self resolved within the confines of existing IFRS 2. Additionally, if the Committee believes that a change to the current requirements of IFRS 2 is appropriate, it requires the introduction of an exception to current IFRS 2 which should not be performed as part of the interpretation process.

(e) *It is probable that the Committee will be able to reach a consensus on the issue on a timely basis.*

n/a. No formal interpretation is needed as far as current IFRS 2 is concerned.

(f) *If the issue relates to a current or planned IASB project, there is a pressing need to provide guidance sooner than would be expected from the IASB's activities. The Committee will not add an item to its agenda if an IASB project is expected to resolve the issue in a shorter period than the Committee requires to complete its due process.*

No. There is no current IASB project covering the issue. The staff notes that a post-implementation review of IFRS 2 is planned for the future.

32. The staff's assessment of the proposed agenda criteria for *Annual Improvements* is as follows:

(a) *The proposed amendment has one or both of the following characteristics:*

(i) ***Clarifying****: The proposed amendment improves IFRSs through one or both of the following:*

a. *Clarifying unclear wording in existing IFRSs.*

b. *Providing guidance where a current lack of guidance is causing concern.*

A clarifying amendment maintains consistency with the existing principles within the applicable IFRSs. It does not propose a new principle, or a change to an existing principle.

(ii) ***Correcting****: The proposed amendment improves IFRSs through one or both of the following:*

a. *Resolving a perceived or actual conflict between existing requirements of IFRSs.*

b. *Addressing an oversight or unintended consequence of the existing requirements of IFRSs.*

A correcting amendment does not propose a new principle or a change to an existing principle. It may create an exception to an existing principle, for example an omitted consequential amendment from a recent change to an IFRS.

No. There is no need for clarification or correction since there is a prevalent view formed within the confines of current IFRS 2 guidance in practice. Additionally, an amendment to address this issue would not be the correction of a prior error.

(b) *The proposed amendment has a narrow and well-defined purpose, i.e., the consequences of the proposed change have been considered sufficiently and identified.*

Yes, The issue is sufficiently narrow and has a well-defined purpose.

(c) *It is probable that the IASB will reach agreement on the issue on a timely basis. An inability to reach agreement on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within Annual Improvements.*

No. The staff is unsure whether the IASB may decide to introduce an exception into IFRS 2 that does not currently exist. In the staff's opinion, this issue should be recommended for reconsideration as part of the Board's post-implementation review of IFRS 2.

(d) *If the proposed amendment is to IFRSs that are the subject of a current or planned IASB project, there is a pressing need to make the amendment sooner.*

There is no current IASB project on IFRS 2. However, the staff notes a post-implementation review of IFRS 2 is planned for the future.

Staff recommendation

33. In the staff's opinion, the issue does not meet the criteria to be added to the Committee's interpretation agenda. Additionally, in the staff's opinion, the issue does not need to be added to the Committee's agenda or *Annual*

Improvements and should instead be recommended for reconsideration as part of the Board's post-implementation review of IFRS 2. Reconsideration of this issue within the post-implementation review will permit the Board to consider several issues in a comprehensive manner. In the staff's opinion, that review process will permit a better understanding of the consequences that may result from the introduction of an exception to the principles currently in IFRS 2 regarding the distinction between cash-settled and equity-settled share-based payment transactions.

34. Consequently, the staff recommends that the Committee should:

(a) not add the issue to its interpretation agenda;

(b) not recommend the Board add this issue to *Annual Improvements*; and

(c) recommend the Board reconsider this issue as part of its post-implementation review of IFRS 2.

Questions for the Committee

35. The staff requests the Committee answer the following questions:

Question for the Committee
1. Does the Committee agree with the staff's recommendation that the Committee should not add the issue to its agenda or recommend the Board add the issue to *Annual Improvements*? 2. Does the Committee agree with the staff's recommendation that the Committee should refer the issue to the post-implementation review of IFRS 2?

Appendix A — Draft tentative agenda decision wording

The IFRS Interpretations Committee received a request to clarify the classification of a share-based payment transaction in which the entity is required to withhold a specified portion of the shares that would otherwise be issued to the counterparty upon exercise (or vesting) of the share-based payment award in order to settle the counterparty's tax obligation.

The Committee noted that the definitions in Appendix A *Defined terms* of IFRS 2 of 'cash-settled share-based payment transaction' and 'equity-settled share-based payment transaction' provide that an award is classified as cash-settled if the entity incurs a liability to transfer cash or other assets as a result of acquiring goods or services. The Committee noted that the payment of cash or other assets directly to the counterparty or to a third-party on behalf of the counterparty does not change the fact that the entity has incurred a liability to pay cash or other assets.

The Committee noted that IFRS 2 provides sufficient guidance on that it does not expect diversity in practice. Therefore, the Committee [decided] not to ass the issue to its agenda. Additionally, the Committee recommended that the issue be reconsidered by the Board as part of its post-implementation review of IFRS 2 to determine if the introduction of an exception to IFRS 2 would be appropriate.

Appendix B – Agenda request

1. The staff received the following Committee agenda request. All information has been copied without modification by the staff.

2. In certain jurisdictions when a share-based award is settled with the employee, the employer will withhold shares from the settlement to the employee in order to settle the employee's tax obligation. In such situations the employee does not have the option to receive the gross settlement of the award but automatically receives the net shares. We understand that certain audit firms apply an interpretation of IFRS 2 that the portion of the award related to the tax withholding should be treated as a cash-settled award from grant date. The inconsistent practice among audit firms may influence a company's plan structure between gross or net settlement of tax withholding. Depending on company plan structure, in some instances it would require the issuance of additional shares out onto the market with the resulting dilutive effects on the share price.

3. Under U.S. GAAP, this issue is specifically addressed in paragraphs 35 and B125 of FAS 123R (now FASB Accounting Standards Codification Topic 718, Compensation – Stock Compensation) where for 'pragmatic reasons' it was decided that the tax withholding should not be treated as cash settled:

> B125. Paragraph 35 of this Statement also indicates that a provision for direct or indirect (by means of a net-settlement feature) repurchase of shares issued upon exercise of options (or vesting of shares) to meet the employer's minimum statutory withholding requirements does not, by itself, result in liability classification of instruments that otherwise would be classified as equity. Interpretation 44 also provided that exception for accounting under Opinion 25. In concept, the Board considers a provision for repurchase of shares at, or shortly thereafter, the exercise of options, for whatever reason, to result in the employer's incurrence of a liability. **However, the Board decided for pragmatic reasons to continue the exception for direct or indirect repurchases to meet the employer's minimum statutory withholding requirements**.

4. We believe that an accounting interpretation to split the award into two parts (one with fixed plan accounting and one with liability accounting) does not give a meaningful accounting answer and brings with it unnecessary complexity.

This complexity is especially evident in jurisdictions with variable tax rates (e.g., tax rates based on income levels).

5. Some awards (common practice with restricted stock) must be exercised on their vesting date, which may occur during a black-out period. Therefore, companies are legally and practically impeded from gross-settling awards with the employee so that an employee is not forced to sell an award when prohibited by regulators. Another pragmatic consideration is that tax withholding requirements are computed based on the fair value of the award at the vesting/distribution date. In situations where grant accounting is otherwise appropriate, it would be problematic to try to project forward to the distribution date what the tax withholding requirements would be. Lastly an additional issue is the potential risk that the employee who receives gross delivery of the awards fails to remit their taxes. In some tax jurisdictions the employer would be required to bear this risk for these unpaid taxes if the employee defaulted due to the employer's "negligence" in not withholding.

6. While some believe this form of settlement is akin to a repurchase of vested equity (IFRS 2.29), we recognize that the cash-settled alternative view is present in the market. The FASB has recognized this issue in paragraph B125 of FAS 123R and we recommend that this point be integrated into IFRS 2 as well to avoid confusion in the application of IFRS 2.

Appendix C – Large international accounting firm guidance
[emphasis added]

C1. Deloitte iGAAP 2010 – A guide to IFRS reporting

Chapter 27 Share-based payment

7.5 Equity awards settled net of tax

Sometimes the settlement of employees' equity-settled awards results in the employee receiving a reduced number of shares and a payment being made to the taxing authority to settle the related tax liability. The value of the shares received is the total value of the award earned reduced by the amount of tax paid by the employer based on the employee tax liability on the transaction. The question arises as to whether this type of settlement arrangement results in the award being considered partly cash-settled.

Whether this type of settlement arrangement should be treated as partly cash-settled or entirely equity-settled awards will depend on whether the employer is acting as an agent for the employee in settling the employee's tax liability. The arrangement should be treated as entirely equity-settled if the employer is considered to be acting as agent for the employee.

The assessment of whether the entity is acting as agent for the employee will be judged on the facts and circumstances of each case. <u>There will be cases where it is clear that the entity is acting as agent, for example, where the entity offers a broker's service to sell employee's shares and passes the cash to the tax authorities, but accepts no liability itself</u>.

In some tax jurisdictions the tax authority specifies situations in which the entity has a statutory duty to act as agent for the employees and remit tax on behalf of employees.

C2. Ernst&Young International GAAP 2010 – Generally Accepted Accounting Practice under IFRS

Chapter 27 ***Share-based payment***

14.3 Sale of shares by employee to meet employee's tax liability

In some jurisdictions, an award of shares or options to an employee gives rise to a personal tax liability for the employee, often related to the fair value of the award when it vests or, in the case of an option, is exercised. In order to meet this tax liability, employees may wish to sell as many shares as are needed to raise proceeds equal to the tax liability (sometimes described as 'sell to cover').

This in itself does not, in our view, require the scheme to be considered as cash-settled, any more than if the employee wished to liquidate the shares in order to buy a car or undertake home improvements. However, <u>if the manner in which the cash is passed to the employee gives rise to a legal or constructive obligation for the employer, then the scheme might well be cash-settled, to the extent of any such obligation</u>.

In some jurisdictions where employees must pay income tax on share awards, the tax is initially collected from (and is a legal liability of) the employer, but with eventual recourse by the tax authorities to the employee for tax not collected from the employer. <u>Such tax collection arrangements mean that even an equity-settled award results in a cash cost for the employer for the income tax</u>.

In such a situation, the employer may require the employee, as a condition of taking delivery of any shares earned, to indemnify the entity against the tax liability, for example by:

- direct payment to the entity;
- authorising the entity to deduct the relevant amount from the employee's salary; or
- surrendering as many shares to the entity as have a fair value equal to the tax liability.

<u>If the entity requires the employee to surrender the relevant number of shares, in our view the scheme must be treated as cash-settled to the extent of the indemnified amount</u>.

C3. KPMG Insights into IFRS 2009/10 – KPMG's practical guide to IFRS

Section 4.5 Share-based payment

4.5.320 Entity facilitates the sale of equity instruments

4.5.320.10 An entity may facilitate the sale of shares or other equity instruments granted. For example, an entity might offer to act as an agent for employees. In our view, if the employer bears no risk in respect of the sale of the shares (e.g., share price fluctuations, credit risks etc.), then classification of the transaction as an equity-settled share-based payment arrangement is not precluded.

4.5.320.20 Determining whether the entity is settling the arrangement in cash or acting as an agent requires an analysis of all terms and conditions. We believe that the following conditions are indicators of an agent relationship (i.e., that the equity instruments are sold on behalf of the recipient of the shares):

- the shares are sold to the market via an independent, third party brokerage firm;
- the grantor has not agreed (explicitly or constructively) to purchase the underlying share from the brokerage firm;
- the grantor does not guarantee, or underwrite in any way, the arrangement between the owner and the brokerage firm; and
- the grantor is obliged to remit only the payments received from the broker. The grantor cannot be obliged to pay if the shares are not sold (e.g., in the event of unexpected market suspensions).

4.5.320.30 In some countries the employee may be subject to taxes upon the receipt of a share-based payment arrangement. In many cases the tax obligation is a liability of the employee and not the employer, although the employer may have an obligation to collect or withhold it. Some share-based arrangements may allow the employer to sell the number of shares required to settle the tax payment obligation. In our view, if the entity is acting simply as an agent for the employee and therefore bears no risk associated with the shares, then the settlement of the tax payable via a partial sale by the employer of a portion of the share-based payment arrangement does not mean that the tax portion is a cash-settled share-based payment. <u>If in contrast the entity is not acting simply as an agent, ie, it bears a risk associated with the shares, then in our view the tax portion would be classified as a cash-settled share-based payment; the remainder would be classified as equity-settled</u>.

C4. PwC Manual of accounting IFRS 2010

Chapter 12 Share-based payment

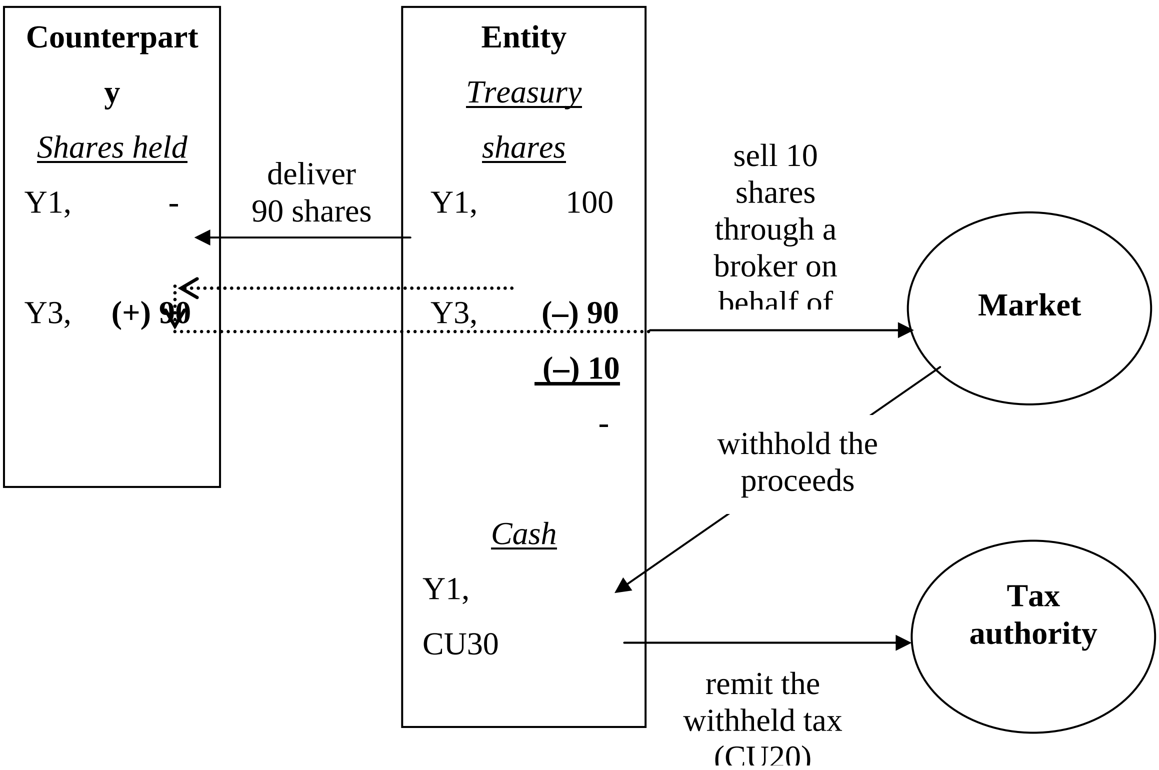
Awards settled net of tax

12.230 Sometimes an entity may agree to pay employee tax on an employee's behalf at the time a share option award vests, giving the employee fewer shares in exchange for doing so. While the majority of the share option award will be treated as equity-settled, <u>because the entity has agreed to settle in shares, the portion relating to tax will be treated as a cash-settled share-based payment transaction because the entity has agreed to pay cash to the tax authorities on its employee's behalf</u>.

12.231 If, instead of paying cash to the tax authorities, the entity sells a portion of the award on the employee's behalf and uses the proceeds to pay the tax authorities, the award would be wholly equity-settled.

Appendix D – Illustrative chart on the comparison example in paragraphs 24-26 of this paper

Situation 1. Broker-assisted cashless exercise



Situation 2. Net settlement