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INTERNATIONAL COMPENSATION AND BENEFITS TRENDS

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About the ius laboris alliance

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In addition, ius laboris prides itself on offering **consistent high-quality services** thanks to its rigorous quality control procedures. Members must comply with the quality standards devised by the ius laboris Board which oversees a rigorous quality management programme, obtains client feedback and monitors member firms on an ongoing basis.

Our members know and trust each other. They are able to refer their clients to other law firms within the alliance, confident that their clients will receive a quality service and first-rate advice.

In its quest for excellence, ius laboris has established various international practice groups dealing with all aspects of employment law, pensions and employee benefits, both locally and internationally. These groups meet regularly to further develop the skills and know-how of our lawyers, to deepen the personal relationships which underlie the close co-operation between ius laboris member firms and to share specific knowledge with clients.

Thanks to ius laboris, clients have access to a **coordinated cross-border service at a competitive cost**. The alliance's rates reflect the local market rates in employment law. There are no hidden costs. Through fee coordination, we offer our clients simplicity and transparency.

Contact

If you have existing links with any of the alliance's member firms, please feel free to contact the lawyer(s) you know. Otherwise you are welcome to contact the alliance's Managing Director who will be pleased to assist you:

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Introduction

Using the expertise of its member firms across the world, ius laboris has produced a global study of current trends and topical issues in compensation and benefits. The study involves 15 different countries: Argentina, Austria, Belgium, Brazil, Canada, Denmark, Finland, Greece, Mexico, the Slovak Republic, Sweden, Switzerland, Turkey, the United Kingdom and the United States of America. It focuses on key legal changes and the impact they have on compensation and benefits packages being offered in major business centres around the world.

Each chapter is dedicated to a single country. Each begins with a brief outline of the current scene for compensation and benefits in that jurisdiction, in order to give the necessary background and to identify any key trends.

Of course each country has unique features in its compensation and benefits landscape. For each country, expert lawyers have selected the trends and topical issues they consider to be most significant for employers who are concerned with compensation and benefits packages in their jurisdiction. Each chapter therefore differs in focus and in content, highlighting the varying factors employers should take into account in respect of each jurisdiction.

To complement the study, a cross-border summary has also been prepared. This is intended to give an overview of current issues in all the 15 countries, as well as to facilitate comparison between different countries on similar issues.

We hope you find this summary and the accompanying study to be valuable resources in assessing the compensation and benefits issues you may be encountering in the changing global marketplace. Contact details for the lawyers in each jurisdiction are included at the end of each chapter.

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Argentina

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The current scene

Many different types of compensation packages have been implemented by multinational companies during the last 15 years. However, changes in laws and jurisprudence regarding the nature of some plans, the income and social security taxes, and the severance payment affect the way in which these packages should be treated.

As a result, these changes also affect the attractiveness of implementing certain programs, both from the perspective of the employee as well as for the employer. Furthermore, and perhaps just as important, an employer's potential liability resulting from an incorrect understanding of the nature of a compensation package can be very significant, involving enormous amounts in fines and interest.

The issues highlighted in this chapter are intended to illustrate the impact on compensation packages of current changes in Argentinean law and new judicial decisions. They are intended to show the complexity involved in implementing various compensation and benefit components in Argentina, and to emphasise the importance of adapting compensation and benefits plans to the local laws.

Disputed Benefits: Background

During the last few years, Argentina has seen growing amounts of claims regarding the nature of benefits such as cell phone, use of company car, stock plans and retirement plans (among others). The issue of determining whether any of these are salary or benefits has significant consequences in Argentina. Social security contributions are quite high in Argentina, and these contributions are calculated on the basis of registered salary, not total benefits. As such, there is continual controversy over whether a particular benefit should be considered salary.

When it is determined that an employer has not properly registered part of an Argentinean employee's salary, and therefore has not paid the corresponding social security taxes due, the employee has right to collect the applicable fines related to non-registration (which are approximately calculated as 25% of the salaries not registered, plus the duplication of the severance payments).

Moreover, legal severance payments are calculated on the basis of registered salary. These were limited to a cap that resulted from the applicable collective agreement (most activities are covered by national industry-wide collective agreements). But during 2004, the Supreme Court of Argentina ruled that the applicable caps placed on severance payments were against the National Constitution. With the elimination of the severance payment cap, there has been a significant increase in litigation before the employment courts over the existence of a higher salary than the registered one. In addition, the cap to the part of salary that is subject to social security contributions was also eliminated. Consequently, this issue is further complicated as the Social Security Administration and the Tax Authority also start claiming the registration of the full salaries, which provides them with the ability to claim increases in the payment of taxes, interest and fines.

Therefore, companies treating salaries as benefits can face judicial claims from the employees and from the governmental agencies, and the amounts at stake are significantly increased because of the fines and high interest rates applicable.

What is salary and what is not?

Argentinean laws treat salary or remuneration in different ways and with different meanings. From some authors' perspective, the meaning of salary is not the same from an employment viewpoint as compared to a social security viewpoint. Not all income received as a consequence of the employment contract is salary. Not all salaries are considered for the basis of calculation of severance payments. Not all income resulting from the employment contract is subject to income tax. Not all salaries are subject to social security taxes.

Under Section 103 of the Employment Contract Act, salary is the payment that the worker must collect as a result of the employment contract. This salary must not be lower than the minimum wage. In addition, according to Section 103 bis of the Act, social security services granted by the employer to the worker, directly or through third parties, are "social benefits". These benefits are not considered as salary, are not paid in cash and are neither accrued nor replaced by cash payments. The object of social benefits is to improve the life quality of the worker or the worker's family group. Examples are (receipts are required in all cases): medical services expenses; school materials for employees' children; kindergarten; lunch vouchers of up to A$15 per day worked; and supermarket vouchers up to 20% of the salary of the employee under collective agreement, or 10% in other cases.

Cell phone and company car

A recent decision from the National Employment Court of Appeals ruled that a cell phone provided for personal and professional use by an employer should be treated as salary for purposes of employment and social security taxes. To avoid having the cell phone classified as salary, employers are advised to restrict the use, avoiding personal calls, or charge the employees the fees for their personal use of the cell phone.

Other decisions of the same Court of Appeals recently decided that a company car, that is also available to the employee for personal use, should be registered as salary. Consequently, employers are advised to restrict the use of a company car, charge the employees for their personal use, or register the value of the use of the car as salary paid to the employee, and apply the corresponding social security taxes. According to current guidance, it is assumed that 50% of the use of a car is for personal purposes.

Finally, claims are starting to arise that parking and gym fees that the employer paid for the benefit of the employee should also have been registered as salary.

Retirement plans

A mandatory retirement system is in force in Argentina, under the Retirement and Pensions Act, 24241. However, in some cases, employers contractually agree to provide additional retirement benefits where employers and employees contribute to a private fund that is different from the mandatory system.

In these cases, depending on the purpose of the additional retirement and the internal rules enacted for the supplementary retirement payment to the employee, the employer's contributions may not be treated as salary.

In addition, if the investment vehicle of the fund is a retirement insurance company (called AFJP), according to the mandatory regime, contributions can be deducted for income tax purposes. These contractually agreed contributions are used to voluntarily increase the contributions to the mandatory Argentinean retirement and pension scheme, and there is no limit on the deduction available for income tax purposes.

Other compensation benefits

Other compensation components (aside any retirement benefits) can include a bonus, which might be paid annually, quarterly, etc. Typically, these bonuses are subject to the accomplishment of certain performance objectives, and are only paid to executive employees. However, when a bonus is a one-off payment, not subject to repetition, and for extraordinary reasons, the bonus would be considered salary not subject to social security contributions. On the other hand, when the bonus is repeated, it becomes regular, and then it is considered to be salary for social security taxes purposes.

It is important, given the Argentinean Supreme Court's recent ruling eliminating the severance payment caps, for an employer to understand how its bonuses can impact on the salary used as the basis for severance calculations.

Another important item to note is that there has been a recent change in the law regarding severance payments. Section 245 of the Employment Contract Act no longer refers to "received salary," but instead to "gained salary" (which includes deferred compensation). Consequently, if a bonus is accrued (i.e., gained) on a monthly basis, the courts have ruled that a proportional piece must be included as part of salary for the calculation of the severance payments.

Stock plans

Stock Appreciation Rights, Stock Purchase Plans and Stock Options, among others, are also featuring in employment claims. In some cases, employees have challenged the plans, claiming damages for the loss of ability to get benefits under the plans due to the decision of the employer to terminate the employment contract. In other cases, the nature of the economic benefit awarded to the employee is being debated with plaintiffs arguing that the difference between the market value of the stock and the amount effectively paid by the employee – the gain - should be treated as salary. Notwithstanding all of this, there are still no official rules regarding application of social security and employment taxes for equity plans. As such, the rule remains that each plan should be studied and analysed on an individual basis.

Due to these risks, employers, especially multinational companies, should not rely on their home country law to apply equity programs internationally.

FURTHER INFORMATION AND CONTACTS

This chapter covers selected issues only. For a comprehensive description of all points relevant to compensation and benefits in Argentina, please refer to the contributors whose details are below, or contact ius laboris.

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The current scene

Although there are changes in labour and social welfare law every year in Austria, they generally have little impact on Austrian companies' compensation and benefits strategies. Instead, it is the current employment and economic situation of the particular local office or branch that determines compensation levels and benefit packages.

In Austria, minimum wages and salaries for each branch are set in collective bargaining agreements following negotiations between representatives of industry and labour. These agreements are adjusted annually in standardized rounds of negotiations to account for the current economic situation and challenges. Labour law disputes generally lead to reforms in company-specific regulations, but increases in compensation and benefits depend to a much lesser extent on such regulations than they do on the conclusion of specific individual employment contracts.

In short, only few compensation and benefits trends in Austria are to be seen currently, whether as a result of new legal provisions or due to the situation in the employment market. With that being said, the pension reforms implemented by the Austrian government in recent years have had a different impact, with the result that the trend toward company pension plans has been greatly accelerated.

This chapter begins with a summary of the major components of compensation in Austria. It then addresses three topics which currently raise important issues for employers' compensation and benefits strategies: company pension plans, the use of equity compensation incentives, and incentive compensation.

Main components of compensation

"Base salary" in Austria refers to gross monthly salary without bonuses or benefits in kind. In almost all Austrian employment relationships, it is paid 14 times a year; the 13th and 14th payments are not considered bonuses but instead serve only to optimize how annual salaries are treated in terms of income tax. Under Austrian law, the 13th and 14th payments are only subject to 6% income tax.

Variable pay components (and regular pay increases) may be foreseen by a collective agreement for the branch. These components might be in the form of allowances or bonuses. Employers can obligate themselves by contract or by works agreements to provide additional variable payments. If this is the case, they are bound by the principle of equal treatment. Variable payments traditionally account for only a small part of overall annual pay in Austria, with exceptions for those working in sales positions. Some 2 – 10% of pay for employees and 10 – 40% of pay for senior management positions is variable. As companies increasingly take on international character, the share of variable pay components for senior management is rising.

Social insurance, including work-accident, health and pension insurance, is legally required in Austria. Because of its mandatory nature, it is generally not perceived as a component of salary. The employer's social insurance contribution must be

paid 12 times a year and amounts to 21.7% of the assessment base for blue-collar and 21.9% for white-collar employees. Additionally, the employer must pay 4.5% to the Family Burdens Equalization Fund (Familienlastenausgleichsfonds).

Withholdings must be made from the employee's base salary (18.2% of the assessment base for blue-collar workers, and 18% for white-collar workers) for mandatory health, pension and unemployment insurance contributions. After these contributions are deducted, any remaining salary amount is subject to tax.

There has been a fairly recent fundamental reform in the Austrian system for severance pay. Under the new severance system (effective since 2003 and called "New Severance Pay" (Abfertigung Neu)), the employer is required to pay 1.53% of the gross monthly salary into an industry-wide employee income provision fund (Mitarbeitervorsorgekasse). Depending on how and when employees leave the company, they can either request disbursement of funds or have the balance be reassigned to their new employer.

Extra compensation that can be significant would be, for example, additional private health insurance for special-class care or private accident insurance for leisure time activities. It depends greatly on the branch in question whether such extras are usual or not. They are usually encountered in banks and insurance companies, rarely in retail trade.

For tax reasons, benefits in kind are quite common in Austria, especially the provision of a car that is owned, leased or rented by the company, including the costs of fuel, insurance, taxes and parking. The more senior the manager is, the more likely he/she is to be offered a car as a benefit: 87% of all managing directors have company cars, as do 51% of next-level managers.

Depending on the branch or local office, additional benefits may also be common, such as housing, clothing, meals, transportation, or the use of company sports facilities.

Company pension plans

In recent years, pension reforms have led to massive reductions in expected pensions. The cutbacks in the public pension system were necessitated by higher life expectancy and longer educational phases. The result was to place more emphasis on individual pension plans and on employers' responsibilities for pension plans, with the ultimate goal being to reduce income loss upon retirement.

The trend toward company pension plans has thus been greatly accelerated. Company pension plans are seen and valued today not only in their function of enhancing loyalty to the company, but are also increasingly recognized by employees as being part of their compensation and benefit packages.

Unfortunately, however, there are still few tax incentives for businesses to offer such independent plans. Where new company pension plans are implemented, the employer often makes its contribution to a pension fund or pension insurance plan on a voluntary basis. Social insurance contributions and tax payments need not be made until the funds due to an employee are actually paid out of the plan. Occasionally, top managers will be offered additional direct or indirect compensation beyond the scope of such contribution-oriented models.

Use of equity compensation incentives

Employee share plans are becoming increasingly important in large companies and particularly in public limited companies, to reinforce management's long-term commitment to the company, and to increase management's motivation.

In particular, start-up companies are motivated to offer employee share plans to improve their liquidity. Employee share plans are a means of equity financing, and therefore allow companies to obtain funds for investment purposes and makes it easier for them to meet their financial liabilities.

As a result of certain statutory changes, such as those set out in the Capital Market Offensive Act 2001 (Kapitalmarktoffensivegesetz), employee share plans are becoming more common. However, employee share plans are not common in small and medium-sized companies, which account for 99.6% of all companies and 65% of all jobs in Austria.

Employee share plans are often introduced when a company makes an initial public offering (IPO), either for the management only or for all employees. Theses plans have different goals. Management plans aim to create incentives to improve business results and share prices. Broad-based plans for all employees aim to promote long-term commitment to the company and tend to be an additional benefit for employees. Company-wide plans that cover all employees also bring other benefits. For example, employees who participate in the plans generally treat company resources with more care and have a greater understanding of certain company decisions, such as reductions in benefits or business-related dismissals.

Incentive compensation

Incentive compensation strategies exist in most medium-sized companies in Austria, but they too often do not meet today's strategic needs. These older plans tend to be based on retrospective figures, overwhelmingly consider quantitative aspects, or use one-sided subjective criteria. More recently introduced incentive compensation plans implement target agreements and/or consider team performance. Depending on the company's current strategic position and on which management or non-management groups are included, profit-sharing schemes might be structured dynamically, or bonus plans that are more long-term – such as stock option plans – might take account of more than simply the company's financial situation on the balance sheet date.

Profit can be shared as money payments, of course, but beyond that it can also take the form of equity participation (stocks, options) or an employer's contribution to a company pension plan.

The decision on whether a discretionary bonus or a performance-oriented bonus is given is in practice co-determined by the works council's participation rights. Any implementation of qualitative or quantitative criteria increases the chance that the measure might be mandatorily subject to participation on the part of the works council. Only if the employer decides about the bonus on a purely subjective basis is the works council's participation not necessary. If the profit sharing plan depends primarily on business success and not on employee performance, then it can be decided upon (also) in an individual employment contract. If, on the other hand, the bonus depends upon actual work performance (quality and exactness, extraordinary cost-saving, etc.), then it is not effective unless it is decided upon in

a works agreement. As such, the required involvement of the works council may impact on whether a company wants to offer an incentive arrangement or not.

FURTHER INFORMATION AND CONTACTS

This chapter covers selected issues only. For a comprehensive description of all points relevant to compensation and benefits in Austria, please refer to the contributor whose details are below, or contact ius laboris.

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Belgium

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The current scene

Social security charges and rates of income tax are relatively high in Belgium. Ordinary salary is subject to a 13.07% social security charge and an employer charge of approximately 35%. Income tax rates go up to 50% (plus communal charges). Given these high rates, employers continuously look for benefits which are taxed more favourably. Very often, compensation packages include company cars and luncheon vouchers. Other benefits which are seen in practice are pension schemes and equity based compensation.

This chapter focuses on two areas of compensation and benefits which have been the subject of recent change and development in Belgium: stock options and occupational pensions.

Granting stock options to employees: not such a bad idea after all?

It has long been a popular sport for HR professionals to warn employers of the dangers related to granting stock options to employees. The disadvantage most often mentioned stemmed from the Belgian tax regime. Stock options granted to Belgian employees are to be taxed at the moment they are actually granted. A downturn in stock prices after the grant date can, therefore, lead to serious losses for employees holding unexercised stock options, who will not be able to recuperate the already paid taxes. A second danger of stock options related to the calculation of severance indemnities. It was feared that the (often huge) benefits of a stock option plan could be considered as salary and would, as such, be included in the computation base for the amount of the severance payment.

However, recent developments have shown that these disadvantages should not be exaggerated.

Avoiding tax risks

As mentioned above, Belgium applies a system of taxation at grant. This taxation is final (i.e., the tax is not refunded if the stock option is not exercised, such as when there is a fall in stock price or because the stock options plan stipulates that the option may no longer be exercised in the event of the employee's dismissal).

For taxation at grant to apply, the stock options should be accepted in writing by the beneficiary within 60 days of the grant being notified.

Immediately, the question arises how stock options that are accepted after the expiry of the 60 day period, must be taxed. Legal authors have expressed different opinions. The Minister of Finance considers that such stock options must be taxed as a purchase of shares at a reduced price. This means that the stock options are taxable at the moment of exercise. The taxable benefit is thus equal to the capital gain at the moment of the exercise.

The Minister thus introduced, indirectly, an optional system for determining the moment stock options are taxed:

- if the beneficiary accepts the stock options within a 60 day period, he/she will be taxed at the time of the grant; or

- if he/she accepts stock options after the 60 day period, he/she will, in accordance with the opinion of the Minister, be taxed on the capital gain at the moment of the exercise.

A circular from the tax administration of 25 May 2005 follows the opinion of the Minister. Employees who wish to avoid the risk of paying taxes on stock options that they might never exercise may now opt for taxation of the benefit they will (hopefully) realize, instead of paying taxes at the date of grant.

When acting in accordance with the Minister's opinion and allowing a choice to be taxed at the time of grant or at the moment of exercise of stock options, attention must be paid to the consequences, which include:

- the more complicated management of stock options plans, since the employees must choose between taxation upon grant and taxation upon exercise; and

- in case of taxation at the time of the grant, there is, as a rule, full exemption from social security contributions. If taxation happens at the moment of the exercise, this exemption will not apply and accordingly, the global capital gain upon exercise would be submitted to social security contributions. However, if stock options are granted by a foreign parent company and if that company does not charge the stock options' cost to its subsidiary, there could be an argument that no social security contribution should be paid at the moment of the exercise.

Calculating the severance indemnity

It has long been feared by employers that the benefits realized through stock option plans should be considered as salary and that these benefits should thus be taken into account for the computation of severance indemnities (the Claeys formula). But on 4 February 2002, the Supreme Court definitively rejected this point of view. According to the Supreme Court, such benefits are only a result of speculation and cannot be considered as the counterpart of work performed.

However, the Supreme Court also stated that the grant of stock options itself constitutes a benefit at the time of grant. This benefit must be taken into account in the calculation of the severance pay, at least if the stock options were granted by the employer during the twelve months preceding the termination of the employment contract. The Supreme Court did not, however, answer the question as to how the benefit resulting from the grant of stock options should be evaluated.

Three different approaches for this evaluation have been identified in the case law of the labour courts. The first approach considers the taxable valuation of the benefit (on a lump sum basis). The second approach involves excluding the benefit from the severance pay when the employee loses the right to exercise the options in case of dismissal. Last but not least, a third approach excludes the benefit from the severance pay because the valuation cannot be made with certainty. It follows therefore that in a large majority of the cases, no benefit or only the (relatively small) taxable benefit is taken into account for the computation of the severance indemnity.

The stock option plan can further reduce this risk, by stating clearly that stock options are granted only occasionally and that the employee does not have a right to receive such options in the future. It can then be argued that the employee is not entitled to options at the time of dismissal and that, therefore, the options are not part of his/her salary at that time.

The possibility of offering employees a choice between taxation at grant and taxation of the realized benefits, along with the reduced risk of having to include stock options in the computation basis for severance indemnities, have taken away two often cited disadvantages of stock option plans. Consequently, utilizing stock awards as a compensation device in Belgium might not be such a bad idea after all.

Occupational pensions

The various social security and tax incentives for occupational pensions make this benefit very popular in Belgium. However, when it comes to individual pension plans, these incentives are limited.

At present the legislation regarding pensions vehicles is being reformed. An Act on the control of institutions for occupational retirement provisions was promulgated on 27 October 2006. This Act creates a new legal form for pension funds: the Organization for Financing Pensions (OFP). The management structure and organisation of an OFP will be different from the existing pension funds. For example, in addition to a General Assembly, an OFP can have several operational bodies, controlled by a Board of Directors. In addition, the liability of the members of the General Assembly and of the operational bodies is extended.

In principle, the OFP will not be subjected to the inheritance tax in Belgium of 0,17%. An Act governing the tax regime for Organizations for Financing Pensions is expected. By implementing new tax incentives and establishing an appropriate and consistent legal framework, Belgium hopes to attract Pan-European pension funds.

Belgian anti-discrimination legislation is also undergoing a profound review at the moment, and this has an impact on pensions. With the Act of 20 July 2006, Belgium used the possibility provided for in the Framework Directive on equal treatment in employment. Under Belgian law, the fixing for occupational social security schemes of ages for admission or entitlement to retirement or invalidity benefits, including the fixing under those schemes of different ages for employees or groups or categories of employees, does explicitly not constitute discrimination on the grounds of age. The same applies for the use of age criteria in actuarial calculations.

FURTHER INFORMATION AND CONTACTS

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Brazil

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The current scene

Brazil is undergoing an important time of social, political and economic development, with a series of current structural reforms and measures to encourage growth and investment. The government has taken major steps in modernising the labour legislation and improving labour market policies, such as regulation of part-time and temporary contracts and flexibility of working hours in order to reduce overtime costs. Besides these measures, the Administration has sent to Congress a proposal of collective reform which reduces the restrictions for union organisation and creates incentives for direct collective bargaining between unions and employees. These measures and proposals are aimed to provide a wider safety net for the unemployed, to reduce job destruction, to increase the proportion of formal labour contracts and to promote labour productivity.

This chapter focuses on the area of stock plan awards, which is currently having a significant impact on compensation and benefits packages in Brazil. The chapter looks in particular at the way that Brazilian law treats income derived by employees from the exercise of stock options. It also looks at the implications of this type of benefit in respect of severance payments at the termination of employment. The chapter also outlines the area of retirement benefits in Brazil.

Stock awards

In Brazilian markets, there are some variations in stock plans. For instance, restricted stock units do not require the purchase of shares by the employee. The company gives a package of shares but establishes certain restrictions on their use, for example that the employee remains working in the company for a given period of time. It is different under a stock purchase plan, which has three distinct steps: (1) when the company concedes the right to the employee and sets the price of subscription of shares, which will be exercised after a certain period (vesting period); (2) the moment at which the employee will exercise the right to buy shares, also called the moment of subscription of shares; and (3) the moment when the shares are sold.

A third type of plan is stock options, which are offered as an option for the employee to buy stocks at a set price (as of the date granted) once the shares have vested. Since the 1990s, stock option plans have become increasingly popular in Brazil as a way to improve the total compensation package for employees. Some companies use this incentive as a way to retain in-house talents, others, as a way to involve and stimulate employees after mergers or acquisitions. Because of their wide use in the United States, such programs were definitively incorporated into Brazilian legal system in 1976, with the statutes of the Corporations (Company Law). Many companies based in Brazil, especially multinational ones, currently give stock options to all employees.

Stock plans do not offer any guarantee against losses that can result from the fluctuations in the price of shares. Upon acquiring, the employee faces the risks of the stock market, whose fluctuation can result in considerable profits or losses. Should the value of the shares be lower than the value of the agreed option (issuing price) at the time of exercise, the employer does not compensate the

employee for the difference. It is the employee who assumes this loss. Therefore, in seeking to make a gain, the employee must accept the inherent risks of the share market.

Legal nature of stock option plans

Despite stock options plans existing in Brazil for over 15 years, there is no definite consensus in the Labour Courts as to whether the profits from stock awards are salary. However, the few existing doctrinal articles agree that stock option plans are not in the nature of salary, and this position has been successfully defended in court.

For example, the Regional Labour Court of São Paulo held that a stock option plan was commercial in nature. It ruled that the exercise of the option to purchase shares by the employee involves risks, since he/she may win or lose in the operation. It is, therefore, a financial operation of the stock market. There is no payment by the employer to the employee as a result of rendering of services, but a risk inherent to the transaction. Hence, the compensation cannot be considered to have a salary nature. (TRT Second Region - proc. RO 20010255561- Decision 20030145141 – 3rd Group - Reporting judge Sergio Pinto Martins.)

In light of this ruling, the tendency of the Brazilian jurisprudence is that stock option plans are not in the nature of labour. Stock options do not fit into the category of salary contemplated by the Brazilian labour law, since they do not represent any kind of commission, percentage adjustment, or bonus. The employee does not have a right to receive stock awards for rendering services to the employer. As such, any income obtained with the sale of the shares will not constitute compensation paid by the employer.

An employee plan in Brazil is thus a financial operation of a commercial nature, which is separate from employment. The employee who opts for acquiring company shares undertakes the risk, in the option, that he/she may win or lose, should the stocks go up or down in the market. Therefore, the legal relationship between the company and the employed shareholder and the instalments, rights and advantages received under the plan, is distinct from employment, and the positive result gained by the employee is as a shareholder, when shares are sold or profits are received.

The consequences of this distinction are as follows. In Brazil, in the event that a benefit is determined to be of a salary nature, the employer will be compelled to include the benefit as taxable income under all the labour laws foreseen in the Brazilian legislation (13th salary, annual vacation, fund of length of service plus 40%), which means that the amounts derived by the employee from the trade of the shares will be computed as salary. This represents a significant increase in the labour values due to employee.

If income from stock options is not considered as salary, then these amounts are excluded from the contributions due to the Social Security System. They are only subject to Income Tax to be paid by the employee at source when obtaining profit in the sale of the shares.

Potential difficulties with stock options

Even though the Court decisions have begun to establish a trend in the sense of stock option plans being of a commercial nature and separate from employment,

employers may still face certain liabilities if they offer this benefit to employees. There are two points of which employers should be aware.

First, it is important to note that a benefit considered as a “free benefit” paid by the employer must be included in the calculation of the severance payment. Thus in respect of stock options (or any kind of choice in benefits offered to an employee), the employer should require the employee to pay for a certain amount in the stock option plan (such as the exercise price). This will avoid the risk of the benefit being considered by the Labour Courts as a free benefit paid by the employer and therefore included in the calculation of severance pay.

Second, an employer may find that it has ongoing liabilities in respect of stock options even after the employee’s employment has terminated. In the decision of the Regional Labour Court of São Paulo referred to above, the Court held that, even if not part of the employee’s salary, stock option plans could be reviewed by the Labour Court under Brazilian civil law. Therefore, it decided that although the employee lost the entitlement to exercise unvested options after termination of employment, the employee was entitled to keep and exercise vested options even following termination of employment.

Retirement benefits

Retirement pensions are assured under the public system in Brazil, supported by social security contributions.

There are also private systems of pension benefits, organised by closed or open entities. The closed entities are created either on a stand-alone or multi-employer basis. This “closed entity” vehicle is used to administer the arrangement, invest the assets, and pay the pension benefits. The open entities are pension products offered by authorized insurance companies. Open entities can offer both corporate and individual programs. In general, most small and some medium-size companies prefer the open entity approach, while other medium-sized and large companies have a strong preference for their own “closed” pension fund or for joining a multi-employer pension scheme.

FURTHER INFORMATION AND CONTACTS

This chapter covers selected issues only. For a comprehensive description of all points relevant to compensation and benefits in Brazil, please refer to the contributor whose details are below, or contact ius laboris.

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Canada

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The current scene

Canada is a geographically large country, but with a relatively small population concentrated close to the 49th parallel, the border with the US. The economy, although diverse, is resource-based and therefore rises and falls with the demand for gas, oil and minerals. Current demand for skilled labour is high. At the same time, Canada's workforce is maturing. Employers are recognizing a need to focus more attention on workforce planning, developing recruitment and retention strategies, and designing effective compensation and benefit programs.

Canada's workforce is ageing. The baby boomer generation is quickly approaching retirement age. A recent study by Watson Wyatt estimates a labour shortage in Canada in ten years' time of one million people and possibly close to three million by 2026. Similarly the percentage of workers age 55 and above is estimated to rise from 29% in 2006 to 35% in 2016 and 45% in 2056. One factor distinguishing Canada from many other countries, however, is that our labour force is not expected to shrink in size. The ageing of the workforce will undoubtedly have an effect on the public pension scheme, on employers' ability to attract and retain talented workers and on the design and delivery of compensation and benefits.

In looking at trends in labour, employment standards and pensions, from a legal perspective it is important to note that the federal and provincial governments in Canada share legislative jurisdiction in each of these areas. Under Canada's constitutional framework, certain industries, such as banking, telecommunications, shipping, interprovincial transportation and federal undertakings are governed by federal laws. Other industries are governed provincially. This division of powers in Canada raises some interesting legal issues and also compliance and administrative challenges for employers. Because labour, employment standards and pensions are regulated both federally and provincially, there are frequent developments across Canada flowing from policy initiatives, amendments to legislation, and court cases.

This chapter provides an overview of some key issues that currently impact on compensation and benefits packages offered by Canadian employers.

Pension funding deficits

The pension landscape has been marked by increasing deficits in defined benefit plans, a movement toward defined contribution plans, several high profile court cases, including class action law suits, pensions playing a key role in corporate insolvencies, and regulatory initiatives to address funding issues.

Pension plans in Canada are regulated by pension laws and income tax legislation. Each province, and the federal jurisdiction that includes certain industries such as banks, airlines, railways and telecommunications, has separate pension legislation. A single employer that sponsors a provincially-regulated pension plan, and that has employees across Canada, is required to comply with pension legislation in each province. Every pension plan must also comply with complex income tax laws, which are established by the federal government.

Since 2001, pension funds have been subject to the combined effect of declining investment returns and lower interest rates. This has resulted in a large proportion

of pension funds having significant deficits. A number of studies have been published in Canada in the past few years, expressing concern about this issue. For example, in August 2005, the Association of Canadian Pension Management ("ACPM") published a report entitled "Back from the Brink: Securing the Future of Defined Benefit Pension Plans". In its report, the ACPM stated that in the ten-year period up to 2003, coverage in defined benefit plans declined from 44% to 34% of the workforce and the number of defined benefit plans declined by 14%. In addition, at the end of 2003, about half of federally-regulated pension plans were less than fully funded. The total shortfall in pension funding among all defined benefit pension plans in Canada was estimated at $160 billion.

There have been several high profile corporate restructurings in Canada in recent years in which pension funding has played a pivotal role. Examples are Algoma Steel, Stelco and Air Canada. The first two cases were subject to the Ontario Pension Benefits Act. Ontario is the only jurisdiction in Canada that has a pension benefits guarantee fund ("PBGF") that guarantees a certain level of pension benefits in the event of bankruptcy. Had either of these companies gone bankrupt, the PBGF would also have been bankrupt or would have required an enormous amount of funding by the Ontario government to stay afloat. Exemptions from the regular funding rules, in the form of special regulations to the Ontario Pension Benefits Act, were granted to both companies. Air Canada's pension plans are regulated federally. It was also granted special relief from the funding rules, in the form of extended funding of solvency deficiencies (ten years instead of five years).

The prevalence of pension funding deficits and the prominence of pension funding in corporate restructuring has led a few pension regulators in Canada to amend or consider amending their legislation in regard to the funding of deficiencies. The provinces of Quebec and Alberta and the federal jurisdiction have taken steps to amend their respective legislation to permit extended funding for solvency deficiencies and to permit the limited use of letters of credit to provide security for a portion of solvency deficiencies. The requirement to fund solvency deficiencies over five years, as contrasted with fifteen year funding for going concern unfunded liabilities, has been particularly onerous in a low-interest economic environment.

Recent case law on pensions

There have been a number of significant court cases recently. Many of the cases brought before the courts are class actions. Because the issues in pension actions are often common among a large group a pension plan members, the class action procedure can be a convenient and cost-effective means for plaintiffs to make a claim. On the other hand, the result can be very costly for plan sponsors. Cases of note are:

i. The case of Monsanto v. Ontario (Superintendent of Financial Services) [2004] 3 S.C.R. 152 was decided by the Supreme Court of Canada in 2004. That case concerned a partial wind-up of a pension plan and the question whether members' rights to surplus assets would be the same as on a full wind-up. The court decided based on the Ontario Pension Benefits Act that the members' rights are the same on partial wind-up as on full wind-up. The court held that the surplus attributable to the partial wind-up group should be distributed. This case has raised numerous issues, such as the manner of distribution of the surplus assets, what happens in the event the pension plan no longer has

surplus assets, how previous undeclared events that may have resulted in partial wind-ups should be dealt with, etc.

ii. The Supreme Court of Canada also recently decided the case of Buschau v. Rogers Communications Inc. 2006 S.C.C. 28. Different issues in this case were heard by the British Columbia Court of Appeal on three separate occasions over a period of ten years. Ultimately the question for the Supreme Court was whether pension plan members could join together to terminate a pension plan trust and become entitled to a distribution of surplus assets. There is a rule in the common law of trusts, emanating from Britain, called the rule in Saunders v. Vautier under which this may be done. However, the court held that the rule does not apply to pension trusts, except perhaps to very small pension plans.

iii. The Ontario Court of Appeal dealt with an interesting question concerning a duty to communicate pension plan amendments to members of a pension plan when the amendments are still pending: Hembruff v. OMERS [2005] O.J. No. 525. The Board of the Ontario Municipal Employers Retirement System ("OMERS") has a lengthy process by which it amends its pension plan covering 900 participating employers and 300,000 participants. It made some plan improvements, effective January 1, 1999. Some members who retired prior to that date alleged that they should be entitled to the value of the improvements and that OMERS had a duty to communicate the details of the plan amendments even before they had been approved by the OMERS Board and filed with the government. The lower court decided in favour of the plan members. The Court of Appeal overturned the lower court decision. Fortunately now the law in Ontario is that there is no duty on the part of pension plan sponsors to communicate potential plan changes. The court held that this information would be speculative in nature and requiring it to be communicated to members would place an unmanageable burden on sponsors.

Public vs private healthcare

In Canada, basic medical and hospital care is covered by provincial healthcare schemes. Healthcare lies within the provincial jurisdiction and as a result, each province and territory has a slightly different scheme. The available services in each jurisdiction are different in some respects as are the payment mechanisms. As far as the services are concerned, in each province and territory, basic standards must be met, otherwise the province or territory loses the benefit of transfer payments from the federal government. Consequently, as employees in Canada move from province to province, they can expect to receive much the same services.

However, the healthcare system is suffering from budgetary constraints, leading to a shortage of necessary practitioners, facilities and resources. There has been a particular concern with wait times for certain procedures, particularly for diagnostic and surgical procedures. This led to a case that proceeded to the Supreme Court of Canada, Chaoulli v. Quebec 2005 SCC 35. In that case, one plaintiff, Mr. Zeliotis, a resident of Quebec, needed hip replacement surgery and waited a year before receiving treatment. In the interim he made inquiries to obtain private treatment or whether he could purchase private healthcare insurance. Both avenues were prohibited. Dr. Chaoulli, the other plaintiff, had been providing private medical care from his home and requested the right to establish a private hospital. His request was denied.

The Supreme Court of Canada ruled that Quebec's ban on private insurance for publicly insured health services violates the Quebec Charter of Rights and Freedoms. A minority of judges also ruled that the ban violates the Charter of Rights and Freedoms, a constitutional bill of rights that binds all provincial governments and the federal government. A ban on such insurance in the circumstances that existed in Quebec, namely, unwarranted wait times for certain procedures, was said to infringe Charter rights. The decision is complex because it deals with both provincial and federal legislation. The outcome, however, is that the controversy concerning the ability to establish a second tier of private health care services has grown across Canada. The provision of public health care in Canada is viewed by many as sacrosanct. The debate will continue on several levels: legal, political, social and emotional.

Although there is a major concern with wait times, employers have not been modifying their benefit programs to provide private insurance for publicly insured benefits or to reimburse employees for treatments outside their province of residence or outside the country and the associated travel costs. Employers are more inclined to make such accommodations for senior executives. The additional costs for such services can sometimes be considered a form of rehabilitation and thereby included as part of the employer's disability benefit program. Some employers also administer lucrative spending accounts, available to executives for all manner of benefits, including out of province/country treatments.

Disclosure of executive compensation

As in the US, there has been an increased level of shareholder activism and increased concern by regulatory bodies for scrutiny in respect of levels of executive compensation and the proper disclosure of such compensation. Significant lobbying efforts for increased disclosure have led to the introduction by the Canadian Securities Administrators of corporate governance guidelines and disclosure requirements. These are in relation to executive compensation, including retirement benefits, severance benefits, change-in-control provisions and the linkage between executive pay and corporate performance. Pay for performance is being demanded with increasing frequency.

Stock options

Stock option plans continue to be prevalent in Canada, particularly among the senior ranks of employees. At the same time, there has been some movement toward full-value long-term incentive plans, whether cash plans or equity plans. However, the tax treatment of Restricted Stock Units is unfavourable in Canada. For this reason, while there has been some growth in the use of RSU's as a full-value LTI vehicle, particularly in Canadian subsidiaries of US-based or global companies, the level of growth has not been as aggressive as in the US.

FURTHER INFORMATION AND CONTACTS

This chapter covers selected issues only. For a comprehensive description of all points relevant to compensation and benefits in Canada, please refer to the contributor whose details are below, or contact ius laboris.

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Denmark

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The current scene

Most employee benefits offered in Denmark have traditionally been based on either work-related needs or the fact that the employee held a managerial position that would customarily qualify for such benefits. For these reasons, the major part of employee benefits have traditionally been reserved for specific employee groups, e.g. sales representatives and employees in managerial positions have traditionally been entitled to a company car. At the same time, benefits have been offered as a form of compensation on top of the employee's cash pay components, and so benefits have tended to increase the employer's payroll costs relating to each employee.

But this situation is changing. One of the latest trends in Denmark in respect of compensation and benefits – and probably the most significant – is the introduction of flexible compensation schemes. Until a few years ago, only few employers offered their employees flexible compensation schemes. The speed at which flexible compensation schemes have gained ground within recent years is a result of several factors. One of the most significant factors is that the Danish labour market has experienced a growing struggle to retain and recruit the right employees owing to the steadily increasing need for labour. Further, owing to the high level of satisfaction among employees normally generated by the flexible compensation schemes, the schemes tend to be seen as a positive retention and recruitment tool.

This chapter describes the nature of flexible compensation schemes currently being used in Denmark. It also focuses on another recent trend, namely the increasing use by employers of stock options (and other equity compensation) as incentive pay and the way stock options are granted. This trend is spurred on by several factors, including the adoption of the Danish Act on Stock Options in 2004 which, amongst other things, stipulates employees' rights to stock options in case of termination. Finally, this chapter briefly highlights a few issues regarding the taxation of stock options and other equity compensation, and retirement benefits.

Flexible compensation schemes

In principle, flexible compensation schemes make it possible to offer all employees an opportunity to receive benefits without increasing the payroll costs relating to the individual employee; the reason being that flexible compensation provides the employees with an opportunity to "buy" one or more benefits by giving up part of their cash pay.

In Denmark, employee benefits are in principle taxed in the same way as cash pay, and the tax value of benefits is as a general rule fixed as the employer's actual costs relating to the benefits in question. Thus, from a financial viewpoint, flexible compensation is more attractive to the employees if it gives them the possibility to "buy" one or more of those benefits that are either exempt from taxation or that are – or may in practice be – subject to a lower tax than cash pay. The financial advantage is gained by the employees' "buying" tax-privileged benefits against accepting a reduction in their pre-tax cash pay.

The high level of satisfaction among the employees is not only based on the possibility to optimise the net value of their salaries; it is also a consequence of the ability to put together a pay package matching the employee's individual needs and wishes. In that way, flexible compensation also conforms to the growing tendency that employees demand and expect individuality and flexibility in their employment. In addition, flexible compensation schemes make it possible to make the value of benefits more visible.

The Danish tax authorities have previously established a number of conditions that should be fulfilled in order to approve a flexible compensation scheme from a tax point of view. These conditions entailed many inappropriate limitations on what could be agreed upon and included in flexible compensation schemes. The conditions were also ambiguous, which in practice created a risk that a flexible compensation scheme would not be approved from a tax point of view.

However, especially within the past year, the tax authorities have modified the conditions. Thus, now it is usually possible to establish flexible compensation schemes fulfilling the conditions under Danish tax law and which are consistent with both the employer's and the employees' interests. This has led to intensified use of flexible compensation schemes.

The tax-privileged benefits that are most often part of flexible compensation schemes are: data communication connection (ADSL connection or similar) at the employee's home; company car; transportation between home and workplace using public transport; telephone expenses (home landline telephone and/or mobile telephone) up to an agreed maximum; parking space for use at work; private health insurance as a supplement to/substitute for the public health service; shares, including free shares and favourable price shares, up to a certain value; and employee bonds up to a certain value.

In addition to the tax-privileged benefits, some employers offer, as part of a flexible compensation scheme, a choice between one or more of the benefits that are taxed as cash pay. Such an option is often motivated by a wish to ease the daily lives of the employees, for instance by offering them dry cleaning services. There is also an increasing tendency towards giving the employees the opportunity through flexible compensation schemes partly to "buy" a higher pension contribution (normally fully tax exempt) or "sell" a part of their pension contribution against receiving cash pay instead - or "buying" or "selling" paid holidays.

When an employer sets up a flexible compensation scheme or expands an existing scheme, it is important to ensure not only that the tax rules are fulfilled, but also that the flexible compensation scheme is compatible with any collective agreement that may apply. Further, it is important to prepare an addendum to the individual employment contracts specifying the individual pay components received by the employees as part of the flexible compensation scheme as well as a policy on the flexible compensation scheme specifying the terms and conditions to which the scheme and the individual pay components are subject. This is a requirement both with regard to the employer's obligations under the Danish Act on Employment Contracts and with regard to ensuring the easy and simple administration of a flexible compensation scheme.

Stock options

When an employee has been granted stock options (or other equity compensation) as part of the employment relationship, the stock option plan will normally have contained provisions stipulating that in case of termination of the employment relationship – depending on the reason for the termination – the employee will either forfeit his/her rights to the stock options or only have a right to exercise vested stock options within a short exercise period, usually 3 months.

In the years leading up to 2004, a number of judgments established that such lapse clauses were void, on the basis of legislation protecting employees' entitlement to remuneration on termination of employment. Due to these judgments, Danish employers became very reluctant to grant stock options to employees, save for employees who were *de facto* managing directors (not only by title).

As a consequence of the judgments and the controversy they brought on, the Danish Act on Stock Options was adopted in 2004. The Act, which governs stock options (and a few other kinds of equity based compensation) granted on or after 1 July 2004, applies to all employees with the exception of employees who are *de facto* managing directors.

Sections 4 and 5 of the Act include provisions on employees' entitlement to stock options in case of termination of employment. These provisions give an employee the rights set out below, unless more favourable provisions are set out in the stock option plan.

The employee will <u>retain the right to exercise any stock options</u> granted to him/her on the same conditions as had the employee still been employed, if employment is terminated as a result of:

- the employer giving notice of termination without such termination being a result of breach on the part of the employee;
- the employee's resignation without notice owing to a material breach on the part of the employer;
- the employee's reaching the retirement age applicable to the trade or the employing company in question; or
- the employee's qualifying for state pension or retirement pension from the employing company.

The employee will also maintain, based on the employees' period of employment during the financial year, the right to a pro-rated part of stock option grants that the employee would have received if employed by the end of the financial year or at the date of grant.

The employee will <u>forfeit the right to exercise any stock options</u> granted to him/her, if employment is terminated as a result of:

- the employee's resignation owing to reasons other than those referred to above;
- the employer's termination of the employment relationship owing to a breach on the part of the employee; or
- the employer's summary dismissal of the employee owing to a material breach on the part of the employee.

Further, in these cases the employee also forfeits the right to receive stock options granted after the employment has been terminated.

The provisions referred to above were introduced as an attempt to find a compromise between the interests of employers and of employees, although employers tended to consider that the provisions were still too favourable for employees, and they continued to be somewhat reluctant to grant stock options to employees covered by the Act. That said, employers seem to have increased their use of stock options as incentive pay over the past year. The use of stock options is, however, still not at a level comparable to that of the years 2000-2002.

Further, there seems to be a growing tendency towards changing the way in which stock options are granted. Where the number of stock options to be granted to an employee was traditionally granted up front and usually on the condition that the options would vest over a specified number of years, for example over a period of 4 years with ¼ each year, some employers now grant stock options in such a way that the employee receives – on such date as would traditionally have been the date of grant - a promise that the employee will be granted the relevant number of stock options over a specified number of years, for example over a period of 4 years with ¼ each year.

This "new" way of granting stock options is based on the fact that when determining employees' right to stock options in case of termination of employment, the Act on Stock Options focuses on the date of grant and not on whether the stock options have vested at the effective date of termination.

If the "new" way of granting stock options is used, and if the employment relationship is terminated for one of the reasons entitling the employee to retain all rights to stock options granted to him, it will presumably - in comparison with the traditional way of granting stock options - be possible to limit the number of stock options that the employee may still exercise.

With respect of those employers applying the "new" way of granting stock options, there seems also to be a growing tendency to make the grant of stock options contingent on the employees' compliance with various individual performance criteria. When applying such performance criteria, it is often possible to further limit the number of stock options to which dismissed employees are entitled in case the dismissals are based on unsatisfactory performance and thus non-compliance with the performance criteria.

If an employer is considering granting equity-based compensation other than stock options, it is advisable to clarify whether the equity compensation is subject to the Act on Stock Options. If it is not, the employees may have better rights in case of termination of employment on the basis of other legislation than those rights bestowed by the Act on Stock Options.

When an employer grants equity compensation that is subject to the Act on Stock Options, within one month after the grant the employer is obliged to provide the employees with a separate statement in Danish regarding certain information about equity compensation granted. If the employer does not comply with this obligation, the employees are entitled to a financial compensation, which will likely be between DKK 5,000 and DKK 10,000 per employee making a claim for compensation.

The above also applies where stock options (and other equity compensation) are being granted by the employer's parent company. In such a situation, the employer will be liable to comply with the employees' rights to stock options granted, including the rights upon termination of employment.

The time of taxation of stock options and other equity compensation

This area is regulated by the Danish Tax Assessment Act. Where an employee is granted stock options as remuneration, liability to pay tax does normally not arise until the time the employee exercises the stock options and either acquires shares or, by differential settlement, receives a cash payment. However, if various conditions are complied with, liability to pay tax does not arise until the employee disposes of the shares purchased by exercise of the stock options.

The above may also apply to grants of other kinds of equity compensation. However, in such cases e.g. restricted stocks, a risk exists that liability to pay tax arises at the time of grant even though the employee's right to dispose of the equity compensation is subject to a vesting period. Here, the employee may have problems in paying the tax and this may cause problems in the relationship between the employer and the employee. Thus, if an employer contemplates granting equity compensation other than stock options, it is advisable to clarify the time when it is subject to tax liability.

Retirement benefits

It is normal that an employer establishes a private pension scheme in a pension insurance company for the employees and that, on top the cash salary (fixed and/or variable salary), the employer pays a pension contribution to the employees' private pension schemes in an amount of between 8 – 12 % of the cash salary. In such a situation, the employees normally pay an employee pension contribution equalling one half of the employer pension contribution with the effect that total contribution amounts to 12 – 18 % of the cash salary.

With this type of pension scheme, the employer has no further obligations than the obligation to pay the agreed employer contribution during the employment relationship.

When an employee is dismissed, it is often agreed that the severance pay to which the employee is entitled, if any, will be paid into the pension scheme. This applies in particular where the dismissal is based on the employee's retirement.

Provided that the pension scheme complies with certain conditions (that normally can and are complied with) any such pension contributions are – without limitation – fully tax exempted.

FURTHER INFORMATION AND CONTACTS

This chapter covers selected issues only. For a comprehensive description of all points relevant to compensation and benefits in Denmark, please refer to the contributor whose details are below, or contact ius laboris.

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Finland

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The current scene

Different alternatives exist in Finland to compensate employees in addition to their base salary. Employees can, for example, be offered conventional fringe benefits such as lunch vouchers, car benefit and housing benefit. Newer benefits include sports tickets. Retirement benefits may also be available, particularly to more senior employees. Further, there are numerous means to reward employees through financial participation arrangements, such as profit sharing, sale (or issuance) of shares to employees at a discount and grant of stock options.

In the private sector, the business strategy and vision of the top management are what guides the development of pay systems. Collective bargaining agreements also hold a central position in guiding the development of pay systems. However, due to the fact that the personal income tax percentage of an employee can be as high as 58% and the employer's social security costs are relatively high, tax legislation has the most important impact on compensation and benefits trends.

This chapter identifies current trends in compensation and benefits packages offered by Finnish employers. It also highlights recent changes in social security legislation affecting shares and stock options, and considers a ruling of the Supreme Court. Any reference to percentages or frequency of certain compensation or benefits is based on the survey of the Finnish Work Environment Fund, "How is compensation changing in Finland" (May 2006) and the survey of the Ministry of Labour, "Current Compensation Systems and their Changes" (2005); both surveys include an extensive sample of Finnish large and medium-sized companies.

Multiple elements of compensation

During the last couple of years, pay systems have been developed actively in Finland and employers have implemented new pay systems. In the private sector, the starting point of the progress was in the beginning of the 1990s when the first real steps towards new pay systems were taken.

Commonly, the majority of employees' base salaries are still determined on the basis of their job title or their seniority. However, the recent trend is that there can be multiple pay elements, several different pay systems in use and various practices among different staff groups in an organisation. One example is the so-called "cafeteria plan" which is quite commonly used at the management and executive level. The "cafeteria plan" means that on top of the base salary the employees can choose the benefits they would like to have, or alternatively take the benefits as cash.

Almost half of Finnish companies are using pay systems based on job evaluation and more than half of the companies are using pay systems based on competence or performance evaluations. Performance-related pay systems have been increasingly popular in the private sector since the latter half of the 1990s.

In general, pay systems consisting of base salary and allowance or bonus as part of the salary are increasing and will become more and more popular. Over 50% of companies are using skills-based or competence-based pay as a part of the total salary, and a further increase in results-based and performance-based pay systems is predicted for the future. Such systems are commonly used among management and (upper) white-collar employees. Surveys have reported that results-based pay can add a maximum of 22% to the average annual salary of the top management.

In contrast, contractual salaries as well as a piecework pay and commissions have diminished in every staff group. The use of merit raises and seniority allowances have also been reduced over the past few years.

Fringe benefits

In Finland, a company-paid mobile phone, luncheon vouchers and a broadband connection provided by the employer to the employee are currently the most common fringe benefits. Car benefit and housing benefit are also used, but not as commonly. Car benefit is used mainly as a benefit for management level employees (approximately 58%). Only fewer than 10% of the managers tend to have a housing benefit and in other staff groups it is hardly used at all.

These fringe benefits are usually not regarded as part of the employee's base salary and thus the employer is entitled to compensate the benefits by monetary compensation corresponding to the tax value of the benefit in question. However, it is also possible to agree on a so-called "total salary" (i.e. the "cafeteria plan" mentioned above).

Large employers in particular have additional benefits such as employee canteens, recreational benefits and sports tickets. Flexible working hours are also considered as an additional benefit.

Retirement benefits

Additional voluntary pension benefits are basically used only at the executive level. The recent changes in tax legislation as well as in the retirement age (i.e. flexible retirement age of 63 to 68 instead of the former fixed retirement age of 65) have made voluntary pension arrangements less beneficial for the employees.

Financial benefits

The most common financial benefit used since the middle of the 1990s has been the issuance of shares and employment related stock options to employees. Shares and employment related stock options were originally offered to key managers only, but currently large employers in particular tend to offer stock options to almost their entire staff. Nearly all Finnish listed companies have introduced stock option plans and more than 50 000 employees are participants in such plans.

The issuance of shares and employment related stock options has diminished, to some extent, during the last few years due to the decrease of share values (i.e. the decelerated increase of share values has made stock options less attractive). Instead, new bonus-based compensation systems have been introduced. The recent changes in Finnish tax and social security legislation referred to below will most likely increase the issuance of shares and employment related stock options once again.

The popularity of staff funds regulated by the Act on Staff Funds has increased during the last couple of years. A staff fund refers to a fund owned and controlled

by the staff of a company with the purpose of managing the profit bonus items paid to it by the company and any other assets covered by the Act. The members of a staff fund comprise the entire staff of the company, excluding only the senior management. A staff fund may be established in a company employing at least 30 people or alternatively, in a profit centre of a company, provided that the profit centre has at least ten employees. Further, it is possible to establish a joint staff fund for two or more companies belonging to the same group of companies.

Recent changes in social security legislation

In Finland both the employer and employee take part in financing the social security costs. Salaries and any other additional benefits (such as fringe benefits) that are regarded as compensation for work and thus salary, are subject to the following social security contributions:

1. By the employer: employer's social security contribution, a pension insurance premium, an unemployment insurance premium, an accident insurance premium and a group life insurance premium.

2. By the employee: a sickness insurance premium, pension insurance premium and an unemployment insurance premium.

The total amount of the employer's social security costs vary approximately between 21.6% and 26.8% (in 2006) depending on the size of the company as well as the industry in which the employer is active. The amount of employee contributions varies between 6.98% and 8.08% depending on the age of the employee (in 2006).

Due to changes in legislation at the beginning of 2006, the following financial benefits are no longer regarded as compensation for work and are, thus, not subject to the social security contributions mentioned above:

- Issuance of new shares, provided that the benefit is offered to the majority (i.e. more than 50 percent) of the company's employees.

- Employment related stock options and other employment related compensation, provided that the value of such compensation depends on the growth of the employer company's share value (stock options have already previously been exempted from pension contributions).

- Compensation given in the form of the employer company's (or a company belonging to the same group of companies as the employer) listed shares (or alike) or alternatively, instead of shares, partly or wholly even in cash, provided that the value of such benefit depends on the development of the value of such shares during a certain period of time (not less than one year) after the promise to award the benefit.

However, the above financial benefits are still taxable income for the employee.

Due to the high level of social security contributions in Finland, it is most likely that these exemptions will increase the use of the benefits identified above.

Supreme Court ruling on stock options

Regarding the question of option income as a part of a salary, the Finnish Supreme Court on 18 May 2006 ruled on employment related stock options. The Supreme

Court ruled that employee stock options should be counted as part of the employee's salary when defining the amount of compensation for unlawful termination. The ruling deviates from previous practice, i.e. income arising from employee stock options has not been regarded as the employee's salary when determining the compensation for unlawful termination.

This ruling raises many questions as to whether it may have wider consequences. For example, it raises the question of whether stock option income should be taken into account in other situations, for example:

- when determining compensation on the basis of the employee's salary at the end of employment, such as compensation for accrued but not used vacation days;
- when determining unemployment benefits after the employment relationship has ceased to exist; and
- in transfer of undertaking situations.

If future cases decide that this ruling is applicable in other situations such as those above, then there may be substantial economic consequences for employers and employees.

FURTHER INFORMATION AND CONTACTS

This chapter covers selected issues only. For a comprehensive description of all points relevant to compensation and benefits in Finland, please refer to the contributor whose details are below, or contact ius laboris.

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The current scene

Global corporate trends such as an increasing investment in human resources management and an emphasis on performance-related compensation have impacted on the compensation and benefits scene in Greece, where a number of new practices and trends have emerged.

One of the genuine problems that arises in Greece is the compatibility of the traditional labour law framework with the new practices and trends in the labour market. Based on the rules of modern developed economies, these trends include market flexibility, progressive institution of CSR net's principles, establishment of "wealth accumulation" retirement plans, investment in human resources by compensation based on schemes of "variable pay", emphasis on qualitative elements by dispensation of productivity and efficiency perquisites, bonus plans and other incentives. Inevitably, compensation schemes have incorporated the new enterprising spirit by introducing new objectives and policies which directly link compensation to performance.

The new trends in Greece have initiated from European countries and basically transcribe the Anglo-Saxon financial and marketing schemes, which rely to a certain extent on discretionary compensation. The area of compensation and benefits has already been the subject of case law in Greece, although until now it has not been entirely regulated by specific legislative acts. It still poses a challenge for the Greek legislator in order to provide an "updated" and integral employment protection, especially for those in the private sector. And since the corporate scenery is continually changing, significant modifications of the relevant legislative framework are forthcoming.

This chapter looks at some current issues arising from the following key aspects of compensation and benefits: retirement benefits, multilateral compensation packages, stock options and bonuses. It also highlights the issue of equal treatment in compensation and benefits.

Retirement benefits

The new trend in company retirement plans is towards collective insurance plans, called DAF (Deposit Administration Funds). The aim of these plans is to offer economic advantages not only to the employee by reinforcing the status of his/her main pension, but also to family members in case the employee suffers a disability resulting in inability to work. These retirement plans are commonly accompanied by health and accident plans, and so cover a multitude of needs.

Specifically, two types of collective retirement plans can be found in the insuring market: defined contribution plans and defined benefit plans.

The contributions in defined contribution plans constitute a determined percentage on the annual wage scale or a constant sum, while the time of payment is specified by the employer. At the same time, the employees can take advantage of the possibility not only to participate with individual contributions, but also to invest either in mutual funds or in titles of constant and guaranteed honour (homologues

and accrued bills of the Greek Public). Moreover, there is an individual account for each insured person and the capital to which the person will be entitled at retirement is the total amount of the accumulated contributions and interest in his/her individual account.

These particular plans are widespread owing to their flexibility and their low risk. One major advantage for the employer is that its prospective obligations towards its employees are clearly ascertained.

With defined benefit plans, the contributions are made exclusively by the employer, while the premium, which is an interrelation of the employee's years of service and wages during the past years of his/her career, is calculated by an actuarial study. The premium is converted at the time of retirement under the form of a lump-sum benefit or lifelong pension paid to the employee. These programs reward employees for their contribution in the progress of enterprise. They are particularly flexible and dynamic, because they integrate the possibility of recognition of previous experience of members and the disinflation of the benefits.

Multilateral compensation packages

Increasingly in Greece, new compensation packages are enforced besides the base salary, with elements which vary according to the reward and salary structure that is selected by each company and followed as business strategy. For example, a complete sale compensation plan (where remuneration is related to corporate results) includes:

- Regular Payment (meaning the agreed base salary, which cannot be lower than the statutory amount set by collective agreements and supplemented by benefits such as Holiday/Christmas/Easter allowance, benefit for overnight employment, employment on Sundays, overtime etc.)

- Benefits for special reasons given in return of services such as: bonus of longevity, bonus of service, bonus for difficult working conditions/bad weather, bonus of accountability, family bonus, location allowance, etc.

- Compensation in money or in kind that meets occupational needs: car allowance and driver, housing, allowance for commuting (such as travel expenses), mobile phone etc.

- Incentive plans, used mostly for executives, such as commissions, share options, bonus banking in the sense of wealth accumulation, and other bonuses the payment of which is subject to company's performance against financial targets and the executive's individual performance.

- Severance pay (the amount is assessed as statutory compensation according to the observance of notice period or not, or it can be augmented in case of a specific agreement between the parties).

One of the major changes discernable in the modern sales compensation plans is the establishment of the "variable payment". This new trend tends to replace the common bonus schemes which were based on the discretion of the employer (decisions of each Board Meeting) without focusing on a definite structure referring to the amount paid to the employee (e.g. multiple of the pay at the end of a successful fiscal year).

The main concept of the "variable payment" is based on a different corporate philosophy. The employee aims at the accomplishment of certain "calculable goals", whilst each level of accomplishment is accompanied by a certain level of compensation, already known by the time of completion. The basic advantage of this system is the direct connection of the individual's performance with the compensation and also the transparency of the payroll process. In this way, it has been proved that the benefits for employers are significant: productivity levels rise due to the fact that employees are galvanized to succeed their goals, since the results of their effort are visibly rewarded and depend entirely on their own individual performance. There are sound reasons why this new trend is gradually gaining ground on former financial and other marketing plans, since it is organised diversely and efficiently covers different levels of productivity by providing respective escalation (straight line, accelerating/progressive, decelerating payment) in the payment scheme.

Employee stock plans

Another common practice that has become widespread in Greece over the last few years, in the framework of an incentive policy, is the rewarding of employees through employee stock plans (a stock option or other stock acquisition plan that allows employees to acquire shares or other forms of equity interest or securities under favourable terms).

In principle, it is lawful to offer participation in such plans to employees residing in Greece. No exchange controls apply and there are no relevant restrictions. The vast majority of companies that apply this kind of compensation plan, in particular to senior employees, are Greek subsidiaries or branch offices of foreign companies and multinational companies, aiming to provide further motivation for increasing productivity and at the same time to highlight their corporate status in the internal market.

Stock options are more commonly offered than other stock acquisition plans. Stock options are given to the individual at a pre-defined price and he/she can only exercise them after a period lapses - in other words, the employer does not give the individual the shares, but the right to purchase them by paying the option price and then acquiring the shares.

In any case, the spread (that is, the difference between the stock exchange price of the share and the pre-determined price paid by the employee) is considered taxable income, but is not subject to social security contributions.

The consequences of granting stock options for the calculation of the severance payment have not yet been the subject of case law. However, where the employee has exercised the option and so purchased the stocks, then the monetary value of the stocks will be included for the purposes of the severance payment. Similarly, if the employer makes an unconditional award of stock as part of the employee's remuneration, then the value of the stocks will be included. Calculation of the value can be made in different ways.

Principle of equal treatment

Article 22 of Greek Constitution enshrines the principle of equality. This principle entitles the employee to claim the right to demand from the employer the benefits it gives, voluntarily or even contractually, to other employees of the company who provide the same services under the same labour circumstances in the same position. This principle is also supported by recent case-law (Supreme Court

1217/2005, Supreme Court 1435/2004, Supreme Court 1554/2004), with the effect that employees have the right to fair and equal treatment in relation to all aspects of their employment, including salary, promotion, bonuses and so on.

On the basis of this principle, decisions about compensation plans are necessarily influenced by the existing company practice of levels of compensation and benefits given to employees in comparable jobs and situations. Even in the case of redundancy, if one employee is given a higher amount than the statutory severance payment, then others in the same circumstances may be entitled to claim equal treatment.

Note that the equal treatment principle is not applied in cases where the employer is obliged to give benefits to one or more employees of the same position by law or decision of a Court. Nor is it applied in the case of perquisites given on an illegal basis.

Bonuses

There are two major tendencies in Greece in respect of compensation plans: a) bonuses provided for in the employment contract that are defined in time, extent and content with transparency (such as the “variable payment” or other bonus plans); and b) bonuses granted at the complete employer’s discretion in certain cases (their offer, form and other elements are also at the employer’s discretion). These are gradually being given up due to the significant defects they present.

There are two points of practical importance in respect of bonuses. First, when the company grants a bonus (either in money or in kind) to its employees regularly, uniformly and over a long period, then this is considered to be the company common practice. If so, any modification or cessation of this bonus by the employer is considered to be a unilateral injurious alteration of the employment terms. Therefore, employers should reserve, in writing, the right to change, alter or stop the bonus at any time unilaterally and at their absolute discretion.

Second, all the contractual or discretionary bonuses must be granted with respect to the principle of non-discrimination, equality and fair treatment. This is pursuant to Law No. 3304/2005 which implements Council Directive 2000/43/EC implementing the principle of equal treatment between persons irrespective of racial or ethnic origin.

FURTHER INFORMATION AND CONTACTS

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Mexico

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The current scene

In Mexico, trends in compensation and benefits tend to be driven primarily by changes in tax and social security laws. For example, the benefits that have been undergoing the most significant changes are those which are understood as “social welfare”. This concept has been changing over time in accordance with tax legislation in respect of allowable deductions, and as the law changes, so too do the compensation and benefits packages offered to employees.

Certain external factors have also been instrumental in forming compensation and benefits trends and have caused substantial changes in labour relationships in Mexico. The primary factor is the entry into effect of NAFTA, in whose introductory chapter the governments of Canada, Mexico and the US agreed to protect, enhance and strengthen basic worker rights. The objectives of the Labour Agreement of NAFTA include the improvement of labour conditions and of the standard of living in each of the countries, and the promotion of specified labour principles such as the right to collective bargaining, minimum labour conditions and the elimination of employment discrimination.

NAFTA’s opening of the Mexican market, along with its accompanying labour agreement, have affected the Mexican labour market in ways not contemplated by the Mexican Federal Labour Law. Labour relationships in Mexico have been undergoing modifications in accordance with the normal impulses of market forces, and from the impetus of US and Canadian subsidiaries doing business in Mexico, which tend to use the internal policies of their parent companies.

A second external factor influencing the direction of labour matters in Mexico are the changes in the global market, including commercial practices, consumer demand and influences arising from the ILO and the OECD. Concepts such as the corporate social responsibility movement, which is gaining strength in the Mexican labour market, are also having an influence on the area of compensation and benefits.

This chapter addresses the main components of compensation in Mexico, and looks specifically at issues relating to bonuses and stock purchase awards. It also highlights the increasing popularity of the use of “Flex plans”. Finally, the chapter looks at the changing concept of “social welfare” in the context of tax law and the implications this has for compensation and benefits packages.

Major components of compensation

The Mexican Federal Labour Law stipulates certain un-waivable mandatory benefits for employees. Besides base salary, the mandatory elements of compensation are: Christmas bonus (15 days of base salary), vacation (6 days of base salary for the first year of service), vacation premium (25% of base salary for vacation time) and Sunday premium (25% of base salary for those employees who render their services on Sundays).

There are other benefits which employers may grant to employees if they wish to, for example benefits which exceed the legal minimums (such as 10 vacation days for the first year of services rather than the 6 legally required days), benefits

granted as social welfare (such as food coupons) and those granted as incentives (such as bonuses).

The tendency in Mexico is to divide employee remuneration into fixed and variable categories.

- The fixed category is basically composed of those elements which are clearly identifiable from the first day of hiring date, such as base salary, Christmas bonus, vacations, vacation premium and, in some cases, savings fund and food coupons.
- The variable category refers to those elements which are variable, depending on specific circumstances, such as bonuses, whether for performance, sales, billing or achievement of goals. These bonuses can be granted on an individual or group basis, and can be regulated in a general manner in the employment agreements, or in a specific manner, through policies applicable to a determined fiscal year.

The implementation of these kinds of bonuses in individual employment agreements is carried out through general clauses, which reserve to the employer the right to modify, expand, restrict or even suspend the payment of said bonuses.

Depending on the nature and duties of the employee's position, other elements may form part of the employee's compensation, such as car, rental of home, payment of moving expenses, life insurance, medical expenses, and stock options. These kinds of benefits are usually granted to employees in management positions.

Stock purchase plans

One tendency which is gradually taking hold in the Mexican labour field is that employees are being allowed to purchase stocks of the company where they render their services, which instils a greater sense of commitment in the employees towards their employer. Stock purchase plans are generally offered only to upper management positions, and constitute a benefit limited to large employers who compete in the international market.

Under Mexican tax law, income derived by an individual who has exercised an option to purchase stock or securities at a lower price than that prevailing in the market, is treated as salary. As a result, the employer is required to withhold the income tax resulted in connection with income earned due to the exercise of stock options. In this case, the income is the difference between the market value of the shares and the price established when the option is granted.

In addition, those making payments for salaries must file, no later than February 15 of each year, a report with respect to the persons who have exercised their option to purchase stock or securities free of cost or at a lower price than the market value during the preceding fiscal year, as provided by the general rules issued by the Tax Administration Service.

Trends in bonuses

As mentioned above, employers are currently granting various kinds of performance-related bonuses to their employees. These are based either on personal performance or productivity, which are mostly granted on a discretionary basis, or on the achievement of specific goals, sales or billing, which are granted on an objective basis. Such bonuses are managed both through incentive plans and through individual employment agreements. Their main purpose is to motivate

employees to raise their performance to a standard which meets the company's expectations.

Due to the history of a strong trade union presence in Mexico, it is usual that in the negotiation of benefits for collective bargaining agreements, bonuses are based on general principles such as attendance, punctuality and personal performance. In light of the complexity for some employers in the administration of such bonuses, many have switched to cash bonuses or have established bonuses which effectively have as their purpose the motivation of individual or group production, through the establishment of goal-based bonuses.

Flex plans

As mentioned above, external factors such as NAFTA and global market forces have influenced changes in compensation and benefits packages in Mexico. One clear example is the "Flex plan". This form of granting compensation and benefits is a leading area of change in Mexico at present. The introduction of the Flex plan is enabling compensation to become more closely oriented toward the individual needs of each employee. The Flex plan allows employers to offer employees more options regarding the variable elements of their compensation.

The interesting point here is that compensation can respond to the specific needs of both the employer and the employee. For example, if an employer usually grants to its employees the option of payment their children's tuition, those employees who do not have children derive no benefit. The Flex concept allows employees to exchange such a benefit for another one, as long as the legal minimum requirements are met.

The benefits which are generally included in the Flex plan are: Christmas bonus, vacations, vacation premium, medical insurance, life insurance, tuition, car allowances, pension plans and food coupons.

Changing concept of "social welfare"

Changes in the granting of benefits and compensation in Mexico are directly influenced by amendments to the tax and social security laws. One of the most important tendencies in the tax area has been the change provoked by a decision of the National Supreme Court regarding what is understood as "social welfare", in the context of allowing deductions from taxes of benefits.

In the past, the concept of "social welfare" allowed employers to grant to their employees boxes of basic necessities, such as milk, rice, beans, etc. Subsequently, employers reached agreements with stores who would then deliver these types of basic products to the employer's employees.

Currently, what employers do is grant food coupons, with which employees can go themselves to stores and buy basic items, as well as any other product they desire. Along with the creation of food coupons, has come the growth of an administrative business devoted to dealing with the issue of such coupons. A current development is that stores are issuing cards which employers then grant to their employees so that they can buy whatever items they want, whether related to basic needs or not.

The definition of social welfare currently set forth in the Mexican tax laws is extremely broad and includes disbursements made to employees in general, taking into account three main aspects: satisfaction of contingencies or necessities;

granting of benefits which tend toward physical, social, economic or cultural improvement; and granting of benefits to improve the quality of life of the employee and his or her family. These terms permit a very broad application.

Employers are however limited to the amount of social welfare costs in order to allow a tax deduction. The tax law stipulates that in order for an employer to be able to deduct social welfare costs from taxes, their amount must not exceed certain percentages of the employee's salary (e.g. saving funds – 13% annualised). Regarding other social welfare benefits, their total amount must not exceed the total of ten times the minimum annual wage. (Minimum wage in Mexico City is MX$48.67 pesos, which is equivalent to approximately US$5 American dollars – thus the annual amount for a minimum wage would be MX$177,645.50, equivalent to US$16,150.00.) In addition, the social welfare benefits must be granted to all employees of the employer.

FURTHER INFORMATION AND CONTACTS

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The current scene

This area remains underdeveloped in the Slovak Republic. Where compensation and benefits schemes do exist, they are usually available to managerial employees only. There is little regulation of compensation and benefit schemes, and the legal framework for compensation and benefits contained in the Labour Code is still under development, drawing inspiration from other countries' legislation and standards, especially from EU members.

Tax and social security legislation that, to a certain extent, regulates the tax regime of compensation and benefits is amended on a frequent basis, and so it is difficult to discern any particular trends. However, due to the membership of the Slovak Republic in the EU, it can be expected that Slovak laws will continue to be approximated with EU standards in the near future.

This chapter identifies the main points of which employers should be aware when considering compensation and benefits packages in the Slovak Republic.

Decisions about compensation and benefits

An employee's gross salary consists of a base salary with the possibility to include some variable compensation. This extra compensation is awarded only

- upon an employer's decision, or
- might be agreed in advance in the employment contract or collective agreement (based on the fulfilment of certain business criteria, such as turnover).

The decision to offer extra compensation and benefits, or incentive compensation, is at the discretion of the employer (although as mentioned below, the Labour Code does contain provisions for certain circumstances). A decision to grant incentive compensation or whatever kind of benefits and/or compensation is governed by the principle of non-discrimination, i.e. an employer is obliged to observe the principle of equal treatment, and base its decision on objective grounds.

The Slovak Labour Code (Act No. 311/2001 Coll.) does set some conditions (e.g. overtime work, holiday work, night work, and work in a harmful environment) under which extra compensation is mandatory and must be paid. The minimum amount for such mandatory extra compensation is also stipulated in the Labour Code. A more favourable rate may be agreed in a collective agreement, as well as in an employment contract.

An employer is entitled to grant its employees compensation in the event of an employee's work anniversary or birthday; however, such benefits are discretionary on the part of the employer.

Although the employer may set any reason for conferring incentive compensation on its employees (provided that it observes the principle of equal treatment), the most common reason is to distribute incentives based on employee performance.

Companies in the Slovak Republic generally use a discretionary basis for setting the standards and criteria for the distribution of incentives. It is up to each company what standards are set, and there are currently no identifiable trends in the standards used by employers.

Equity compensation incentives (stock options, restricted stock, etc.)

Until December 31, 2001 there was a special type of employee stock regulated by the Commercial Code. Employee stocks were assigned to an employee and could only be obtained by, or sold to, the retired employees of the company. Employers who decided to issue employee stocks also decided what preferential rates would apply to them. But employee stock ceased to exist as of January 1, 2002. The employer, however, may still provide its employees preferential conditions for acquiring company shares.

It is not uncommon for an employer to provide shares to its employees at preferential rates. Usually, an employee's entitlement to a certain number of stocks depends on the employee's salary achieved over a certain period, e.g. in the past year. But again the concrete terms for the acquisition of shares by employees are up to the employer, and there is no law stipulating any applicable limits.

For tax purposes, the value of the employee option is subject to taxation since it is considered as employee income (Section 5/3/b of the Act No. 595/2003 Coll. on Income Taxes). The value of the employee option for tax purposes is calculated as the difference between the real-market value of the stock during the first days when the option was taken and the price offered to the employee, guaranteed by the option, minus the amount paid by the employee to purchase the option.

Use of perquisites as incentive compensation

Before the collapse of communism in 1989, perquisites (such as loans for newly married couples) were commonly used by employers – state enterprises or public authorities. However, the political situation and social conditions were substantially different to those at present. After the liberalization of the economy, it is now up to the employer what kind of perquisites will be provided to employees.

Today, perquisites are mostly used for employees in managerial and administrative positions and might take on different forms, depending on the company's profitability or social programs. The company might design its own social program; in most cases the social program includes various employee benefits which are granted above obligatory standards stipulated by labour legislation. This might include various employee benefits, such as dinner for employees, language courses, sports events and weekend programs for employees and their family members.

It is common that a managerial employee can use a company car for both business and personal purposes. According to the tax law the use of a company car is considered as an employee's non-monetary income; therefore, the employee is obliged to pay for using the company car for personal reasons (but the taxation is quite advantageous for the employee).

Housing allowances are not common in the Slovak Republic, but if such a program exists with the employer, it applies mostly to managerial positions and employees from abroad (expatriates). A housing allowance is mostly provided by large companies that need to attract qualified employees from different parts of the state.

An employer might contribute to its employee's life insurance and special-purpose savings. These contributions are a tax-deductible expense for the employer in the maximum amount of 6% of the employee's gross salary.

Use of holiday residencies, health programs, educational courses, sports programs or pre-school facilities are all benefits which are not subject to income taxation for the employee.

Retirement/pension benefits

The pension scheme was reformed in the Slovak Republic. Currently, the Slovak pension scheme consists of three pillars:

1. Compulsory first continuous pillar (organised by the Social Security Insurance Company);
2. Capitalization pillar (organised by commercial licensed insurance companies);
3. Voluntary pension saving scheme.

The state pension scheme is based on obligatory contributions from every employee and employer as part of social security contributions. All employees must participate in the first pillar. In addition, employees who started working as of 1 January 2005 have an obligation to participate in the second pillar. Other employees might have decided whether they stayed in the first pillar or whether they also took part in the second pillar (they could do so only until 30 June 2006).

The obligatory contributions for the state pension scheme amount to 18% and are divided between the employees and employer (employee: 4%, employer: 14%). If an employee takes part only in the first pillar, all contributions are paid to the Social Security Insurance Company. On the other hand, if an employee also takes part in the second pillar, the contributions are divided between the first pillar (9%) and second pillar (9%).

Participation in the third pillar is voluntary. In addition to the first two pillars (the obligatory state pension scheme), an employer may make tax-deductible contributions to its employees' pension savings in the same way as it can make contributions to life insurance or to special-purpose savings accounts. However, such contributions can be no more than 6% of the employees' total salary and wage compensation in order to be considered a tax-deductible expense of the employer.

Social Fund

An employer is obliged to create and contribute to a fund called the Social Fund. The Social Fund can only be used for the purposes specified by law: (i) travel-related expenses for an employee whose salary does not reach approximately USD 350, provided that his/her monthly travel-related expenses are at least approximately USD 7, (ii) providing meals to the employees (above the minimum standards set in the Labour Code), (iii) contributions for employee regeneration and recovery, and (iv) contributions to a voluntary pension scheme. If there is a collective agreement concluded at the employer, there also might be other criteria agreed upon for the use of the Social Fund.

An employer's contribution to the Social Fund depends on the base that is calculated from the total sum of all of the employees' gross salaries. An employer is obliged to contribute a sum of 0.6 – 1.0% of the base. In addition to the obligatory contributions, a collective agreement might state that the contributions to the Social Fund will be increased by 0.5% of the base. An employee's income

from the Social Fund is subject to taxation. However, the contributions to the Social Fund do not pertain to social security funds.

Disclosure of compensation

No legal regulation exists that requires an employer to disclose information relating to the range of the salaries it pays to its employees. Nor does the current law stipulate any reporting requirements for incentive schemes, even in the case of listed companies.

Information about remuneration is considered an individual's personal data and is therefore protected by the Act on Personal Data Protection (Act No. 428/2002 Coll.). That said, there are some exceptions whereby the law obliges certain companies to disclose the salaries of the members of the boards of directors, such as with pension insurance companies, which must inform the National Bank of Slovakia of the salaries they pay to the members of the board of directors. Additionally, the director and members of the board of state undertakings must disclose their salaries (including the information on the amount of profit sharing) in their Annual Reports.

FURTHER INFORMATION AND CONTACTS

This chapter covers selected issues only. For a comprehensive description of all points relevant to compensation and benefits in the Slovak Republic, please refer to the contributor whose details are below, or contact ius laboris.

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Sweden

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The current scene

During the last decade in Sweden, employers have increasingly used different kinds of equity compensation in order to motivate and retain their employees.

From an international perspective, Swedish taxes on labour are high. By law, employers must pay an employment payroll tax of 32,82% on the employee's gross earnings. The employee in turn pays income tax at rates ranging from 28,9 to 34,04%. On taxable earnings above SEK 291,800 (EUR 31,720), another 20% rate is added, and above SEK 441,300 (EUR 47,970) another 5%.

The elevated taxes on labour are burdensome not only for the employer but also for the employee. Thus, equity based compensation, which is taxed at a lower level or in a more generous manner, is often viewed as an attractive alternative to regular salary or bonus.

During the boom of IT industry, foreign-based companies especially from the US gave a strong impetus to the proliferation of equity-based compensation outside the management group. Nowadays, equity based compensation is used all over the private sector of the labour market. However, the lion's share of equity-based programmes is still found in start-up companies and publicly listed companies, and still tends to be offered only to upper-level employees.

This chapter focuses on the tax treatment of stock options, and also looks briefly at pension benefits.

Tax treatment of stock options

In principle, there are two major kinds of options that can be granted to employees: employee stock options ("personaloptioner") or stock options ("optioner som är värdepapper").

An employee stock option is an option for the holder to purchase a share at a fixed price at a certain date in the future. The employee may not transfer or in any other way dispose of the option and the right to exercise the option will be forfeited if the employee leaves the employment. Since the employee stock option is not transferable, it does not give rise to any taxation when it is issued. However, when the option is exercised the employee is liable to pay income tax for the difference between the exercise price and the value of the share. The employer is liable to pay payroll taxes on the same amount. If the exercise price exceeds the market price at the exercise date the employee will naturally not use the option and the event will not bring about any tax consequences.

For the employee, the main advantage with employee stock options (compared to stock options) is that taxation of the benefit is postponed and that it does not trigger any taxation obligation if it becomes worthless. The down sides are that the whole value increase is taxed as salary with up to 57% and that the employee becomes tied to the employer.

For the employer the main advantage is that the employee gets a strong incentive to remain in employment. The down side is that the employer will be liable to pay payroll tax on a value increase, which may be very difficult to forecast.

If the stock option is transferable it will be regarded as a security ("option som är värdepapper). If the stock option is granted at favourable terms i.e. below market value the benefit will be regarded and taxed as salary. Any future increase in value will be taxed as a capital gain for which the employee will be taxed at a flat rate of 30%.

For the employee, the main advantage with stock options (compared to employee stock options) is that the value increase is taxed at a lower level (30%) than an employee stock option (57%). The down side is that the employee may be exposed to a capital loss if the value of the option decreases.

The main advantage for the employer is that it is not liable to pay payroll taxes on the value increase. The down side is that the employee has less incentive to remain in employment since a termination will not result in the options being forfeited.

Pension benefits

Sweden was one of the first countries in Europe to reform its state pension system, which was done in 1999. In the new pension system, the linkage between lifetime income and pension is much clearer than in the former pension system. Another main feature of the new pension system is that it includes a right for the employee (for part of the pension entitlement) to choose the pension fund that best suits his or her investment preferences. The new Swedish pension system is often referred to as an example that pension reforms and privatization are sound solutions to the pressing problems that are created by an increasingly older population.

In addition to the state pension, employees are normally covered by occupational pension schemes ("OPCs") which are governed either by collective agreements or individual agreements. Within the private sector, the dominating OPC for white collar employees is the ITP plan. For employees born before 1979, the ITP plan is a defined benefit plan with certain elements of flexibility for employees with higher salaries to freely invest a part of the pension contribution in, for example, unit-link funds.

The fact that both the state pension and OPCs include elements of personal choice between different pension funds has brought about a major boom in the pension industry. At present there is fierce competition between banks, insurance companies and pension advisers. The tendency is that the number of products on the market is increasing while the fees and other costs related to the pension schemes are decreasing.

FURTHER INFORMATION AND CONTACTS

This chapter covers selected issues only. For a comprehensive description of all points relevant to compensation and benefits in Sweden, please refer to the contributor whose details are below, or contact ius laboris.

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The current scene

Employee compensation schemes have developed rapidly over the past few years in Switzerland. This holds true both for the levels as for the components of compensation. Many multinational groups of companies, especially quite a few which are US-based, have regional headquarters in Switzerland and steer business activities in Europe, Africa, Middle East and sometimes even Far East from Switzerland. Many Swiss companies, especially large financial services groups like UBS, Credit Suisse, Zurich Financial and Swiss Re do business globally and are forced to adapt to global and predominantly US compensation standards if they want to remain attractive in the labour market for key talent. Compensation for the most senior managers has exploded very much here as it has in the US.

As this chapter will show, changes in tax laws, security laws, labour laws as well as company laws have had and shall in the near future have considerable impacts on the structuring of employee compensation in Switzerland. Although Switzerland is rightly perceived as very liberal in the regulation of its workforce, there are certain pitfalls of which employers should be aware. This chapter highlights some of the major ones.

Fixed versus variable pay

Employers in Switzerland tend to minimize the fixed part of the employee compensation and increase the variable part, which can consist of a cash payment (bonus), employee stock option awards, employee share purchase programmes or contribution to pension schemes. Disputes often arise at the end of an employment because employers try to reduce payments for the last service year or during the notice period to the guaranteed fixed salary payment.

However, courts have increasingly held that employees are entitled to payments irrespective of whether such payments are earmarked as “fixed” or “variable”, if and to the extent such payments form a considerable part (more than one fifth) of overall compensation. Even contractual clauses explicitly stating in individual employment agreements that no variable pay is due where the due date for payment falls within the notice period (which is often six or even twelve or more months for senior people) or after the end of the employment are declared void.

If cash bonus payments are made repeatedly (for three or more consecutive years), every single payment has to be clearly defined as variable and discretionary. It is not sufficient to foresee in employment contracts, employee handbooks or the like that bonus is discretionary. Even if marked as discretionary, bonuses that are paid regularly risk becoming part of the fixed base salary. Bonus may be defined depending on overall company results or personal performance of the employee but if the discretionary bonus is also paid in years of poor results or low performance, it will in future be considered as part of the fixed salary and will be due even after termination.

Compensation in kind

Another interesting legal development is a decision by the federal Supreme Court which held that it might not be lawful to allocate more than a certain percentage of the guaranteed income to the employee in the form of (employer) stock. The

decision is based on an old industrial rule of law on prohibition of paying wages in the form of goods or services instead of money (truck act), but the court explicitly stated that this also applies to senior managers. The final meaning of this recent practice is not yet clear.

Taxation of stock options and stock

There has been a considerable uncertainty and instability with respect to taxation of allocation of stock and taxation of the grant of stock options. To a certain extent, the source of the problems was that income and wealth taxation in Switzerland follows the federalist structure and is in the competence of the cantons. New federal tax harmonisation legislation has now resulted in important clarifications.

Stock allocation is taxed when the employee acquires a definitive acquisition right. Blocking periods (i.e. periods during which the employee must not sell his/her stock) are taken into account by discounting the tax value of the stock (basically at a rate of 6% per year).

Stock options are now also taxed at date of irrevocable acquisition, which can be date of grant or date of vesting, depending on the specific rules of the stock option plan.

Stock Exchange regulatory aspects

Companies that offer stock to their employees have to publish offering prospectuses if the circle of the addressees of such offering is not limited. The circle is considered “not limited” if twenty or more persons are concerned. This obligation also applies where Swiss employees are offered to participate in a stock offering of a foreign (mother) company of their Swiss employer. It is important to note in this context that a prospectus prepared in compliance with the legislation applicable at the domicile of the foreign issuer is not in itself sufficient; Swiss stock regulations have to be observed.

Disclosure obligations

From January 1, 2007, new legislation on compensation transparency enters into force with detailed obligations to publish any kind of compensation paid to members of the board of directors, members of the executive board, members of advisory boards, their relatives, and to a certain extent former members of corporate bodies, if the company stock is listed. The rules differentiate between the bodies concerned and the function of the recipient of the compensation. The reporting obligation applies to e.g. salary, cash bonus, stock, options, loans or guarantees of any kind.

In addition, the federal government is working on a legislative project (not yet in parliament) that plans to introduce some (less strict) transparency obligations with respect to non-listed companies.

Retirement benefits

Under Swiss law, payments by the employer into a company pension fund on behalf of the employee are not taxable or, if made by the employee out of his/her salary may, to a certain extent, be deducted from the taxable salary. Such payments have been made in the recent past in very large amounts (two and three digit million figures) and have been therefore widely been perceived as abusive. New

legislation introduced in 2006 has now put a cap at a maximum CHF 774'000 per year.

New salary statement

A new salary statement developed by the federal tax authorities in cooperation with the conference of the cantonal tax administrations becomes compulsory in 2007. It introduces a number of additional reporting requirements and reduces the flexibility in designing tax-preferred elements of compensation.

Sex discrimination

There is not much legislation and even less court law on anti-discrimination in Switzerland. But one very important decision taken by the federal Supreme Court in 2005 has caused quite some discussion. It gave the right to equal pay to a female lawyer on the grounds of a federal law on equal treatment of male and female employees. The claimant, an employee of a Swiss multinational, was awarded considerable additional pay. The decision lists in great detail functions and compensation of a large number of other employees of the company concerned.

Data protection

Swiss data protection legislation prevents the transfer of personal data (such as data on employee compensation) to countries without adequate data protection (for example, the US) absent specific protection such as data processing agreements, adherence to safe harbour policies and individual and explicit consent. This reduces the flexibility to implement compensation models (e.g. ESOP) administered abroad.

FURTHER INFORMATION AND CONTACTS

This chapter covers selected issues only. For a comprehensive description of all points relevant to compensation and benefits in Switzerland, please refer to the contributors whose details are below, or contact ius laboris.

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The current scene

Employers in Turkey tend to value the link between company performance and the level of motivation and confidence that employees have in their financial future. They therefore give importance to employees' "social benefits", which include, for example, health benefits, pension benefits, housing benefits, car allowance and family benefits (marriage grant and child allowance). There are some compulsory social benefits which employees must be provided with, and some benefits which are at the sole discretion of employers.

This chapter aims to give an outline of how employee compensation and benefits operate in Turkey. It focuses on some common types of benefit, both compulsory and discretionary. It explains the important concept of "acquired rights". Finally, the chapter describes the current system for retirement benefits, and highlights that significant reform in the area of retirement and social security is due to take effect in January 2007.

Common types of benefit

There are various types of compensation benefits in Turkey, some of which are compulsory due to the Turkish Labour Law number 4857, and some of which are at the entire discretion of the employer. A selection of benefits is explained below, in order to give a brief overview of how the benefit system functions in Turkey.

First of all, employers in Turkey are obliged to pay overtime salary to their employees. The right to additional salary for overtime work was secured many years ago by the endeavours of the trade unions.

Second, there are certain elements of compensation which, whilst not determined by Turkish labour law and therefore not compulsory, have become common practice. Two examples are private health insurance and lunch meals. In addition, large employers meet the needs of their employees in areas such as transportation.

In terms of discretionary benefits, there is a wide range. Today in Turkey, with the understanding of the importance of satisfaction in social life in the increase of efficiency, many examples exist, such as the granting of free memberships to gyms and free day-schools where employees can leave their children throughout the day.

Other than these, employers commonly provide cars for the use of their top management and other important employees, the expenses of which (including tax) are covered by the employers themselves. Some employers favour their employees, in addition to their general salaries, with bonuses at the end of the year in proportion with the revenues of the company. Moreover, some employers in Turkey, especially some foreign companies, pay double salary to their employees at the end of every third month.

Other discretionary benefits include marriage grant, child allowance and childbirth allowance, which are excluded from the income tax. On the other hand, bayram allowance (religious holiday), fuel oil allowance or transport money for employees are all liable to the income tax.

The social benefits provided by employers to employees are not limited to those mentioned above. Turkish Labour Law and the related legislation do not place limitations on the benefits an employer may provide to its employees. The power to grant these rights belongs to the employer.

Acquired rights

As explained above, Turkish labour law does not limit the benefits that can be provided to employees, and employers have a wide discretion in deciding upon their compensation and benefits strategies. However, employers should be aware of the concept of "acquired rights".

According to the Turkish labour legislation, some rights to benefits are considered as acquired rights. This can include discretionary benefits. Acquired rights are the rights that are specified in the employment contract or in the workplace regulations and that the employer undertakes to grant for the whole of the employment relationship. It is not possible for the employer to withdraw these rights once they are granted. If the employer makes a fundamental change to these rights, it must obtain the written consent of the employee or such changes will not bind the employee.

Certain rights, such as providing employees with lunch in the company dining hall or with meal tickets in order to enable employees have lunch outside of the work place, are considered as acquired rights once they are outlined in the employment contract or workplace regulations. Such rights are not determined by law, so they are specified in the contract as rights affiliated with salary.

On the other hand, if an employer provides its employees with cars while stating that there may be changes throughout the course of the employment relationship, this right does not become a part of the salary and will remain as a right subject to the will of the employer. As we have mentioned before, Turkish Labour Law and related legislation does not use the limited number principle on the subject of social rights and leaves the decision up to the employers.

Retirement benefits

Social Security Institution (SSK – Sosyal Sigortalar Kurumu)

In both the private and public sector, employees who are employed by one or more employers based on a verbal or written employment contract are protected by the Social Security Law ("SSL"). This covers occupational accidents and occupational diseases, old age (retirement) and death risks. Such Social Security is obligatory for anyone who works as an employee under the SSL. According to the related articles of the SSL, being insured is not only a right, but also an obligation for the employees as it is alike for employers. This benefit cannot be waived or be the subject of a transaction.

According to the SSL, employers must pay the employee's monthly insurance premium to the SSK. The insurance premiums represent an amount based upon a certain percentage of the income of the insured employee.

Insured employees, who are also the members of SSK, are entitled to receive the employee pension after they complete their employment period. Such employees should complete the amount of premium days mentioned in SSK's related regulations (7000 working days) and reach the retirement age (58 for women, 61 for men) in order to be entitled with such pension payments. Members of the SSK

also receive medical care from contracted hospitals free of charge and can obtain medicine from contracted pharmacies with a discount price. In addition, the generality principle of social security also protects the employee's family against certain social risks. Therefore, the insured employee's wife and children are included in the group of people that will benefit from the support of the insurance.

Private Pension System (BES – Bireysel Emeklilik Sistemi)

The purpose of the BES is to enable individuals to make secure savings to be used in the years ahead and also arrange and promote such savings. The savings, which are a supplementary accumulation to the social security system, can be paid back – according to the employee's choice - either as a monthly pension payment during his or her lifetime and/or as a lump sum at one time.

Once employees become a part of the BES, they may choose to quit earlier along the way or suspend their payments for a while. The amount of revenue they earn along with the right to retire is dependent on the amount of their payments and the revenue collected through these payments bring.

The main advantages of the BES are that the funds are managed by professionals and so savings can be increased; it secures tax advantages; it enables the employee to plan his/her own retirement and it enables the employee to choose risks and revenues. There are also tax incentives for membership of the BES. If the employer pays on behalf of the employee an amount not exceeding the yearly total of the minimum wage up to 10% of the gross salary, the amount may be subtracted from the employer's income tax base. There is no tax on the appreciations in retirement investment funds, and on retirement, there is no tax taken from 25% of the accumulations, and a 5% withholding tax is applied on the rest. If the employee leaves the job at an earlier stage, a withholding tax of 15% is applied in the first 10 years, and 10% after this.

Social security reform

The Social Security and General Health Insurance Code will come into force on 1 January 2007 and bring about major reform. Currently in Turkey there are 3 social institutions: the Social Security Institution for employees, the Social Security Organisation for artisans and the self-employed, and the Association of Pension Funds for government officers. The new social security system aims to merge the present institutions under one institution, so that the differences in the obligations and rights between the different types of workers will be eliminated and all will have the equal rights and obligations in respect of social security.

This reform will cause a large number of renewals regarding social supports and payments without premiums. For example, job placement and child allowance have come up with the reform for the first time.

FURTHER INFORMATION AND CONTACTS

This chapter covers selected issues only. For a comprehensive description of all points relevant to compensation and benefits in Turkey, please refer to the contributors whose details are below, or contact ius laboris.

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The current scene

Competition for recruiting and retaining key talent in the United Kingdom remains fierce. It is widely recognised by employers that it is necessary to have a competitive remuneration package to attract, retain and motivate staff.

However, increasing cost for employers, demands for flexibility from employees, complex and ever changing tax and employment legislation and growing corporate governance and scrutiny means that the challenge to establish and maintain a competitive remuneration package is constant.

UK remuneration practices are capable of being affected by many different factors such as changes to the tax and pensions legislation, changes to the rules on accounting for share-based payments and the views of institutional investors in the larger listed companies. There have recently been significant changes in all these areas, and this has had a corresponding effect on remuneration practices. Whilst the scale of the recent changes is unlikely to be repeated, remuneration practices will continue to be affected by political, social and economic factors, and practice is constantly evolving.

This chapter looks at the main elements of remuneration packages in the UK, highlighting for each element the main trends and changes in law over the past year.

Salary and benefits

Remuneration packages in the UK have traditionally been structured as salary plus specific benefits in kind such as pension contributions, a company car and private health insurance.

The increasing cost for employers of providing some benefits (in particular private health insurance and critical illness cover) together with changes to the pensions legislation and pressure from employees for greater flexibility and a work life balance has led to a rethinking of the traditional structure.

Current trends

About two-thirds of employers in the UK now offer “flexible benefits” particularly for more junior and middle ranking employees.

With flexible benefits employees are given a cash supplement, which they can effectively “choose” (by means of a salary sacrifice mechanism) to spend on benefits in kind from a wide menu. Typical benefits provided under a flexible benefits package include additional holiday, private health care, dental care, critical illness insurance, travel insurance and additional pension contributions.

In addition to being popular with employees, flexible benefits can significantly reduce tax and social security costs for both the employee and the employer, depending on the type of benefits selected. This is because the rules for taxing benefits in kind can be more generous than the rules for taxing salary.

Bonuses

Discretionary cash bonuses (normally expressed as a percentage of salary) are a common feature of remuneration packages, particularly of senior executives.

The Combined Code on corporate governance (followed by all listed companies) and guidelines issued by institutional investors, require that a significant proportion of executive pay should be performance related. Payment of bonuses is therefore usually dependent on the achievement of personal and/or corporate performance targets.

Current trends

The trend in recent years has been towards:

- An increase in the potential level of annual bonus awards;
- More challenging performance conditions being imposed; and
- A requirement to defer some of the bonus (for example to invest some of the bonus in the form of company shares over say a three year period, sometimes with free matching shares being conditionally awarded by the company).

Changes in law

It has been common practice to seek mechanisms for paying cash bonuses in an income tax and social security efficient way. This has led to bonuses being paid in a variety of forms (e.g. dividends through special purpose vehicle companies).

There have been numerous changes in the tax legislation in an attempt to ensure that income tax and social security is charged on all forms of disguised remuneration. In addition, legislation has been introduced to require disclosure of certain arrangements if one of their main objectives is to avoid tax. The trend in the future therefore is likely to be for bonuses to be paid in cash, albeit on a deferred basis.

Share awards

Compensation in the form of share awards makes up a significant proportion of remuneration packages in the UK with some 3.5m employees owning shares in their employer companies. This is certain to continue for EEA employing groups (see below for non-EEA employing groups) but the changes to the accounting rules for share plans (see below) appear to be causing some companies to abandon or restrict more widely-based plans.

Again, in accordance with the Combined Code, the vesting of share awards is dependent on the satisfaction of performance targets.

Current trends: Share options or LTIPs?

Traditionally, share options have been the most popular form of share award in the UK. Over the last three or four years, however, there has been a move to long-term incentive plans (LTIPs). There are different types of LTIP but the most common are performance share awards (the promise of shares in the future if performance conditions are met) and restricted share awards (the acquisition of shares upfront subject to forfeiture if performance conditions are not met). There are three main reasons for the shift in the balance away from options.

- First, changes in the way in which share options are accounted for in a company's profit and loss account has meant that share options are perceived to be more expensive. Financial Reporting Standard (FRS 20) requires companies to charge the value of share options/awards at the time of grant to be expensed over the vesting period. These rules apply to listed companies for accounting periods beginning on or after 1 January 2005 and from 1 January 2006 for unlisted companies. Before the introduction of these rules options were 'free' in accounting terms.

- Second, institutional investors increasingly view options as focussing the attention of key executives on share price. LTIPs are considered a better means of aligning the interests of executives and employees with those of investors.

- Third, falls in the stock market have resulted in a number of options being underwater (with the exercise price being higher than the market value of the shares under option) which has had a demotivating effect on employees/executives. The effect of volatility has led to an increase in the practice of companies making smaller annual grants as opposed to larger one-off grants.

However, it is highly likely that options will remain a popular tool for incentivising executives and employees. Research indicates that around 25% of FTSE 100 and mid 250 companies operate only an LTIP, with around 40% of FTSE 100 and 20% of mid 250 companies operating both option plans and LTIPs.

Changes in law: non-EEA companies

A significant change in law, which may affect whether non-EEA companies continue to award shares to their EEA staff, is the implementation of the Prospectus Directive.

The Prospectus Directive requires a full prospectus to be published whenever transferable securities with an aggregate value in excess of €2.5m in a 12 month period are offered to the public in the EEA or an application is made for transferable securities to be admitted to trading on a regulated market in the EEA and no exemptions are available. Whilst in most cases EEA listed companies will be exempt from the rules, non-EEA companies will need to publish a prospectus where previously no document, or a shorter document, was required.

A recent survey has suggested that one fifth of non-EEA listed groups are considering amending or abandoning their shares schemes other than for senior executives.

Pensions and retirement benefits

Pensions are an emotive subject in the UK and can be a significant factor for an executive in deciding whether to move from his existing employment or accept new employment.

For employers, the increasing cost of pensions has led a number of employers to close their final salary occupational schemes to new joiners and instead to opt for defined contribution personal pension schemes.

The pension position has been complicated over the years by the tax legislation. Different tax regimes for different types of pensions have resulted in

inconsistencies and anomalies. It is not uncommon for a company to have different executives performing similar roles but each receiving significantly different pension benefits (resulting in a huge variation in the value of their total remuneration packages).

Changes in law

In an attempt to simplify the tax rules for pensions, a new regime was introduced on 6 April 2006. For the majority of employees, the new regime is simpler. However, for high earners and internationally mobile employees the new regime is complex and may result in significant tax charges.

The key features of the new regime are:

- There is no longer any limit on the amount of contributions that can be paid into a UK Revenue registered scheme.

- Tax relief on employee contributions is limited to the individual's relevant UK earnings for the tax year.

- The employee will be subject to an income tax charge at 40% if the total employee and employer contributions in the tax year exceed the annual allowance (2006-07 £215,000).

- On retirement, an individual can receive a tax-free lump sum of up to the lower of 25% of the value of his registered pension fund(s) or 25% of the life time allowance (2006-07 £1.5m).

- When an individual starts taking benefits from his pension, the value of the funds from which the benefits are taken must be determined. If the value exceeds the life-time allowance, an income tax charge will apply which can result in a tax charge of 55% on the excess above the life time allowance.

- There will be no social security charge on employer contributions into registered pensions and benefits from registered pensions will generally also be exempt from social security.

The new regime also makes a number of changes to the taxation of unregistered pension schemes. Generally there will be no income tax or social security charge on contributions into unregistered schemes. However there will also be no corporate tax relief for employers. Benefits from unregistered schemes will generally be subject to income tax in full.

Current trends

Institutional investors have suggested that the introduction of the single tax regime should be used as an opportunity by companies to rationalise existing pension provision. Whilst we believe that the differentials in total remuneration package values will not be sustainable in the long term, currently we see no desire from employers to deal with this issue.

Employers recognise that those whose pension values which already exceed or will exceed the annual allowance are adversely affected by the new regime. However, employers have been reluctant to increase pension contributions. Instead, most employers have opted for giving employees a cash supplement of between 15% to 35% of their annual salary.

Age discrimination laws

On 1 October 2006 new laws came into effect in the UK which generally make age discrimination unlawful.

The new legislation has far-reaching implications. It aims to prevent discrimination on grounds of any age, whether that means older employees being discriminated against or older employees being favoured to the detriment of younger employees.

Employers need to review their pay and benefit policies and structures (in particular share awards and benefit in kind policies) to ensure that they are not age discriminatory. If they contain discriminatory provisions then unless they fall within one of the limited statutory exceptions or can be objectively justified, the employer will be at risk of age discrimination claims.

FURTHER INFORMATION AND CONTACTS

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The current scene

Although creativity in designing compensation packages has a large impact on attracting and retaining employee talent, compensation and benefit changes and trends that occur over time are equally driven by changes in the law. Changes in the law can make certain compensation and benefit provisions offered by an employer more or less attractive depending on the particular legal change being made.

From a US perspective, compensation packages for the broad cross-section of employees typically include base salary and bonus. The differentiation and trends more typically occur with respect to employees at the executive level. The changes and trends recently being seen in the US are primarily driven by changes in the Securities Exchange Commission (SEC) executive compensation disclosure rules, changes in the Institutional Shareholder Services (ISS) guidelines which are intended to reflect what shareholders of companies are willing to accept and want to see with respect to the compensation packages being offered to executives, as well as certain tax law changes.

This chapter focuses on these particular legal changes and the impact they have had on what is currently being offered in terms of compensation in the US. It also broadly addresses another area of legislative change that has significance for compensation and benefits, namely changes in the law applicable to retirement/pension benefits.

SEC Executive Compensation Disclosure Rules

On June 26, 2006, the SEC finalized new rules detailing how companies must disclose the compensation of their top executives. Generally, a single number must now be reported for SEC reporting purposes which fully represents the total compensation provided to certain executives and directors. The total compensation number will include and incorporate the executive's:

- Take home pay (i.e. base salary and bonuses);
- Wealth accumulation (i.e. equity-compensation awards – current value, cumulative retirement benefits and cumulative deferred compensation);
- Severance type pay (i.e. triggered upon change in controls and corresponding gross-ups for taxes); and
- Any other form of compensation (including, but not limited to, perquisites, insurance coverage, etc).

This information will not only be presented in total, but also separately reflected as individual pieces in various tables with accompanying narrative discussions. Companies will be required to describe their compensation objectives, policies and elements of compensation and how these pieces fit into the overall decisions of the company. The objective is that these new disclosure rules will be more useful to the average investor in making its investment decision.

However, the requirement to report items such as "wealth accumulation" potentially may have a chilling affect on compensation awarded going forward.

Because this was not previously a requirement, some companies simply never ascertained an executive's current position, cumulatively and financially, with respect to all amounts previously provided to him or her as compensation. Given that these reportable amounts are now going to be subject to the public eye, this scrutiny could have a significant impact on the amount of compensation awarded in the future. Companies will have to identify what is the upper cap in terms of reasonableness with respect to "wealth accumulation" during employment. This will be a difficult question to answer and something that Boards and Compensation Committees will struggle with as they begin to implement the new disclosure rules.

Companies anticipated that these new disclosure rules would eventually be finalized in some form or another. In response, some opted to either reduce or eliminate the perquisites provided (i.e., car allowance, housing allowance, country club dues, etc.) altogether and merely increase the executives' base salary and require them to bear such costs directly. The SEC requirement on disclosure of perquisites is for amounts exceeding US$10,000. Rather than have to continually track this type of detail, some companies merely opted to eliminate it altogether.

Another trend that is likely to occur relates to abuses associated with stock option backdating (i.e., stock options with grant dates that were retroactively set to immediately precede a rise in price of the underlying shares) and spring-loaded options (i.e., stock options with grant dates schedules immediately prior to a positive company announcement or just after a negative company announcement). The SEC disclosure rules now require the company to outline the role of the compensation committee and the executive officers in making the equity grants, and respond to questions such as whether the timing of the grants was intended to affect the value of the equity award. The accountability now associated with this particular disclosure is intended to lead over time to a significant reduction in the manipulation of these types of events, resulting in fewer windfalls to executives.

ISS Guidelines

ISS is the world's leading provider of proxy voting and corporate governance services. ISS analyses proxies and issues informed research and objective vote recommendations for companies worldwide. Consequently, their perceived objectivity makes their opinions immediately valid in the shareholder marketplace, and guidelines outlined by ISS are considered "best practices" in most situations.

In 2004, ISS updated its pay-for-performance policy to allow companies the opportunity to provide specific public disclosure that demonstrated transparency and a commitment to performance-based compensation. ISS adopted its pay-for-performance policy in 2004 in response to investor concerns about the disparity between rising executive pay and companies' poor stock performance. Under that policy, ISS examines executive pay relative to the company's total shareholder return. Particularly with respect to equity compensation, in order to better tie executive compensation to shareholder return, the ISS guidelines emphasized pay-for-performance vesting as well as mandatory holding periods.

In response to the above, a significant number of companies began to migrate away from the more typical time-based vesting toward performance-based vesting with respect to their equity compensation awards. This may not necessarily equate into a reduction in the overall value of the stock option or restricted stock grant, but makes certainty with respect to vesting in those grants more conditional upon the executive delivering certain value before being rewarded. This trend tends to reward both the executive and the shareholders, whereas time-based vesting may

have required no return on the part of the executive at all (yet he or she would still be entitled to this compensation).

Additionally, there is a move toward companies implementing a mandatory holding period with respect to shares of stock acquired through an equity compensation vehicle. Requiring an executive to hold acquired shares within a certain level (such as a multiple of base salary) or for a certain time period, inherently requires a commitment on the part of the executive to the company at least financially or for a period of time. This is viewed as a valuable indicator to shareholders regarding the executive's commitment.

Changes in tax law

In 2004, important rules came into force regarding the taxation of what is termed "nonqualified deferred compensation". The new rules are in Section 409A of the Internal Revenue Code of 1986, enacted by the American Jobs Creation Act of 2004. These rules have an impact on the taxation of equity awards and of their relative attractiveness.

Generally, any equity award which is not issued at least at fair market value on the date of grant constitutes "nonqualified deferred compensation" under the new rules. This is because the difference between an exercise price (which is less than fair market value on the date of grant) and the fair market value of the stock on the date of grant is immediately a built-in compensation benefit to the participant, and this benefit merely waits to be recognized by the participant upon exercise. This has been viewed as an abusive situation, and hence the application of the new Section 409A.

In response, employers needed to review and possibly modify their equity compensation plans to ensure that they complied with these rules. Generally, stock options and stock appreciation rights (SARs) can be structured to be exempt from the rules on nonqualified deferred compensation if:

- the exercise price can never be less than the fair market value of the underlying stock on the grant date, and
- the employee's taxable income under the stock option or SAR, which is required to be recognized upon exercise, cannot be deferred beyond the exercise date (i.e., there is no ability to defer the taxation of the stock option or SAR past the exercise date).

This requirement obviously caused concern for companies issuing stock options and SARs at less than fair market value.

Section 409A also has an impact on restricted stock units and other performance-based units. Many companies typically settle these types of awards by issuing stock a short time after the units vest. Because they are subject to a substantial risk of forfeiture, such units will not be subject to Section 409A if settled (whether in stock or cash) before the later of two and one half months after the end of the company's fiscal year in which vesting occurred, or March 15 following the calendar year in which vesting occurred.

Again, although possible to fit these types of awards within the requirements of the law, it makes these awards less attractive or time based on the additional compliance required.

On the other hand, the granting of restricted stock is fully outside the scope of Section 409A. Consequently, in addition to the Microsoft trend in moving toward restricted stock as the normal form of equity compensation vehicle, grants of restricted stock are also more advantageous to the company because of their exclusion from coverage by Section 409A. The additional legal compliance associated with grants of restricted stock definitely has some companies migrating toward the use of restricted stock over other forms of equity compensation. But this is by no means an immediate change; companies must first understand the employee's input regarding the preferred equity award for incentive purposes, and then factor this into the equation.

Retirement benefits

In the US, qualified retirement plans (i.e., plans which provide income upon retirement and defer taxation until the payments are received) are a significant benefit provided to US employees (broad-based as well as executives). In the past several years, financial trouble has compelled many major US companies to freeze or terminate their pension plans. In many cases, the underlying reason these plans were terminated was tied to outdated federal pension laws that mandated certain assumptions that may not have been realistic given current market conditions. The flood of pension plan defaults forced the US Congress to address the outdated pension laws, strengthen the US worker's retirement security, and reduce the prospect of a future multi-billion dollar taxpayer bailout.

On August 17, 2006 President Bush signed into law the Pension Protection Act of 2006 that provides large-scale changes to the US qualified retirement rules. Although it is too early to analyse any direct impact of these legal changes, some of the more significant changes include items such as the following:

- Requirement that employer with defined benefit plans (namely typical pension plans with no employee contributions) make contributions to those plans so that they are 100% funded over the next seven years;
- Prohibits employers as well as unions from increasing benefits under a defined benefit plan if the plan is less than 80% funded, unless the increased benefits are paid immediately;
- Restricts the use of deferred executive compensation arrangements by employers with severely under-funded defined benefit plans; and
- Prohibits companies from forcing employees to invest any of their own retirement savings contributions into company stock.

Each of these changes is aimed at increasing pension protection for US employees. However, some of the requirements (such as the new funding requirements) may prove to be too burdensome financially for some companies to be able to comply. Consequently, any trends resulting from these newly passed retirement laws (such as companies freezing their pension plans going forward) remain to be seen. Ultimately, however, these changes will have some type of an impact of the benefits offered to employees under these qualified plans.

FURTHER INFORMATION AND CONTACTS

This chapter covers selected issues only. For a comprehensive description of all points relevant to compensation and benefits in the US, please refer to the contributor whose details are below, or contact ius laboris.

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