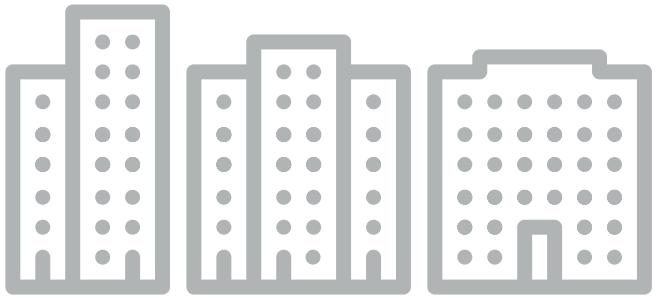
Deloitte.

DELOITTE'S TAKE ON EQUITY

Don't discount a match: Thoughts on matching share ESPPs

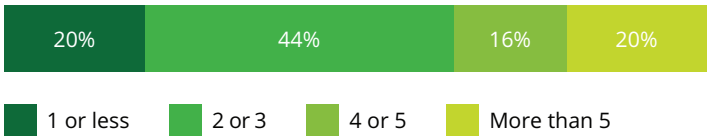
It is widely known that an employee stock purchase plan (ESPP) can be a valuable component of a company's benefits offering. Usually offered as an all-employee plan, an ESPP affords employees the opportunity to purchase shares in their employer company, by way of payroll deductions, at a discount to market value. The most common design in the United States is a qualified stock purchase plan, also known as a 423 plan,[1] due to the tax benefits that it provides for employees.

What is perhaps less widely known, though, is that more and more companies are receptive to the idea of offering a nonqualified plan that operates under a matching design instead of a discount. This growing interest stems from the flexibility that a nonqualified plan offers in terms of avoiding contribution and share purchase limits, and evidence that plan participants often do not meet the stock-holding periods necessary for preferential tax treatment.



The concept of a matching design is straightforward: Employees buy shares under the ESPP and the company offers a matching number of shares at no cost to the employee. Survey data indicate that the most common matching ratio is one matching share for every two or three shares purchased by the employee.[2] The matching shares can be subject to some condition such as continued employment, or a requirement to hold the purchased shares for a fixed period.

Features of ESPP share matching provisions: 44% of companies noted that employees receive one matched share for every two or three shares they purchase.



What is the appeal of nonqualified ESPPs that use matching shares in lieu of a discount? We might find the answer in the **Attract** + **Retain** + **Motivate** compensation equation. With companies using equity compensation as a way to attract, retain, and motivate talent, a matching shares program can be a compelling incentive vehicle. Let's look closer at the **Attract** + **Retain** + **Motivate** equation and how it applies to a matching shares approach.

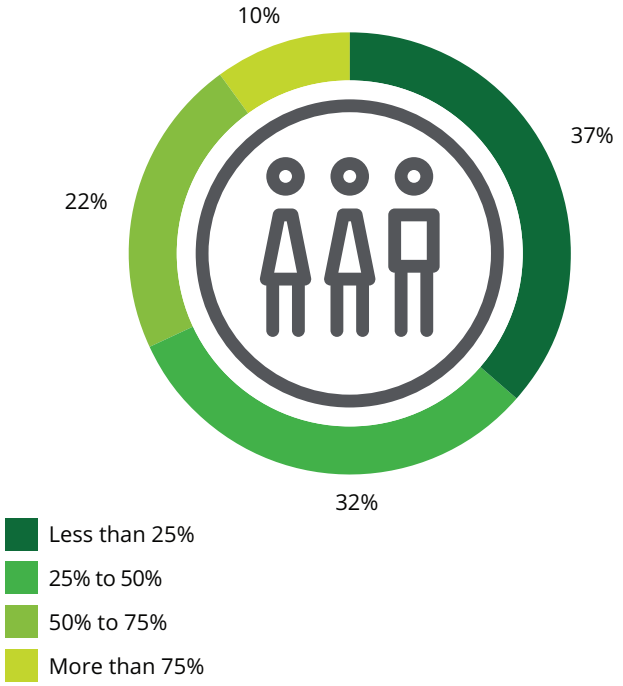
[1] Section 423 of the Internal Revenue Code.

[2] Deloitte 2018 employee stock purchase plan trends survey.

Attract

We start from the premise that if a company offers an ESPP to a broad-based population, participation rate is important to management. Indeed, survey data support the finding that achieving high levels of employee participation is a primary consideration in the structuring of an ESPP. Despite this deliberate emphasis, nearly two-thirds of companies achieve less than 50 percent employee participation.[3]

Although the vast majority of respondents offer a stock purchase plan, employee participation in ESPPs is low.



With a matching plan, employers are free to decide what they want the match ratio to be, and can design it to be more generous than the discount available under a qualified plan. For example, one matched share for every four shares purchased under a nonqualified plan is akin to a 20 percent discount. That is higher than the maximum 15 percent discount allowed under a qualified plan.

A matching plan is also often much easier for an employee to understand than a discount plan. Challenges in grasping plan terms or understanding the taxation of qualifying and disqualifying dispositions under a 423 plan can be an impediment to employee participation. Better understanding may drive comfort and excitement about participating in the plan.

Retain

A matching plan enables companies to impose a longer time horizon on the ESPP. Vesting conditions can be attached to matching shares, which can achieve some of the retentive qualities seen in free share awards such as restricted stock and restricted stock units. No longer are employees incentivized to just make it to that next purchase date. The matching shares can also have additional features such as voting or dividend rights attached to them.

Motivate

The flexibility that nonqualified plans offer generally, and that matching share plans offer specifically, provides employers a powerful vehicle to foster a real sense of employee ownership in their companies. Employers are free to decide on a match ratio that makes sense for them and that aligns with their overall compensation strategy rather than simply adopting a set discount to fit within the limits prescribed by tax law. And the placement of vesting conditions on the matched shares may encourage employees to act more like business owners and truly commit to the long-term objectives of their employer company.

Given the ability to structure an ESPP with a longer-term horizon and ultimately drive higher levels of attraction, retention, and motivation, you might want to consider a matching shares program as part of your company's ESPP design discussions.

Contacts

Sean Trotman
Principal
Deloitte Tax LLP
+1 212 436 2211
strotman@deloitte.com

Sandy Shurin
Senior Manager
Deloitte Tax LLP
+1 713 982 2163
ashurin@deloitte.com

[3] Deloitte 2018 employee stock purchase plan trends survey.