

Payroll Update

Understand Stock Option

Terminology

Stock Option Issuance Date- The date of issuing stock option to employees.

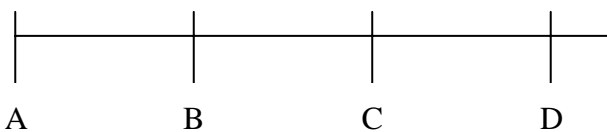
Lock in Period- This is period covering from date of issuance to vested date.

Stock Option Vested Date- The date when stock options become applicable or exercisable.

Exercise Date- The date of buying or selling the Underlying asset via the option contract.

Stock Selling Date- The date of selling stock in the market.

Timeline



A = Issuance Date

B = Vested Date

C = Exercise Date

D = Selling Date

Tax Computation on stock option exercised by employees prior to 1 January 2005

Employer should within 3 months from announcement of the stock option tax ruling (17 May 2005), provides a summary listing of stock options exercised by employees (This includes Name, ID numbers, Address and Taiwan source Income from exercising stock options) to Tax Office. Employer should also issue tax certificates to employees for the stock option income earned by employees. Employees should within 4 months from announcement of this tax ruling file personal income tax return rectifications.

The above obligations can be exempt, if one of the following conditions exists:

- 1) Overseas Parent/ Head Office Company did not charge or allocate stock option cost to Taiwan and employee already exercised stock option prior to announcement of this tax ruling.
- 2) Employees in Taiwan have in the past paid tax on stock option exercised in Parent/ Head Office Company country.
- 3) Expatriate employees received stock option prior to entering Taiwan and the lock in period has expired prior to entering Taiwan. The stock option exercised during period of stay in Taiwan can be exempt.

Tax Computation on stock option exercised by employees after 1 January 2005

Scenario 1: Stock option cost is not

charged to Taiwan entity

The difference between Market Value of stock at exercise date and Exercise Price is deemed to be other income of the expatriate employee.

Other income of expatriate employee is taxed depending on total number of days the expatriate employee stayed in Taiwan during lock in period. If stock option is exercised prior to 17th May 2005 and stock option cost is not charged to Taiwan, stock option profits can be exempted (MOF ruling 0940452755). If stock option is exercised after 17th May 2005, the entire period of stay in Taiwan (from date of stock option grant) during the lock-in period must be taken into consideration in computing taxable profits.

Employer should in accordance with Article 89-3 of Income Tax Regulations issue withholding tax certificates on stock option income to employees prior to end January of the following year. No withholding tax is applicable on stock option profits as stock option profits is deemed as other income of employee and not salary income.

Withholding tax category for other income is 94.

Scenario 2: Stock Option Costs charged to Taiwan entity

- If Taiwan entity passes on all associated costs directly to employees, Taiwan employees would be viewed as having

acquired the shares in full value and there is no clear benefit granted to employee. Under this scenario GT is of the opinion that no withholding tax scenario should occur.

- If Taiwan entity grants stock option to employees free of charge or at reduced charge, Taiwan entity may elect to treat this as fringe benefits. Such fringe benefits would be subject to salary withholding tax.

If stock option costs charged to Taiwan cannot be associated with each individual employee and Taiwan entity has intention to grant stock options free of charge to employees, payment to overseas Company for the stock option should be subject to 20% withholding tax. Taiwan entity needs to deduct this amount prior to remitting stock option costs back to foreign Company.

Example (Expatriate Employee)

If an expatriate employee is granted a stock option at the price of TWD 20 per share. The lock in period is 2 years and the option can be exercised for the first time on 1 Feb 2005. The expatriate employee entered Taiwan on 1 January 2005 and exercised the option on 31 May 2005. Market Price of stock at exercise date is TWD 30 per share. Taiwan Taxable Income is computed as $31/730 \times (30-20) = 0.42$.

Other MOF Announcements

Valuing stock- Date

If date of exercising the stock option ended up on a non-trading day of the stock exchange, the value of the stock shall be determined using the trading value of the stock in the next trading day of the exchange market. (25th May 2005 Supplementary Announcement)

Valuing stock- Method

MOF Ruling TaiTsaiSui 0930451436, for stock trading in the stock exchange, value should be the closing trading price for the day. For stock not traded in the stock exchange, the value should be net asset value per share computed based on latest audited set of accounts.

Compliance with Regulations

In order to assist clients to comply with regulations as per above, Grant Thornton Taiwan has designed an information request form as per attached. Employer can compute stock option profits earned by employees from the information gathered.

If GT assistance is required, please contact our tax division partner Jay Lo.

**THE TAX LEGISLATION IS COMPLEX -
YOU ARE STRONGLY RECOMMENDED
TO SEEK PROFESSIONAL ADVICE
BEFORE UNDERTAKING BUSINESS
TRANSACTIONS IN TAIWAN**

If you have any comments or require further information please

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