

GMS Flash Alert

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Ireland - Examining the KEEP Proposals in Finance Bill 2017

The Irish government published the Finance Bill 2017 on 19 October 2017.¹ The bill contains the taxation measures announced in the Minister for Finance's Budget speech on 10 October 2017², as well as a small number of measures not previously announced.

In this GMS *Flash Alert*, we will focus on the new Key Employee Engagement Programme ("KEEP") incentive. This new employee share incentive scheme is designed to help small and medium enterprises attract and retain key personnel.

The new legislation is due to apply to qualifying options granted to employees during the period 1 January 2018 to 31 December 2023.

For a complete analysis of the Irish Finance Bill, see "[Taxing Times: Finance Bill 2017 and Current Tax Developments](#)," a publication of the KPMG International member firm in Ireland.

WHY THIS MATTERS

The bill confirms the Budget announcement introducing a much-welcomed employee share-option incentive scheme targeted at the Small and Medium Enterprises sector (SMEs).

With this new incentive, a "qualifying company" within the SME sector would be allowed to provide "qualifying individuals" with "qualifying share options," as long as certain conditions are met throughout the option-holding period.

Moreover, the incentive provides for a saving of 19 percent, based on current tax rates, in the tax payable by an employee on the gain as compared to standard share option gains.

KEEP will aim to support SMEs in attracting and retaining key talent by effectively deferring the taxation of gains on employee shares until the sale of the shares.

KEEP

Background

In 2016, the Department of Finance launched a consultation on the Taxation of Share Based Remuneration. In the response from the KPMG International member firm in Ireland ("KPMG") to the consultation, a number of detailed changes were suggested, including the introduction of a new employee share option plan which would seek to place start-up companies and SMEs on an equal footing with larger employers in attracting and retaining key employees. A copy of KPMG's submission can be accessed at <https://www.kpmgpublications.ie/publication/taxwatch-quarter-2-2016/kpmgs-response-to-the-department-of-finance-public-consultation-on-the-taxation-of-share-based-remuneration/>.

Current Rules

Currently, where an employee exercises a share option, a liability to income tax, Universal Social Charge (USC) and employee Pay Related Social Insurance (PRSI) generally arises on the date of exercise of the option. The taxable amount is the difference between the market value of the shares acquired and the price paid to exercise the option. The timing of this tax-trigger point places most SMEs at a disadvantage to listed companies as, unlike their larger competitors, SMEs are unable to offer their employees a ready market in their shares which would allow the employee to sell some of the shares to fund the tax liability.

What KEEP Offers

Broadly, in the case of share options granted and exercised when the share option is still a qualifying share option under the KEEP, the bill confirms that the tax liability for the employees would only arise at the date of disposal of the relevant shares. In addition, the gain will be subject to capital gains tax instead of income tax, USC, and employee PRSI. Therefore, the incentive provides for a saving of 19 percent, based on current tax rates, in the tax payable by an employee on the gain as compared to standard share option gains.

This new incentive will allow a "qualifying company" within the SME sector to provide "qualifying individuals" with "qualifying share options," provided certain conditions are met throughout the option-holding period.

A qualifying company is broadly defined as an unquoted SME which exists wholly or mainly for the purpose of carrying on a "qualifying trade." The definition of a qualifying trade is narrower than we would have hoped for, as many activities are excluded, including professional services (e.g., medical, legal, accountancy, engineering services to list a few examples), financial activities, building and construction, dealing in or developing land, forestry, and activities in the coal, steel and shipbuilding sectors. A company whose business consists wholly of the holding of all of the shares in a qualifying company will also be a qualifying company. The qualifying company must be either incorporated in Ireland or in another European Economic Area (EEA) country and be tax resident in Ireland, or be resident in another EEA country but carrying on a business in Ireland through a branch or agency.

While generally the qualifying company cannot be a quoted company, a SME whose shares are listed on the Enterprise Securities Market ("ESM") of the Irish Stock Exchange will qualify. Similarly, SMEs whose shares are listed on an EEA equivalent of the ESM or on corresponding markets in a country with which Ireland has a double taxation agreement will also qualify.

More Details on the SMEs

One of the key conditions to qualify for KEEP is that, throughout the entire period between the date of the grant and exercise of an option, the group must continue to be regarded as a SME. A SME for this purpose is defined as an enterprise that employs fewer than 250 persons and has an annual turnover not exceeding €50 million and/or an annual balance sheet total not exceeding €43 million. There are also certain reporting requirements the company must comply with to be regarded as a qualifying company.

KPMG NOTE

The KPMG International member firm in Ireland has made representations to the Department of Finance suggesting that it reconsider the excluded trades and also consider expanding the holding company definition, which we view as very restrictive.

As the group can outgrow the turnover and balance sheet limits before an option is exercised means that the option will no longer be a qualifying option. This will create uncertainty for both the company and the employee as to the nature and tax benefit of an option at the date of grant of the option. Unlike the U.K. EMI option scheme, the employee is not afforded any time within which to exercise the option (for example 90 days in the U.K.) and retain the tax-favoured treatment of a qualifying option. This has also been raised with the Department of Finance.

A Qualifying Individual

To be regarded as a qualifying individual, the individual must be a full-time employee/director of the qualifying company from the date of grant of the option to the date of exercise, working at least 30 hours per week for the qualifying company. Also, an individual will cease to be a qualifying individual if he or she, together with connected persons, owns more than 15 percent of the ordinary share capital of the qualifying company.

KPMG NOTE

This is a much lower ownership limit than many had been hoping for. In KPMG's submission to the Department of Finance, we recommended a limit of 30 percent to facilitate rewarding and incentivising senior team members in smaller companies where an expectation of holding shares up to 30 percent could exist.

A Qualifying Share Option

To be considered a "qualifying share option," the option must:

- be an option to acquire shares in the company at a price at least equal to the shares' market value at the date of the grant of the option;
- be held for a minimum of one year before exercise (with certain limited exceptions applying); and
- only be exercisable for 10 years, commencing on the date the options are granted.

KPMG NOTE

As noted previously, practical difficulties can arise in arriving at the market value of a minority shareholding in a private company. It is hoped that practical administrative procedures will be introduced to help provide certainty on meeting the market value condition.

Additional Aspects of the Shares

The shares acquired on exercise of the option must be new, ordinary, fully paid-up shares that carry no present or future preferential rights to dividends or to a company's assets on its winding-up, and no present or future preferential right to be redeemed.

The new legislation provides for the value of the shares over which share options can be granted to any one employee to be limited to:

- €100,000 in any year of assessment,
- €250,000 in any three consecutive years of assessment, and
- 50 percent of the annual emoluments of the individual in the year in which the option is granted.

Similarly, the total value of unexercised qualifying options that can exist per SME is capped at €3 million.

KPMG NOTE

While the introduction of the KEEP is a very welcome development and, on balance, the new provisions mirror many of the recommendations put forward by KPMG in our submission, some key provisions are omitted which will severely limit the application of KEEP by SMEs. As outlined above, a number of KPMG's suggestions do not feature at all. It is also worth noting, in KPMG's response to the consultation, we suggested that the period of ownership of the options should be treated as a period of ownership of the share for Entrepreneurs' Relief. This could reduce the CGT rate to 10 percent on lifetime chargeable gains of up to €1 million. This has not been included in the bill.

KEEP raises certain practical issues, including the need to agree the market value of unquoted shares. It is to be hoped that, as KEEP is rolled out, guidance will be provided as to the precise nature of trades which will qualify, as well as practical administrative procedures will be introduced in order to eliminate any uncertainties on such matters and to foster the workability of the incentive.

While the new legislation is due to apply to qualifying options granted to employees during the period 1 January 2018 to 31 December 2023, the provisions are subject to EU State Aid approval before they can be formally implemented.

We understand from the minister's Budget speech that engagement with the European Commission is ongoing and is expected to conclude shortly. It is worth noting that the U.K. and Sweden recently obtained EU State Aid approval for similar employee share option schemes.

FOOTNOTES:

1 For text of the Finance Bill, see: <http://www.finance.gov.ie/wp-content/uploads/2017/10/Finance-Bill-2017.pdf> .

2 For the Budget speech and related Budget 2018 documentation, see:
<http://www.budget.gov.ie/Budgets/2018/2018.aspx> .

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