GMS Flash Alert

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Ireland – Finance Bill Measures for KEEP Scheme, Dividend Withholding Tax

Ireland's Finance Bill was published a few days following the government's presentation of the Budget.[1] (For coverage of other Finance Bill measures, see GMS *Flash Alert* 2019-165, 30 October 2019.)

The Bill includes a number of enhancements to the Key Employee Engagement Programme (KEEP), which is an employee share option incentive scheme targeted at the Small and Medium Enterprise (SME) sector. There are also some changes in relation to the Dividend Withholding Tax (DWT).

This article is excerpted, with permission, from "Taxing Times - Finance Bill 2019 & Current Tax Developments," (17 October 2019) and "Taxing Times: Budget 2020 & Current Tax Developments," publications of the KPMG International member firm in Ireland. For full coverage of the Finance Bill and the Budget, see the above two publications, or go to: https://home.kpmg/ie/en/home/campaigns/2019/10/finance-act-2019.html.

WHY THIS MATTERS

Under the proposed amended KEEP rules, the expanded definition of a "qualifying company" and "qualifying individuals" will make KEEP more flexible and broader in scope, thereby facilitating the use of this type of compensation and incentivising the take-up of the KEEP scheme.

KEEP aims to support small- and medium-sized enterprises in attracting and retaining key talent by effectively deferring the taxation of gains on employee shares until the sale of the shares.

The increase in the DWT – which we discuss below -- will raise the tax costs to shareholding taxpayers who receive dividends distributed by Irish resident companies. This may impact non-Irish resident shareholders who do not avail of a domestic or tax treaty exemption. The extent to which this affects international assignment costs will depend on whether taxation of dividends is covered in the employer's tax reimbursement policy.

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Key Employee Engagement Programme (KEEP)

The minister for finance announced in his Budget speech that a number of enhancements will be made to KEEP. The intention of the KEEP scheme is to help Irish SMEs to attract and retain employees.[2] The KEEP scheme allows qualifying employees to exercise their share options without triggering an income tax charge. In the ordinary way, the employee would pay capital gains tax at a rate of 33 percent (or 10 percent where Entrepreneur Relief applies) on any gain arising on the future disposal of the shares.

In his Budget speech, the minister indicated that changes would be made in order to extend the relief to certain companies operating in a group, as well as to allow for greater flexibility for qualifying employees to move within such groups. The Bill confirms the Budget Day changes announced by the minister.

Currently, the rules operate to limit the applicability of KEEP relief to companies holding shares in a single subsidiary. The Bill provides for a number of technical amendments to the legislation so as to allow employees of companies who are within a group to qualify for KEEP. Broadly, a group will comprise the 50-percent direct and indirect subsidiaries of the holding company, at least one of which should be carrying on a qualifying trade (most trades other than construction, share dealing, professional services, financial activities and some others).

At present, only full-time employees and/or directors of a qualifying company who devote substantially the whole of their time to the service of the qualifying company qualify for the relief (with a minimum of 30 hours per week being required). The Bill clarifies that the "qualifying individual" definition will be amended to allow for part-time and flexible working employees to qualify and for the movement of employees between qualifying companies within a qualifying group. In particular, KEEP relief will now be extended to qualifying individuals who devote at least 75 percent of their working time to a qualifying company or who work at least 20 hours per week for such a qualifying company.

Finally, the Bill confirms that the legislation will be amended to extend the relief to options over existing shares, as opposed to just newly-issued, fully paid-up, ordinary shares in a qualifying company/qualifying holding company.

The proposed amendments are subject to a ministerial commencement order.

KPMG NOTE

The uptake of the scheme could be restricted given the narrow definition of a "qualifying group." It is hoped that further amendments will be made to the KEEP scheme to bring it in line with the equivalent Enterprise Management Incentive ("EMI") scheme that many make the case has successfully operated in the United Kingdom. Comparing the two schemes, it appears that the EMI scheme is open to a broader range of companies and the rules are less complex than the rules that apply in the context of the KEEP scheme.

Dividend Withholding Tax (DWT)

DWT at 20 percent is currently imposed on distributions made by Irish resident companies. This is subject to a number of exemptions which means, in practice, DWT tends to apply only to distributions made to Irish tax-resident individuals and residents in countries which do not have a double taxation treaty ("DTA") with Ireland, or are not in the European Union (EU).

On Budget Day, 8 October 2019, the minister outlined that Revenue has identified a potential gap between the DWT collected and the income tax and USC ultimately payable by Irish tax-resident individuals.

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To address this issue, the minister announced two changes in relation to DWT: (1) the rate, and (2) a “modified” regime.

Finance Bill 2019 increases the rate of DWT from 20 percent to 25 percent, with effect from 1 January 2020. This increase will represent an incremental cash-flow cost for Irish tax-resident individual shareholders who may claim a credit for DWT against Irish tax payable on the distribution received. Equally, this will affect non-Irish-resident shareholders who do not avail of a domestic or tax treaty exemption, increasing the absolute tax cost of dividends to such shareholders to 25 percent.

From 1 January 2021, the government intends to introduce a “modified” DWT regime, which will use real-time data collected under the PAYE system to allow a personalised rate of DWT to be applied to each individual taxpayer based on the actual rates of tax he or she pays.

As part of Budget 2020, Revenue has launched a public consultation under which it has invited submissions until 12 December 2019, on how the proposed DWT collection system would operate in practice. Complementing the public consultation, Revenue has also indicated it will engage directly with relevant representative bodies on DWT real-time reporting.

KPMG NOTE

These consultations are welcome as the modified regime could introduce significant complexity, in particular for companies with a wide shareholder base.

FOOTNOTES:

1 For the Finance Bill on the website for the Houses of the Oireachtas, click here.

For the Budget speech and related Budget 2020 documentation, click here.

2 For related coverage, see GMS *Flash Alert* 2019-143 (13 September 2019).

Also see “Taxing Times: Finance Bill 2018 and Current Tax Developments,” a publication of the KPMG International member firm in Ireland. Moreover, see “Employee Share Incentive Schemes,” also a publication of the KPMG International member firm in Ireland.

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