A Guide to **Employee Share Incentive Schemes**

McCann FitzGerald

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Employers are increasingly looking for methods to retain key talent and reward employees. Employee share incentive schemes which offer a tax saving to both the employer and the employee can be a valuable approach to achieving such objectives. This briefing outlines the different types of tax efficient share incentive schemes currently available in Ireland.

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Revenue Approved Schemes

Certain incentive schemes which typically have greater tax efficiency must meet strict conditions and require advance approval from the Revenue Commissioners.

Approved Profit Sharing Scheme (APSS)

An APSS can be used by an employer to provide shares to employees in a tax efficient way. An APSS must be available to all employees who meet certain criteria.

Shares may be allocated on the basis of length of service, basic level of salary or similar factors. In addition, an APSS can be used by employees to convert an otherwise taxable discretionary bonus or element of salary into shares in their employing company. Employees may also apply a percentage of basic gross salary towards the purchase of shares, known as salary forgone. There is an annual limit on the value of shares that can be appropriated of €12,700 per tax year. Shares are then held in trust for a minimum of two years, and if held in trust for three years no charge to income tax arises on their allotment to the employee.

Tax consequences

No income tax is payable on the transfer of ownership to the employee at the end of the three year period. USC is payable on the value of the shares at appropriation. Capital gains tax may arise on the ultimate disposal of the shares by the employee on the difference between the disposal proceeds and the market value of the shares on appropriation.

Social security

Employee PRSI is payable on the value of the shares at appropriation through payroll. Employer PRSI does not apply.

Withholding

The employer must withhold USC and Employee PRSI through the payroll system

Reporting

Trustees are obliged to file an annual return (Form ESS1) to the Revenue Commissioners regarding the APSS by 31 March in the year following that year of assessment.

Save As You Earn (SAYE)

SAYE Share Option Schemes allow employers to grant employees options over company shares at a discount of up to 25% of the market value of the shares at the beginning of the savings period.

Employees must commit to regular monthly savings of between €12 and €500 over a predetermined period of three, five or seven years*. The employee must then use those savings to purchase all or some of the shares granted by the option.

Tax consequences

No income tax is payable on the grant or exercise of the option except where the option is exercised within three years of having been obtained. USC is payable on the gain (i.e. the difference between the market value of the shares and the option price) at exercise. Capital Gains Tax may arise on the ultimate disposal of the shares on the difference between the disposal proceeds and the option price on acquisition.

Social security

Employee PRSI is payable on the gain (i.e. the difference between the market value and the option price) at exercise. Employer PRSI does not apply.

Withholding

The employer must withhold USC and Employee PRSI through the payroll system when options are exercised.

Reporting

The employer must deliver details of options granted or exercised on the Form SRSO1 to the Revenue Commissioners by 31 March in the year following the year of grant or exercise.

* A shortage in the number of qualifying savings institutions acting in the Irish market is impeding the establishment of new SAYE plans.

Unapproved Schemes

These arrangements do not require Revenue approval and do not require equality of treatment.

Share Options

(other than those that qualify for the Key Employee Engagement Programme regime, *see details below*)

Where an employee is awarded an unapproved share option, there is no upfront charge to tax on the grant unless it is capable of being exercised more than seven years after it is granted.

Tax consequences

(i) ***Short Options*** (***not capable of being exercised more than seven years after grant***)
Income tax and USC are payable on the exercise of a short share option on the difference between the market value at exercise and the option price payable. Capital gains tax may arise on the ultimate disposal of the shares by the employee on the difference between the disposal proceeds and the base cost of the shares (generally the market value of the shares at the date of exercise).

(ii) ***Long Options*** (***capable of being exercised more than seven years after grant***)
Income tax and USC may arise on both the grant and the exercise of a long share option. Income tax and USC are only payable if the option price is less than the market value of the shares at the grant date. Credit is given for any income tax charged on the grant of the share option against the income tax due on exercise. Capital gains tax may arise on the ultimate disposal of the shares by the employee on the difference between the disposal proceeds and base cost of the shares (generally the market value of the shares at the date of exercise of the option).

Social security

Employee PRSI is payable on the exercise of the option on the difference between the market value at exercise and the option price payable. Employer PRSI does not apply where the shares are in the company in which the office/employment is held or in a company which has control of that company.

Withholding

The employer does not withhold taxes in relation to a short share option. The employer must withhold taxes and social security arising at grant of a long option through the payroll system (if any).

Reporting

Income tax, USC and PRSI arising at exercise must be remitted by the employee with the Form RTSO1 to the Revenue Commissioners within 30 days of exercise. The employee should include details of options exercised, as well as details of the disposal of their shares on an annual self- assessment tax return.

The employer must withhold income tax, USC and Employee PRSI arising on grant of a long option through the payroll system. Details of options granted, exercised or released on the Form RSS1 to the Revenue Commissioners by 31 March in the following year of assessment. The employer is generally responsible for filing this return.

Key Employee Engagement Programme ("KEEP") Share Option Scheme

KEEP Share Option Scheme is a share based remuneration scheme for small and medium-sized enterprises ("SMEs")[1] that carry on a "qualifying trade"[2].

The KEEP scheme is designed to support SMEs in their effort to attract and retain "qualifying individuals" i.e. employees or directors of a qualifying company who work at least 20 hours per week for the company. In addition to Irish incorporated companies, a qualifying company also includes companies which have been incorporated in the EEA or in the UK and are tax resident in Ireland, or a company which is resident in another EEA State or the UK and carries on business in Ireland through a branch or agency.

The KEEP scheme is available for qualifying share options granted between 1 January 2018 and 31 December 2025.

Currently, the value of shares over which share options can be granted to any one employee is limited to;

- €100,000 in any year of assessment;
- €300,000 in all years of assessment; or
- 100% of the annual emoluments of the individual in the year in which the option is granted.

Finance Act 2022 gives effect to certain measures previously announced in Finance Act 2019 including that companies operating through a group structure may now qualify for the KEEP scheme. In addition, Finance Act 2022 increases the market value of the unexercised qualifying share options that companies can issue under the KEEP scheme from €3million to €6million, as well as permitting capital gains tax treatment where certain conditions are satisfied on the buy-back of KEEP shares by the company from the employee.

1 A SME for this purpose is an enterprise which employs fewer than 250 employees and which has an annual turnover not exceeding €50 million and/or an annual balance sheet not exceeding €43 million.

2 A "qualifying trade" means a trade other than a trade which is involved in share dealing, financial activities, professional services, dealing in or developing land, building and construction, forestry, coal or ship building.

Tax consequences

Under the KEEP scheme, gains arising to an employee on the exercise of qualifying share options will, provided certain conditions are met, only be subject to capital gains tax when the employee disposes of the shares. This is in contrast to the income tax, USC and Employee PRSI which would normally apply on gains arising on the exercise of share options.

Social security

No Employee PRSI or Employer PRSI is payable on gains realised on the exercise or disposal of KEEP shares.

Reporting

The employee must return details of any capital gains tax due in their self-assessment capital gains tax return. The employer granting the options must deliver details of options granted or exercised to the Revenue Commissioners in a Form KEEP1 by 31 March in the following year of assessment.

Free or Discounted Share Schemes

Tax consequences

Income tax and USC are payable on the fair market value of the shares at the date of acquisition, less the purchase price paid by the employee, if any. Capital gains tax may arise on the ultimate disposal of the shares by the employee.

Social security

Employee PRSI is payable on the fair market value of the shares at the date when beneficial ownership is transferred, less the purchase price paid by the employee, if any. Employer PRSI does not apply where the shares are in the company in which the office/employment is held or in a company which has control of that company.

Withholding

The employer must withhold income tax, USC and Employee PRSI through the payroll system. The value of any shares awarded, less any price paid, will be treated as notional pay at the time the shares are given to the employee. If the liability exceeds the employee’s pay, the employer is obliged to account for and remit the total tax and PRSI due on the actual and notional pay in the payroll return. The tax must then be recouped from the employee or the employee is deemed to have received a further benefit.

Reporting

The employee must return details of the disposal of their shares in their self-assessment tax return.

Income tax, USC and PRSI are to be remitted by the employer to the Revenue Commissioners in the payroll return. Since 1 January 2019, employers must submit 'real-time reporting' of notional pay on either the day the taxable benefit arises or the earlier of (i) the next pay day or (ii) 31 December in that year. Employers must also report details of the award of free or discounted shares in a Form ESA by 31 March in the year following the award.

Restricted Shares

Where employees are given discounted or free shares subject to restrictions requiring that the shares must be retained for a fixed period before they can be sold, the taxable value of the shares can be abated.

The restriction on disposal must be absolute and for genuine commercial reasons. The permitted abatement is determined by the period of years for which the restriction applies - 10% abatement for a one year restriction increasing to a maximum 60% abatement for a restriction of greater than five years. If the restriction is relaxed, an additional tax liability can arise. Where shares are forfeitable the employee will be entitled to a rebate of tax paid. Abatement can also apply to shares granted by way of option.

Tax consequences

Income tax and USC are payable on the market value of the shares at the date of acquisition, but may qualify for abatement of taxable value (10% abatement per year of restriction, up to 60% for a restriction of greater than five years). Capital gains tax may arise on the disposal of the shares by the employee on the difference between the disposal proceeds and the market value of the shares at the date of acquisition (where such shares were already in existence at the time of acquisition). Where the restricted shares acquired were newly issued shares, then the charge to capital gains tax arises on the difference between the disposal proceeds and (i) the price paid for the shares (if any) and (ii) the amount charged to income tax on acquisition, taking into account any abatement (and any additional charge if the restriction was varied or lifted). Where the restricted shares were acquired on the exercise of a share option, the charge to capital gains tax arises on the difference between the disposal proceeds and (i) the cost (if any) of the option (ii) the price paid for the shares on exercise of the option and (iii) the amount charged to income tax on acquisition, taking into account any abatement (and any additional charge if the restriction was varied or lifted).

Social security

Employee PRSI is payable on the market value of the shares at the outset but may qualify for abatement of taxable value (10% abatement per year of restriction up to 60% for a restriction of greater than five years). Employer PRSI does not apply where the shares are in the company in which the office/employment is held or in a company which has control of that company.

Withholding

The employer must withhold income tax, USC and Employee PRSI on restricted share awards through the payroll system.

Reporting

Where the restricted shares are acquired on the exercise of a share option, the employer granting the options must deliver details of options granted, exercised or released on the Form RSS1 to the Revenue Commissioners by 31 March in the following year of assessment. In any other case, employers must report the award of restricted shares as well as any disposal of such shares before the end of the restricted period in a Form ESA by 31 March in the year following the award or disposal.

Forfeitable Shares

Employers can award employees shares which are dependent on certain performance targets or criteria being met, or the employee remaining with the company.

In order to qualify as forfeitable shares, there must be a bona fide written agreement under the terms of which there will be a forfeiture of the shares if certain circumstances arise or do not arise, as a result of which the employee will cease to have any beneficial interest in the shares.

Tax consequences

An income tax charge will arise where the employee acquires the forfeitable shares for less than market value. The charge is computed by reference to the market value of the shares at the date of acquisition, without regard to the risk of forfeiture. If the shares are forfeited, any income tax charge already imposed in respect of the acquisition of the shares is reduced to nil, and any tax overpaid may be claimed back by the employee within four years from the end of the tax year in which the shares are forfeited.

Social security

Employee PRSI is payable on the market value of any free shares awarded, or on the value of discounted shares. If the shares are forfeited, any Employee PRSI overpaid may be claimed back within four years from the end of the tax year in which the shares are forfeited. Employer PRSI does not apply where the shares are in the company in which the office/employment is held or in a company which has control of that company.

Withholding

The employer must withhold income tax, USC and Employee PRSI on forfeitable share awards through the payroll system.

Reporting

Where the restricted shares are acquired on the exercise of a share option, the employer granting the options must deliver details of options granted, exercised or released on the Form RSS1 to the Revenue Commissioners by 31 March in the following year of assessment. In any other case, employers must report the award of forfeitable shares as well as any forfeiture of such shares in a Form ESA by March 31 in the year following the award or forfeiture.

Growth/Flowering Shares

Growth/Hurdle/Flowering share schemes involve the issuance of new shares with very limited rights which may grow into more valuable shares on the happening of certain specified events. The advantage of these schemes is that they deliver shares upfront to employees.

Tax consequences

It may be possible to structure such shares in such a way as to minimise the income tax arising on the share issuance at the outset, and to ensure capital gains tax treatment on the ultimate disposal of the shares by the employee.

Reporting

Employers must report the award of growth/hurdle/flowering shares in a Form ESA by 31 March in the year following the award.

Restricted Stock Unit

A Restricted Stock Unit ("**RSU**") is a promise to an employee that on completion of a vesting period, the employee will receive a number of shares or cash to the value of such shares.

Tax consequences

Income tax and USC is payable on the market value of the shares (or the cash amount of such shares) provided to the employee on vesting. Capital gains tax may arise on the ultimate disposal of the shares by the employee on the difference between the disposal proceeds and the market value of the shares at the date of acquisition.

Social security

Employee PRSI is payable on the receipt of the shares or cash. Employer PRSI does not apply where the shares are in the company in which the office/employment is held or in a company which has control of that company. Employer PRSI is payable where cash is provided to the employee.e.

Withholding

The employer must withhold income tax, USC and Employee PRSI through the payroll system.

Reporting

Income tax, USC and Employee PRSI are to be remitted by the employer to the

ABOUT MCCANN FITZGERALD LLP

With almost 600 people, including 430 lawyers and professional staff, McCann FitzGerald LLP is one of Ireland's premier law firms. We are consistently recognised as being the market leader in many practice areas and our preeminence is endorsed by clients and market commentators alike. Our principal office is located in Dublin and we have overseas offices in London, New York and Brussels. We provide a full range of legal services, primarily to commercial, industrial and financial services companies. Our clients include international corporations, major domestic businesses and emerging Irish companies. We also have many clients in the State and semi-State sector.

MARKET COMMENTARY

"Very professional. Always available. Sound advice. Great service."
THE LEGAL 500, 2022

"The team have been extremely proactive, knowledgeable and supportive in guiding me through any of the transactions that I have worked on with them. From partner level right through to trainees, the quality of their people is second to none."
IFLR 1000, 2022

"Know our business very well - very aware of developments in the industry - very strong on sustainability."
IFLR 1000, 2021

"The familiarity with our business and knowledge of the wider landscape ensures the advice we are receiving is airtight."
THE LEGAL 500, 2022

"A very experienced and capable team that understands the complexity of the challenges faced in large-scale projects. They listen well to the client and understand all the issues. They clearly communicate their recommendations and opinions."
THE LEGAL 500, 2021

"McCann Fitzgerald has been excellent to deal with and we received focused and timely responses," adds a second source.
CHAMBERS GLOBAL, 2022

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