BRADLEY TAX CONSULTING

Key Employee Engagement Programme

Introduction

Budget 2018 introduced a new tax-advantaged share scheme in Ireland known as the "Key Employee Engagement Programme" (KEEP). KEEP is an employee share option scheme aimed at helping SMEs to recruit and retain employees in Ireland.

Unlike share options granted and exercised under standard share option legislation, the KEEP scheme contains the following tax advantages:

- there is no income tax on a grant of a qualifying share option;
- there is no income tax or employee PRSI liability on exercise of the share options if the qualifying share options were granted **between 1 January 2018 and 31 December 2023**;
- the employee will only pay Capital Gains Tax (CGT) on the ultimate disposal of the shares, which in effect means that **there is no upfront tax cost for employees who acquire shares under this schem**e; and
- the value of shares acquired by key employees under the KEEP incentive will also be exempt from employer PRSI contributions, as is the case with the current regime applying to share-based remuneration.

Example

Below we illustrate the difference between the tax treatment of options granted under the standard employee share option provisions and the tax treatment of options granted under the KEEP scheme.

Our example assumes the following facts:

- Options are granted on 10.02.2018 to purchase €5,000 €1 shares at €1 (the current market value at the date of grant).
- On 10.02.2021 the shares are worth €3 per share so the employee exercises the option and purchases for €5,000, i.e. purchasing the shares at a discount of €10,000. This is a "gain" and is subject to income tax, USC and PRSI under the standard employee share option scheme but not under KEEP. We assume that the employee's income is such that he/she pays USC at 8%.
- On 10/02/2024 the shares are worth €4 per share and the individual sells for €20,000.

	Standard provisions	KEEP
	€	€
Employee tax liability on grant	NIL	NIL
(Grant price was at market value)		
Employee tax liability on exercise		
(Gain of €10,000 i.e. €3 less €1* 5,000 shares)		
Income tax: 40% of gain on exercise	4,000	NIL
PRSI: 4% of gain on exercise	400	NIL
USC: 8% of gain on exercise	800	NIL
Total employee liability on exercise	5,200	NIL
CGT on disposal of shares		
Proceeds of disposal	20,000	20,000
Cost of acquisition	-5,000	-5,000
Discount on exercise	-10,000	0
Taxable gain	5,000	15,000
CGT at 33%	1,650	4,950
Taxation summary		
Gross value received by employer	20,000	20,000
Total taxes paid	-6,850	-4,950
Net value received by tax payer	13,150	15,050
Net additional value received through KEEP		1,900
Effective tax rate	34.25%	24.75%

Please note that in addition to the fact that the employee pays significantly less tax under KEEP, it is also the case that no tax liability arises until the shares are actually sold.

To be eligible to grant options over its shares under the KEEP scheme, a company must be a "qualifying company". This means that the company must:

- be incorporated and resident in Ireland, or resident (or incorporated) in an EEA State and carrying on business in Ireland through a branch or agency;

- **exist wholly or mainly for the purpose of carrying on a "qualifying trade" on a commercial basis with a view to the realisation of profit**;

- be a **micro, small or medium-sized enterprise ("SME")** within the meaning of the Annex to Commission Recommendation 2003/361/EC at the date of the grant of the option;

- be **an unquoted company** none of whose shares, stock or debentures are listed in the official list of a stock exchange or quoted on an unlisted securities market of a stock exchange other than on the Enterprise Securities Market of the Irish Stock Exchange or on any similar or corresponding stock exchange in an EEA country or country with which Ireland has a double taxation agreement; or an unquoted is incorporated or resident in an EEA state other than Ireland and carrying on business in the State through a branch or agency;

- not be regarded as a company in difficulty for the purposes of EC Commission Guidelines on State Aid; and

- **not have issued qualifying share options of the company with a market value exceeding €3,000,000 on the date of the grant of an option.**

A holding company which directly holds the entire issued share capital of a qualifying company may also grant options under the KEEP incentive. However, in the case of holding companies, it may be difficult to qualify unless its business consists wholly of holding shares i.e. the holding company can engage in no other activity. Revenue clarification is awaited on this point.

It is not clear if an Irish trading company with subsidiaries will qualify for KEEP. On the one hand if the trading company exists wholly or mainly for the purpose of carrying on a "qualifying trade" on a commercial basis with a view to the realisation of profits and this dominates its holding company activities, then it should be a qualifying company for KEEP purposes.

On the other hand, if Revenue deems it to be a holding company, then Revenue may deny relief as its activities comprise and of trading and holding company activities. We await Revenue guidance on this point.

The company issuing KEEP options must carry on a "qualifying trade", which includes most trading activities with the exception of the following "excluded activities", which are similar to the excluded activities that apply in the case of SURE relief:

- adventures or concerns in the nature of trade (e.g. one-off transactions),
- dealing in commodities or futures in shares, securities or other financial assets,
- financial activities,
- certain professional services companies,
- dealing in or developing land,
- building and construction,
- forestry, and
- operations carried out in the coal industry or in the steel and shipbuilding sectors.

The relief will not apply if the company employs in excess of 250 people and has either a turnover of over €50 million or a balance sheet total in excess of €43 million at the date of grant of a qualifying share option.

A "qualifying share option" means a right granted to an employee or director of a qualifying company to purchase a predetermined number of shares at a predetermined price, by reason of the individual's employment or office in the qualifying company.

The following conditions must be met for the share option to be a "qualifying share option":

1. The share which may be acquired by the exercise of the share option is **new ordinary fully paid up shares in a qualifying company,** which carry no present or future preferential right to dividends or a to a company's assets on its winding up and no present or future preferential right to be redeemed,

2. The option price at the date of grant is not less than the market value of the same class of shares at that time,

3. There must be a written contract or agreement in place detailing:

    - the number and description of the shares which may be acquired by the exercise of the share option,
    - the option price, and
    - the period during which the share options may be exercised.
    - the option price at the date of grant is now less than the market value of the same class of shares at that time.

4. The total market value of all shares in respect of which qualifying share options have been granted to an employee or director does not exceed:

    - €100,000 in any one year of assessment,
    - €250,000 in any 3 consecutive years of assessment,
    - **50% of the annual emoluments of the individual in the year of assessment in which the share option is granted.**

5. The share option must be exercised by the qualifying individual during a period of not less than **12 months from the date of grant,**

6. The shares are in a qualifying company, and

7. **The share option cannot be exercised more than 10 years from the date of grant.**

In addition, the option **must be granted for commercial reasons** to recruit or retain an employee and not as part of a scheme or arrangement of which the main purpose (or one of the main purposes) is the avoidance of tax.

Where relief applies under the KEEP incentive, further tax relief will not be available for investment in corporate trades under the Employment and Investment Incentive or Seed Capital Scheme. This restriction is significant and the costs and benefits of each option should be discussed with a tax advisor.

In general, a "qualifying individual" (an employee to whom the relief applies) is a person whose employment or directorship with a qualifying company is "capable" of lasting at least 12 months from the dates on which the qualifying share option is granted.

An individual will cease to be a qualifying individual if he or she, together with connected persons, acquires whether directly or indirectly more than 15% of the ordinary share capital of the qualifying company. This means company owners are excluded from KEEP.

With respect to individuals leaving employment or office of the qualifying company, they will still be in a position to avail of relief under the KEEP incentive if the exercise of the qualifying share options occurs within **90** days of the individual ceasing to hold the employment or office.

Where a qualifying company grants a qualifying share option under KEEP, it will be required to submit a return to the Revenue Commissioners by 31 March of the following year of assessment in a specified format.

In addition, the Revenue Commissioners may require a company which grants KEEP share options to provide information which will allow Revenue **to publish** the following information on the incentive as it applies to employees/directors:

- the name, address and Companies Registration Office (CRO) number of the company;
- the date of exercise of the qualifying share options;
- the amount of the tax advantage granted;
- details on the principal activity of the company and the territorial unit (as defined under EC Regulations) in which the company is located.

If the above requirements are not met, the company will cease to be regarded as a “qualifying company” for the purposes of the relief.

The implementation of the KEEP scheme is subject to approval by the European Commission under State Aid rules. Assuming that this is granted, the scheme will come into operation through an Order of the Minister of Finance.

As can be seen from the above brief introduction, the benefits of KEEP are significant. However, the many conditions to be met must be considered carefully when deciding whether or not to avail of the scheme. Therefore, it is important to seek tax advice in advance of any specific proposal regarding the KEEP scheme.

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