Irish Tax Institute Response

Department of Finance Consultation on the Tax Treatment of Share-Based Remuneration

Contents

About the Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's AITI Chartered Tax Advisers (CTA) and is the only professional body exclusively dedicated to tax. Our members provide tax expertise to thousands of businesses and individuals in Ireland and internationally. In addition, many hold senior roles within professional service firms, global companies, Government, Revenue and state bodies.

The Institute is the leading provider of tax qualifications in Ireland, educating the finest minds in tax and business for over thirty years. Our AITI Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice. A respected body on tax policy and administration, the Institute engages at the most senior levels across Government, business and state organisations. Representing the views and expertise of its members, it plays an important role in the fiscal and tax administrative discussions and decisions in Ireland and in the EU.

Executive Summary

We welcome the opportunity to provide views on the tax treatment of share-based remuneration and to suggest ways to improve our current regime. Share-based remuneration can play an important role in rewarding key employees at all stages of a businesses' development. It can significantly reduce fixed labour costs and free up business cash-flow. As outlined in research[1] employee share ownership can be a key contributor to profitability, productivity and employment creation, with the resulting positive impact on economic growth and exchequer yield.

Our current regime

There are two main categories of share-based remuneration in Ireland from a tax perspective. These are set out in detail in the Consultation Paper, but broadly break down into.

- Revenue-approved share schemes; e.g. the Approved Profit Sharing Scheme (APSS) including Employee Share Ownership Trusts (ESOT) and the Savings Related Share Option (SAYE) scheme, and
- Unapproved share schemes; e.g. unapproved share options, Restricted Shares, Restricted Stock Units (RSUs), phantom shares etc.

There are advantages to both categories of share schemes but also significant limitations at present.

Revenue-approved share schemes

The current Revenue-approved incentive regimes for employee share participation, for example the APSS, have positively contributed to greater employee participation in public companies and subsidiaries of multinational companies.

[1] Nuttal Review of Employee Ownership July 2012

However, the requirement in these schemes to allow all employees participate on similar terms is not appropriate for many businesses and this has limited their use. Many businesses need the flexibility to award equity to key staff on a selective basis and this is not possible under the Revenue-approved schemes.

Unapproved share schemes

Participation in the approved schemes is still relatively low because of the lack of a flexible approach (as outlined above). As a result, most companies that reward employees with equity, use unapproved share schemes which affords them greater flexibility in rewarding employees. However, these shares are heavily taxed as an employee is liable to income tax, USC and employee PRSI at their marginal rate immediately on receipt of a share award or on exercise of a share option and then liable to Capital Gains Tax (CGT) at 33% on any subsequent disposal of the shares. The combination of this double charge to tax (both at high tax rates), makes equity less attractive to employees by significantly reducing the value of their share awards.

Practical issues for Start-ups and SMEs

Start-ups and SMEs face particular challenges in promoting employee share ownership.

- They are competing for talent with larger employers that can offer more competitive remuneration packages, which often include equity.
- There may be no market for their shares.
- The employee has to pay tax on receipt of shares or on the exercise of a share option. They may have to fund this tax on a “paper gain” from their own resources or from borrowings.
- Calculating the tax due can be difficult due to difficulties in valuing the shares, in the absence of a ready market.
- A re-purchase of shares (buy back) by the employer can give rise to an income tax liability for the employee on disposal of the shares (rather than CGT), due to the legislative rules on share buy backs. We have provided further details on this matter further below.

Given the extent of the difficulties SMEs face, the Irish Tax Institute is recommending the introduction of a targeted new share scheme aimed at SMEs. We have outlined below our recommendations on the design of such a new scheme.

Practical issues for larger businesses

Different types of business have different challenges and priorities in rewarding staff with equity. The issues for large private companies and listed multinationals will differ fundamentally from those of small high-growth start-ups or private companies offering key employees equity to compensate for reduced salaries.

We have considered ways in which the current tax treatment of share-based remuneration awarded by larger private companies and multinational (MNC)/publicly listed (PLC) companies could be modified to enhance the attractiveness of equity awards.

Enhanced flexibility in the APSS and SAYE would increase the usefulness of these regimes for larger private and listed companies.

Share schemes are generally costly and time-consuming to implement for large listed multinational businesses in particular, who operate global plans and have cross-border employees. This is because jurisdictions, in addition to Ireland, often have taxing rights over the share awards and employers may need to operate payroll withholding taxes in two jurisdictions. It is important that the Irish tax treatment does not add to this complexity and move out of line with international norms. We have outlined below how the tax treatment of Restricted Stock Units (RSUs), a common form of share-based remuneration, could be modified to align Ireland with international practice by taxing vested awards on a pro-rata basis, based on the work days the employee spends in Ireland. We have outlined in further detail the Irish tax treatment of RSUs in this submission.

Employer PRSI

A key positive in our current regime is that share-based remuneration is exempt from Employer PRSI. At a time when competitiveness is critical to economic growth, it is essential that this exemption is maintained. Any steps to reinstate Employer PRSI would make share-based remuneration unaffordable for many businesses and would give would rise to uncertain future liabilities on shares not yet vested.

The impetus for change

We are at a critical juncture in taking steps to improve our competitiveness in Budget 2017.

- The government has forecast challenging growth targets of 5% for GDP and the generation of 200,000 new jobs by 2020. The export economy will play a key role in reaching these targets. Recruiting skilled expertise who understand these markets will be critical to success.
- Equity participation is still at a low level in SMEs. Our high rates of CGT and income taxes on investment income do not encourage investment. As such, other sources of equity investment are vital to fund businesses in Ireland.
- The BEPS agenda has placed greater focus on substance and sourcing and retaining talent and expertise in Ireland is a key strategic challenge.
- Employees are increasingly mobile and this gives rise to additional complexity and costs in dealing with tax issues in two or more jurisdictions.
- Ireland is already falling behind competitor jurisdictions such as the UK, which has sophisticated share regimes aimed at encouraging share participation in different categories of business at all stages of their development. An overview of these schemes is outlined in the appendix to this submission.
- Irish businesses also face uncertainty about the impact of the Brexit referendum on access to the UK market and UK tax policy measures to improve the tax offerings to encourage investment.

Competing for talent

Recruiting, motivating and retaining top talent is critical to business and economic growth. Skilled workers are increasingly mobile and Irish companies are competing in a global market place for the individuals they need to drive business growth and innovation. Skill shortages in some key sectors are already emerging e.g. in the IT, engineering sectors etc.

Our high marginal income tax rate, the 9th highest marginal tax rate in the OECD, is already a barrier for businesses seeking to recruit international expertise. In addition to this, many of our competitor jurisdictions have sophisticated and targeted schemes to support and incentivise share-based remuneration. Some of these schemes defer the taxation point until the shares are actually sold. This is in contrast with the Irish regime where share options are subject to both personal taxes at exercise (i.e. purchase) and CGT at the top rate of 33% when the shares are sold. A summary of some of our competitor countries regimes is outlined in the appendix to this submission.

The availability of talent will be the key differentiator for locations to win FDI in the future. In light of the implementation of the OECD BEPS project MNCs and countries are competing to attract globally mobile talent to support substance and profits in their territory. Smaller economies like Ireland will have to work even harder to be attractive to MNCs and start-ups considering a range of investment locations. We need to enhance our tax offering on share-based remuneration to enable us compete and thrive in these challenging times.

It is against this backdrop of existing challenges and impetus for change that we outline a number of recommendations below.

Recommendations

Introduce a targeted SME share regime

1. Start-ups and SMEs face particular challenges in attracting and retaining the calibre of employees they need to drive business growth, as we have outlined above. We therefore recommend a new regime is introduced in Budget 2017 which is targeted at SMEs. Under this new regime:

- No income tax, USC or PRSI would arise on the exercise of a share option by an employee. This treatment could be limited to cases where e.g. the employee does not hold a 30% or more shareholding in the employer company. (The UK has designed a share scheme specifically targeted at helping SMEs and start-ups attract key staff, the Enterprise Management Incentive scheme. An outline of this regime and its key features is detailed on page 10).
- CGT only would arise on the ultimate disposal of shares.
- Employees could qualify for the Revised Entrepreneur Relief on disposal of the shares, where the relevant conditions are met.
- Where the employer buys back the shares issued under this regime, this disposal should qualify for CGT treatment. This may require an amendment to the conditions for CGT treatment in S176 TCA 1997.

2. Once this new SME share scheme is in place, a broad communications campaign on the scheme and its merits is essential. This should be supported by "plain English" guidance, tool kits and information phone lines on the regime to ensure broad awareness of the regime.

Exempt from BIK loans to employees to acquire shares in their employer

3. Under our current regime, if an employer provides a loan to an employee to fund the purchase of shares in the employer, the loan is treated as a preferential loan and the employee is liable to tax as a benefit-in-kind (BIK) at an imputed interest rate of 13%.

To encourage share participation and alleviate one of the key barriers for employees i.e. funding the share acquisition and the tax, consideration should be given to removing the BIK charge where an employer loan is used to purchase shares in the employer (if the shares do not qualify for tax-exemption under the proposed new regime).

Introduce greater flexibility in the APSS and SAYE schemes and eliminate the charge to USC and PRSI

4. The current Revenue-approved schemes e.g. APSS/SAYE have positively impacted on employee share participation in Ireland, but the requirement that all employees must be allowed to participate on similar terms reduce their usefulness. Businesses need greater flexibility to selectively reward key employees and the terms of the schemes should be amended to allow this flexibility.

   Further flexibility could also be introduced in the APSS by increasing the €12,700 annual limit on the value of shares an employee can receive without deduction of income tax, PRSI and USC. This limit has not been increased for some time and should be revisited.

5. The APSS and SAYE regimes could also be made more attractive by eliminating the charge to USC and employee PRSI on allocation of the shares into the scheme trust. An exemption from income tax already applies and extending this exemption to USC and PRSI would be consistent with this position.

Align the tax treatment of Restricted Stock Units (RSU) with international practice

6. Greater employee mobility has added to the costs and complexity of operating share-based remuneration for large business and multinationals. It is important that the Irish tax treatment does not add to this complexity. Our current treatment of RSUs is not in line with international practice and can give rise to a disproportionate tax liability, relative to the value of the share award. The tax treatment should be modified to align Ireland with international practice by taxing vested awards on a pro-rata basis, based on the work days the employee spends in Ireland over the vesting period.

   Consideration should also be given to expanding the tax treatment of Restricted Share Awards in S128D to RSUs. This would allow abatement of the taxable value of RSUs by reference to the length of the vesting period and would reflect the investment risk.

   Taxation of RSUs is a complex issue and we have outlined the use and taxation of RSUs in further detail in this submission.

Retain the exemption from Employer PRSI on share-based remuneration

7. It is critical that the Employer PRSI exemption on share-based remuneration is retained. The administration and delivery of share based award schemes is already complex and costly for businesses. Any further increase in business costs by application of Employer PRSI to share-based remuneration, would reduce the attractiveness of rewarding employees with shares and could make it unaffordable for many businesses, especially SMEs.

Simplify the administration of share schemes

8. The administration of share schemes could be simplified by adopting the following recommendations:

   a) Develop clearer guidance on share valuation methodologies and safe harbours to minimise uncertainty, these could be developed from joint fora between Revenue, business and tax advisers.
   b) Introduce a single employer return form to report information on share-based remuneration. This would also be an efficient mechanism for collecting data on the use and prevalence of share-based remuneration.
   c) Align the administration of share options with other share-based remuneration by collecting tax on the exercise of an option through the payroll, rather than via the self-assessment system.
   d) Align the income tax return filing date for vested RSUs with the normal “pay and file” income tax return date.

Overview of the Irish Regime

Different types of business have different challenges and priorities in rewarding staff with equity. In designing a tax policy to incentivise share-based remuneration it is critical that these differences are recognised. We have gathered feedback from our members on the different needs and issues for different categories of business.

We have identified below the current challenges and our recommendations for legislative change for:

- Start-ups and SMEs.
- Large private companies.
- Listed companies – multinationals (MNCs) and publicly Listed companies (PLCs).

We have also identified common ways that the administration of share schemes could be improved to reduce compliance costs for business generally. We outline these suggestions on page 15 of this submission.

Start-ups and SMEs

The challenges

SMEs and start-ups need flexible mechanisms for attracting and retaining the key staff they need to drive business growth. They have limited cash resources, and often are unable to match the salaries offered by their larger competitors. They cannot operate the tax-incentivised Revenue-approved share schemes, such as APSS and SAYE, because of the costs involved and the lack of choice to offer shares to key staff on a selective basis. Founders will also be concerned about the impact on control and dilution of share value from awarding shares to all employees.

Feedback suggests that there is a low take-up of share plans in SMEs in Ireland. Some start-ups and SMEs may offer share options or restricted shares to key personnel at pivotal points in the company's life cycle. For example, share options can be a very attractive form of remuneration in high-growth potential start-ups where a key employee is prepared to take on the risk of accepting a lower salary with equity in the expectation that the value of their shares will increase in value over time and this gain can be realised.

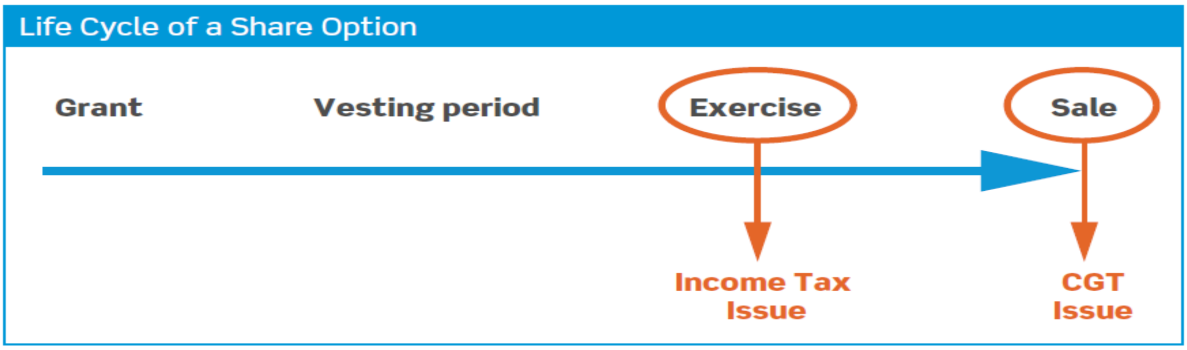
The primary disadvantage for employees accepting equity is that private company shares are generally illiquid. The trigger points for releasing the value of the shares are generally a trade sale, a funding round introducing new investors or a company floatation on the stock exchange. In the absence of these events, the shares or share options may ultimately be worthless.

The tax issues

For the reasons outlined in the Executive Summary, SMEs do not use Revenue-approved schemes. Unapproved schemes are more commonly used given the flexibility they afford to selectively award shares to key personnel. However, shares awarded under these schemes have very high tax costs, which further reduces their attractiveness to employees.

In an unapproved share option scheme, the employee is liable to income tax, USC and employee PRSI at their marginal rate when shares vest e.g. when a share option is exercised. This tax must be paid within 30 days of exercise of the option, notwithstanding that the shares are unlikely to have been sold and the tax liability must be funded from the employee's own resources or from borrowings.

Furthermore, the tax is due on the difference between the market value and the option price at exercise. However, as there is no market or benchmark against which to measure the value, it can be very difficult to accurately value the shares and calculate the tax due. This gives rise to compliance costs in engaging professional assistance. There is also no certainty that Revenue will not challenge the valuation.



- **Income Tax** due even though the gain is only on paper.
- Any gain is subject to income tax, USC and employee PRSI at marginal rates of 52%.

- **CGT** of 33% will be charged on the difference between the sales proceeds and the value of shares when acquired.
- Competitor countries have lower CGT rates.

Furthermore, any gain on a subsequent sale of the shares is liable to CGT at 33%. This disposal may even be liable to income tax at the marginal rate in certain circumstances. Private companies sometimes buy back their shares from their shareholders, in certain circumstances this can lead to tax treatment even more onerous than that outlined above i.e. income tax (rather than CGT) can arise on the share disposal, if certain conditions are not fulfilled. For example, to avail of CGT treatment: [2]

- The purchase must be wholly and exclusively for the benefit of the trade.
- The shareholder must have held the shares for at least 5 years.
- The buyback must result in the individual's shareholding being reduced by at least 25%.

If these, and other, conditions are not met the buyback is treated as a distribution and liable to income tax at the marginal rate. These restrictions were introduced as anti-avoidance provisions to curb any measures to remunerate shareholders from company profits without the payment of a dividend. However, they have a much broader application and act as impediments to holding shares in SMEs.

Countries such as the UK have identified that SMEs and start-ups are at a disadvantage in offering share-based remuneration and need greater supports. The UK has designed a share scheme specifically targeted at helping SMEs and start-ups attract key staff.

Spotlight on the UK EMI

In the UK "Enterprise Management Incentive Scheme" share options with a market value of up to £250,000 can be granted tax-free to employees of certain trading companies which have less than 250 employees and gross assets not exceeding £30 million. Certain requirements on working time must be met and the employee cannot have a material interest in the company, broadly a 30% shareholding.

No income tax or NIC is paid on the grant of an option to the employee. No tax or NIC is payable on exercise of the option either, unless the exercise price is less than the market value at the date of grant. CGT is paid once the shares are ultimately disposed of. If the shares are held for one year or more from the date of grant they can qualify for the reduced rate of CGT of 10% (under Entrepreneur's Relief). You can obtain prior approval from HMRC to operate the scheme although it is not a requirement.

Feedback from members has indicated that this regime has been successful in assisting the up-take of share ownership in UK start-ups and SMEs. The scheme can be tailored to suit business needs and the right to exercise a share option can be limited by virtue of time in employment, performance criteria, or the happening of an exit event.

Some employers may try to mitigate the cash-cost to an employee of share ownership, by providing a loan to purchase the shares/exercise a share option and discharge the tax. Under our legislation[3]

[2] Section 176 TCA1997
[3] Section 122 TCA 1997

loans of this nature are treated as a benefit-in-kind and liable to tax under the PAYE regime. The employee is taxed on 13% of the amount of the loan annually until it is paid off. This treatment operates as a further barrier to employee participation in share ownership.

The Irish tax treatment of share-based remuneration does not offer any supports for SMEs. We have outlined below our recommendations for reform to assist them address the challenges they face.

Recommendations

1. Introduce a targeted share scheme for SMEs

One of the biggest barriers to incentivising employees with shares is the funding of the income tax, USC and employee PRSI arising on the exercise of a share option or award of shares. We recommend a new regime is introduced which has similar approach to the UK EMI scheme so that:

- No income tax, USC or PRSI arises on exercise of a share option by an employee, where the employee does not have a shareholding in the company exceeding a certain threshold e.g. a 30% or more shareholding.
- CGT will apply to the ultimate disposal of shares, a required holding period of e.g. three years could be required to avail of this treatment.
- Employees could qualify for the Revised Entrepreneur Relief on the disposal, where the relevant conditions are met.
- A company buyback of shares issued under this regime would automatically qualify for CGT treatment. This may require an amendment to the conditions for CGT treatment in S176 TCA 1997.

2. Launch a broad communication campaign on the new regime

Once the legislative measures introducing this new regime have passed, a broad communication campaign on the scheme and its merits is essential. This should be supported by "plain English" guidance, tool kits and information phone lines on the regime. It is critical that SMEs are fully aware of the scheme.

3. Exempt employer loans from a BIK charge where the loans are used to purchase employer shares or fund the tax on share acquisition

The take-up of share ownership by employees could be further supported by removing the BIK charge on loans by an employer to an employee to fund the purchase of shares in the employer company or fund the tax arising on a share award.

Large Private Companies

The challenges

Large private companies may have significantly more cash resources than SMEs. However, they face similar challenges in the use of share schemes. They need the flexibility to reward skilled staff with equity, due to employee expectations and sectoral norms in e.g. IT and the knowledge-based sectors. They directly compete with listed companies which may have sophisticated share plans for high-calibre internationally-experienced senior executives. There are often existing investors or institutional investors who may not be willing to dilute their shareholdings, so share plans that require a common approach e.g. the APSS or SAYE are not commercially feasible.

The tax issues

Large private companies will also often seek to reward key personnel with shares/stocks with certain restriction or conditions on sale, in order to prevent dilution or transfer of ownership.

Section 128D TCA 1997 provides a reduction in the taxable value of shares that employees receive where there is a restriction on selling those shares for a certain period. This "clog" varies from 10% to 60% depending of the number of years during which there is a prohibition on sale. This relief is useful but is limited to share awards and does not apply to other forms of restricted stock or share options.

Restricted stock units (RSUs) are increasingly common in both listed and large unlisted companies. An RSU is a promise to an employee that on the completion of a "vesting period" he/she will receive shares (or cash to the value of such shares). Vesting typically occurs a number of years after the grant of the stock option and after the happening of a liquidity event, such as a public offering or a funding round. The award is liable to PAYE on vesting if the employee is Irish resident and CGT is payable on a subsequent disposal of the shares.

In calculating the tax due on vesting, no account is taken of the employee's investment risk i.e. that the shares may reduce in value over the vesting period or the liquidity event may not materialise. The employee is taxed on the full value of the award on vesting.

Large private companies face particular difficulties in determining share valuation in the absence of a market disposal and need to use complex methodologies to try to ascertain the share value. This can result in significant compliance costs. We have outlined further below a range of ways this administrative complexity could be minimised for all private companies.

Recommendations

1. **Allow companies more flexibility in awarding shares to key employees under the APSS and SAYE schemes**

Large private businesses need more flexibility to selectively reward key staff. The requirement in the APSS and SAYE schemes that all eligible employees/directors must be allowed to participate in a scheme on similar terms, renders these schemes unfeasible for many large private companies. We believe that these regimes should be amended to allow companies selectively reward key personnel.

Consideration should also be given to increasing the limit in the value of shares employees can receive under the APSS without deduction of income tax, employee PRSI and USC. Currently, the limit stands at €12,700 and has remained unchanged for many years. An increase in the limit would further improve the flexibility of the scheme and its attractiveness for both employers and employees.

2. **Extend USC and PRSI exemption to the allocation of shares to an APSS or SAYE scheme**

The APSS and SAYE could be made more attractive by eliminating the charge to USC and employee PRSI on allocation of shares into an APSS and SAYE trust. These shares are already exempt from income tax under the rules governing these schemes.

3. **Extend the tax treatment of Restricted Share Awards to RSUs**

An employee has to wait a number of years for an RSU award to vest, and there is no certainty that the vesting conditions will be met. Therefore, account should be taking of this time lag and the uncertainty it creates by reducing the taxable value of the RSU by reference to the vesting period, using the abatement set out in S128D TCA 1997.

Listed Companies – MNCs/PLCs

The challenges

The majority of multinational and listed companies implement some form of employee share plan, whether an all-employee plan and/or an "executive- only" plan. Share ownership is often a key component of a competitive remuneration package. It aligns employees' interests with shareholder interests and promotes corporate identity.

Remuneration policy is generally decided centrally. Share plans are often an extension of headquarter-country plans; they cannot be customised to each jurisdiction. A key priority for these large organisations is to minimise the complexity involved in managing these global plans across multiple jurisdictions with different tax and reporting rules. Increased global mobility of staff and a plethora of new reporting requirements, such as FATCA, over the last number of years have further added to this complexity.

Staff mobility can also have a major impact on employees with equity-based remuneration, and give rise to unexpected personal tax liabilities. These must be monitored carefully to ensure that tax does not act as a disincentive to the take-up of an overseas assignment and lead to increased costs for the employee or employer.

The tax issues

Many companies, especially US headquartered companies use Restricted Stock Units (RSUs) to reward key executives. As outlined earlier, an RSU is a promise to an employee that on the completion of a "vesting period" he/she will receive shares (or cash to the value of such shares). Vesting typically occurs three or more years after grant of the RSU and is in most cases subject to certain performance criteria. There is no specific Irish tax legislation dealing with the taxation of RSUs. However, under Revenue's rules [4] an employee is liable to income tax, USC and employee PRSI at their marginal rate on the full market value of the shares delivered at the date the RSU vests, if the employee is Irish resident at that time. This tax is collected through the payroll, often by a sale of a portion of the employee's shares by the employer who withholds the proceeds to pay the PAYE due.

In the case of employees seconded to work in Ireland, payroll taxes may be due in Ireland and in the assignee's home country at the same time. While Revenue has procedures in place to allow for real-time relief from double–taxation that can arise where the RSUs are liable to tax in Ireland and in another jurisdiction, the combination of foreign and Irish tax liabilities can mean in some cases the full value of the share award is discharged in paying the tax liabilities arising and the employee ends up with nothing.

The Irish tax treatment of RSUs differs from the practice in other jurisdictions, such as the UK. In the UK, where a foreign assignee is working in the UK at the time the RSU vests but has not been working there over the full vesting period, the tax liability is calculated on a time-apportioned basis. This means that UK tax is due on only a portion of the value of the vested shares, which is calculated by reference to the period for which the employee was liable to UK tax during the vesting period. The Irish approach to tax the entire gain at the time the RSU vests, regardless of whether the employee was working in Ireland throughout the vesting period, is also not consistent with the tax treatment of share options in Ireland. A share option gain is time apportioned and taxed on a pro-rata basis by reference to the period working in Ireland.

Furthermore, as outlined above, the employee is taxed on the full market value on vesting which takes no account of fact that there has been a vesting period and the investment risk.

[4] Revenue Operational Manual 05.05.30 Restricted Stock Units and Tax Briefing 63

Recommendations

Tax RSUs on a pro-rata basis by reference to the period working in Ireland over the vesting period

Administering global share plans is extremely challenging for international businesses. It is even more difficult due to the mobility of employees and exposure to payroll taxes in more than one jurisdiction. It is important that the Irish tax treatment does not add to this complexity. Our current treatment of RSUs is out of line with international practice and can give rise to a disproportionate tax liability relative to the value of the share award. As a result, Ireland is less competitive in attracting internationally mobile executives who are critical to growth and demonstrating business substance in light of the new BEPS rules.

RSUs should be taxed on a pro-rata basis by reference to the workdays spent in Ireland over the vesting period.

Overall suggestions on administration

The administration and implementation of share based remuneration can be complex and time-consuming for all businesses. A number of common themes arise and we have outlined below our recommendations to improve the administration process, reduce compliance costs and encourage engagement in share schemes.

Recommendations

1. **Clearer guidance on share valuation and "safe harbours"**
   The valuation of shares in private companies is a difficult process regardless of business-size, due to the absence of a ready market for the shares. It is not an exact science [5] and companies use various methodologies to try to accurately value their shares for tax purposes. However, they do not have any certainty that Revenue will accept their valuation. Nor is there any reassurance that Revenue will not revisit the value should a subsequent sale of shares reflect an unexpected boost in value.

   We believe that there should be clearer guidance, methodologies and "tool-kits" for share valuation to assist business in correctly valuing shares. This could include "safe harbours" and a pre-approval mechanism for particularly complex valuations. The best way to develop practical and robust guidance would be from engagement between practitioners and Revenue through fora such as the Tax Administration Liaison Committee (TALC).

2. **A single employer return of share-based remuneration**
   Currently, there are three different returns which employers must file annually to provide information to Revenue about share-based remuneration, depending on the share schemes they use.

[5] Revenue CAT Manual

- Form RSS1 - Return of Share Options and other rights (unapproved)
- Form SRSO1 - Return of Information of an Approved Savings Related Share Option Scheme
- Form ESS1 - Return of Information by the Trustees of an Approved Profit Sharing Scheme

It should be possible for an employer to report information on share awards via a single annual return. The consultation paper seeks views on the most efficient way to collect data on share based remuneration and a single return is the best mechanism in our view.

The current filing deadline for employer returns is three months after the year end. This deadline should be extended by a least a further month to allow for collation and aggregation of the data.

3. **Collecting tax on exercise of share options through the payroll**

   As we have outlined above, tax arising on the exercise of a share option is collected through the self-assessment system. This differs from the treatment of other share awards, such as RSUs and Restricted Shares referred to above. Income tax, USC and employee PRSI is payable by the employee within 30 days of the date a share option is exercised. The employee must submit a Form RTS01 together with the payment due. For administrative simplicity this tax should be collected through the payroll under the PAYE regime, rather than under the self-assessment system. A lead-in time may be required to enable businesses put the appropriate procedures in place to track the exercise of share options and incorporate them into their payroll procedures.

4. **One income tax filing dates for employees**

   If an employee becomes a chargeable person for a tax year and is obliged to file an income tax return, the tax return filing date should be the same regardless of the type of share award involved. Currently, if an RSU vests during the year, an employee is required to file their income tax return by 31 March of the following year. This should be extended to the normal Pay and File deadline.

Appendix

The International Backdrop

Share based remuneration

The UK

The UK has three key schemes in place.

Share Investment Plans (SIPs)
Share Investment Plans (SIPs) are an “all-employee” plan i.e. the shares must be offered to all employees on similar terms. As such, they are mainly used to deliver shares by listed companies given the administrative costs of valuation and delivery of share awards. SIPs replaced the UK version of our APSS in 2000. Under SIP an employer can give an employee up to £3,600 of free shares in any tax year. The employee can also buy shares out of their pre-tax salary “partnership shares”. This is capped at the lower of 10% of your salary or £1,800. The employer can provide two shares tax-free for every partnership share acquired. All the shares acquired/awarded must be held in a special UK resident trust. In general terms, there is no income tax or NIC on the share award/acquisition once the shares are held for 5 years. There is no CGT on the subsequent disposal if the employee holds the shares in the trust until they are sold.

Employer Shareholder Scheme (ESS)
Employer Shareholder Schemes (ESS) are mainly used to deliver shares to senior executives in corporate environments where there is a close working relationship between the executives and shareholders. Under the scheme an employee gives up statutory employment rights, in exchange for shares. Once certain conditions are met, there is no income tax or NIC on the first £2,000 of shares awarded. No CGT arises where the company buys back their shares. The scheme cannot be implemented in Northern Ireland as the necessary amendments to employment legislation were not made.

Enterprise Management Incentive (EMI)
The Enterprise Management Incentive (EMI), is designed to help small companies and start-ups attract and retain key employees. It is commonly used in the technology sector. It affords companies a high level of flexibility in choosing how the terms of the options will operate. Share options with a market value of up to £250,000 can be granted tax-free to employees of trading companies which have less than 250 employees and gross assets not exceeding £30 million. Certain requirements on working time must be met and the employee cannot have a material interest in the company, broadly a 30% shareholding.

No income tax or NIC is paid on the grant or exercise of an option to the employee, unless the exercise price is less than the market value at the date of grant. CGT is payable once the shares are ultimately disposed of. If the shares are held for one year or more from the date of grant they can qualify for the reduced rate of CGT for entrepreneur's relief of 10%. You can obtain prior approval from HMRC to operate the scheme although it is not a requirement. The rules around the regime are quite detailed and complex.

US

Employee Stock Purchase Plan

Many companies have stock purchase plans where shares can be purchased by employees at a discount. A trust purchases the shares for employees. No tax is paid when the trust exercises the option to purchase the stock and credit it to your account. If you request the stock is credited to you and you sell it you are liable to income taxes. However, if you hold the stock within the trust for 2 years before you sell it you are liable to capital gains taxes instead.

Non-Qualified stock options (NSOs) and Incentive Stock Options (ISO)

A NSO is not taxable at the date of grant unless the option is traded through a public exchange. The employee is taxed on exercise at income tax rates on the difference between the cost and fair market value. Any gain on a future sale is liable to capital taxes.

Incentive stock options (ISOs) are not taxable on grant or exercise. If you hold the option for two years after grant and for a further 12 months after exercise, the subsequent disposal is taxed as a capital gain.

Austria

Austrian tax law provides for tax exemption for benefits received under an Employee Stock Option Plan (an ESOP exemption) in case the employee receives shares in the employer or a related group member of the employer. Any taxable benefit from such grant may be exempt from income tax up to €3,000 annually if the ESOP and the employee meet certain requirements. Any (additional) benefit received after the grant date or at the trigger event is also taxable and either subject to progressive income tax rates or the preferential investment in-come tax rate of 27.5%, depending on the underlying interest.