Provisions on the new Employee Stock Ownership Plan

Legal newsletter

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Deloitte Legal Szarvas, Erdős and Partners Law Firm provides its clients with a monthly newsletter on the most recent changes and newly adopted regulations in economic law and the most notable legal cases.

The regulations on the amendments of tax laws in 2016 contain several peculiarities including the provisions on the new Employee Stock Ownership Plan (hereinafter: ESOP) extending the range of employee incentives. According to the new rules, the programme may also facilitate the management of securities obtained under employee incentive schemes leading to significant savings both on the employer's and the employee's side. This issue of our Newsletter will introduce the key provisions pertaining to the new ESOP.

Aim of ESOP

The ESOP may be launched to manage financial assets obtained under an incentive scheme. The general aim of incentive schemes is to **provide employees of a company (group) with free or preferential shares issued by the company (group) or with the associated rights**. Obtainment of the shares is mostly linked to the future improvement of the company's business performance or its efficient risk management, thus **making the employees involved in the scheme interested in effective work performance**.

The new rules also respond to a practical need, namely that in case of financial institutions, insurance companies or investment firms an ESOP may only be launched to manage financial assets obtained under the remuneration policy.

Operating an ESOP

The amendment lays down the specific requirements pertaining to the remuneration policy as well as the criteria for the establishment, operation and termination of the relating ESOP.

The ESOP is a legal entity, which must be registered by court after the acceptance of its statutes. The ESOP – similarly to a business association – **has its supreme body and senior executive, and the members must be listed**. The ESOP is required to hold accounting records in a way that the remuneration scheme serving as a basis for the ESOP may be monitored and controlled, and the necessary data supplied.

The ESOP may only include natural persons that are subject to the relating written remuneration policy equally known to all the employees concerned. Participants – i.e. the employees and senior executives subject to the remuneration policy – hold membership shares in the ESOP, and are entitled to their share from the ESOP organisation's profit accordingly.

It is a general rule that the ESOP will convert the securities or rights obtained by the participant under the scheme to cash if the criteria stipulated in its statutes or in the internal policy corresponding to the remuneration policy are met.

Advantages of an ESOP

A key advantage of the scheme is that it may be linked to the remuneration policy and incentive schemes otherwise applied by the company, thus making participating employees interested in increasing the company's (group's) performance and reaching its future goals.

At the same time, compared to the "traditional" stock option schemes this arrangement has **more favourable tax implications**: the tax burden on the net value obtained under the remuneration policy may be **reduced from 93.23% to 17.5% by establishing an ESOP.**

As opposed to the previous stock option schemes the rules pertaining to an ESOP are **less strict**, e.g. (i) there is no value limit on the compensation obtained; (ii) there is no mandatory participation (holding) period and (iii) there is no restriction regarding the proportion of executives in the programme and the rate of their benefits.

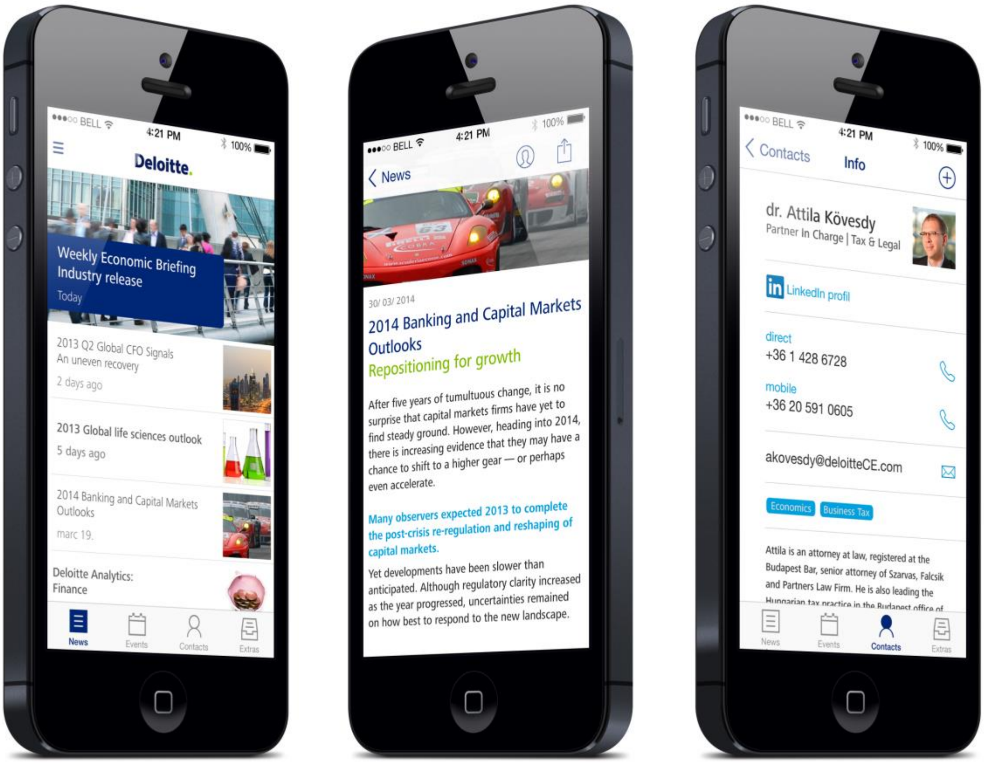
These features will probably encourage more employers to consider introducing the ESOP or modifying the existing incentive schemes.

Issues to consider

Any company wishing to improve employee incentives should consider incorporating an ESOP into the existing remuneration and incentive policy with its numerous benefits.

Perhaps the existing remuneration and incentive policy may be modified in a way that it should meet the criteria of establishing an ESOP.

However, it should always be considered whether its benefits offset the costs incurred in relation to the establishment and operation of an ESOP, and the individual companies should launch or modify their employee incentive programmes accordingly.



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