



## **Key Employee Engagement Programme (KEEP)** Public Consultation Response



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Dear Sirs/Mesdames:

We are pleased to submit comments on behalf of Deloitte in response to your consultation paper on the Key Employee Engagement Programme (KEEP). We appreciate this opportunity to share our views and trust that you will find our comments valuable to the discussion.

We are responding in our capacity as an adviser.

We look forward to continued collaboration with the Department of Finance on this and other tax initiatives and are available to discuss anything in this document, as needed.

Yours faithfully,

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## 1. Executive Summary

The introduction of KEEP was heralded as a welcome move to incentivise Small & Medium-Sized Enterprises (SMEs) to retain and reward staff in a tax efficient manner. KEEP was intended to bring Ireland into line with a number of other jurisdictions in order to assist SMEs in competing with publicly quoted companies who have the ability to use share-based remuneration to attract talent. However, KEEP in its current design has unfortunately failed to provide SMEs with an easy-to-implement and cost-effective way to offer shares to employees.

The restrictions, complexities and numerous conditions, both at implementation and during the relevant period, result in increased costs for the employer company, including professional costs, which we believe are prohibitive for SME companies who are considering implementing KEEP.

Currently companies are facing challenges of cost increases coupled with a constrained labour market and these businesses need to consider alternatives to cash remuneration. The SME sector, and in particular start-up companies with limited cash resources, require a competitive tax effective share scheme to allow them to compete with domestic and international MNCs to attract and retain key employees in the challenging labour market.

The main positive feature of KEEP is the deferral of the tax until point of sale when the employee has cash resources to pay the tax liability. The programme also envisages that CGT will apply at sale, but we have recommended that changes be made to ensure that this remains the case where there is no third-party sale or listing on a relevant stock exchange.

A major challenge for SMEs is the various market valuation criteria that must be met and monitored at grant and throughout the life of the programme. In order to have certainty in relation to these conditions being met professional valuations would be required, often on an ongoing basis, which are typically costly. To reduce these costs we have recommended that Revenue develop and issue guidance on the appropriate valuation methodologies that can be used by SME companies that adopt KEEP and that this guidance includes a "safe harbour" approach.

We have also recommended that changes be made to limit the companies that are excluded from KEEP. These excluded companies will be at a major disadvantage to companies that have qualifying share schemes, so it is important that exclusions only apply where there is a genuine need and where the exclusion will not affect Ireland's strategy for growth such as in relation to the international financial services sector.

The current legislation and related Revenue guidance only allows relief to be claimed by the most simple of group structures. However, in our experience, very few SME group structures are this simple. Overall, it would be significantly simpler and more in line with commercial reality if KEEP options could be granted in either the qualifying company or in a company which controls the qualifying company irrespective of whether that parent company operates only as a holding company as currently defined within Section 128F. Our recommendations in relation to this are set out below.

## 2. Public Consultation Questions

### **Q 1: What aspects of the current design of KEEP work effectively and why?**

We welcomed the introduction of KEEP in Finance Act 2017 as a tax efficient manner for SMEs in Ireland to attract and retain key employees. This is particularly relevant given the current competitive international labour market and certain skills shortages in the local Irish labour market coupled with inflationary pressures on the cost base for companies.

The availability of other tax efficient share schemes to multinational companies that are quoted on a relevant stock exchange had given these companies a competitive advantage in attracting and retaining key staff. It was necessary to ensure that SMEs in Ireland could compete with them in terms of the overall remuneration package they could offer to key employees.

The most positive aspect of the current design of KEEP is the deferral of the tax cost until the shares are ultimately sold. Prior to the introduction of KEEP, the upfront tax cost was prohibitive to SMEs offering share participation to key employees. The employees were, more often than not, unable to afford to fund the upfront tax cost on the receipt of the shares / exercise of the share options from their normal annual cash remuneration. These SME companies, in particular start-up companies, are typically offering employees' share participation because they have limited cash resources and they cannot afford to assist employees in meeting these upfront tax costs.

Another positive feature is that CGT rates will normally apply at disposal as opposed to income tax rates, which are generally higher. However, we recommend changes below in section 2.3 to ensure that this will always be the case.

There are also PRSI cost savings, as with other share remuneration, for the employer which is a positive for SMEs from a cash flow perspective.

### **Q 2: What aspects of the current design of KEEP do not work effectively and why?**

The main aspects of KEEP that do not work effectively are as follows

1. There is currently **no safe harbour provided in relation to share valuations**.
2. The **exclusion of certain companies** including, in particular, technology companies that are also carrying on financial activities, will result in these companies continuing to face unfair competition in the war for talent.
3. The **scheme should allow a company buy back of the shares** from the employee and ensure that CGT treatment still applies.
4. **Changes are necessary in relation to holding companies and group structures** to reflect the realities in relation to typical group structures.
5. We recommend that **changes are made to the remuneration limits** to apply a monetary de-minimis that can apply regardless of cash remuneration. This should ensure that KEEP is relevant to start-up companies in particular that have very limited cash resources.

6. **Revise the requirement for a qualifying individual to be a full-time employee.** We recommend this change to incentivise workers to return to work e.g. returning parents, etc.
7. We recommend that the **relief should be extended where existing shares are granted** – rather than relief only being applicable to new shares.

Section 2 below includes further commentary in relation to each of the above.

**Q 3: What do you see as the most important barriers to further take up of the KEEP, and what is your suggestion for overcoming these constraints?**

We have set out above, in response to question 2, the main aspects of KEEP which are not working. These are the barriers to further uptake of the scheme. We have set out in section 2 our suggestions in relation to addressing these barriers.

**Q 4: There are currently three amendments to the operation of the KEEP scheme which are intended to be commenced shortly. What impact do you expect these changes will have on the take up and operation of the KEEP scheme?**

The three amendments to KEEP from Finance Act 2019 which have yet to be commenced are:

- The scheme will apply to qualifying group company structures allowing options over shares in the employer company or in a qualifying parent company,
- It will permit the use of existing rather than just new shares, and
- The hours required to be worked by an individual have been reduced from 30 hours per week to either 20 hours per week or at least 75% of the individual's working time.

While these are welcome changes, in our view they may have limited impact. In particular the amendment in relation to group companies does not address the issue in relation to the definition of a qualifying holding company. We have included comments regarding these amendments within our suggestions set out in section 2 below.

**Q 5: Do you have further proposals for changes to the operation of KEEP assuming it is extended for a further three-year period from the start of 2023? If so, please provide a brief description of these.?**

Our recommendations are set out in section 2 below.

## 2.1 No safe harbour provided in relation to share valuations

KEEP requires that market valuation criteria be met in the context of 1) the share option price, 2) each key employee's quantum of KEEP share rights and 3) the aggregate quantum of share rights that the company may issue under KEEP.

It is our opinion that one of the most significant practical issues facing SMEs in implementing KEEP is the uncertainty that such valuation conditions have been met i.e. that the share options have been granted at market value, that each employee's entitlement does not exceed the relevant annual/lifetime limit and that the aggregate issued but unexercised share options do not exceed the €3 million company limit.

The valuation of shares can be a complex exercise - especially for non-listed SMEs. Professional valuations (which are not only required on implementation of the KEEP but on an ongoing basis as each new tranche of KEEP shares are granted to employees) place a significant cost burden on smaller enterprises in delivering KEEP share awards to employees. In our view, this is a significant barrier to these companies implementing KEEP.

As an example from another country, companies in the UK can apply to HMRC for agreement to a valuation of shares for the Enterprise Management Incentive (EMI) scheme, which is similar to KEEP. This approval can be sought in advance of issuing the EMI options. This works well as it removes the excessive cost and risk associated with valuing shares giving certainty to the UK company.

We recognise that Revenue may not wish to formally approve valuations on an ongoing basis for KEEP. As an alternative, we recommend that Revenue develop and issue guidance on appropriate valuation methodologies to support SME companies in adopting KEEP.

We recommend that such valuation should include a 'safe harbour' approach on valuing shares in the company.

We suggest that this might be achieved as follows:

- A joint working group (including Revenue's valuation teams and practitioners / industry groups) should develop templates or "safe harbour" approaches for valuing shares in SMEs for the purposes of KEEP. Where a company adopts the safe harbour approach, they should be assured of Revenue's acceptance that the share valuation is not less than market value for KEEP purposes.
- An agreement should be reached that for the purposes of meeting the market value requirements for the purposes of KEEP, a market value determined by reference to:
  - a third party share valuation event (such as investment by a private equity or angel investor),
  - a valuation exercise that meets the safe harbour methodology agreed as per the above, or
  - a standard share valuation exercise that has occurred within the previous 6 months will be accepted by Revenue provided there has been no material change in the circumstances of the company.

## 2.2 Exclusion of Certain Companies

The current definition of excluded activities in relation to KEEP is too widely framed.

Excluded activities currently means

- a) Adventures or concerns in the nature of trade
- b) Dealing in commodities or futures in shares, securities or other financial assets
- c) Financial activities
- d) Professional services companies
- e) Dealing in or developing land
- f) Building and construction
- g) Forestry
- h) Operations carried out in the coal industry or in the steel and shipbuilding sectors.

Financial activities has the same meaning as in Section 489 TCA 1997 and means the provision of, and all matters relating to the provision of, financing or refinancing facilities by any means which involves, or has an effect equivalent to, the extension of credit.

Professional services means

- (a) Services of a medical, dental, optical, aural or veterinary nature,
- (b) Services of an architectural, quantity surveying or surveying nature, and related services,
- (c) Services of accountancy, auditing, taxation or finance,
- (d) Services of a solicitor or barrister and other legal services and
- (e) Geological services

The exclusion of these companies from KEEP places them at a disadvantage in attracting and retaining key staff that are vital to their trading operations. In particular, this exclusion is likely to exclude certain "FinTech companies" and "InsurTech companies".

Ireland has become globally recognised as a hub for financial services technology companies in recent years. "Ireland for Finance" was published on the Department of Finance website in 2019. This contains the strategy for the development of Ireland's international financial services sector up to 2025. The document outlines four pillars, the first of which deals with the key enablers necessary to ensure that Ireland has an effective and efficient operating environment. The document outlines the policies aimed at supporting the industry's development and includes the availability of KEEP as an example. We recommend that changes are made to ensure that these companies qualify for KEEP as in the absence of changes they will be at a major disadvantage in attracting and retaining key staff, as they will have to compete with both multinational companies (that already have other tax efficient share schemes) and also qualifying KEEP companies.

We suggest that it would be more appropriate to align the definition of excluded activities in relation to KEEP with the definition which applies for the purposes of Entrepreneur Relief in section 597AA, TCA 1997. "Qualifying business" in Section 597AA means a business other than:

- a) the holding of securities or other assets as investments,
- b) the holding of development land, or
- c) the development or letting of land.

### **2.3 Amend relevant legislation and related Revenue guidance to clarify the position for a Company Buy Back of Shares**

A major challenge for SME companies who wish to operate KEEP for its key employees will be ensuring that the employees have liquidity in relation to their investment in shares.

Not all of the companies that introduce KEEP will ultimately be sold to a third party or become listed on a stock exchange. We therefore recommend that changes be made to the relevant legislation that applies CGT treatment to a company buyback or redemption of its own shares to ensure that CGT treatment will apply when a company buys back or redeems KEEP shares.

These changes should ensure that a company buyback / redemption of its own shares that were acquired under KEEP will meet the "benefit of the trade" test which is one of the conditions necessary for CGT treatment to apply.

KEEP does not impose any holding period in relation to the ownership of shares by an employee. However, there are holding period requirements in Section 177(6) TCA 1997 in order for CGT treatment to apply to a buy back / redemption of shares. An additional change will therefore be necessary to ensure that CGT treatment is available in relation to KEEP shares that are bought back / redeemed by the company.

A change will also be necessary to Section 178 TCA 1997 to remove the requirement for a substantial reduction in a shareholder's ownership in relation to KEEP shares. This is to ensure that a company can buy back shares in tranches from an employee – rather than having to buy back all the employee's shares at the one time.

This above is in line with the comment made by practitioners at TALC in 2017 as follows:

*Practitioners noted that it would be welcome if Revenue could confirm in guidance that the buy back of shares acquired under KEEP could meet the conditions for the benefit of trade test under Section 176 TCA, given there is a bona fide test in the KEEP provisions. It was noted that this would be necessary to ensure sufficient liquidity in the shares for employees. Practitioners also raised consequential amendments required to Sections 177 and 178 TCA, in particular to allow KEEP shares to be bought back in tranches. ...*

These changes should ensure that the distribution treatment should not apply when a company buys back or redeems shares from employees that were acquired under KEEP.

## **2.4 Changes are necessary in relation to holding companies and group companies**

The current legislation in relation to KEEP only allows relief to be claimed by the most simple of group structures.

It would be significantly simpler and more in line with commercial reality if it was possible for the KEEP options to be over shares in the grantor company (qualifying employer company) or in a company which controls that company irrespective of whether that parent company is purely a holding company (as currently defined in Section 128F). In our experience, companies typically want to grant options over shares in the parent company rather than at a lower level. Allowing this to happen in a much broader context would bring KEEP in line with SAYE and APSS provisions that allow shares to be granted in the grantor company or a company which has control of the grantor company. Making this amendment would resolve many of the issues raised below in sections 2.4.1 to 2.4.6. The FA2019 amendment extends the use of KEEP to issuing shares in the holding company. However, the amendments are too narrow as they do not address the issue of the activities of the holding company (2.4.2 below).

We recommend that changes be made to reflect the commercial reality in relation to typical group structures and to ensure that holding companies of qualifying companies qualify for KEEP.

We have set out below our recommendations in relation to the changes necessary.

### **2.4.1 More than one subsidiary**

Section 128F (4) states that "A company whose business consists wholly of the holding of shares in a qualifying company shall be a qualifying company for the purposes of this section, where the shares are directly held and comprise of the entire issued share capital".

Currently relief is therefore arguably only available where shares in a holding company are issued if the holding company only holds 100% of the ordinary share capital of the qualifying trading subsidiary.

The current Revenue Manual in relation to KEEP states that "This definition (of Holding Company) intends to limit applicability of relief to companies holding shares in a single subsidiary. It is not the intention to deem companies holding shares in multiple group companies as qualifying for the purposes of the relief".

We recommend that this be amended to reflect the fact that very few SME companies will have such a simple group structure and many holding companies are likely to hold shares in more than one qualifying company. This may include the holding of shares in a foreign subsidiary that the holding company has set up in order to expand its operations abroad. The Finance Act 2019 amendment, yet to be commenced, is welcome in that it extends the definition of a holding company to include a company holding shares in a qualifying subsidiary or subsidiaries.

### **2.4.2 Other activities**

In addition, the definition of holding company for KEEP states that its business must consist wholly or mainly of the holding of shares in a qualifying subsidiary.

We welcome the fact that the current Revenue KEEP manual states that Revenue are prepared to accept that "the condition that the business consists wholly of the holding of shares will be met where the holding

company holds a bank account solely for purposes required by holding those shares (e.g., distribution of dividends)".

However, we would recommend that this guidance be widened to include the other bona fide activities that are normally carried out by holding companies in trading groups.

Examples include holding companies raising debt and lending to subsidiaries, overseeing and managing the activities of their subsidiaries, and in doing so, charging management expenses to their subsidiaries. This should include Irish and foreign subsidiaries. The Finance Act 2019 amendment in relation to qualifying groups does not address this issue as the definition of a holding company still states that its business must consist wholly or mainly of the holding of shares in a qualifying subsidiary or subsidiaries or where it has a relevant subsidiary of subsidiaries, in that subsidiary or in each of them. This will, in our view, limit the impact of the Finance Act 2019 amendment.

#### **2.4.3 Holding company that also trades**

It is not uncommon for a holding company to be engaged in the conduct of a trade.

This type of group structure often arises as a business evolves and a subsidiary is set up to develop a new product or service line, whilst the original trade remains within the holding company.

We recommend that the definition of a qualifying holding company for KEEP be widened to allow for this. The Finance Act 2019 amendment does not address this.

#### **2.4.4 Other shareholders**

For many different commercial reasons, the relationship between a holding company and its subsidiaries is often less than 100 percent.

Other persons may hold shareholdings in subsidiaries that are controlled by the holding company and form part of a group with the holding company.

This may be the case where an outside investor makes an investment in a particular group company for example.

We recommend that the definition of a qualifying holding company for KEEP be widened to allow for this. The Finance Act 2019 amendment, yet to be commenced, amends the definitions to allow for a company to qualify where the holding company holds directly or indirectly more than 50% of the subsidiary. This amendment is welcome.

#### **2.4.5 Cross company duties**

The KEEP legislation also envisages that employees will be carrying out duties for a single qualifying company.

In reality, an individual may hold a directorship or employment contract with one group company but their services may often be made available to other group companies e.g. the holding company and one or more subsidiaries. This is very common within SMEs in particular.

In addition, an employee may have their employment contract transferred to another group company because of specific business needs during the relevant period. The SAYE and APSS legislative provisions allow for a group scheme such employees who remain within the group can retain the tax benefits of their options or APSS shares.

We recommend that changes be made to ensure that employees should still be able to qualify for KEEP in these situations. This has not been addressed by the Finance Act 2019 amendments.

#### **2.4.6 Group structure changes summary**

We suggest that the changes outlined above are made to reflect the commercial reality of holding company structures and the manner in which many employee / director arrangements work within SMEs.

We recommend that consideration is given to a revised approach to the definition of an eligible corporate structure. We suggest that this may be achieved by adopting the approach in section 597AA which defines a qualifying group and recognises that individuals may be an employee and/or director of different companies within the qualifying group structure.

## **2.5 Changes to the remuneration limits**

Changes were made in Finance Act 2018 to make KEEP more attractive by increasing the value of share options that could be granted to an employee in one year from 50% to 100% of the employee's annual emoluments. This change was a welcome one.

However very many start-up companies are, while in their infancy, only in a position to pay relatively low salaries to employees. This restriction of the annual award to a % of the remuneration limits the ability of these companies to attract the key staff needed to grow their business. We recommend that there is an annual cap on the value of KEEP shares that can be issued to an employee, irrespective of the employee's annual emoluments e.g. up to €100k.

The Finance Act also changed the overall limit in relation to qualifying KEEP shares that could be granted to an employee from €250,000 in any three consecutive years to a lifetime limit of €300,000, which made the programme less attractive.

Clarity is also needed that this lifetime limit applies per employment within a qualifying group, rather than per individual, given that employers will not have information on KEEP shares issued by other 3<sup>rd</sup> party/ non-group employers.

## **2.6 Revise the requirement for a qualifying individual to be a full-time employee**

The definition of qualifying employee for KEEP means an employee who throughout the entirety of the relevant period is a full-time employee or full-time director of the qualifying company and is required to devote substantially the whole of his or her time to the service of the company. For the employee to meet this condition there is a minimum requirement for the individual to work at least 30 hours per week for the qualifying company.

In the current labour market, employers are becoming increasingly flexible with employees in order to attract key staff (including in particular parents who are returning to the workforce). Many employees work part time hours on a fulltime basis including for example employees who may job share or work mornings.

We recommend that changes are considered to allow KEEP to apply in these circumstances. For example, the minimum hours required could be reduced to say 20 which would allow those working sufficient part time hours on a fulltime basis to qualify. The Finance Act 2019 amendment changes the definition of a qualifying employee to one that works at least 20 hours per week for the company or at least 75% of their working hours. This is a welcome change.

## **2.7 Relief should be extended to existing shares**

In order for shares to qualify for KEEP they must currently be new ordinary fully paid up shares in a qualifying company.

It is common for a trust arrangement to be used by companies to set aside shares for employees and to manage the delivery of shares to them.

We recommend that changes are made to ensure that existing shares can qualify for KEEP. The Finance Act 2019 amendment to the definition of a qualifying share option allows for this which is a positive change.



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