Public Consultation

Taxation of Share Based Remuneration

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Dear Sir/Madam,

We are pleased to submit comments on behalf of Deloitte in response to your call for input on the Taxation of Share Based Remuneration. We appreciate this opportunity to share our views and trust that you will find our comments valuable to the discussion.

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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Table of Contents

Executive Summary

Overview

Share based remuneration has long proven to be an effective tool for rewarding employees. The provision of share based remuneration incentivises employees as the performance of the company impacts their return and the value of any shares they hold. It empowers employees by linking their reward to their employer’s financial performance leading to increased employee motivation. Positive employee performance can drive growth for the company which has a positive impact on the economy overall and translates into increased employment and more revenue for the exchequer through increased tax-take.

We believe that there is a clear policy rationale for supporting share based remuneration. Such remuneration is shown to improve company performance. Where companies based in Ireland perform well, this results in wider economic benefits. The tax treatment of share based remuneration is a key factor in the success of such schemes and needs to be effective in two ways.

Firstly, it is critical that there are no cost barriers to employers offering share based remuneration schemes to employees. The current Pay Related Social Insurance (PRSI) exemption on share based payments is critical to the success of these share plans. The cost saving on the reward by way of share based remuneration (rather than cash remuneration to employees) generates a saving for employers. This saving may be used to cover the costs of establishing and operating the scheme such that there may not be a net cost to the employer of operating the scheme.

Secondly, the tax treatment on the share based remuneration itself must be favourable for the employee. The employee is taking a risk by accepting shares rather than cash remuneration so the potential benefit must be worthwhile. Without favourable tax treatment, both on the issuance of any shares and on any subsequent disposal, the employee may be inclined to simply opt to accept an additional cash reward instead of share based remuneration. Given the overall potential benefits share based remuneration can bring to the growth and development of companies, we would consider it critical that the tax treatment of such remuneration is viewed as favourable from an employer and employee perspective.

Given Ireland's high personal and capital gains tax rates, the regime in Ireland is not as attractive as in some of our competitor jurisdictions. We would suggest that the Government consider implementing lower rates of personal tax and capital gains tax on share based remuneration and the subsequent disposal of such shares. This would incentivise employees to bear the risk of share based remuneration over cash reward if their potential tax liability would be lower. In addition, it would make Ireland more competitive in attracting key personnel to Ireland from abroad to take on key roles in Irish companies or Irish based Multinational Companies (MNCs).

Suggested measures

Some of the current share schemes in operation in Ireland are not working effectively and should be reconsidered in order to offer attractive, competitive alternatives to cash that can incentivise people to locate in Ireland. The key measures we are proposing are summarised below.

1. The introduction of the Capital Gains Tax (CGT) Entrepreneur Relief in Finance Act 2015 was a welcome move and this relief should be expanded in upcoming budgets.

2. We also believe that the introduction of a CGT tapering relief could act as an incentive for individuals to invest in companies on a long-term basis.

3. The government should consider introducing reduced tax rates on the receipt of dividends from share based remuneration. The marginal rate of tax in Ireland charged on dividends earned by an individual is high compared to, for example, our counterparts in the UK and the US and could act as a disincentive to key executives locating here.

4. The application of PRSI and Universal Social Charge (USC) to the Approved Profit Sharing Schemes (APSS) and Save As You Earn (SAYE) schemes in Ireland is a further competitive disadvantage as the similar incentives in the UK are not subject to the UK's National Insurance Contributions (NICs). As such, the disapplication of PRSI and USC to these schemes could put Ireland on a par with the UK and act as an encouragement for employers to implement such arrangements.

5. The tax treatment of share awards imposes an immediate charge on the employees when the shares are vested or the options are exercised. This up-front tax charge must be self-funded by the employee. This could act as a disincentive to the employee if they do not have the cash flow available at this time. We would recommend that any tax due on share awards is derferred until the shares have been disposed of or for a fixed period of time.

6. With regard to the tax treatment of 'long options' which are common in certain growing industries such as the pharma and tech industries, the application of income tax up-front is a disincentive. In their start-up phase, companies would often grant long options in an effort to tie-in key personnel for this growth phase. Australia extended the maximum period for a tax deferral for such long options from seven years to fifteen years and in the UK, share options schemes can be exercised up to ten years after the grant date. We would suggest the Irish government consider amending Irish law and extending the maximum period of tax deferral to attract key personnel.

7. S128C of the Taxes Consolidation Act 1997 (tax treatment of directors and employees who acquire convertible securities) is challenging for Small and Medium Enterprises (SMEs); given their nature, they often wish to purchase back the shares from employees when they leave the business. However, this may invoke the broad provisions of S128C, which we understand is not the intention of the legislation. In addition, there is a risk that employees in this situation subject to a share buy-back would be treated as having received an income distribution rather than crystallising a capital gain on their disposal. This provision should be amended together with an amendment to S128C to relieve the challenges facing private SMEs.

8. Careful consideration should also be given to the share schemes operated in other jurisdictions, such as the UK and US. For example, the Enterprise Management Incentives (EMI) scheme in the UK has greatly enhanced employee ownership in UK start-ups and aided entrepreneurs in attracting top talent as has the US Employee Stock Purchase Plans (ESPP), both of which are discussed in this submission. We would recommend that similar schemes be considered in Ireland, including the introduction of new incentives.

9. The administration of share options and other share awards can be confusing for employers and employees. We would recommend that an elective option is put in place in respect of share based remuneration that would allow an employer to operate withholding, which would also ensure that the relevant taxes on this remuneration is delivered to Revenue.

10. In order to ensure accurate data is obtained by Revenue, a simplified data collection mechanism should be considered. Given that there is currently a myriad of forms to be submitted depending on the scheme(s) being operated by a company, this could all be simplified to one form and perhaps submitted as part of the P35 or on one separate form rather than the multiple different forms in operation at present.

Conclusion

In summary, we believe that share based remuneration has a significant role to play in attracting and retaining key talent in companies based in Ireland, be they start-ups, established SMEs or MNCs. Attractive share based remuneration packages are also key for Ireland being competitive globally in attracting talent to Ireland. When key executives are choosing a location, their personal tax position is a critical factor in their decision and attractive share based remuneration treatment can play a major role in that decision. The above suggested measures are outlined in further detail as part of our submission. The aim at all times is to make Ireland an attractive place to do business for both indigenous and multinational companies which benefits Irish employers and the economy as a whole.

Consultation Response

General Comments

Share based remuneration has been proven as an effective method of rewarding employees.

In 2002 Congressional Testimony in the US, Douglas Kruse, of Rutgers, the State University of New Jersey, summarised the results of thirty empirical studies conducted over a twenty year period that directly addressed the issue of whether an employee-owned company does as well as other companies. Most of the studies on the relationship between employee ownership and company performance found a positive correlation, Kruse reported, though some found no correlation. None found that equity ownership actually hurt business performance.

Among the specific findings:

- Companies adopting an Employee Share Ownership Plan (ESOP) saw between four percent and five percent higher productivity the year they did so; the higher productivity level was maintained in subsequent years.
- Employee ownership was associated with greater stability of employment, without any corresponding reduction in economic efficiency.

- Employee ownership was linked to faster employment growth, and to higher survival among companies [1]

Kruse, together with Joseph Blasi, a colleague of Kruse's in Rutger, in another study, studied 105 publicly traded companies. Each of these companies implemented plans providing stock options to at least 75% of their employees. Kruse and Blasi found that, in the three years following implementation, the productivity of these companies improved by 17 percent and return on assets by 2.3 percent.

It is worth noting that some significant business leaders are publicly declared fans of employee ownership. Business leaders such as Intel ex-chief executive Craig Barrett, Google co-founder Larry Page, ex-Chief Executive Officer of Cisco Systems John Chambers and Howard Schultz, founder of Starbucks have all spoken favourably on the impact employee ownership had on the growth of their businesses.

Question 1

What aspects of the current system of taxation of share based remuneration are working effectively and why?

The current system of taxation of share based remuneration has some elements that work effectively.

PRSI

The exemption from employer's PRSI is effective as it encourages employers to offer shares to employees. The administrative costs of operating share schemes are generally funded by this saving. This is particularly beneficial to cash strapped start-up companies/SMEs who need to be able to offer incentives to attract and retain staff but who cannot afford to fund higher cash remuneration.

APSS

The APSS is effective to a degree and provides a reasonable framework for allowing employees to obtain shares in their employer. The APSS scheme is available on an equal basis to all employees. However, it can be quite restrictive in terms of its use, as discussed below. Another advantage of the APSS is that a qualifying discretionary bonus can be applied as the employer contribution, resulting in no additional costs for an employer.

Question 2

What aspects of the current taxation of share based remuneration are not working effectively and why?

Tax Rates

Ireland's high personal tax and CGT rates are out of line with other countries resulting in share based remuneration being unattractive by comparison to our competitors.

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[1] Douglas Kruse, "Research Evidence on Prevalence and Effects of Employee Ownership" testimony before the Subcommittee on Education and the Workforce, U.S. House of Representatives, February 13, 2002

For example, the standard rate of CGT in the UK is 20% compared to 33% in Ireland. In addition, the UK Entrepreneurs' Relief reduces the rate of capital gains tax to 10% for certain business assets, subject to a lifetime limit of GBP 10 million of gains per individual. Such a relief can result in a disparity in the amount of tax payable by an Irish tax resident individual compared to a UK tax resident individual. This disparity could have a significant impact on key executives choosing to base themselves in Ireland compared to the UK. While the Entrepreneur Relief introduced in Finance Act 2015 was a welcome move, this relief is limited in that it applies a 20% rate of tax on the first €1 million of qualifying gains. We recommend that this relief should be extended to apply to an equivalent amount of gains to the UK and that the rate should be reduced to 10% to allow Ireland to compete with the UK in this regard. This should be considered as part of upcoming Finance Acts.

However, we believe that the Government can go further in encouraging entrepreneurship and share ownership in Ireland. We would suggest that some form of tapered tax relief for CGT purposes could be introduced. This tapered tax relief could operate in such a manner that the applicable CGT rate would be reduced on a pro-rata basis, depending on the length of ownership in the relevant assets by the individual concerned. CGT tapering relief was brought into Irish legislation previously in the 1970s, with the then Minister for Finance, in outlining the rationale for such treatment, said that *"A basic aim of any capital gains tax should be, I believe, to discriminate between the speculator and the genuine entrepreneur or businessman or famer. Equity clearly demands that investment and hard work should not be penalised while economic logic demands that a capital tax should not act as a disincentive to economic activity. A man who builds up a business over 15 or 20 years, putting time, effort and money into its improvement and expansion, should not be taxed on the same basis as somebody who simply buys and sells an asset within a short time, relying solely on market forces to increase the value of the asset in question."* In our view, one way of making this important distinction in the CGT code would be to have the rate of tax depend on the period of ownership. The length of ownership should be, in general, an indicator as to whether the owner acquired the asset as a genuine non-speculative investment or whether he acquired it merely in the hope of disposing of it to achieve a short-term gain as soon as market forces were favourable.

In our view, the design of such a tapering relief should encourage long-term ownership, which could be achieved by providing for the CGT rate to be reduced over time depending on the period of ownership/active involvement as follows:

Period of ownership	*CGT rate applicable*
0-5 years	33%
5-10 years and a full-time working director for 5 years	16.5%
10+ years: working director for 10 years and a full-time working director for 5 years	8.25%

In addition, 100 per cent rollover relief should be allowed for persons who exit the business earlier but then re-invest 75 per cent of the proceeds in another company.

From an income tax perspective, the UK income tax marginal rate is 47% and this applies only on income over GBP 150,000. Income between GBP 31,786 and GBP 150,000 is subject to an approximate 42% marginal income tax rate. From 6 April 2016, a new annual dividend allowance of GBP 5,000 was introduced, with rates of tax on dividend income in excess of this allowance being between 7.5% and 38.1% depending on the income tax band applying (taking the dividend income and other taxable income into consideration in determining the rate of tax payable on dividends). This rate is also slightly lower than the usual rates of income tax in the UK (at 20%, 40% and 45% respectively depending on the income tax band). This is significantly lower than the Irish marginal rate of tax of up to 52%, In the US, dividends may be subject to tax at a rate of 20%, which again, is far lower than the applicable marginal rate of income tax in Ireland.

Such differences in the potential tax rate on the disposal of shares and on the receipt of dividends from any shares granted as part of a share based remuneration scheme could act as a disincentive to key personnel considering relocating to Ireland and indeed to directors or employees viewing share based remuneration as an appropriate motivation tool.

In the US, the excess of net long-term capital gains (generally gains from investments held for more than one year) over net short-term capital losses (net capital gains) generally is taxed at a maximum rate of 20%. The net capital gains rate is also applicable to qualified dividends received from domestic corporations generally and from certain foreign corporations.

SAYE & APSS

The SAYE Scheme is not working effectively. There are only a limited number of banks acting as the approved savings provider. In our experience, the majority of Irish banks are not offering the SAYE scheme as approved savings providers, with only one UK bank operating the scheme. The challenge is to involve Irish banks in this scheme to enable more companies take part in SAYE schemes or perhaps removing the requirement for a savings provider.

While the relevant shares are acquired at a discount the base cost on disposal is the amount actually paid on acquisition and not the market value of the shares on that date. This effectively means that the individual pays tax at the capital gains tax rate on the amount of the discount received. This is in contrast to the APSS where the base cost for a future sale is the market value on allocation of the shares at the start of the 3 year holding period. This treatment for an SAYE can act as a disincentive to employees as the tax saving is reduced and we would suggest that the base cost should be the market value on the allocation of shares.

Another drawback of the SAYE scheme is that it is very long term in comparison to similar schemes globally such as the Employee Share Purchase Scheme in the US. The SAYE scheme generally involves 3-5 years of saving before shares can be purchased. However, under the US scheme, shares can generally be purchased quarterly or twice annually. A similar approach could be taken in Ireland.

With regard to the APSS scheme, it is understood that the APSS is intended to treat all employees in an equal manner and to treat all employees and directors on similar terms. In practice, the percentage that can be given to any one person is restricted by reference to the percentage target bonus for lower level employees for investment in the APSS.

The maximum shares that can be obtained per annum is €12,700 which may be further reduced by the restrictions mentioned above regarding the percentage target bonus for lower level employees.

The fact that the APSS and SAYE schemes must be offered to the entire workforce on similar terms can make it difficult, in particular for SMEs to use share based remuneration as a motivator to attract talent for particular roles within the business. If companies were enabled to offer such schemes to particular employees only, there is likely to be an increased uptake of the schemes.

By contrast with the UK where NIC is not payable in respect of approved share plans such as the SAYE or Share Incentive Plan (SIP) the application of USC and PRSI to the APSS and SAYE is a disincentive in Ireland.

Share Options

Where share options which have been granted by a company are exercised, income tax, USC and employee PRSI is charged on the date of exercise on the difference between the market value at the date of exercise and the option price. The payment of these amounts must be funded by the employee themselves. Given that the employees have not received cash remuneration upon which they are being taxed, employees may not have sufficient funds to make such income tax, USC and employee PRSI payments and this could act as a disincentive to employees exercising their options. We recommend that any tax due on the exercising of share options is deferred until the shares have been disposed of or for a fixed period of time. This would incentivise employees to take part in share option schemes as they would not have to, at the time of exercising their options, self-fund these amounts on the transaction.

Long options

A separate point worth noting with regard to elements of share based remuneration which is not working effectively relates to the tax treatment of 'long options' with a vesting period in excess of 7 years. Under current Irish tax law this could attract an income tax charge up front on the granting of the share options concerned if they are offered at a discount. This can be viewed as a particularly punitive provision from the perspective of start-up companies in, for example, the pharmaceutical or technology space which can typically go through an investment period in excess of 7 years until shareholder value is created given that the business is based on the success of the underlying research and development taking place. In this context, it is relevant to note that the Australian Government extended the maximum time for tax deferral on share options from 7 to 15 years, which is aimed at giving companies more time to build their businesses and succeed. In the UK, share options can generally be exercised up to ten years after the grant date and avail of beneficial tax treatment in this ten year period. We would recommend that Ireland follows suit in this regard and introduces a similar change in law to recognise the investment period required for certain start-up companies.

Convertible Securities

S128C of the Taxes Consolidation Act 1997 looks at the tax treatment of directors and employees who acquire convertible securities and is very widely drafted. It applies where there is a contract, agreement or arrangement or condition which provides for the conversion of employment related securities, either by the holder or a person other than the holder, into money or money's worth. If the legislation applies an income tax charge applies on the conversion (chargeable event).

In presenting the Finance Bill which introduced S128C into Irish tax legislation, Minister for Finance of the time Brian Cowen outlined "As with all Finance Bills, there are a number of measures to address tax avoidance. Section 16 is one such provision relating to convertible securities. The provision will ensure that the full value of the securities received by an employee or director will be subject to income tax." The explanatory memorandum for the Finance Act provides some additional background on the reasoning for introducing this legislation, providing that "Currently, the income tax charge on the acquisition of a convertible security is based on the market value of the security at the date of acquisition. This does not reflect the reality of the director or employee acquiring a security plus a right to convert that security subsequently into a more valuable security. The rules set out in the new section 128C rectify this by imposing an additional income tax charge on the occurrence of a number of events associated with such securities (including but not limited to conversion and disposal)."

Deputy Willie O'Dea, in discussions in the Seanad, outlined that "the current position is that where an employer gives employees shares in the company, these shares are taxable at their current market value. What is happening in many cases is that companies are giving shares, securities or other types of financial interest in the company to employees at a certain market value, which is quite low, which these employees have immediate right to transfer to a different type of security what is much higher in value. However, the tax applies only on the lower value. This represents straight tax avoidance. The shares might as well have been given tax-free."

It would seem that the main intention of the legislation was to capture specific transactions where the securities were immediately convertible into securities of a higher value. This situation is unlikely to apply in the context of SMEs and other private companies who seek to put a share scheme in place, but depending on the applicable fact pattern they may still be within the legislation.

This legislation creates two commercial challenges for private companies, largely SMEs, when seeking to put a share scheme in place, namely liquidity as there is no market for the shares and protection for the shareholders when an employee may leave the business. Commercially these companies need to be able to provide for shares to be purchased from employees when they leave the business (whether as a good or bad leaver as defined in the relevant plan) so as to protect shareholders or to be able to provide liquidity to the participants after a set holding period. For these private SMEs we believe S128C should be relaxed such that in specific circumstances a company buy back provision would not invoke the convertible securities legislation.

Where there is to be a buy-back of shares in a private company context, the provisions of S176 of the Taxes Consolidation Act 1997 also need to be considered. S176 allows the share buy-back to be treated as a transaction for CGT purposes and not as an income distribution where certain conditions are met e.g. where the employee has held (or is deemed to have held) the shares for at least five years and not if Revenue were to consider that the transaction failed the trade benefit test. An employee ceasing their employment is not explicitly mentioned in Revenue's Tax Briefing Issue 25 which discusses circumstances where the trade benefit test is met. In our view, it would be preferable if the law were amended to ensure the benefit of S176 applied for SMEs and other private companies.

RSUs

Share options and Restricted Stock Units (RSUs) are widely used by companies to incentivise and motivate employees. However the current Irish tax treatment applicable to such share options is not fully aligned to incentivising employees given that employees are subject to Irish income tax rates on any share option gains triggered on exercise of the underlying options. The underlying objective behind the granting of share options to employees can be to incentivise employees to work to the goals of the company and to increase shareholder value as the holders of the share options will then be entitled to participate in this value increase through the exercise of their share options. However, the fact that any share option gain triggered will attract the marginal rates of income tax in the hands of the employees can act as a disincentive for the employees.

Alternative share purchase scheme

A new employee share purchase scheme similar to the US ESPP should be introduced. The key provisions of this type of plan would be:

- Allows employees to acquire shares at a discount which we suggest should be up to 25%
- The shares would be acquired either on a quarterly or bi-annual basis
- The employer could hold the funds deducted by employees thereby removing the need for an approved savings institute
- The discount would be taxed at capital gains tax rates but this tax would not be payable until the shares are sold.

This type of plan would encourage employees to hold on to their shares for longer periods leading to a greater connection to their employer and commitment to the success of the business.

Administration

The variance in payroll treatment between share options and other share awards can be confusing for employers and employees. In particular the ESPP (Employee Share Purchase Plans) utilised by US multinational companies are generally classified as share options under Irish legislation. These plans are open to all employees with shares being purchased at a discount each quarterly or every 6 months. This results in relatively small gains but currently gives rise to significant administration for the employees who are required to file RTSO1s and tax returns due to becoming chargeable persons for income tax purposes. Many employees would be content to have withholding applied to such gains to minimise their personal reporting requirements. We recommend that an elective option be put in place in respect of ESPPs and other share options which would allow an employer to elect to apply withholding. If an employer so elects this would then mean that the employee would not, by virtue of their participation in the relevant share option plan, be classified as a chargeable person and they would not be required to file a Form RTSO1. This elective option should give flexibility such that the employer could elect to withhold on ESPPs but not on other share options. However once an election was made in respect of a particular plan this would remain effective indefinitely to ensure consistency of treatment. We believe that this arrangement would potentially increase the tax take as the relevant taxes on this remuneration would be delivered directly by the employer.

Where loans are granted to employees to enable them to participate in share based awards, such loans are subject to benefit-in-kind rules (BIK). We would suggest that the Government consider deferring tax incurred on this BIK until the disposal of the shares. An employee may wish to invest in shares and the employer may be willing to facilitate this through a loan, but the tax on the BIK could act as a disincentive, particularly when this must be paid annually. Deferral of the tax on the BIK could facilitate further employee participation in this regard.

The HMRC in the UK have a share and assets valuations division which will consider a taxpayer’s valuation of shares and confirm if they are in agreement with same. It would be useful if Revenue were to operate a system whereby they would provide confirmation that they are in agreement with the taxpayer’s valuation. This would provide welcomed certainty to the taxpayer concerned.

In addition, it is worth noting that there is a level of bureaucracy around share schemes that all companies have to deal with but which dis-proportionately effect start-ups and entrepreneurs. An example includes the requirement for a trust company for the ”clog shares” arrangement under S128D of the Taxes Consolidation Act 1997. Our recommendation is that action is taken to remove this increased bureaucracy which has the effect of increasing costs for smaller companies operating share schemes.

Approval requirement

We acknowledge that there have been approved share option schemes in Ireland in the past. However, the uptake of such schemes was often low, owing to the onerous conditions. An approved share option plan could be attractive if correctly structured. The conditions incorporated into the re-introduction of any such similar initiative should be carefully considered in order to ensure they are less onerous in order to encourage businesses to operate these schemes and employees to take part in such schemes.

The UK have moved away from the requirement to obtain HMRC approval on tax advantaged share remuneration plans and instead offer a self-certification process for tax advantage schemes such as Share Incentive Plans (outlined below), SAYE scheme and Company Share Option Plans (CSOPs). The removal of the approval requirement for APSS and SAYE schemes and the implementation of a notification process similar to that in place in the UK would incentivise more companies to operate such schemes when the requirement to obtain Revenue’s approval is removed. The HMRC in the UK retain the right to enquire into such schemes but the approval process no longer exists in the UK. In particular, this may act as an incentive for companies, including SMEs, to be more willing to offer such schemes without such onerous requirements to go to Revenue.

Question 3

Evidence has shown that companies with Employee Financial Performance perform better. If this is the case, is there a policy rationale for the tax system to support share based remuneration?

Yes, we believe that there is a policy rationale for the tax system to support share based remuneration. The performance of companies is critical for economic growth and to fund the Exchequer. Where companies perform strongly, this has far reaching benefits, some of which may include:

- Increased employment
- Increased tax revenue (both direct and indirect) for the Exchequer
- Increased local economic activity

Encouraging company performance through supporting Employee Financial Performance can lead to larger economic benefits.

Where employees have accepted, as part of their remuneration, share awards in the company then they have taken on a level of commercial risk in the sense that if the company does not generate increases in shareholder value over the vesting period of the options then the share options have little or no value for the employees. In this situation, the employees are likely to be de-motivated as they may have been better off accepting an additional salary payment subject to full PAYE, PRSI and USC deductions at source rather than the share options.

If, on the other hand, any share award gains realised by the employees attracted a final rate of tax on income equivalent to the Irish CGT rate of 33%, this would act as a further motivator for the employees to maximise shareholder value in line with the company's goals and objectives. Additionally, the employees would perhaps be happier to accept the commercial risk associated with the share awards in the knowledge that any share award gains would attract the lower final rate of tax on income of 33%. We would therefore recommend that, in order for share awards to fulfil their commercial purpose of acting as an incentive for employees to maximise shareholder value, a final rate of tax on income equivalent to the Irish CGT rate should apply to share award gains realised on exercise.

Question 4

Does the rationale for use of share-based remuneration vary based on the size and/or age of the company? If so, what factors are relevant to

i. **Start-up companies**

ii. **Established small to medium enterprises**

iii. **Large established enterprises**

In our view, it is likely that the rationale for the use of share-based remuneration varies based on the size and/or age of the company.

Start-up companies

In the case of start-up companies, attracting and retaining talent can be key to the success, growth and development of such companies. The availability of share-based remuneration can be used to tie in executives and attract executives to take key positions in start-ups. The experience and knowledge of these executives can be invaluable to the development of start-up companies to enable them to grow and become medium or large enterprises.

Often start-ups are cash poor and the provision of share-based remuneration acts to attract key executives and to encourage employee and director buy-in to work towards the success and future of the business.

The tax cost of preferential tax treatment on share-based remuneration for start-up companies is likely to be small as the value of shares in start-up companies would generally be low and therefore the tax foregone by the Exchequer may be, in a lot of cases, minimal.

The 2005 OECD report "The Taxation of Employee Stock Options" Report (2005)" highlights how share based remuneration can be "an effective instrument in attracting and retaining personnel that otherwise would prefer to work in larger companies".

The commercial rationale for making share based remuneration attractive for start-ups together with the probable low value of the share options granted in the first instance would cause us to encourage attractive share based remuneration packages to be available to start-up entities.

Established small to medium enterprises

In the case of established small to medium enterprises, such enterprises have the potential to continue to grow and become a major Irish company in the global market. Enterprises such as Kerry Group, CRH and Glanbia contribute massively to the Irish economy. However, they too had to grow and develop over time. Providing small and medium enterprises with the opportunity to attract and retain the best personnel to help them grow and develop could result in a growing number of Irish PLCs being successful globally.

In addition, Irish companies may seek to attract talent from abroad and it is important that the Irish tax system is competitive in this regard. For example, share based remuneration is very common with US MNCs. As such, Irish companies need to be in a position to offer competitive share based remuneration schemes that will allow them to attract and retain the best personnel that can facilitate their growth and development.

Large established enterprises

While start-ups and SMEs may wish to use share based remuneration to attract and retain personnel to facilitate their growth and development, large established enterprises may have already experienced the majority of their growth and may not have the same reasoning for wanting to offer share based remuneration.

However, with large established enterprises, it is also important that they can retain valuable employees and share based remuneration can be a good way to do this. While large enterprises may not be as cash poor as start-ups, share based remuneration offers an incentive to existing employees to continue to work towards increasing shareholder funds in the company where they have a personal interest in same. Large established enterprises often have to include share based remuneration as part of their reward packages to attract the right people in a very competitive market.

Large established entities may also want to use share based remuneration to reward loyal employees who have assisted in their growth and development and contributed to the success of the company to date.

Finally, with large established enterprises, such as multinational companies (MNCs), there is an increasing global requirement for such MNCs to have real substance in jurisdictions where they are operating. In line with this, there is a real requirement to attract and retain key executives in Irish based MNCs in order to ensure that they are meeting the enhanced global substance requirements under the OECD BEPS initiative. Share based remuneration is a key method of rewarding these employees and as such, there is rationale for ensuring the tax treatment of such reward is favourable to attract the right executives to Irish companies.

Question 5

Is the existing exemption from Employer PRSI for share-based remuneration an efficient use of the State's resources, or could this expenditure be more profitably employed in other forms support for employment and/or enterprise?

The existing exemption from Employer PRSI for share-based remuneration does encourage companies to put share-based remuneration schemes in place. There are costs associated with setting up and administering a share-based remuneration scheme. The Employer PRSI saved by virtue of the existing exemption may incentivise employers to put such schemes in place if they feel that there is no additional cost to them. If there was no Employer PRSI exemption in place, and the costs of setting up and administering the scheme remained, companies may be less likely to set up such schemes at an additional cost. Companies may feel that the Employer PRSI that would otherwise be payable can be used to fund the administration of the scheme.

Question 6

Accurate data is essential to the review and justification of tax incentives, but it is recognised that data must be collected efficiently in order to minimise the administrative burden for the employer and/or employee. With this in mind the Department is seeking views on the most efficient way to collect data on share based remuneration. Options may include a stand-alone share remuneration return by the employer and/or employee, or inclusion in the company's annual tax return, or P35 employers' return.

We would agree that it is important to obtain accurate data. Ensuring that share schemes do not increase the level or complexity of reporting is an important consideration for any data collection mechanism. Currently, information is collected on a myriad of forms depending on the scheme operated e.g. Form RSS1 for Share Options, Form SRS01 for SAYE schemes, Form ESS1 for an APSS scheme and Form ESOT1 for an ESOP plan.

The creation of an additional form would create a further administrative burden which disproportionately affects smaller companies. Given the main class of shares that are not currently reported are those which are processed through payroll, then additional reporting through the P35 would be the most straightforward. It is also likely that the individuals preparing the P35 would have this information to hand rather than those who are preparing the annual corporate tax return. Concerns include the fact that this would accelerate the information filing deadline to 23 February which places additional pressure on those teams at a busy time of year, and also that this filing requirement may be outsourced to a different service provider that provides share scheme support.

An alternative would be to consolidate all the share scheme reporting into one form and include any additional information required in that form which could be filed by March 31. The practicalities of being able to file on ROS by allowing an agent to register for that form needs to be incorporated into any solution.

Other options/tax treatment in other jurisdictions

Given that Ireland strives to be competitive in the international market, it is important that we consider the share based plans being offered in key competitors, such as the UK and the US. Any schemes offered by Ireland needs to offer similar benefits as other jurisdictions that are competing for key personnel.

It should be noted that the UK operate a number of different approved share plans.

Enterprise Management Incentives

Enterprise Management Incentives (EMI) are tax advantaged share options. They are designed to help small, higher risk companies recruit and retain employees who have the skills to help them grow and succeed. They are also a way of rewarding employees for taking a risk by investing their time and skills to help small companies achieve their potential. Tax advantaged share options with a market value of up to £250,000 may be granted to a qualifying employee of a qualifying company, subject to a total share value of £3 million under EMI options to all employees. The shares must be in an independent trading company that has gross assets of no more than £30 million and has a permanent establishment in the UK. The grant of the option is tax-free and there will be no tax or National Insurance Contributions for the employee to pay when the option is exercised provided it was granted at market value. A CGT charge arises on the ultimate disposal of the underlying shares. However provided that a period of 12 months has elapsed between grant of the option and the sale of the shares a preferential capital gains tax rate of 10% may apply to the first £10 million of the gain. This regime has greatly enhanced employee ownership in UK start-ups and aided entrepreneurs in attracting top talent and we would therefore recommend that consideration is given to the introduction of a similar initiative in Ireland.

In the 2009/2010 UK tax year, 12,500 companies in the UK operated one or more tax advantaged employee share schemes. Of these, 10,610 companies operated EMI schemes, with 16,900 people being granted options and 5,200 people exercising options in that financial year.[2]

In a 2008 survey commissioned by HMRC "Enterprise Management Incentives (EMI) Evaluation Survey: Use of EMI and its perceived impact"[3], 79 per cent of employers said that EMI had been most successful in helping the companies retain key or skilled employees and improve staff motivation. In addition, 78 per cent of employers said that they would keep using EMI in the future. Those who will not use it in the future said the reason for this would be the company is no longer eligible for EMI or that they have already achieved what they wanted from using EMI.

Share Incentive Plan

A further UK approved plan is a Share Incentive Plan (SIP) which is a tax advantaged share award and share purchase plan which must be made available to all UK employees. The main features of the SIP are as follows:

- Four types of shares can be purchased/awarded:
    - Free Shares: employers can give employees up to £3,600 worth of shares a year
    - Partnership Shares: employees can buy up to £1,800 (or 10% of salary if less) worth of shares from their gross (pre-tax) pay
    - Matching Shares: employers can give employees up to 2 free Matching Shares for every Partnership Share purchased
    - Dividend Shares: employers can allow the reinvestment of any cash dividends paid on Free, Partnership and Matching Shares into further shares to be held under the SIP.
- Any shares acquired under the SIP must be held in a UK resident trust.

Where the Free, Partnership and Matching shares are held in the plan for more than 5 years, there is no income tax or NIC to pay. (A 3 year holding period is required for Dividend shares to be income tax free.)

Where the shares are removed from the plan before 5 years (3 years for Dividend shares) income tax and NIC may arise on the date the shares are removed (subject to certain good leaver provisions). This type of plan encourages long term share ownership by employees helping to drive growth within the business. By contrast the Irish APSS, which is similar, is not as attractive due to PRSI and USC applying on the appropriation of shares.

Qualifed Incentive Share Options

There are two statutory share based plans in the US, providing tax advantages to employees. The first, Qualified Incentive Share Options (ISOs) which are discretionary market value share options. The main features of ISOs are as follows:

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2 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/198444/ots_share_schemes_060312.pdf Appendix D

3 http://webarchive.nationalarchives.gov.uk/20140109143644/http://www.hmrc.gov.uk/research/report41-summary.pdf

- The exercise price cannot be less than the fair market value of the shares on grant.
- The maximum value of shares under option that can be granted to any participant is USD 100,000.
- Options normally lapse on leaving employment (other than certain 'good leaver' circumstances).

ISOs will not be subject to income tax on exercise; however, the untaxed gain on exercise may be subject to alternative minimum tax when the ISO is exercised.

Generally, once an ISO has been exercised, the shares are not taxable until the date of disposal at which time the entire gain is taxed as a capital gain, subject to certain minimum holding requirements.

Qualified Employee Stock Purchase Plans

The second share based plan in the US is the Qualified Employee Stock Purchase Plans (ESPP). The ESPP is a tax advantage share purchase plan. The ESPP must be made available for all employees of the US company. The main features of the ESPP are:

- The purchase price must not be lower than 85% of the fair market value of the shares at the option grant date, or, if lower, at time of purchase.
- The shares must be held at least two years after granting of the option and one year from the date of acquisition of the shares.

An ESPP will not be subject to taxation until disposal of the shares which encourages employees to retain the shares. To avail of a beneficial tax treatment the shares must be held for at least two years after the granting of the option and one year from the date of acquisition of the shares. If the participant disposes of the shares after this statutory holding period the tax charge will be as follows:

1. A part of the gain will be subject to income tax. The amount so taxed will be the lesser of:
   a. Fair market value (FMV) on grant less the exercise price; or
   b. Sales price less the exercise price;
2. Any additional profit/loss realised on sale will be subject to capital gains tax.

If the participant sells the shares before the end of the statutory holding period the full gain on sale will be treated as income and subject to income taxes. This gain is the FMV of the shares on sale less the exercise price.

Effectively there is, under US legislation, a deferral of the income tax on the ESPP to sale of the shares with a reduced charge where the shares are held for the required period of time.