

EMPLOYEE SHARE SCHEMES IN IRELAND



LK Shields Solicitors 39/40 Upper Mount Street Dublin 2
Tel +353 1 661 0866 Fax +353 1 661 0883 Email email@lkshields.ie Web www.lkshields.ie

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INTRODUCTION

This booklet has been written to provide clients with a general guide to and outline of employee share schemes in Ireland.

In this booklet we:

- (a) look at the reasons why companies have share schemes;
- (b) review the types of share schemes that are available;
- (c) deal with the factors to be taken into consideration when setting up a scheme; and
- (d) discuss action which may be appropriate for companies which already have schemes in existence.

If you wish to establish a share scheme or discuss the full range of possibilities available to meet your specific objectives please contact Fiona Thornton, **telephone (01) 6385827**, **Email: ftThornton@kshields.ie**.

This booklet has been written as a general guide and detailed legal and taxation advice should be sought before taking or refraining from any action in relation to any share plan or intended share arrangement. The information in this booklet is based on the law as at 30 April 2011. The types of share plans referred to in this booklet are not exhaustive but are aimed to give the reader a general idea of current trends.

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1 WHY HAVE A SHARE SCHEME?

- 1.1 For some companies, encouraging employee share ownership may be a goal in itself. Others may decide to set up a share scheme to provide tax efficient benefits to employees under a Revenue approved scheme.
- 1.2 There are other important reasons for introducing share schemes. For instance, they can:
 - 1.2.1 aid recruitment and retention of staff;
 - 1.2.2 encourage employees to identify with the company and make them more interested in how their employer is performing in the market place;
 - 1.2.3 motivate employees to give better service and improve profit; and
 - 1.2.4 encourage employees to drive company performance.
- 1.3 Revenue approved schemes (or arrangements) are framed to comply with detailed tax legislation and may not suit a company's commercial requirements, especially in the run up to an Initial Public Offering ("IPO") or trade sale.
- 1.4 Consequently, many companies which are unable to achieve their objectives within the rigid framework of a Revenue approved scheme will instead choose to set up an unapproved arrangement. Although offering no special tax advantages this can still provide other very worthwhile benefits.
- 1.5 Establishing a successful share scheme and tailoring it to a particular company's needs is a challenge. Under a well designed scheme, there can be major benefits for both the company and its employees.

2 FACTORS TO BE CONSIDERED WHEN SETTING UP A SHARE SCHEME

Many of the below factors in this Section need to be addressed when deciding what type of share plan is appropriate for a company's needs at any particular time. This is not an exhaustive list and some factors may be relevant for one type of company and not another.

2.1 Who pays for the shares?

- 2.1.1 An initial decision for a company is whether it will give shares to its employees free of charge or whether they will be required to pay for the shares and, if so, at what price or value. In the former case it is usual for a trust to be established.
- 2.1.2 If employees are to pay for their shares, a share option scheme may be suitable. Under such schemes a company grants an option to employees who obtain rights to acquire company shares in the future at a price fixed at the date of the grant.
- 2.1.3 Such a scheme can provide that before the option can be exercised a minimum period of continuous employment and the attainment of targets must arise. On exercise, the employee benefits from the increase between the

option price and the then value of the shares. For more information about share option schemes see paragraph 4.1.

2.2 Exit routes: is it always possible for a participant to realise value for his shares?

2.2.1 Where the scheme shares are not traded, on a stock exchange or other market, it may not be possible for scheme participants to access the value of their shares even though this may have significantly increased.

2.2.2 Frequently, the promoters of private companies will set up a share scheme as part of their strategy to effect a trade sale or an IPO.

2.2.3 In some circumstances, inability to trade the shares can be overcome by establishing an internal market in the shares, possibly in conjunction with an employee benefit trust. However, to establish such a market, usually significant turnover in shares should be contemplated. This type of arrangement may be suitable to a group of companies with a very large workforce.

2.2.4 It is important to decide, from the outset, how participants will be able to access value for their shares. Failure to address this may frustrate the aims behind setting up the plan.

2.2.5 Alternatively, it may be possible for one or more of the other shareholders, or even the company, itself to buy an employee's shares.

2.3 Leavers: what happens if a participant leaves the company?

2.3.1 When designing a share plan decisions need to be taken on what will be the outcome when a participant leaves service for good (e.g. normal retirement or death) or bad (e.g. due to misconduct or possibly joining a competitor) reasons before and after entitlement to the shares arises.

2.3.2 It will be necessary to decide what are good and bad leaver conditions. Private companies may also wish to legislate for what must or may happen to the employee's shares when he leaves on good or bad leaver terms.

2.3.3 In addressing these points the following questions should be considered:

- (a) ought the shares be capable of being bought back? If so, by whom?
- (b) will the intending purchaser be able to afford to buy the shares at the relevant time?
- (c) who ought to be the intending purchaser?
- (d) what value should the shares be acquired at?, and
- (e) should this be the same value for bad and good leaver circumstances?

2.4 Will a tax approved or unapproved scheme suit the company's needs?

Another decision is between the flexibility of an unapproved scheme and the tax advantages of an approved one.

2.5 What are the tax consequences of the different types of share schemes?

Some of the key tax issues affecting each type of arrangement are set out in the description of each type of scheme described in this booklet. This is, however, not a definitive or exhaustive summary. Professional taxation advice should be sought.

2.6 Will Stock Exchange rules apply?

Companies whose shares are dealt on the Irish Stock Exchange are required to comply with Irish Stock Exchange Rules. These set out detailed terms which Irish listed companies must comply with when establishing and amending employee share plans.

2.7 Will IAIM guidelines apply?

The guidelines of the Irish Association of Investment Managers (“IAIM”) are usually relevant if the scheme shares will be listed on the Irish Stock Exchange. These guidelines cover the number of newly issued shares that may be made available under the company’s share schemes, the flow rate and duration over which they may be made available and the type of performance targets that must be met before the participant becomes entitled to acquire shares under the relevant scheme. IAIM represents institutional shareholders and the guidelines aim to ensure that shareholders’ interests will be protected even though the issue of new shares under the scheme will be dilutionary. When a company listed on the Irish Stock Exchange is establishing or amending a share plan it will usually ensure that the terms of the IAIM guidelines are included under the scheme. Sometimes these may be discussed in advance with the IAIM prior to adoption.

2.8 Will there be any company law issues?

2.8.1 Financial assistance

Any company establishing a share incentive scheme will need to be satisfied that it does not contravene company law concerning the provision of financial assistance for the acquisition of its own shares.

2.8.2 Market abuse and insider dealing

If the share scheme being established relates to shares traded on a European Economic Area regulated market, the Market Abuse Directive regulations may apply. Advice must be taken to ensure that the scheme is not operated in a way which breaches these provisions and related applicable laws. The company will have to adopt its own internal procedures to enable compliance with these laws by its affected employees.

2.8.3 Directors’ declarations of interest

Where company directors are potential beneficiaries of a share scheme, they must declare the nature of their interest in the scheme at the board meeting at which the scheme is proposed to be adopted.

2.8.4 Disclosure of interest in shares by officers of a company

- (a) Whenever the director or secretary of an Irish company acquires or disposes of an interest of shares in that company or its holding company, he must notify that event to the company within five days. Similar requirements apply to the grant and exercise of options. The company must then enter details of the notification received in a register of directors’ interests within three days. Breach of these

provisions results in the non-enforceability of the director/secretary's interest in shares under Irish law as well as giving rise to penalties.

- (b) Where the company's shares are dealt in on the Irish Stock Exchange, the company must comply with applicable notification requirements.

2.8.5 Freedom of company to issue shares to employees

When establishing a share scheme, it is important to ensure that any statutory or other applicable provisions which require a company to issue new shares to its existing shareholders are disapplied. This is to ensure that new shares can be issued directly to the share scheme beneficiary.

2.8.6 Securities laws

- (a) The Prospectus Directive aims to harmonise the public offer and listing regimes across the EU by creating common standards for the offering and listing of securities. Irish domestic laws are designed to reflect the terms of this directive. Whenever a share scheme is being contemplated it is essential to ensure that the terms of the Prospectus Directive and related Irish laws are completed with. Certain exemptions apply to employee share arrangements.
- (b) The Prospectus Directive is of particular relevance to the offer by an overseas parent of shares in that parent to employees of Irish based employer(s). Where an offer of such shares is being contemplated it is essential that prior legal advice is obtained before the offer is made.

2.9 What about the accounting treatment of the share awards?

Depending on the type of plan which a company intends to establish the manner in which the share awards are treated for accounting purposes will vary. When proposing to establish or amend a share plan, professional advice should be sought to establish the applicable accounting treatment.

2.10 How are the shares valued?

- 2.10.1 Usually shares will be valued by reference to their market value at the relevant date. This value is also usually relevant for tax purposes. It may, however, be difficult in practice, to clearly determine the market value of shares in a company for tax purposes at a particular time, especially if its shares are not listed on a stock exchange. In those circumstances, careful consideration of how their value is to be ascertained is desirable and professional advice should be sought.
- 2.10.2 Sometimes private companies may wish to enable employees acquire shares at a discount to market value, but nonetheless the shares' market value will be required to be ascertained for tax purposes.
- 2.10.3 When ascertaining tax values of share awards that are liable to PAYE/PRSI/Universal Social Charge ("USC"), employers are required to make their "best estimate" of the amount of notional pay which is liable to the particular withholding. The "best estimate" needs to take into account all relevant information available to the employer.

2.11 Trust law considerations

Where the share scheme involves a trust, the trust must be designed to comply with the general requirements of trust law.

2.12 Equality laws

Every share plan operated in Ireland must be framed to comply with and be operated in accordance with equality laws. Essentially, this means that selection for participation and entitlement to benefit cannot breach one of nine discriminatory grounds, including gender and age. Most times participation is generally framed to be at the discretion of the employer and it is essential that the practice operated by the scheme does not inadvertently breach equality laws.

3 TAX BASED SCHEMES

Set out below is a summary of some common types of tax based (at Section 3) and non tax based (at Section 4) schemes. These are not exhaustive lists and many companies will design a share plan to its own bespoke requirements.

3.1 Revenue approved profit sharing schemes

3.1.1 These are Revenue approved arrangements that must comply with Chapter I of Part 17 and Schedule 11 to the Taxes Consolidation Act 1997 and the practice of the Revenue Commissioners. These schemes are particularly suited to companies whose shares are dealt with on a stock exchange or other market. Many Irish subsidiaries of companies whose shares are so dealt operate Revenue approved profit sharing schemes.

3.1.2 Under such schemes, a company pays money (not necessarily related to the amount of its profits) to a trust. The trustees use the money to acquire shares in the company (or its holding company), and the shares are then allocated to employees. The shares must first be allocated to individual participants and held by the trustees on their behalf, usually for three years, before they are transferred into the employees' names.

3.1.3 Broadly, such schemes must be open to all employees. Shares to the value of IR£12,700 per tax year may be allocated to employees free of tax. Payments to the trust by the company are tax deductible, provided certain conditions are met.

3.1.4 Participation will also be limited by the level of contributions made to the scheme by the employing company. These contributions do not have to be geared to any particular percentage of the company's profits, although some companies choose to do this in order to incentivise employees more effectively.

3.1.5 Some companies operate "Salary Sacrifice" arrangements where an employee is given the facility to set aside part of his salary each year to be used to buy scheme shares. Where this arrangement occurs, it must be made in conjunction with a usual offer of shares and certain conditions must be complied with.

3.1.6 Eligible employees must all be entitled to participate in the scheme on similar terms. These may vary by reference to the salary and service record of employees or similar factors. The purpose of this requirement in the legislation is to ensure that the approved profit sharing scheme genuinely benefits all levels of employees and is not, for example, merely focused on

senior executives. The Revenue pays particular attention to the system of share allocation between employees.

- 3.1.7 Before any shares are awarded to a participant, a contractual agreement must be entered into by each participant with the trustees of the scheme (in accordance with specific statutory obligations).
- 3.1.8 The trustees are appointed under a Trust Deed which governs the scheme and a majority (where individuals are appointed) must be Irish tax resident. They receive cash contributions from the employer with which they acquire and hold shares on behalf of the employees for a minimum required period. After this period has elapsed, they must transfer the shares into the employees' names.
- 3.1.9 Companies wishing to set up an approved profit sharing scheme may find that their shares are unsuitable because of the limitations on the type of shares that can be used for such schemes.

The relevant provisions are detailed and complicated but the main provisions cover:

(a) **The identity of company whose shares are scheme shares**

- (i) The shares must form part of the ordinary share capital of a company setting up the scheme; or
- (ii) one which controls such a company at (i); or
- (iii) one which is or has control of a company which is a member of a certain type of consortium.

(b) **Share restrictions**

The scheme shares must be fully paid up, not redeemable and must not be subject to any restrictions that do not apply to all shares of the same class.

(c) **Separate classes of shares**

Difficulties may arise if the ordinary share capital in a company is divided into separate classes. In that event, a majority of the class of shares which are scheme shares generally must be held other than by employees and directors or trustees holding on their behalf.

(d) **Subsidiaries**

In a group of companies, the shares used must generally be those of the parent company. Shares in a subsidiary can be used only if either the subsidiary or the parent is quoted on a recognised stock exchange.

3.1.10 **Income Tax, USC and PRSI issues**

- (a) Payments made by an employer company to the trustees of the scheme are allowed as a deduction in computing the employer's profits provided certain conditions are met. Shares to the value of €12,700 may be allocated to each employee per annum and, generally, these are free of income tax in the hands of the employee, provided they remain within the scheme for a period of five years from their

allocation. On a subsequent sale, the base cost for capital gains tax purposes is their market value (determined in accordance with usual tax rules) at date of allocation.

- (b) Employer and employee PRSI as well as USC is payable on the value of shares appropriated after 1 January 2011.
- (c) Where the shares are sold after 2 years of allocation and before the end of the 3 year holding period, income tax, PRSI and USC will arise.
- (d) When income tax, PRSI or USC arises it is collected via the PAYE collection system.

3.2 Revenue approved savings related share option schemes

3.2.1 These must comply with Chapter 3 of Part 17 and Schedule 12A to the Taxes Consolidation Act 1997 (and the practice of the Revenue Commissioners). They are also known as SAYE schemes or save as you earn schemes.

3.2.2 SAYE schemes are suitable for companies who also operate Revenue Approved Profit Sharing Schemes and operate on a similar basis to such plans. The shares used for SAYE schemes must also comply with more or less equivalent terms as those which apply to Revenue approved profit sharing schemes and participation must also be made to qualifying employees on similar terms.

3.2.3 These arrangements envisage participants saving part of their after tax salaries (between €12 and €500 per month over a 3 year period) with an authorised savings carrier pursuant to a certified contractual savings scheme. The savings are then used to buy shares upon the exercise of an option granted at the start of the savings period.

3.2.4 Options may be granted at up to a 25% discount to the market value of the shares at the date the option is granted.

3.2.5 Income Tax, USC and PRSI issues

The gain on exercise of an option is free of income tax and although liable to employer and employee PRSI and USC, where the option is granted after 1 January 2011, the Revenue has indicated that it will only seek to collect USC and PRSI on the gain arising on the exercise of options. Options exercised after 1 January 2011 which were granted before that date do not currently attract employer and employee PRSI when exercised, although USC will then be payable. PRSI and USC is collected via the PAYE collection system.

3.3 Restricted share schemes

3.3.1 These arrangements envisages employees being given shares free of charge in their employer group on the basis that they may not dispose of the shares for a specified period, save on death or other limited circumstances. The value of the shares which would otherwise be taxed as a benefit will be reduced depending on the period of the restriction.

3.3.2 The terms of the restriction must be set out in writing.

3.3.3 The employee in receipt of the shares may not pledge, sell or otherwise encumber the shares during the period of the restriction.

3.3.4 The level of the abatement varies between 10% and 60% of the market value of the shares at the time of receipt reflecting restricted periods of between in excess of 1 year and in excess of 6 years.

3.3.5 Since 1 January 2011 employer and employee PRSI and USC arises on such benefits, however, and is collected via the PAYE collection system

3.4 **Employee Benefit Trusts (EBTs)**

Increasingly EBTs are used by sponsoring employers to hold a block of shares for the benefit of employees for use in conjunction with one or more share plans. These arrangements may also assist employees in buying in shares to be made available for future participation under a company's share plans. EBTs can thus be used to provide employees with an exit mechanism where the shares are not dealt with on a regulated or informal market. Sometimes EBTs are established as Revenue approved Employee Share Ownership Trusts.

4 **SCHEMES WITHOUT TAX INCENTIVES**

Frequently, even though a scheme may not carry with it a tax incentive the employing company will nonetheless wish to establish an employee share scheme. The scheme may provide greater flexibility than, for example, a Revenue approved profit sharing scheme and may be more in line with corporate philosophy.

4.1 **Executive share option schemes**

4.1.1 Under such schemes a company grants an option to employees who obtain rights to acquire company shares in the future at a price fixed at the date of the grant. It is usual for the price to be the market value of these shares. Newly issued shares are usually used to satisfy options. In some cases, however, it may be possible to make use of existing issued shares held by an employee trust.

4.1.2 Below are some of the key points that will need to be addressed in such plans:

(a) **Eligibility**

In establishing an option scheme, a company is free (within IAIM guidelines, if applicable, and subject to compliance with equality laws) to choose which of its executives may participate in the scheme and on what terms. No Revenue considerations apply since such schemes are not capable of approval. Frequently, the rules will give the Board of directors of the company complete freedom to select which executives can participate, but such discretions must be operated within the ambit of employment law, especially equality laws.

(b) **Option price**

Options are usually granted at an option price determined by reference to the market value of the company's shares at a date on or shortly before the option is granted. Sometimes private companies grant options at below market value, but no lower than the par or nominal value of a share.

(c) **Exercise conditions**

Exercise of options may be conditional on attainment of performance targets. Such may be additional individual targets in conjunction to those required by the IAIM guidelines, where these are relevant.

It is important to ensure that any performance target is a fully understood by the company and participant alike. The target must be clearly framed and communicated to the participant.

A participant to whom an option is granted will be required to agree to be bound by the scheme's terms. Whether or not options remain exercisable on leaving service, in any case, can be determined by the company when the scheme is designed.

(d) **Shareholder authority**

An option scheme is usually established pursuant to a resolution of the board of directors under shareholder authority.

(e) **Newly issued or existing shares**

Usually options over new shares to be issued by the company will be granted to participants. In suitable cases, options may be granted over shares which have already been issued. In those cases, the shares are usually held by an employee benefit trust.

(f) **Dilution**

Existing shareholders' interests in a company are diluted whenever the company issues new shares otherwise than to those shareholders and in proportion to their holdings. The impact of dilution is an important issue in considering whether a share option scheme is suitable for the company. This issue is addressed by the IAIM in considering shareholders' interests in companies whose shares are quoted on the Irish Stock Exchange. It also requires to be considered where the shares are not so dealt.

(g) **Exit**

Where a share option scheme is established in a private company, it is sensible to consider at the outset what will be the exit mechanism for participants. For example, a principal shareholder may be required to buy an executive's shares in the event of his leaving service. In other cases, it may be appropriate to set up an internal market in the shares: for example, an employee benefit trust may be required to buy the shares in those circumstances. When an option scheme is framed, it is always important that a participant will be able to realise value (calculated on a realistic basis) for his shares in foreseeable circumstances. Otherwise the scheme will become meaningless for the executives whom it was intended to benefit.

(h) **Good and bad leaver terms and the consequences**

See paragraph 2.3 above for the issues which can arise.

4.1.3 **Income Tax, USC and PRSI issues**

- (a) A charge to income tax and USC arises on the exercise of an option. The assessable amount is the increase in the share value at date of

exercise above the option price paid for the shares when the option is exercised.

Because an option scheme may encourage a sale of shares by employees to enable them pay their tax liabilities, the scheme may be unattractive to companies aiming to increase the number of shares held by employees.

- (b) The participant may require to sell part or all of the holding acquired in order to fund the tax. If the sale occurs at a time when there has been an increase in the share price at date of sale above the price at date of exercise, a capital gains tax charge may arise on the profit on sale.
- (c) Employer and employee PRSI usually arises on the exercise of a share option awarded under a written agreement entered into between the employee and employer after 1 January 2011 and must be paid by the employer via the PAYE collection system.
- (d) Income tax and USC is payable within 30 days of option exercise directly by the employee exercising the option. These payments must be made when a form RTSO1 is filed and payments must be made to the Collector General.
- (e) A tax issue also arises in relation to the “seven year” rule.

If the option is capable of exercise more than seven years after grant, an income tax charge can theoretically arise at the time of grant on the value of the option itself. In practice, however, the Revenue does not normally pursue this liability unless the option price is less than the market value of the shares at the date of grant.

However, if the option period is less than seven years so that the option cannot be exercised more than seven years after it has been granted, no tax liability will arise on the grant even if the option price is below market value.

4.2 “Phantom” share option schemes

- 4.2.1 Essentially, these are a cash bonus arrangement linked to a company’s shares. For example, employees are given options over “**notional shares**” and later receive cash payments related to any increase in the value of those shares.
- 4.2.2 Arrangements of this sort can avoid the necessity to issue new shares to participants. The company pays out cash and does not dilute existing shareholdings. If it is intended that the arrangement should operate as a pure cash bonus scheme, a company should consider whether its share value is the most appropriate measure of performance for quantifying bonuses. Earnings per share, profits or some other performance target may reflect the company’s success more reliably.
- 4.2.3 Also, careful consideration needs to be given to the problems of a company giving an open-ended financial commitment of this sort. Possibly, its share value could rise higher than its ability to pay the related bonus.
- 4.2.4 The payment of the cash benefit will attract PAYE, PRSI and USC in the usual way which must be collected via the PAYE system.

4.3 **Restricted stock units**

- 4.3.1 The employees are awarded the right to receive shares provided they stay in employment for a specified period at which time the shares are treated as having vested. Once the period has elapsed they become entitled to the shares. These arrangements are commonly used by US corporations.
- 4.3.2 Some Irish companies provide similar benefits in conjunction with a company sponsored employee benefits trust.
- 4.3.3 The receipt of the award is generally not taxable, but when the award vests, income tax, USC and PRSI will arise and is due to be collected via the PAYE collection system.

4.4 **Jointly owned shares**

The employer company establishes a trust to which shares are transferred. The trustees are then directed to hold certain shares for the benefit of named employees on the basis that the increase in value of the shares will be made available for the employees, provided certain conditions are met. The trust may be established offshore to minimise Irish taxation. One of the aims behind such arrangements is to confer a share related benefit on employees with a view to this benefit being subject only to capital gains tax. This may be possible where the employee pays full value for the joint interest when it is first awarded.

5 **OVERSEAS SCHEMES**

Legal and tax issues arise where an overseas share scheme is extended to Irish based employees. Professional advice should be taken to minimise the pitfalls and maximise the opportunities which can apply to those arrangements.

6 **ACTION FOR EXISTING SCHEMES**

- 6.1 Any company which already has employee share schemes should regularly review them.
- 6.2 It may be appropriate to introduce a replacement scheme where an existing one is due to expire.
- 6.3 Companies may also wish to measure their scheme(s) against those introduced by their competitors to ensure that their scheme(s) are still the aids to recruiting and retaining staff that were originally envisaged and that they still achieve the other objectives which the company had in mind when establishing them.
- 6.4 Some companies may only operate one type of share scheme, e.g. a profit sharing scheme and not another e.g. a share option scheme and may wish to set up another scheme.
- 6.5 Employers may wish to consider amending existing schemes to pass on the cost of employer PRSI to participants.
- 6.6 Employers should regularly review their plans to ensure that they are delivering the benefits that they are intended to achieve. Where this is not happening the terms of the plan may need to be amended. Sometimes, targets may go off line and may need to be recalibrated to accommodate the business' current needs and objectives.
- 6.7 Companies may need to consider whether or not their share plans are being operated in compliance with equality laws, especially age discrimination?