



EMPLOYMENT, PENSIONS AND EMPLOYEE BENEFITS

Employee Incentives for SMEs

by **Gillian Dully, Philip Daly**

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In this article, Gillian Dully explains what types of share schemes or employee incentive arrangements are available to a start-up or a Small to Medium Enterprise (SME) to attract and retain key talent.

Introduction

The type and size of the business will influence the suitability of a particular type of incentive arrangement. A review of the schemes available for start-ups and SMEs is set out below.

Types of Schemes

Revenue approved share scheme arrangements (e.g. Save As You Earn Schemes and Approved Profit Sharing Schemes) are tax efficient, but they are generally unsuitable for start-ups or SMEs, because such schemes must be made available to all employees on similar terms. Unapproved schemes do not generally require Revenue approval or equality of treatment of employees and are more flexible for start-ups and SMEs.

KEEP Share Options

The Key Employees Engagement Programme (KEEP) is a relatively new tax advantageous share option incentive arrangement for SMEs.

Qualifying SMEs may grant KEEP share options to key employees. There is no charge to taxation on the grant of a KEEP share option. Income tax is not payable on the exercise of an option which is a major advantage to KEEP. Capital Gains Tax (CGT) will be charged when the employee disposes of the shares acquired on the exercise of the share option.

There are a number of restrictive conditions that must be satisfied under the KEEP programme which may impact on KEEP's effectiveness for SMEs. The Finance Act 2018 is to amend certain conditions relating to KEEP in an effort to encourage and support SMEs in granting KEEP options to employees.

Other Unapproved Share Option Schemes

An employer may grant options to acquire shares under an unapproved share option scheme. Generally, income tax becomes payable shortly after the exercise of share options on the difference between the market value at the exercise date and the option price paid on exercise. CGT may also apply on the disposal of shares acquired on the exercise of a share option. A private company might consider granting both KEEP options and non-KEEP options to maximise the levels of awards of share scheme remuneration to its key employees.

Restricted, Clogged or Forfeitable Shares

An employer may award employees free or discounted shares up front and income tax and USC are payable based on the market value of such shares. CGT may arise on the disposal of the shares. Where such shares contain genuine restrictions on the sale or transfer then the taxable value of those shares may be abated by up to a maximum of 60% for restrictions of in excess of five years. If the shares are

subsequently forfeited the employee may be entitled to a rebate of tax paid.

Growth or Flowering Shares

An employer may issue shares to employees with limited rights attaching to such shares at the date of issue. The shares will only grow into more valuable shares when certain specified events occur. A business might be able to structure growth or flowering shares so as to minimise income tax arising on the issue of the shares and ensure CGT treatment on the subsequent disposal only.

Phantom Share Schemes and Long Term Incentive Plans

There are a wide range of employee incentive arrangements that an employer can establish, which do not involve the issue of shares to an employee. These arrangements are essentially a form of bonus arrangement for employees. They are not generally tax efficient, but they are flexible for employers and avoid the issue of shares to employees in the private company.

Conclusion

As outlined above, there are many employee incentive arrangements available and there is no one size fits all approach. An employer should consider its objectives for establishing a scheme to assist in adopting the most appropriate type of incentive arrangement for its business.

Philip Daly is a Partner in the Corporate and Commercial Department of LK Shields Solicitors. Gillian Dully is an Associate Solicitor in the Corporate and Commercial Department of LK Shields Solicitors who advises on all legal aspects of share plans and employee incentives.

About the Authors



Gillian Dully
Consultant

Gillian has considerable experience in advising Irish and international clients on a broad range of employment, pensions and employee benefits matters.

T: + 353 1 638 5863 **E:** gdully@lkshields.ie



Philip Daly
Partner

Philip's practice is primarily in the areas of Corporate and Commercial, and Energy and Natural Resources.

T: +353 1 637 1582 **E:** pdaly@lkshields.ie