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Share Based Remuneration: Budget 2017 and Beyond

by **Gillian Dully**

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Earlier this month in the Financial Statement for Budget 2017, the Minister for Finance, Michael Noonan, announced his intention to develop a new share based incentive scheme focused on small and medium sized enterprises.

The new scheme is to be introduced in Budget 2018 and it will require the approval of the European Commission to comply with state aid rules.

Whilst the announcement is a welcome development for Irish businesses, there are no details of how the scheme will be structured and when it will become operative.

Background to the Announcement

The Minister's announcement for a new share based remuneration scheme follows on from a recent public consultation process on the tax treatment of share-based remuneration and the publication of the Department of Finance's Tax Strategy Group's Paper on Taxation of Share Based Remuneration.

Inefficiencies of the Current Share Based Remuneration Tax System

The current Irish tax system for share based remuneration imposes considerable restrictions on small and medium sized businesses (SMEs) in attracting and retaining highly skilled workers, including the following:

- Tax becomes payable shortly after the exercise of share options, but generally employees do not have the resources to fund the tax and exercise price, as there is no market for the shares in an unquoted company.
- There are increased rates of CGT from 20% to 33% that may apply on the disposal of shares.
- The application of employee PRSI and USC on share-based remuneration.
- The current Revenue approved share scheme arrangements are inflexible, in that these schemes must be made available to all employees on similar terms rather than to key employees only.

What Reforms Can Be Expected in Budget 2018?

As highlighted above, unfortunately no details of the proposed new share-based incentive scheme are available at this early stage.

Interestingly, the Minister did indicate that the new scheme will be focused on SMEs and it is hoped that the proposals will include a postponement of the tax charge on the acquisition of shares in an unquoted company, as the current tax treatment is a significant impediment to the operation of share option schemes.

The UK operates a tax efficient share option scheme (the Enterprise Management Incentive (EMI) scheme) designed for smaller companies. Under an EMI scheme, a company may grant options to selected employees to acquire its shares over a specified period subject to certain qualifying conditions. The advantages of an EMI scheme include the following:

- There is no tax charge on the exercise of an EMI option if it was granted at market value.
- If the share price increases in value between the date of grant of the option and the exercise date the uplift is not charged to income tax.
- CGT is charged when the employee disposes of the shares and proceeds exceed the market value as at the date of the grant of the option.

The introduction of a scheme in Ireland similar to the EMI scheme would be greatly welcomed.

Other potential wider measures for share based remuneration which would be welcomed include:

- Changing existing Revenue approved schemes to permit an element of them to be targeted at key employees only; and
- Reducing the CGT rate for disposals of shares.

What Will the Reforms Need to Take Account of?

In addition to the state aid rules highlighted by the Minister, any potential measures to be introduced for share based remuneration will need to take account of the limited fiscal space available for tax measures. Accordingly, it is important that the introduction of a new scheme for small and medium businesses does not result in the discontinuation of Revenue approved arrangements (albeit these should be amended to permit key employee participation only) and it is important that the current employer PRSI exemption is retained.

Advantages of Reforms

There are many advantages to the introduction of a new share based incentive scheme focused on SME including:

- Assisting SMEs in attracting and retaining key hires by enabling them to offer flexible remuneration packages;
- Increased competitiveness for SMEs against large multinational employers;
- Growth in employment; and
- Increased productivity from employees

Conclusion

The announcement to introduce a more tax efficient share-based remuneration regime for SMEs is greatly welcomed and is an important development for SMEs in their efforts to remain competitive and attract key new hires with Brexit looming.

Gillian is an Associate Solicitor at LK Shields Solicitors and is a member of the IPSA Council. She has considerable experience in the structuring of share incentive schemes and the treatment of share options and other employee benefits in mergers and acquisitions.

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