Submission on the Review of the Key Employee Engagement Programme

May 2019

> *The 'Key Employee Engagement Programme' (KEEP) incentive, introduced in Budget 2018, has the objective of supporting SMEs in Ireland in competing with larger enterprises to recruit and retain key employees. Smaller and/or younger companies with growth potential may not have the cash resources available to offer comparable salary packages to large, established businesses. However, where the employee believes in the growth potential of the firm, and by extension the potential for the company shares to increase in value, remuneration in the form of share options may improve the attractiveness of the SME employment offer.*

Dublin Chamber welcomes this opportunity to make a submission to the Department of Finance in respect of its public consultation on operation of the Key Employee Engagement Programme (KEEP) introduced in Budget 2018.[1] The Key Employee Engagement Programme is a tax incentive introduced to make share-based remuneration more attractive and workable for scaling businesses. Under the scheme, gains arising on the exercise of a share option by qualifying SME employees are not subject to Income Tax, PRSI or Universal Social Charge at the date of exercise. They are only subject to CGT (33%) on a subsequent disposal of the shares.[1]

Dublin Chamber is the largest Chamber of Commerce in Ireland, representing businesses throughout the Greater Dublin Area. Our cross-sectoral membership base, spanning the spectrum from small start-ups to major multinationals, gives the Chamber a keen insight into the issues facing commercial enterprises at various stages in the business life cycle. Dublin Chamber has a longstanding interest in policy to support entrepreneurship and SME growth, including through share-based remuneration.

Dublin Chamber welcomed the introduction of KEEP in Budget 2018, having campaigned for the measure to help SMEs retain talent and compete with larger firms; and the Chamber is keen to ensure that KEEP proves successful.

However, business feedback suggests that certain conditions attached to the scheme are making it impractical for most SMEs, and that the legislation is proving to be inoperable. As a result of these practical constraints, Dublin Chamber does not expect a significant uptake of

[1] Dept. Finance, Public Consultation Paper, Key Employee Engagement Programme, https://assets.gov.ie/8469/cd5830e78c384b4eb248ebd5e93acb1e.pdf

KEEP in its current form. While Government has committed to progress on improving 'mechanisms through which SMEs can reward key employees with share options in a tax-efficient manner',[2] reform of KEEP will be required in Budget 2020 if this goal is to be achieved under the present Government.

The principal areas of concern are as follows:

1. *Valuations*

The obligation to issue share options at market value creates a compliance burden and a legal risk for SMEs that can discourage them from issuing KEEP options. Guidance was promised on the topic but only a paragraph was included in the published guidance.[3] This is giving rise to uncertainty for businesses wishing to avail of the relief. The burden could be alleviated somewhat if some practical rules of thumb were set, such as being able to utilise valuations set in third party transactions (e.g. fundraisings within 12 months of the issue of a KEEP option where there is no evidence of a material change in valuation).

2. *Restrictions on the value of share options granted to an individual*

In the start-up scene, the market practice for cash-strapped scaling SMEs is often to offer high equity rewards and comparatively lower salaries. Under KEEP rules, the total market value of all shares upon which qualifying share options are granted cannot exceed the value of 50% of an employee's annual remuneration. This restriction is counterproductive for the typical scaling SME that would be likely to use KEEP to attract and retain employees who might otherwise work for larger enterprises where they take on less career risk and are likely to receive higher remuneration.

3. *Restriction of qualifying individuals to full-time employees in the service of one company.*

The requirement for the individual to be an employee of and carrying out duties for a single company is overly restrictive. Employees are often employed by one entity in a group but make their services available to other group entities. Part-time employees are also very important for many scaling SME which need to access particular skillsets but which may not be able to afford or gain fulltime access to important employees. This tendency is particularly pronounced in the tech sector. Reducing the requirement to work 30 hours a week for a qualifying company would expand the ability of SMEs to attract part-time employees.

Other concerns highlighted by Dublin Chamber members include:

4. The requirement that the shares be newly issued, which is restrictive as, in practice, companies will set aside a particular amount of shares at the establishment of a scheme or re-use shares when employees leave.

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[2] Programme for a Partnership Government, p. 38, https://www.merrionstreet.ie/MerrionStreet/en/ImageLibrary/Programme_for_Partnership_Government.pdf#page=38

[3] Revenue Tax & Duty Manual, Share Schemes Manual, Chapter 9, Key Employee Engagement Programme (KEEP), April 2018, p.7 https://www.revenue.ie/en/tax-professionals/tdm/share-schemes/Chapter-09.pdf#page=8

5. The restrictions around connected parties and the requirement that these be maintained over the relevant period.

6. Under the current legislation, a company must retain the status of unquoted company throughout the entire 'relevant period' during which the option can be exercised. The only exception is if a company becomes quoted on the Enterprise Securities Market of the Irish Stock Exchange or on any similar or corresponding stock exchange in an EEA country or a country with which Ireland has a double taxation agreement. This disqualifies share options if the company becomes quoted on a full stock exchange. E.g. if, after eight years, an SME has successfully scaled and decides to list on the Irish Stock Exchange, all KEEP options that are not exercised prior to the IPO will cease to qualify for the KEEP regime. Precluding the ambition of companies to scale successfully to list on a full stock exchange represents an unnecessary restriction.

Key Recommendations

- ✓ Detailed guidance should be issued on valuations to provide clarity for firms facing the compliance burden of issuing share options at market value;
- ✓ The restriction of the value of share options granted to any individual to 50% of the value of his/her annual remuneration should be lifted.
- ✓ Qualifying individuals should be allowed to make their services available to other entities in a company group and the time required to work for a qualifying company should be reduced.