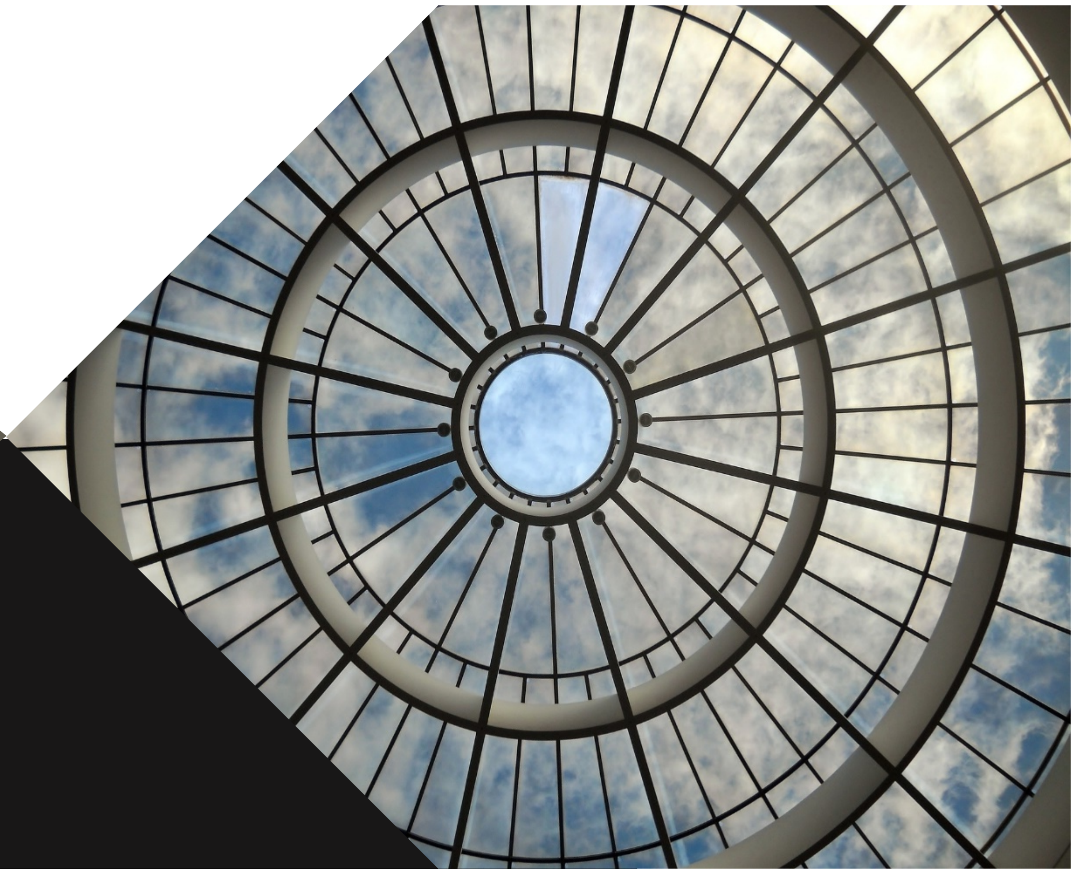
MOORE

SHARE INCENTIVES

Finding the best fit



Share incentives: Finding the best fit

Share incentives are an invaluable means of attracting, retaining, motivating and promoting employees. Sharing together in the success of a business aligns the interests of owners and employees, allowing all to work together towards mutually beneficial goals.

Motivating employees based on their performance is often a logical step for any company, whether it be through salary, bonuses, or perks. Where share incentive schemes have the advantage over other benefits is that they inspire employees to participate in the longer term growth of the company rather than focus on short-term targets. This encourages higher levels of employee participation, loyalty and knowledge retention.

3rd party purchasers and investors understand that the intrinsic value of a company often resides within the experiences of its key employees. Having a capable and engaged management team in place often results in higher exit prices being achieved when owners are looking to realise value from their business.

Despite the benefits and over-arching goals there is no "one-size-fits-all" share based solution which will work for all companies. Share incentives may be given to all employees under formal employee share plans. Alternatively, a scheme can be tailored to an informal arrangement or one off awards of shares or share options.

From our experience, the type of share incentive scheme to implement depends on a subtle combination of a number of factors, including:

- Employer intentions
- Shareholding arrangements
- Employee(s) aspirations
- Cost to employee and employer
- Current and projected company values
- Company life cycle
- Exit strategy

Employer considerations

There are many aspects which affect what type of share incentive scheme might be appropriate for a particular employer.

Principal amongst these are the age of the business owner, company growth aspirations, and exit ambitions. Often the scheme most appropriate will differ greatly for an owner who is gearing towards retaining a key management team ahead of a retirement; from an owner looking to remain in the business long term and stimulate growth through employee motivation.

Employee considerations

For share incentives to be effective they have to seek to deliver the right results for the included employees. The key is to identify and tailor a scheme which achieves the owner's aims, whilst also working effectively for the employee.

Some schemes may involve an upfront investment from employees, whilst others may be at a cost to the employer, "giving away equity". Alternatively, some schemes can be structured to avoid any upfront costs, whilst locking in employees for a vesting period.

Types of share incentives

Shares

The simplest form of share incentive is shares, either by allowing an employee to buy in, or by giving free or discounted shares. Where free or discounted shares are awarded to an employee, PAYE taxes (Income Tax, PRSI, and USC) will need to be operated on the value of the benefit (discount) being given, akin to BIK or cash bonus.

With a private company the opportunity for an employee to sell their shares generally only arises when the company is sold, or by virtue of a company buy-back of the shares. CGT rather than Income Tax will often apply on an exit or sale event.

There are various methods which can be employed in the implementation of a share

scheme which can reduce the upfront cost to the employer/employee; as follows;

Minority discount:
A discount of up to 70% may be applied to the market value of shares where the shareholder acquires a minority interest in the business. This discount reflects the lack of control and influence the shareholder would have in the company.

Restricted or clog shares:
A further tax geared discount of up to 60% can be applied to restricted or clog shares. A restricted or clog share is generally a share held in trust for the benefit of an employee, where there are restrictions imposed on the employee from transacting in the shares for an initial minimum period of time.

Flowering shares:
When implementing an employee share scheme an employer may often choose to issue a new class of share in the company. The new class of share may have restricted or limited rights or entitlements, such as voting rights.

Equally, a new class of share may have no entitlement to participate in the current company value. A flowering share will often only be entitled to participate in the growth of the company from the date the shares are granted.

The use of a flowering share often negates any upfront tax charge for the company or employee.

Share options

Options give employees the right, but not the obligation, to purchase a set number of shares at a predetermined "option price" in the future when exercised. Vesting periods may be imposed on share options, such that the size of the holding increases with length of service.

From our experience, share options serve two purposes which shares often cannot achieve. Firstly, there is often no upfront tax charge on granting share options. Secondly there is often no capital cost to the employer on implementing a share option scheme; share options will generally only be exercised on a sale, meaning the purchaser of the company is the ultimate funder

of the scheme. However, the trade off with options is that the employee will generally not become a shareholder.

The applicability and timing of tax depends on the type of share option scheme used, as follows:

Short share options:
Options expire if unexercised after a period of no more than seven years. Income Tax can apply on exercise, based on the share's market value at that time.

Practically, employees will only exercise their options on a defined exit event, i.e. a company sale. The shares acquired at exercise will be sold simultaneously, generating cash, which funds the discharge of any tax liability. The employee retains the net of Income Tax proceeds.

Long share options:
These options are capable of being exercised more than seven years after they are granted. Unlike short options, a tax charge can arise when the options are granted. A further tax charge can arise when the options are exercised.

From our experience, long options are less favourable and more expensive to implement than short options.

Key Employee Engagement Programme ("KEEP") scheme share options:
KEEP - the new SME scheme introduced in Budget 2018. The scheme allows qualifying SMEs to grant share options to employees where the exercise of the share option is not subject to Income Tax. Instead, CGT may arise when the shares acquired on the exercise of the options, are sold.

The KEEP scheme, whilst having limitations is a welcome addition. In our view the key benefits are that it allows employers to impose vesting periods and restrictions on shares, whilst allowing employees an achievable means by which to acquire shares, whilst managing any upfront tax costs.

Revenue approved schemes

Finally, there are a few remaining Revenue Commissioner approved schemes which remain available today.

From experience, these schemes are often best suited for larger organisations seeking to roll out a companywide program. Most schemes provide that the scheme should be for the benefit of all employees on similar terms. As the conditions applicable to Revenue Approved Schemes can be more onerous, they can be of limited benefit to owner managed businesses seeking a tailored solution. Likewise, owing to the requirement to seek Revenue approval, the schemes may be more costly to implement.

The following types of share incentives may be considered:

Approved Profit Sharing Schemes (APSS):
A limited amount of shares may be placed in trust for employees each year, for a period of retention. After which, the shares can be transferred to the employees free from Income Tax (PRSI and USC still apply).

Save As You Earn Schemes (SAYE):
Options are granted in conjunction with a fixed term savings plan. Monthly contributions are deducted from employee's salary. At the end of the term the savings can be used to exercise the options free from Income Tax (PRSI and USC still apply).

Selecting the right scheme

If you are interested in implementing share based incentives in your business, we would be happy to meet with you and understand your specific requirements.

We can then help identify the key criteria impacting on your business, and tailor a solution to best fit your business and your goals.

MOORE GLOBAL NETWORK

We've spent more than 100 years serving clients through our professional services. With more one-to-one support from senior partners than you might be used to, you'll always be working with professionals. Our services will help you navigate new markets effortlessly, and take advantage or every opportunity.

For more information on how our global services and sector expertise can help your business thrive in over 100 countries, just get in touch.

CONTACT US

Find your nearest member firm at
www.mooreireland.ie

Or email:
marketing@mooreireland.ie

Moore – Dublin
Ulysses House, Foley Street,
Dublin 1, Ireland
T +353 (0)1 888 1004

Moore – Cork
83 South Mall, Cork,
Republic of Ireland
T +353 21 427 5176

Ned Murphy – Managing Partner
ned.murphy@mooreireland.ie

James Hughes – Tax Partner
james.hughes@mooreireland.ie

Eoghan Bracken – Partner
eoghan.bracken@mooreireland.ie

Padraig O' Donoghue - Partner
padraig.odonoghue@mooreireland.ie

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www.mooreireland.ie