Guide to Employee Share Ownership Plans (ESOP)

https://www.ipsa.ie/wp-content/uploads/2017/04/Guide-to-Employee-Share-Ownership-Plans.pdf

In Ireland ESOP is the term commonly used to describe an all-employee share participation plan which is made up of a combination of two Revenue approved share schemes, viz, the Employee Share Ownership Trust (ESOT) and the Approved Profit Sharing Scheme (APSS). Historically ESOPs are most prevalent where semi-state bodies are being privatised or sold, although any company may choose to implement one. The ESOT is a tax favoured vehicle which typically stockpiles shares for employee participants for distribution over time. It does not itself afford participants direct access to shares in a tax efficient manner. Tax relief is afforded to participants by way of share appropriations via an APSS. The main features of an ESOT are outlined below. For more information on the operation of an APSS please see the Guide to Approved Profit Sharing Schemes.

Characteristics of ESOT

- The Trust requires Revenue approval
- Trustees must use the money provided by the company for qualifying purposes
- Tax relief for the company for set-up costs and contributions to the trust
- Securities and sums (cash amounts) must be offered to all beneficiaries and the transfers made at the same time must be on similar terms
- Securities can be transferred to the trustees of an APSS, or sold by the trustees to repay borrowings free of CGT
- If established in conjunction with an APSS, securities can be distributed to employees in a tax efficient manner
- Most common in privatisation or sale of semi-state bodies, though they can have broader application
- Requires Revenue approval.

What is an ESOT?

These schemes were introduced by Finance Act, 1997 and legislation has been amended in nearly every Finance Act since then. Payments made by a company to an ESOT set up to acquire and distribute securities to its employees are tax deductible. An ESOT is usually established in conjunction with an APSS. The APSS is the vehicle through which shares (or securities) are issued to afford the employee beneficiary tax relief on appropriation of securities up to an annual limit of €12,700.

What companies qualify?

Any company can establish an ESOT as long as it is not under the control of another company. Schemes to date have in general been established in semi-state bodies.

Which employees qualify?

All employees and full-time directors of the founding company, or a group company, who have been such for a qualifying period of not more than three years, must be eligible to be beneficiaries under the ESOT.

In general, former employees and directors can only be beneficiaries of an ESOT or participants in a APSS for up to 18 months (18 months rul) after they cease employment, however, the period of participation can increase up to 15 years (15 year rule), where the following conditions are met:

- The person must have been an employee/director of the founding company or group company
  (i) during a qualifying period, and
  (ii) on the date the ESOT was established or
  (iii) within nine months prior to that date or at any time in the five years beginning with that date.
- In the five years (or a lesser period approved by Dáil Eireann) since the ESOT was established, 50% of the securities held by the trustees were pledged as security for borrowings.
- The ESOT has not been established for more than 15 years.

How are ESOTs structured?
An ESOT operates by the company passing funds to the trustees who use the funds for qualifying purposes which include acquiring company securities. These securities are held within the ESOT and typically distributed over time to employee participants via an APSS.
A trust deed and rules are drafted which must gain prior Revenue approval.

What is the role of the trustees?
The trustees are appointed under a trust deed. Unless there is a single corporate trustee, at all relevant times there shall be not less than three trustees all of whom must be resident in Ireland.
Three alternative forms of trustee are provided for:
Majority employee representation
Equal company/employee representation
Single corporate trustee with a board of directors comprised of company and employee nominated directors and a professional trustee director.

The sums received by the trustees must normally be expended for qualifying purposes within nine months.

Qualifying purposes include the following:
Acquisition of securities which are shares (including stock) and debentures in the company
Repayment of borrowings
Payment of interest on borrowings
Payment of any sum or shares to a beneficiary, or personal representatives of a deceased beneficiary
Meeting expenses.

What shares qualify?
The trust deed must provide that securities acquired by the trustees shall be shares in the founding company which form part of the ordinary share capital. These are fully paid up, not redeemable and are in general without restrictions. This has been relaxed somewhat whereby the transfer of securities other than ordinary shares to beneficiaries in an ESOT/APSS in the circumstances of certain takeovers may take place in a manner to preserve the tax benefits of the beneficiaries as set out below.

What are the tax consequences for employees?
Payments received out of the ESOT are taxable. Employees will incur income tax on

payments outside of the trust.
However, if shares are distributed to the trustees of an APSS these shares can in turn be distributed to employees tax free up to €12,700 (€38,100 if certain conditions satisfied) in a tax year. The securities must have been held for three years by the trustees of the ESOT/APSS for the tax relief to apply.

What about capital gains tax (CGT)?
There is an exposure to CGT where the beneficiary employee disposes of shares acquired through the ESOT either directly or through an APSS. Capital gains tax is normally payable on the excess of the net sales proceeds over the market value when the shares were acquired. In the case of shares transferred from an ESOT to an APSS, in certain situations the base cost for CGT purposes will be the market value on the date when the shares are transferred from the ESOT to the APSS. The annual small gains exemption of €1,270 may be availed of if it has not already otherwise been used. The current rate of CGT is 20%.

How is CGT paid?
There are 2 payment dates:
For disposals between 1 January and 30 September/31 October in the relevant tax year
For disposals between 1 October and 31 December/31 January in the following tax year.

Does the ESOT pay tax?
Yes. Subject to certain reliefs the ESOT can be subject to income tax, surcharge on undistributed income and CGT, and is subject to the rules of the self-assessment system. However, dividend income can be received free of income tax and surcharge if used for qualifying purposes within a qualifying period.

There is no PRSI on distributions of shares either to the APSS or to the employee. However, Revenue contends that PRSI applies when cash is distributed by the ESOT to employees. CGT will not be payable on transfer of shares to the trustees of an APSS or when the proceeds are used to repay borrowings or make distributions to the personal representatives of deceased beneficiaries.

Does the company get tax relief?
The company obtains tax relief for the costs of setting up an ESOT and for contributions made which are used by the trustees for qualifying purposes within the qualifying period.

Are there reporting requirements?
Revenue require the trustees to give the information within 30 days as they think necessary to determine whether:
To approve an ESOT, or
To withdraw approval, or
To determine the tax liabilities of the beneficiary employee, or
An annual reporting return (Return of Information) has been designed by Revenue for this purpose. The annual trust tax return (Form 1) must also be completed.