IRISH PROSHARE ASSOCIATION

IPSA Guideline to Approved Profit Sharing Schemes (APSS)

An APSS is an all employee share plan, whereby a company may appropriate shares to its employees and the employees subject to certain conditions are exempt from the income tax charge on share appropriations.

The use of an APSS facilitates broad employee share ownership in a tax efficient manner, subject to legislative and Revenue requirements. The value of shares appropriated, whilst not liable to income tax, will be subject to the Universal Social Charge (USC) and employee PRSI. These charges are collected by the employer by way of payroll tax deduction. However, there is no employers PRSI on the value of any shares allocated under an APSS.

An APSS may also be referred to as an Approved Share Participation Scheme or an Employee Share Ownership Plan.

The Scheme is optional, however, all employees eligible to participate must be offered participation on similar terms.

An APSS encourages employees to identify with the interests of the employing company or group and its shareholders by making them shareholders. It does so within a legislative framework that offers participants the benefit of tax reliefs.

Why is a trust needed?

Under the legislation governing an APSS there is a requirement that the APSS be established under a trust structure which is governed by a trust deed and rules. The acquisition of shares is funded by the employer and possibly also by participating employees ("participants"). The shares are acquired and held by the trustees. Upon acquisition of shares by the trustees, they allocate shares to the participants on whose behalf the trustees continue to hold the shares for specified minimum periods. The allocation is usually referred to as "an appropriation of shares".

Who is eligible to participate?

Persons who must be eligible to participate are:

- employees and full-time directors;
- who have been such at all times during a qualifying period not exceeding 3 years; and
- who are chargeable to income tax under Schedule E.

Who is ineligible to participate?

Those not eligible to participate are:

- former employees and directors, or
- persons who were appropriated shares under certain other approved Schemes in the same tax year (subject to an exception applying to reconstruction or amalgamation), or
- persons who within the previous 12 months had a 15% interest in a close company (a close company is one under the control of 5 or fewer participators or of participators who are directors) and
    - the close company is the company whose shares are to be appropriated, or
    - the close company has control of the company whose shares are to be appropriated, or
    - the close company is a member of a consortium owning the company whose shares are to be appropriated.

A Scheme may have one participating company or be a group Scheme in which more than one group company participates. However, a group Scheme will not receive approval if it results in shares being appropriated wholly or mainly to the higher paid employees and directors in the group.

What are "similar terms"?

Participation is required on what the legislation refers to as similar terms. However, this does not mean the same number of shares must be allocated to each participant. Appropriations by reference to objective criteria such as a percentage of basic salary or length of service would generally be acceptable to Revenue.

What are qualifying shares?

Qualifying shares are ordinary shares in the establishing company or in a company which controls the establishing company. The shares may also be ordinary shares in a company which is a member of a consortium or which controls a company which is a member of a consortium owning or controlling the establishing company, provided the company whose shares are to be used beneficially owns at least 15% of the company so owned.

The shares must be:

- quoted on a recognised stock exchange; or
- in a private company not under the control of another company or
- in a company under the control of another company whose shares are quoted.

The shares must be fully paid up, not redeemable and not subject to restrictions other than those which attach to all other shares of the same class.

If the share capital consists of shares of more than one class, there is an additional condition, viz, the majority of the shares in the class must be held by persons other than:

- those who acquired the shares under (in effect) employee share schemes and not as part of public offers,
- trustees holding shares on behalf of members under (in effect) employee share schemes, or
- quoted companies which control or are associated with the company one class of whose unquoted shares are used as scheme shares.

The shares must not be shares:

- in a service company; or
- in a company that has control of a service company, where the company (the company that has control of the service company) is under the control of the same person(s) as that of the service company.

What are the requirements for trustees?

The trustee must act independently of the company and may be a corporate trustee or individual trustees subject to a minimum of 3 individuals. The trust and each of the trustees must be resident in Ireland for tax purposes.

How is the acquisition of the shares financed?

The acquisition of shares is financed by the provision of monies by participating companies in any year that the company decides to operate the Scheme. If shares are funded by discretionary bonuses or length of service payments, then under current Revenue practice the monies applied to finance the acquisition of those shares will be considered to be an employer contribution.

Any monies which are paid over to trustees are used to acquire shares which are appropriate and held in trust for participants until the three-year release date.

What is salary forgone?

A Scheme may be established with a salary forgone facility whereby participants who have been given shares or who have elected to invest their bonus in shares may also elect to forgo an amount from gross salary to acquire additional shares. The salary foregoing facility must:

- form a subsidiary element of the Scheme;
- be optional;
- be restricted to the lower of the bonus invested in shares or 7½% of basic salary; and
- the same choice must be provided for all.

What is a Contributory Scheme?

Revenue will also permit a Scheme to be established on the basis that participants are required to purchase shares in order to receive free shares. The employees purchased shares must be out of net salary. A maximum 7½% basic salary applies to the employee funded element and the minimum cannot exceed the lesser of 1% of basic salary and €127. The free shares must at least be at a 1:1 ratio between purchased and free shares. While the shares purchased by the participant do not form part of the Scheme, they must be held by the trustees for a minimum 2-year retention period. Such a Scheme is known as a Contributory or BOGOF Scheme.

What is a contract of participation?

In order to be allocated shares in an APSS, a participant must enter into a contract of participation with the company and the trustees under which the participant agrees among other things:

- to a retention of shares by the trustees generally for two years;
- not to assign or charge the shares during that period;
- to pay an amount equal to income tax at the standard rate to the trustees for any share transfer between years 2 and 3; and
- to require sale only for the best consideration available if this occurs before the release date, generally the third anniversary of the appropriation date.

Investment Limits

There are specific rules with regard to the investment in an APSS as follows:

- The Revenue Commissioners' current limit on the total amount (bonus plus salary foregone) a participant may use to purchase shares through this Scheme is €12,700 per annum.
- There is a Revenue limit applied to all APSS Schemes on the amount of salary a participant may forego for investment in the Scheme. A participant may only forego the lesser of:
  - The equivalent of the amount of employer contribution used to purchase shares; or
  - 7.5% of annual Basic Salary.
- A participant may not carry forward any bonus or salary foregone paid in the current year for investment in subsequent years.

How long do the Trustees hold the Shares?

Normally, shares must be held by the Trustees for a minimum period of two years from the date on which they are allocated to a participant (the "Retention Period"). During this time, a participant may not deal with their shares in any way, e.g. they may not sell them, give them away or use them as security for a loan.

Whilst a participant may instruct the sale or transfer of their shares after two years, it is more tax efficient to leave the shares with the Trustees for at least three years (the "Release Date").

At the end of the three-year holding period, a participant can sell or transfer their mature shares without incurring an income tax charge.

What rights does a participant have whilst the Trustees hold their shares?

A participant will enjoy the rights of a shareholder through the Trustees, who will hold the shares on their behalf and carry out their instructions. A participant will receive any dividends declared and be eligible to participate in any bonus or rights issue for new shares. However, until the shares are transferred into their own name, or are sold by the Trustees on their instructions, their shares will appear on the company's register of shareholders in the name of the Trustees. It is, therefore, the Trustees, as holders of the shares, who will have the legal right to attend and vote at general meetings.

Does a participant receive dividends?

Any dividends declared on the shares of the company held by the trustees on a participant's behalf will be paid to the participant with the relevant withholding taxes and encashment taxes deducted. Following the dividend payment, the Trustees will issue a dividend tax voucher detailing the payment.

A participant will have to pay income tax at their marginal rate, PRSI and the USC on the gross dividend declared with credit given for up to 15% of the withholding tax and the encashment tax deducted.

What happens if a participant leaves the Company?

If a participant leaves the Company other than in the specified circumstances mentioned below, their shares will continue to be held by the Trustees until the third-year anniversary, as if the participant was still employed by the Company.

If a participant reaches the State Retirement Age (currently aged 66 but changing to aged 67 from 2021) or leave the company due to injury, disability or redundancy, the Period of Retention automatically ends, and a participant may instruct the Trustees to transfer the shares into their name or to sell them on their behalf at any stage up to the end of the three-year holding period. In these particular circumstances, if a participant instructs the sale or transfer of their shares within three years of the date they were allocated to you, the amount liable to income tax is only 50% of the original cost of the shares (or the market value of the shares as at the date of sale or transfer – if lower). If the sale or transfer occurs more than three years from the allocation date, then as previously indicated, no income tax will be payable. Therefore, due to the potential tax liabilities, the Trustees will continue to hold their shares for a participant until three years from the date of allocation unless a participant instruct them to do otherwise.

In either case, depending on the participant's personal circumstances there may be some capital gains tax to pay on the sale of the shares.

What happens if a participant dies?

In the event of a participant's death, their shares will be transferred to their personal representative and become part of their estate. No income tax or capital gains tax will be payable on death (regardless of how long the shares have been held in trust).

What are the advantages of an APSS?

The advantage of an APSS is that it achieves two objectives:

- employee incentivization; and
- income tax relief for employees and employers.

On the appropriation of shares to a participant, no income tax charge but USC and employees PRSI will be due on the value of the shares appropriated. The shares must remain in the trust for three years in order that the shares can be sold free of income tax.

Will capital gains tax (CGT) apply?

CGT will generally be chargeable on a disposal of shares if the net disposal proceeds exceed the market value of the shares at their appropriation date. Any such gain will be liable to CGT, currently at a rate of 33%. If not utilised elsewhere, an employee's €1,270 annual CGT exemption can be offset against the gain. It is possible, by selling tranches of shares each year, to reduce the overall liability to CGT. However, participants should note, that there are special rules for identifying which shares have been sold for CGT purposes.

What corporation tax deductions are available?

A corporation tax deduction will usually be available for any amounts paid in respect of:

- the establishment of a Scheme;
- the acquisition of shares; and
- to meet administration expenses,

by the deduction of such amounts from profits.

What issues should be considered in implementing an APSS?

The issues which a Company must consider include:

- the company/group must decide what type of Scheme to operate. Will it simply be free shares or an employer-funded performance related Scheme, with or without a salary forgone facility, or will it be a contributory type Scheme;
- the size of the share pool that is to be made available under the Scheme given that any new issue of shares will dilute the interests of current shareholders. Investor guidelines may also influence this decision for quoted companies;
- the Board of Directors might also reserve to itself the power to decide whether to operate a Scheme in any particular year;
- the agreed level of profit or bonus Scheme or some other formula which determines how much money will be available for the acquisition of shares in a particular year and how those shares will be allocated to participants: and
- whether employees and directors will have an option to take the employer contribution in cash rather than shares or in a combination of both.

Once a decision has been made to implement a Scheme the following issues need to be considered:

- a trust deed and rules must be prepared to establish the Scheme;
- the identity of the trustees must be established;
- a communications strategy for potential participants must be planned;
- the means by which shares will be acquired by the trustees both prior to and during the life of the Scheme; and
- a submission to Revenue for approval for the Scheme must be made.

Who can administer the APSS?

The administration of an APSS may be done in-house or outsourced. If discretionary bonuses, length of service awards or salary forgoing is to be a feature of the Scheme, then this must be coordinated with the payroll system. Data must be kept concerning the number of shares appropriated, their retention dates, release dates, dividend payments and this must be checked in the context of data protection legislation. Annual tax and reporting returns to Revenue will be required. The trustees must make an annual return to Revenue and participants must include details of all appropriations, share disposals and dividends received on their annual tax returns.

What are the requirements for Revenue approval?

Once the Trust Deed is executed, the company must then apply to Revenue for formal approval of the Scheme by submitting the following documentation and information:

- a copy of the company resolution establishing the Scheme;
- a copy of the executed trust deed and rules;

- copies of all documents that will be issued to participants in the Scheme;
- a description of the basis of calculation of entitlement and where an appraisal Scheme is to be used as the basis of calculation of entitlement for the Scheme, copies of all forms etc. used for the Scheme and an example of how this Scheme operated;
- a copy of the Constitution/Memorandum and Articles of Association of any company whose shares will be allocated under the Scheme and where the shares to be used for the Scheme are in a private company, a copy of the Shareholders Agreement if one exists;
- a Company Secretary declaration that the shares to be used in the Scheme satisfy certain conditions.
- where the company concerned is a member of a group of companies, a declaration that the Scheme does not and would not have the effect of conferring benefits wholly or mainly on directors of companies the group of on those employees of companies in the group who are in receipt of higher or the highest levels of remuneration; and
- details of tax reference numbers for corporation tax purposes and employer return purposes of all participating companies.

No shares can be allocated until formal Revenue approval is received for the Scheme.

Any subsequent amendments to the trust deed and rules or any resolution passed authorising an amendment, must be agreed by Revenue.

The foregoing reflects current tax rules and Revenue practice which is subject to change. This document is of a general narrative only and should not be regarded as a substitute for professional advice. Such advice should always be taken before acting on any of the matters discussed.

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