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24 May 2019

Dear Sir/Madam

**Re: Key Employee Engagement Programme**

The Institute welcomes the opportunity to provide input to the Public Consultation on the Key Employee Engagement Programme (KEEP).

Irish SMEs continue to experience difficulties recruiting and retaining skilled workers. Indeed, access to talent is regarded as the most important issue facing all tech start-ups in Ireland.<sup>1</sup> Attracting the best talent is central to building a successful company and is crucial to the future growth and export potential of the business.

Irish SMEs and start-ups in many instances cannot match the salaries paid by large multinationals. This is the case across most employment categories, but is particularly acute in areas facing skill shortages, such as, engineering, design, product management, machine learning and AI, senior sales and leadership roles.<sup>2</sup>

Even though the KEEP is designed to incentivise talent to take up employment in such companies and allow them to compete with listed companies, only 38 employees have been granted KEEP options to date.

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<sup>1</sup> Feedback provided by the "Start-up Policy Project" facilitated by Dogpatch Labs, 17 May 2019.

<sup>2</sup> Ibid

Based on the feedback that we have received from members and directly from Irish innovation-driven start-up enterprises, we believe the current low level of take up is due to a number of limitations that significantly affect the feasibility of the scheme.

In our view, the policy aim of KEEP to help SMEs attract and retain key employees can only be achieved if these limitations are addressed. In May 2018, we outlined the limitations in the scheme in our Pre-Finance Bill 2018 submission to the Minister for Finance and Public Expenditure and Reform, together with our recommendations for reforms to the existing legislation. We reiterated our recommendations on the KEEP in a letter to the Minister in November 2018, following the publication of the 2018 Finance Bill.

We note that the proposals set out in Appendix 1 of the Consultation Paper largely reflect the recommendations made by the Institute on the KEEP in our submissions last year. For completeness, we have addressed each of the proposals and detailed the rationale for our recommendations in the Appendix to this letter.

The Institute would welcome the opportunity to attend the stakeholder consultation event on 6 June 2019 to engage further on proposals to improve the KEEP scheme. Please contact Anne Gunnell at [agunnell@taxinstitute.ie](mailto:agunnell@taxinstitute.ie) or on (01) 6631750 if you wish to discuss matters raised in this submission.

Yours truly

A handwritten signature in black ink that reads "Marie Bradley".

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Marie Bradley  
*Institute President*

## Appendix

### Institute Recommendations on the KEEP

#### 1. Amend the employment conditions for the ‘qualifying individual’

Under KEEP, the individual exercising the qualifying share option must be a full-time employee or full-time director of the qualifying company and devote substantially the whole of his/her time to the service of that company throughout the entirety of the relevant period.

The current provisions<sup>3</sup> envisage that an individual will be an employee of and carry out duties for a single company. In reality, an individual may hold the office of director or have a formal contract of employment with one group member, but their services are available to other group companies. For example, employees may carry out work for the holding company and one or more subsidiaries and devote their time to the qualifying KEEP company within the group, as the business needs dictate.

The current legislation would also appear to preclude an employee who has been temporarily absent from work, for example, due to maternity or paternity leave, from qualifying for the relief.

**Institute Recommendation:** We believe that the definition of a ‘qualifying individual’ should be amended to provide more practical flexibility (particularly in SMEs), to allow employees, who spend substantial time in the KEEP company to qualify for the relief, even where they carry out some duties for other group companies.

Clarification should also be provided that an employee who has been temporarily absent from work due to maternity/paternity leave is not automatically prevented from qualifying for the relief.

#### 2. Allow employees who transfer to a group company to retain their KEEP options

While the existing legislation provides for the exercise of a KEEP option within 90 days of an employee ceasing employment, there is no provision for continued ownership of the options where the employee works for or transfers to another group company.

**Institute Recommendation:** We believe an employee, who transfers to a group company should be permitted to retain their KEEP options that qualify for CGT treatment, provided all the other conditions of section 128F TCA 1997 are satisfied.

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<sup>3</sup> See definition of a ‘qualifying individual’ in section 128F (1) TCA 1997

### 3. Amend the conditions regarding remuneration

Undoubtedly it is challenging to draft measures for a broad population of SMEs in Ireland, which includes companies still in start-up mode with high growth potential (but with limited cash resources) and more mature companies (possibly of long-standing) which are owned by a family or related persons. These are very different companies, but both have the commercial need to attract and retain key employees, whilst competing for that talent with listed companies that can already offer equity-based awards.

Linking the amount of share options that can be awarded under KEEP to the employee's annual emoluments restricts high growth companies in start-up mode availing of the scheme. In an attempt to address this difficulty for early stage businesses, Finance Act 2018 amended the definition of a 'qualifying share option' in the KEEP to permit the maximum market value of shares that can be awarded to equate to the employee's total annual emoluments, rather than 50%<sup>4</sup>.

While we welcome this step to increase the level permitted, we understand from feedback<sup>5</sup> we have received from innovation-driven enterprises that this change does not go far enough to help them avail of the scheme. At the early stage of development of an innovation-driven enterprise, cash is the most precious resource and consequently, salaries often do not reflect market rates. Therefore, the remuneration test unnecessarily restricts the ability of start-ups to attract and retain talent through the grant of share options.

We suggest that, rather than discriminate in practice against the remuneration strategies of these companies and the mix of cash-based and equity-based remuneration that they offer employees, the KEEP measures should simply set absolute values, such as those included in subparagraph (i) and (ii) of part (d) of section 128F (1) TCA 1997. It should be left to companies to determine the proportionate mix of cash and share-based remuneration as a commercial matter and to follow market driven pay awards.

It would also appear that by linking salaries to the amount of share options that can be awarded under KEEP can negatively impact employees, who are temporarily absent from work due to maternity/paternity leave, from qualifying for the relief, as often their salary levels would be reduced during this time.

**Institute Recommendation:** We suggest that the restriction to limit the value of share options that can be granted under KEEP to 100% of an individual's annual emoluments should be removed, so not to restrict high growth companies in start-up mode from availing of the scheme.

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<sup>4</sup> This amendment is subject to a Ministerial Order.

<sup>5</sup> Feedback from a Tech-start-up based in Dublin with 80 employees, provided by the "Start-up Policy Project", facilitated by Dogpatch Labs, 17 May 2019.

#### 4. Creating liquidity in KEEP shares by allowing a company buy-back of shares

A substantial challenge for SMEs wishing to operate a KEEP scheme will be to provide assured liquidity for their shares, as not all of these companies are likely to be sold or listed on a stock exchange. SMEs may need to consider how to create a market in the absence of a third-party exit, such as the owner, other employees or the company itself buying back the shares from an employee.

In general, a company buyback of shares is treated as income rather than capital. However, section 176 TCA 1997 provides that CGT treatment can apply to a buyback or redemption of shares if it is for the benefit of the trade. The KEEP provisions include a *bona fide* commercial reason test<sup>6</sup> to be met as part of the scheme's requirements. We therefore ask that section 176 is amended to reflect that a buyback of shares acquired under KEEP can be expected to meet the conditions for the benefit of the trade test in that section.

In addition, KEEP does not impose an ownership or holding period for the shares on the employee once the shares have been acquired under the terms of a KEEP scheme. Section 177(6) TCA 1997 should be amended to align its application with the understood policy intent of the KEEP provisions which is not to impose a post-acquisition holding period on scheme shares. The section should also clarify that CGT treatment can apply to KEEP shares acquired by the employee (the 'vendor' for the purposes of section 177). This subsection already includes provisions related to approved employee share schemes which, unlike KEEP, impose certain holding period requirements on the scheme shares, once acquired by the employee.

An ancillary amendment should also be made to section 178 TCA 1997 to remove the requirement to substantially reduce shareholder ownership where the shares have been acquired under KEEP. As outlined above, it is foreseen that many SMEs will need to put in place redemption or buyback mechanisms to provide liquidity in scheme shares to employees. An amendment to section 178 is necessary to allow the SME to buyback employee KEEP shares in tranches and not be required to repurchase the entire employee's holding at one time.

Furthermore, KEEP shares should be excluded from the requirement under section 178(1) TCA 1997 to have a substantially reduced shareholding immediately following the buyback/redemption.

We believe that without the amendments outlined above, KEEP will be unworkable for many companies who will not be in a position to offer listed shares (e.g. on ESM) or a third-party sale event to provide liquidity in their shares.

**Institute Recommendation:** Section 176 TCA 1997 should be amended to reflect that a buyback of shares acquired under KEEP could be expected to meet the conditions for the

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<sup>6</sup> Section 128F(11) TCA 1997

benefit of trade test in that section and consequently, subject to CGT treatment. Without making this change, SMEs wishing to operate a KEEP scheme will continue to face the significant challenge of providing assured liquidity for their shares, as not all companies are likely to be sold or listed on a stock exchange.

## 5. Allow existing shares to qualify for KEEP

A qualifying share option under the KEEP scheme requires that “*new ordinary fully paid up shares*”<sup>7</sup> are provided to a qualifying individual when the option is exercised. However, in many cases, an SME may wish to use shares set aside, for example, 5% or 10% of the shares in the company, as a pool of shares that would be available to key employees as they are recruited.

By removing the requirement to have new shares, this would allow a company to appropriate and deliver existing shares to qualifying individuals. Delivery of existing shares to employees upon exercise of an option could also be appropriate in circumstances where an employee leaves the company and is replaced by a new recruit (e.g. where existing scheme shares could be bought back from the departing employee by the SME).

It is common in the case of other share schemes that a company may choose for commercial reasons to manage the delivery of shares to eligible employees under a trust arrangement or they may choose to set aside a pool of shares to be made available as key employees are recruited. Such flexibility could be permitted under the KEEP if existing rather than new shares qualified under the scheme.

**Institute Recommendation:** We suggest that the flexibility of delivering existing shares could be permitted under KEEP by deleting the reference to ‘new’ in part (a) of the definition of a qualifying share option under section 128F TCA1997.

## 6. Amend the definition of a ‘holding company’ under KEEP

The scheme recognises that an employee may acquire KEEP shares directly in a company, which is engaged in a qualifying trade or acquire shares in a holding company. However, the definition of ‘holding company’<sup>8</sup> under the existing legislation makes it practically impossible to give employees KEEP shares where the business corporate structure has a holding company.

Holding companies generally do not only own shares (i.e. a holding company can hold money in a bank account to discharge its running expenses or advance a loan to a subsidiary) and are not always the 100% parent company, which is what is required under the existing provision to qualify for KEEP.

<sup>7</sup> See part (a) of the definition of a ‘qualifying share option’ in section 128F (1) TCA 1997

<sup>8</sup> Section 128F (4) TCA 1997

A holding company often oversees and manages the activities of subsidiaries and in doing so, may charge and recoup management expenses whether in the course of the conduct of a services trade or otherwise. This means that the assets of a typical holding company do not consist wholly of the holding of shares that comprise the entirety of the issued share capital of another company, as is required by the existing provisions.

**Institute Recommendation:** We recommend that the definition of a holding company under KEEP should be amended to adopt a similar approach to Revised Entrepreneur Relief, where a holding company *“means a company whose business consists wholly or mainly of the holding of shares of all companies which are its 51 per cent subsidiaries”*<sup>9</sup> and which provides for a qualifying group.<sup>10</sup>

## 7. Where a SME undergoes a reorganisation

The current KEEP legislation does not provide for the continuing availability of the relief in the event that the SME (e.g. holding company and its subsidiaries) undergoes a corporate reorganisation during the period in which the KEEP share option rights are outstanding.

**Institute Recommendation:** We would suggest amending the KEEP legislation to include similar provisions to those contained within the Revised Entrepreneur Relief legislation,<sup>11</sup> which seeks to address reorganisations<sup>12</sup> that might affect the entitlement of a qualifying individual and a qualifying company to meet the scheme requirements.

## 8. Develop an agreed ‘safe harbour’ approach to share valuation

One of the most significant practical issues that SMEs face when implementing KEEP is the ability to achieve as much certainty as possible that the valuation conditions have been met (e.g. that the share option price is not less than the market value of the shares at the date of grant).

The valuation of shares can be a complex exercise; especially for non-listed SMEs and valuation costs can place a significant burden on smaller enterprises in delivering share awards to employees.

**Institute Recommendation:** Revenue published guidance<sup>13</sup> on the operation of KEEP in 2018. However, in addition to providing general guidance on the KEEP provisions, we believe comprehensive guidance on share valuations is also required to support companies adopting the scheme. We believe this would make the process more accessible, easily understood and capable of implementation without undue duplication of effort and cost.

This could be achieved by:

<sup>9</sup> Section 597AA (1) (a) TCA 1997

<sup>10</sup> See definition of a ‘group’ and ‘qualifying group’ in section 597AA (1) (a) TCA 1997

<sup>11</sup> Section 597AA (1) (b) (i) and (ii) TCA 1997

<sup>12</sup> Corporate reorganisations under section 586 and 587 TCA 1997

<sup>13</sup> Chapter 9, Share Schemes Tax and Duty Manual

- Developing templates or safe harbour approaches for valuing shares in a SME. This would mean that a taxpayer would have assurance from Revenue that the share valuation is not less than market value for tax purposes, where the taxpayer had adopted the safe harbour approach to valuing the KEEP shares.

It is worth noting that it is possible to agree a valuation of a company with HMRC for the purposes of the Enterprise Management Incentive (EMI), a share scheme in the UK which is similar to KEEP. The valuations from HMRC are valid for 60 days, if there have been no significant events, like changes in the share or loan capital, or preparations for a floatation or takeover, or the company publishing new financial information.

- Agreeing that, for the purposes of meeting a market value requirement for an employee share, a market value determined by reference to:
  - > a third-party share valuation event (such as investment by a private equity or angel investor),
  - > a valuation exercise that meets the safe harbour requirements described above, or
  - > a standard share valuation exercise,

that has occurred within the previous 12 months can meet the tax requirements for establishing the market value of the shares, provided there was no material change in the circumstances of the company.