



South Block  
Longboat Quay  
Grand Canal Harbour  
Dublin 2

+353 1 663 1700  
www.taxinstitute.ie

## Consultation on the Key Employee Engagement Programme (KEEP)

Tax Division  
Department of Finance  
Government Buildings  
Upper Merrion Street  
Dublin 2

By email: [keepconsultation@finance.gov.ie](mailto:keepconsultation@finance.gov.ie)

17 June 2022

## Consultation on the Key Employee Engagement Programme (KEEP)

Dear Sir/Madam

The Irish Tax Institute welcomes the opportunity to provide feedback to the Department of Finance as part of its public consultation<sup>1</sup> on the KEEP.

Irish SMEs continue to experience difficulties recruiting and retaining skilled workers. 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, which has been further exacerbated by the current upward pressure on salaries due to the substantial increase in the cost of living.

Even though the KEEP was designed to incentivise talent to take up employment in such companies and allow them to compete with listed companies, there has been a very low uptake of the share scheme. According to the latest data available, less than 10 employees exercised shares in 2019.<sup>2</sup> In July 2019, it was confirmed that some 10 companies had granted qualifying share options to 87 key employees during 2018 (the first year of the scheme).<sup>3</sup>

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<sup>1</sup> Department of Finance, Key Employee Engagement Programme (KEEP) Questionnaire 2022, May 2022.

<sup>2</sup> Response to Parliamentary Question (369), 19 October 2021.

<sup>3</sup> Response to Parliamentary Questions (95-100), 4 July 2019.

Directors: Karen Frawley, President, Peadar Andrews, Brian Brennan, Colm Browne, Oonagh Carney, Ian Collins, Amanda-Jayne Comyn, Maura Dineen, Stephen Gahan, Aileen Keogan, Aoife Lavan, Laura Lynch, Sarah Meredith, Colm O'Callaghan, Tom Reynolds, Kieran Twomey, Shane Wallace, Tommy Walsh, Martin Lambe (Chief Executive).

Immediate Past President: Sandra Clarke.



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Since the introduction of the KEEP in Finance Act 2017, the Institute has continued to highlight limitations with the operation of the KEEP which are significantly impacting the feasibility of the scheme and ultimately, its success in achieving the policy aim of helping SMEs to attract and retain talent.

We have set out our recommendations to improve the feasibility of the KEEP in several submissions to the Minister for Finance over the last five years and most recently in our response to the consultation undertaken by the Commission on Taxation and Welfare in January this year, including:

- [Pre-Finance Bill 2018 Submission](#), May 2018
- [Response to the Department of Finance Consultation on KEEP](#), May 2019
- [Pre-Finance Bill 2019 Submission](#), June 2019
- [Pre-Finance Bill 2020 Submission](#), July 2020
- [Pre-Finance Bill 2021 Submission](#), July 2021
- [Response to the Commission on Taxation and Welfare Consultation](#), January 2022

To help us formulate our response to the questions posed by the Department of Finance in the current consultation questionnaire, the Institute carried out a short member survey<sup>4</sup> over the last three weeks. The purpose of the survey was to gather feedback from our members, who advise businesses on the operation of the KEEP, on the likely impact that the Finance Act 2019 amendments may have on the uptake of the scheme and to identify further key policy changes required to improve the overall effectiveness of the KEEP.

### **Impact of the Finance Act 2019 Amendments to the KEEP**

Three amendments were made to the KEEP in Finance Act 2019 which remain subject to a Ministerial commencement order, while State aid approval is sought from the European Commission.

The 2019 amendments include:

1. Extending relief under the KEEP to certain companies operating in a group (i.e., a group will comprise the 50% direct and indirect subsidiaries of the holding company, at least one of which should be carrying on a qualifying trade).
2. Allowing individuals who work part-time or have flexible working arrangements to be regarded as qualifying individuals for the KEEP.
3. Extending relief under the KEEP to existing shares, as well as newly issued shares.

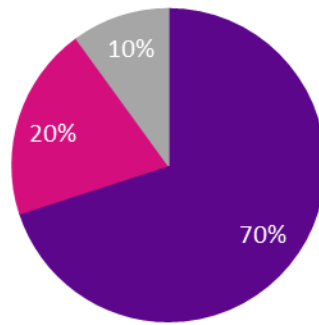
In our survey, we asked members for their views on whether each of the above three amendments would increase the level of uptake of the scheme, if commenced.

70% of the members who completed the survey were of the view that extending relief under the KEEP to certain companies operating in a group would increase the uptake of the scheme, while 20% believed it would have no impact on the number of SMEs availing of the relief (10% could not say what the impact might be).

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<sup>4</sup> Irish Tax Institute KEEP Survey 2022, June 2022, based on 49 respondents, who are tax advisers that advise SMEs on the operation of the KEEP.

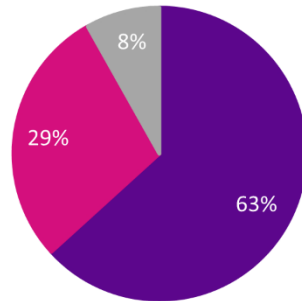
**2019 amendment to allow companies operate through a group structure to qualify for the KEEP**



■ Increase Uptake ■ No Change ■ Don't Know

63% of the respondents indicated they believed the 2019 amendment to permit part-time/ flexible workers qualify for the KEEP would increase the uptake of the scheme, while 29% considered the amendment would result in no change (8% of respondents did not know what the impact might be).

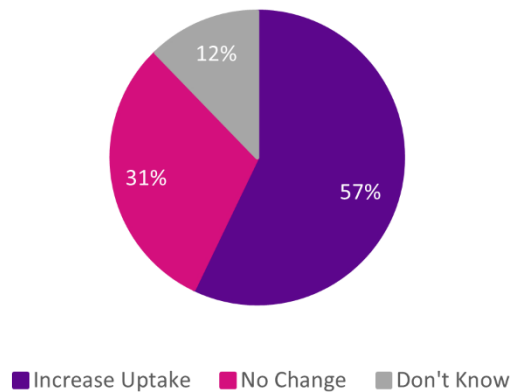
**2019 amendment to allow part-time/ flexible working arrangements qualify for KEEP**



■ Increase Uptake ■ No Change ■ Don't Know

Finally, 57% respondents considered the 2019 amendment to allow existing shares, as well as newly issued shares, to qualify for the KEEP will help to increase the uptake of the scheme by SMEs, while 31% believe it will have no impact (12% of respondents did not know what the impact might be).

### 2019 amendment to allow relief under the KEEP for existing shares, as well as newly issued



It is clear from the survey findings that the majority of respondents would welcome the commencement of the Finance Act 2019 amendments to the KEEP, as they believe they will help somewhat to improve the uptake of the scheme by SMEs.

However, it is also evident from the feedback we received from members that other measures, in addition to the 2019 changes, need to be taken to ensure the KEEP can operate effectively and deliver on its policy objective of helping Irish SMEs to attract and retain key talent.

*“These were restrictions which reduced the number of companies and employees that would be eligible to participate; however, these amendments alone will not increase uptake without the other limitations being removed in a future Finance Bill.”* Comment by a Tax Adviser in response to the Irish Tax Institute Survey on the operation of the KEEP, June 2022.

*“Flexibility in some qualifying conditions should increase uptake on the basis that the substance of the legislation as originally drafted will still apply - but be more accommodating.”* Comment by a Tax Adviser in response to the Irish Tax Institute Survey on the operation of the KEEP, June 2022.

*“The extension to group companies is welcome and should for certain groups allow for the uptake of KEEP. However, the rules are very complex and still do not fully address the potential complexity of a group structure and the Finance Act 2019 changes are unlikely to address the needs of a significant number of companies.”* Comment by a Tax Adviser in response to the Irish Tax Institute Survey on the operation of the KEEP, June 2022.

*“KEEP is an unsuitable scheme for the vast majority of SMEs who don't have a market for their shares.”* Comment by a Tax Adviser in response to the Irish Tax Institute Survey on the operation of the KEEP, June 2022

*“The group changes, although still very restrictive for reasons that are unclear, should open up the scheme to more employers, given the prevalence of group structures. While in theory the extension of qualifying employees is welcome, share options such as KEEP are more likely to be offered to full-time, senior employees than to part-timers. I don't see the extension to existing shares as being a significant issue.”* Comment by a Tax Adviser in response to the Irish Tax Institute Survey on the operation of the KEEP, June 2022

*“Government must allocate sufficient budget to fund this tax relief/expenditure. Is it a priority for Government to allow SMEs to compete with multinationals for talent? If so, this must be a realistic remuneration strategy open to SMEs.”* Comment by a Tax Adviser in response to the Irish Tax Institute Survey on the operation of the KEEP, June 2022.

### **Institute Recommendations on further changes to the operation of the KEEP**

Under current legislation, the KEEP is due to expire on 31 December 2023.<sup>5</sup> We would urge the Government to extend the scheme beyond this date for at least a further three-year period because the KEEP has the potential to enable SMEs to compete with multinationals for key talent, through share-based remuneration, in circumstances where they often struggle to match the salaries offered by larger companies.

However, we would stress that policymakers must also take the opportunity to implement key changes to the rules of the KEEP in tandem with extending the relief for a further period, to ensure it can deliver on this potential.

As mentioned above, we have highlighted difficulties with the operation of the KEEP and recommended several measures to enhance the feasibility of it, based on the feedback from our members, in numerous submissions since the KEEP was enacted into Irish law.

In our June 2022 survey, we asked members to once again identify the further changes required to the KEEP, given their experience in advising SMEs, which they believe are needed to enhance the overall effectiveness of the scheme and to prioritise the measures required.

Members have identified the following six changes to the KEEP, which we strongly recommend policymakers to adopt under the current review of the legislation. These recommendations are listed in order of priority:

#### **Institute Recommendations on the KEEP**

1. Develop an agreed ‘safe harbour’ approach to share valuation and impose an appropriate sanction where there is an undervalue. **(Ranked 4.06 out of 6)**
2. Further amend the definition of a ‘qualifying holding company’ to permit the group as a whole to be considered, rather than simply considering the holding company in isolation. **(Ranked 4.02 out of 6)**

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<sup>5</sup> Section 125F (3) TCA 1997.

3. Create liquidity in KEEP shares by allowing a company to buy-back KEEP shares. **(Ranked 3.86 out of 6)**
4. Simplify the qualifying share option limits for the KEEP by removing the annual emoluments cap. **(Ranked 3.57 out of 6)**
5. Allow the continuing availability of the relief should the SME (e.g., holding company and its subsidiaries) undergo a corporate reorganisation during the period in which the KEEP share option rights are outstanding. **(Ranked 3.14 out of 6)**
6. Provide for 'roll over relief' in respect of KEEP share options which would apply in situations where during the exercise period, a transaction is entered into which results in the share capital of the company being acquired, and unexercised KEEP share options are exchanged or assigned for new options in the acquiring company. **(Ranked 2.35 out of 6)**

It is clear from the feedback we received from members in response to our survey that simplifying and amending the rules of the KEEP is critical, if the scheme is to operate in line with its stated policy aim, including:

*“Every time we mention this scheme, the client is excited by it until we go through the rules. It rarely works for all the items mentioned above.”* Comment by a Tax Adviser in response to the Irish Tax Institute Survey on the operation of the KEEP, June 2022.

*“I found it difficult to prioritise the recommendations as all of them are important changes that are necessary to enable the scheme to be implemented.”* Comment by a Tax Adviser in response to the Irish Tax Institute Survey on the operation of the KEEP, June 2022.

*“Extend the availability of Entrepreneur Relief to KEEP shares, along the lines of UK EMI schemes.”* Comment by a Tax Adviser in response to the Irish Tax Institute Survey on the operation of the KEEP, June 2022.

We have outlined in further detail the policy rationale for each of the six proposed changes to the KEEP and recommend how these reforms could be implemented in the Appendix to this letter. The Institute would be happy to engage further on the matters raised in this submission.

Please contact Anne Gunnell at [agunnell@taxinstitute.ie](mailto:agunnell@taxinstitute.ie) or (01) 6631750 if you require any further information.

Yours sincerely



Karen Frawley  
Institute President

## Appendix

### Institute Recommendations to Enhance the KEEP

We believe further legislative amendments are required to improve the feasibility of the scheme. In our view, the policy intention of KEEP, which is to help SMEs attract and retain key employees, can only be achieved if these limitations are addressed by policymakers. The Institute has outlined the limitations to the KEEP together with our recommendations for key reforms to the existing legislation below:

#### **1. Develop an agreed 'safe harbour' approach to share valuation and impose an appropriate sanction where there is an undervalue**

In our response to the 2019 consultation on KEEP, we highlighted that 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. For example, that the share option price is not less than the market value of the shares at the date of grant.

Currently, there is no guidance on how to determine what market value is for the purposes of the KEEP. If qualifying options are not granted for market value or the market value is subsequently determined by Revenue to be higher than originally projected, the options would not qualify, as KEEP options under section 128F TCA 1997, resulting in no exemption from income tax, USC and PRSI on exercise.

Comprehensive guidance on share valuations is required to support companies adopting the scheme. 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 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 the KEEP. The valuations from HMRC are valid for 90 days from the date of the agreement. An application request for a share valuation in connection with the EMI can be made online by the SME and are given priority by HMRC.

In addition, where options are granted at an undervalue, we believe that a more proportionate sanction would be for a charge to income tax to arise on the exercise of the options on the difference between the market value at the date of grant and the option price. This would allow the options to remain qualifying share options, but it would also enable Revenue to collect income tax on the portion of the gain attributable to the undervalue.

The income tax arising on exercise could be collected under the same mechanism as

section 128 TCA 1997 (i.e., a charge to income tax under Schedule E is imposed on any gain realised by a director or employee from a right granted to him/her, by reason of his/her office or employment, to acquire shares or other assets in a company).

## **2. Amend the definition of a ‘qualifying holding company’**

While the amendments introduced by Finance Act 2019 are welcome and are likely to go some way to increasing the number of groups that can now qualify for the KEEP, there are certain conditions attaching to the new definitions of ‘qualifying holding company’ and ‘qualifying group’ that will also hinder certain groups availing of the scheme.

For example, it is common for a new business to start up as a single trading entity, then, as the business grows and expands into new territories or delivers new products, it can become necessary for commercial reasons to incorporate another entity. Often, such new entities are established as subsidiaries of the original trading company. As the business activities expand, the original company often continues to carry on the existing trade but also evolves into a holder of the shares in the new trading subsidiary.

Generally, such businesses would not put a company in place whose sole or main business is that of holding shares, as the stage of development of the business may not warrant it or it may not be commercially necessary to do so, particularly given the complexity and cost that can be involved in undertaking a group restructure to put a holding company in place.

Many businesses that wish to set up a KEEP scheme are prevented from doing so because of the restrictive definition of a ‘qualifying holding company’ under the rules of the scheme.

The following conditions for a ‘qualifying holding company’ are particularly problematic:

- A qualifying holding company for KEEP purposes cannot be a trading company. If it is trading, it is not a qualifying holding company, even if it is wholly or mainly holding shares in trading subsidiaries.
- Company structures with an intermediate holding company may not be regarded as a qualifying company if there is no qualifying subsidiary held directly by the ultimate holding company. By way of comparison, Revenue guidance for Revised Entrepreneur Relief (section 597AA TCA 1997) acknowledges that structures with a double holding company are not precluded from that relief.
- A holding company can only hold shares in a qualifying subsidiary and a “relevant subsidiary” and no other companies. A “relevant subsidiary” is one in which the qualifying holding company holds more than a 50% interest in the ordinary share capital. Therefore, if the holding company had a 50% joint venture interest in another company it cannot be a qualifying holding company, even if it had a qualifying subsidiary that was a qualifying company.



We believe that the definition of qualifying holding company should be amended to permit the group as a whole to be considered, rather than simply considering the holding company in isolation. This could be achieved by amending the wording of the definition of a “qualifying holding company” at subsection (c) to state that it means a company where *“the business of the company, its qualifying subsidiary or subsidiaries, and as the case may be, its relevant subsidiary or subsidiaries, taken together consists wholly or mainly of the carrying on of a trade or trades.”* This approach would be similar to the approach taken for the CGT holding company exemption in section 626B TCA 1997.

In addition, the legislation is unclear as to whether it is possible to issue the KEEP options in a single company within a group that meets the “qualifying company” tests or whether it is necessary for the group, of which the qualifying company is part, to be a “qualifying group”. This should be clarified in the legislation.

### **3. Create liquidity in KEEP shares by allowing a company buy-back of shares**

A substantial challenge for SMEs wishing to operate a KEEP scheme is to provide assured liquidity for their shares, as not all such 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 to be met as part of the scheme’s requirements.

In our response to the 2019 public consultation on KEEP, we recommended that section 176 TCA 1997 should be amended to reflect that a buyback of shares acquired under the KEEP can be expected to meet the conditions for the benefit of the trade test in that section.

In addition, in our 2019 response, we recommended that sections 177 and 178 TCA 1997 should also be amended, as follows:

- 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 intention 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 the 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 remain unworkable for many companies that will not be in a position to offer listed shares or a third-party sale event to provide liquidity in their shares.

An alternative approach would be for the KEEP legislation to be amended to permit CGT treatment to apply to a buyback or redemption of shares in certain circumstances without meeting the conditions of Part 6, Chapter 9 TCA 1997.

#### **4. Simplify the qualifying share option limits for the KEEP by removing the annual emoluments cap**

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.

Currently, the total market value of all shares, in respect of which qualifying share options have been granted by the qualifying company to an employee or director, must not exceed €100,000 in any year of assessment, €300,000 in all years of assessment or 100% of the annual emoluments of the qualifying individual in the year of assessment in which the qualifying share option is granted.

In our response to the 2019 consultation, we outlined that linking the amount of share options that can be awarded under the KEEP to the employee's annual emoluments restricts high growth companies in start-up mode availing of the scheme. Often in start-up businesses, employees and directors have lower salaries, compared with larger multinationals, which can prohibit such companies under the KEEP offering equity as an incentive for these individuals to stay in the business.

We suggest that rather than discriminating 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.

We believe that such an amendment to the qualifying limit of 100% of the annual emoluments of the qualifying individual would take account of situations where an employee's salary has reduced because of reduced working hours or a temporary layoff. It would also address situations where employees, who are temporarily absent from work due to maternity or paternity leave, are limited in terms of the relief which may apply, as often their salary levels would be reduced during this time.

In addition, we have received feedback from members that the lifetime limit of €300,000 can act as a barrier to claiming relief under the scheme where shares have increased in value. In our view, consideration should also be given to applying the limit on a rolling basis. It is noteworthy that the cap is on the value of the share options in the UK scheme as opposed to the value of the shares, which can be rolled over every three years.

## **5. Allow for the continuation of the relief where a SME undergoes a reorganisation**

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

We would suggest amending the KEEP legislation to include similar provisions to those contained within the Revised Entrepreneur Relief legislation, which seeks to address reorganisations<sup>6</sup> that might affect the entitlement of a qualifying individual and a qualifying company to meet the scheme requirements.

## **6. Provide for 'roll over relief' of the KEEP share options**

We believe that section 128F TCA 1997 should be amended to provide 'roll over relief' of KEEP share options, similar to that provided in section 128(8)(a) TCA 1997. Where share rights are exchanged between directors and employees or a company grants a new right in exchange for the surrender of an original right, the new right and the original right are looked at as one for the purpose of the charge to tax under section 128. This 'roll over relief' effectively means that the tax charge arises at the point of exercise of the new right, with the history of the original share right taken over in respect of a future exercise of the new right. A similar relief is not included in the KEEP legislation.

For example:

- Company A grants share options that meet the conditions of the KEEP under section 128F TCA 1997 and would qualify for an exemption from income tax on exercise.
- During the exercise period, a transaction is entered into which results in the share capital of Company A being acquired, and unexercised share options are exchanged or assigned for new options in the acquiring company.

In our view, section 128F should be amended to provide 'roll over relief' in respect of KEEP share options. This would apply where during the exercise period, a transaction is

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<sup>6</sup> Corporate reorganisations under section 586 and 587 TCA 1997

entered into which results in the share capital of a company being acquired, and unexercised KEEP share options are exchanged or assigned for new options in the acquiring company.

In such circumstances, we believe that if the acquiring company meets the qualifying company/group criteria set out in the legislation, the future exercise of the new replacement options should qualify for relief, with the history of the original share option being taken over for the purposes of determining the charge to tax.