Restricted share plans

The purpose of implementing employee share schemes will often be two fold, with an employer seeking to both incentivise and retain employees.

A simple approach is to give shares to an employee outright. However, whilst this may achieve the motivational objective of the company it may not be an effective retention tool. This is particularly true if there is an available market for the shares. An alternative which satisfies the retention objective is the use of restricted shares.

Tax advantages of restricted shares

- The taxable value of the shares can be reduced based on the restriction on the shares.
- Growth in the value of the shares following acquisition will be subject to capital gains tax (33%) rather than income tax,USC and PRSI.
- No employer PRSI is payable.

What are restricted shares?

Restricted shares are shares acquired by an employee or director of a company, including shares acquired on the exercise of a stock option, where there is a "clog" or restriction on the disposal of those shares. Under the terms of a written agreement, the shares are held in a trust established by the employer for the benefit of the employee for a specified period of at least one year. During this period the employee is restricted from assigning, transferring, pledging as security for a loan, or selling the shares in any circumstances. The only exception being on the death of the employee or on a merger or acquisition of the company such that the employee receives an offer for the shares.

What is the tax treatment of shares received?

In general, where an employee acquires shares from an employer free, or at a discount, they will be subject to income tax, PRSI and USC. The amount chargeable to tax will be the excess of the market value of the shares on the date of acquisition over the consideration, if any, paid for the shares.

What is the tax impact of a restriction on the shares?

The amount chargeable to income tax on the date of acquisition of the restricted shares may be reduced in recognition of the fact that the shares cannot immediately be sold. The reduction in the taxable value depends on the length of the restricted period as outlined below.

Restricted Period	Reduction
1 year	10%
2 years	20%
3 years	30%
4 years	40%
5 years	50%
> 5 years	60%

The award of restricted shares is liable to tax when the shares are awarded. The income tax is payable by the employee through payroll.

Example 1:

Restricted shares received free of charge from employer Finance Act 2016	
Market value of shares received	€10,000
Restricted period	5 years and 1 day
Reduction in amount chargeable to tax	60%
Amount chargeable to income tax	€4,000
Tax (40%)	€1,600
USC (8%)	€320
PRSI (4%)	€160
Total taxes	€2,080
*The USC rates applicable are 0.5% to 8% depending on the individuals overall income. Employee PRSI of 4% applies.	

The employer is required to withhold the taxes due via payroll.

The effective rate of tax in the above example compares favourably with the current CGT rate of 33%.

What are the implications of amendments?

If the restricted period is removed or varied, the income tax, PRSI and USC charge calculated on the acquisition of the shares will be adjusted to take account of the actual period of restriction. Similarly, if the shares are sold during the restricted period, for example, on the sale of the company, the income tax, PRSI and USC charge will be adjusted.

What are the disadvantages of a restricted share plan?

The employee will have a funding cost in that they do not have recourse to the shares during the restricted period to finance any tax liability that may arise on the award of the shares. A tax change arises at award irrespective of the proceeds realised on a future disposal.

Employer obligations

The employer is obliged to report details of the event to Revenue by 31 March of the following year on form RSS1 where the restricted shares are acquired on the exercise of a share option. The employer must include the income and amount of taxes withheld in the company's P30/P35 returns for all other restricted shares.

What are the tax implications on the sale of restricted shares?

The sale of restricted shares may be subject to capital gains tax on the difference between the proceeds of the share sale and the base cost of the restricted shares. The base cost of the shares will depend on whether the shares are newly issued or are existing shares. The current rate of capital gains tax is 33%.

Example 2:

The employee disposes of the shares received in Example 1 which were newly issued.	
Sales proceeds	€15,000
Less cost (amount liable to income tax)	€4,000
Chargeable gain	€11,000
Annual exemption	€1,270
Taxable gain	€9,730
CGT @ 33%	€3,211

As outlined above, if the shares are sold before the end of the restricted period, the amount charged to tax will be amended to take account of the actual period of restriction. Any additional amount charged to tax in this scenario can be used in computing the base cost of the restricted shares for capital gains tax purposes.

How can we help?

Our dedicated Compensation & Benefits specialists can meet with you to identify the key objectives of a proposed plan and assist in drafting and implementing a plan.

Under anti-avoidance legislation, remuneration due to an employee which is "sacrificed" in exchange for a tax free benefit will continue to be liable to PAYE, PRSI and USC. If the restricted share plan is an entirely new plan unrelated to existing bonus arrangements, there should be no salary sacrifice. In other circumstances it is important to consider the implications, if any, of salary sacrifice legislation when changing an existing share scheme or implementing a new share plan as part of a change in remuneration arrangements.

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