

# Approved profit sharing schemes

For more information in relation to any employee share incentive arrangements, please get in touch with your usual PwC contact, or any of the following from our HR Services Group who specialise in this area:

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A Revenue approved profit sharing scheme is a tax efficient means of distributing “profits” in the form of shares to employees. Taken further, it can also be structured as a mechanism for motivating employees and giving them the opportunity to take a stake in the company’s future. The typical structure would offer employees a choice of receiving tax-free shares as an alternative to cash bonuses on which income tax, the income levy and social insurance would be withheld. The former has attractions for many employees and employers.

## Basic scheme

In order to obtain the tax efficient status, a scheme must first be approved by the Revenue Commissioners. There are strict rules which must be observed by the employer and the employee if the scheme is to obtain and retain its approved status.

Subject to these conditions being fulfilled, the scheme allows an employer to distribute “profits” in the form of shares to employees, up to a total value of €12,700 per employee in any one tax year. The employee acquires the shares tax-free and the company will generally get a tax deduction for the costs incurred. Furthermore, neither employer nor employee social taxes will apply to these share awards.

## Approval of schemes

Schemes must be approved in advance by the Revenue Commissioners. All approved schemes must be established within the framework of a trust, the trustees of which must be resident in Ireland.

In the case of a group of companies, a single scheme can be set up to cover all employees of the group. There are now over 500 schemes approved, primarily in Irish public companies and subsidiaries of multinational companies with operations in Ireland.

## Operation of the scheme

A company with an approved scheme has discretion each year whether to make awards. In a year in which the company may decide to operate the scheme, the company makes a payment to the trustees who buy or subscribe for shares in the company. Whilst the shares will be beneficially owned by individual employees, the trustees must hold the shares in trust on their behalf. Provided the trustees use the amounts they receive from the company to acquire shares for the employees, or to meet the reasonable expenses in running the scheme, payments made by the company will be deductible from profits for corporation tax purposes.

If the company issues new shares for subscription by the trustees, then effectively the funds stay within the company and the company still obtains the benefit of the corporate tax deduction.

## Employer contribution

In order to obtain Revenue approval for the scheme, there must be an employer contribution. This may be funded from a number of sources, including increased profits, cost reductions, gain sharing or perhaps in the form of certain discretionary bonus payments available to all employees on similar terms. Therefore, it may be possible to introduce a scheme without

any increase in payroll costs. Indeed to the extent that employees take shares through the scheme, rather than cash through payroll, there will be savings in employers PRSI costs as the shares will not attract a PRSI charge.

It is also possible to include company performance targets to determine whether the scheme will operate in any particular year or to measure the quantum of the funds to be allocated to the scheme.

Changes in Revenue practice mean that fixed bonus arrangements are no longer accepted mechanisms for funding new schemes. Since 2005, Revenue have also phased out Flex based plans.

In recent times, Revenue have accepted certain discretionary bonus plans which deliver rewards by reference to corporate or individual performance. Whilst very careful planning is required in advance of introducing such mechanisms, they are becoming increasingly important to organisations seeking to align distinct corporate performance strategies and reward philosophies into one framework. When the company framework can be managed in a manner which satisfies the Revenue Commissioners, the result is that employers are getting a return on their investment in variable pay, employees are benefiting from a tax efficient investment and the interests of shareholders and employees are aligned for an extended period.

## Additional employee contributions

### (i) Salary foregone

Any approved scheme can be designed to permit employees to top up an employer's contribution in a tax efficient manner by means of a contribution from gross salary. This optional employee contribution, by way of a salary foregone facility, may not exceed the amount of the employer's contribution taken in shares, or 7.5% of basic salary if less.

Any amounts deducted by way of salary foregone must be utilised to acquire shares within the same tax year as the corresponding employer contribution.

### (ii) Buy-one-get-one-free (BOGOF)

It is also permissible to introduce a Contributory Profit Sharing Scheme whereby the company's contribution is dependent on the employee making the initial contribution to the scheme. Such schemes are often referred to as "Matching Schemes" or "BOGOF". They operate in a similar manner except that the employee's contribution is mandatory

if the employee is to obtain the matching free shares in a tax efficient manner. However, the additional employee's contribution in this instance is deemed to come from net pay rather than gross pay, so it is not as tax effective as salary foregone arrangements.

## Eligibility of employees

All employees and full-time directors with at least three years service must be eligible to participate in the scheme. However, the company is free to include employees with less than three years service. All participating employees must be eligible to participate on similar terms, though this does not preclude an allocation of shares by reference to length of service, salary levels, or other similar objective criteria, which can include a thoroughly documented appraisal system acceptable to the Revenue. Employees may, of course, elect not to participate in the scheme.

## Scheme shares

The shares to be appropriated must form part of the ordinary share capital of the company, or its parent company, as appropriate. The shares must be non-redeemable, fully paid up and not subject to specific restrictions.

The shares must be of a class quoted on a recognised stock exchange, or shares in a company controlled by a quoted company. It should be noted that shares in a private company can also qualify, provided that the company concerned is not controlled by another company.

## Ownership of shares

While the employee will retain beneficial ownership of the shares from the date of appropriation, the employee must be bound in contract with the company to permit the shares to remain in the hands of the trustees throughout a period of retention. This is two years from the date of appropriation of the shares.

If the full tax-free status is to be maintained, the shares must be held by the trustees until the release date, i.e. three years from the date on which the shares are appropriated. If the shares are sold before this release date, an income tax liability, at the employee's marginal tax rate, will arise.

Any dividends which may be payable on the shares while they are held in trust must be paid over to the participating employees by the trustees.

## Disposal of shares

The disposal of shares by the employee at any time may give rise to a capital gains tax liability. The gain will be computed by reference to the excess of the net sales proceeds over the market value of the shares on the date they were originally appropriated, as adjusted for inflation for periods of ownership prior to 1 January 2003.

Capital gains tax is currently payable at 25% of the net gain. The employee will be entitled to the annual capital gains tax personal exemption of €1,270 against any chargeable gain arising on the disposal of the shares (assuming the annual exemption has not otherwise been utilised).

## Corporate reporting obligations

When a scheme has been approved by the Revenue Commissioners, various annual tax returns must be filed. These include a Form ESS1, Form 1 and dividend withholding tax returns where dividends are received from certain foreign parents.

Beginning with the 2008 tax year, the form ESS1 automatically falls due by 31 March of the following year. The Form 1 is due by 31 October of the following year.

## Our services

At PricewaterhouseCoopers, in association with our correspondent law firm, Landwell, we can provide a comprehensive range of services to assist you in the implementation of any share incentive scheme.

The services available include:

- Evaluating your specific needs and designing the appropriate scheme to reflect your specific requirements.
- Drafting the necessary formal documentation which will govern the operation of the scheme, together with the necessary resolutions and notices for shareholders.
- Managing the Revenue and institutional investor approvals, as required.
- Providing assistance and advice with regard to employee communications and presentations.
- Establishing the scheme and ongoing administration of same.
- Dealing with annual tax return filing requirements for the company and the trust with regard to the particular share incentive arrangement.

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The information provided is for general guidance only. No action should be taken without obtaining specific advice relevant to your business needs.