Employee Stock Options in the EU and the USA

FINAL REPORT

AUGUST 2002

Ireland

Contents

Ireland

1. General remarks

1.1 History

1.1.1 Companies in Ireland have used stock option plans for many years though they were initially confined to executive discretionary schemes in public companies. Specific tax legislation governing stock options was not introduced until 1986 (Finance Act 1986). Until this point in time the Irish Revenue authority taxed any benefit in connection to stock options in accordance with a decision in a UK case. Thus there was only a tax charge if the exercise price was less than the market value at the date of grant, and there was no further tax charge on exercise[1].

1.1.2 Finance Act 1982 introduced Approved Profit Sharing Schemes ("APSS"), but this is a share purchase plan rather than a share option arrangement so is not dealt with in any further detail in this report[2].

1.1.3 Options granted between 6 April 1986 and 29 January 1992 were governed by tax legislation and divided into "approved" and "unapproved" stock options. However, the favourable tax treatment given to approved options was withdrawn for options granted on or after 29 January 1992[3].

1.2 Current situation

1.2.1 Finance Act 1999 introduced savings-related share options schemes, also known as Save As You Earn ("SAYE") schemes. These have proved very popular with over 80 now in place, across a range of sectors[4].

1.2.2 Finance Act 2001 re-introduced approved share option schemes ("ASOS") with favourable tax status, but there are a number of restrictions attached, particularly the need for schemes to be open to all employees and the requirement to grant options on "similar terms" and plans could be approved retrospectively. As at July 2002 only 15 companies had obtained approval for their schemes, which is less than 10% of the companies that applied for approval.

1.2.3 Both of the approved share option schemes are designed to encourage companies to offer options to all of their employees, not merely on a discretionary basis to senior staff. This ties in with the government's stated commitment of promoting wider share ownership, and is endorsed by the unions, who play a key part in negotiations with government on policies affecting employees. There has been an active policy of containing increases in labour costs through national wage agreements and these have tied in to the general tax reductions and incentives for broad based employee share incentives.

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[1] Abbot v Philbin (39 TC 82)

[2] S128 Taxes Consolidation Act 1997

[3] S519A and Schedule 12A, Taxes Consolidation Act 1997

[4] S519D and Schedule 12C, Taxes Consolidation Act 1997

1.2.4 The regulatory environment does not currently present significant obstacles to overseas companies exporting their stock plans to Ireland.

1.2.5 Stock options are now much more common in Ireland than they were 10 years ago. Ireland's favourable corporate tax rates have attracted significant inward investment from non-Irish multinational companies, particularly US hi-tech companies where employee stock options have traditionally formed part of remuneration packages. Ireland has also seen much growth in entrepreneurial business, which tends to foster a "high risk/high reward" stock option culture.

1.2.6 In general, discussions in relation to stock options have been led by the business community, rather than legal or academic circles.

2. Key features of stock option plans

2.1 There are three types of stock option plan operated in Ireland.

2.2 Irish Revenue Approved Share Option Plan ("ASOS")[5]

2.2.1 There is no minimum term for which the share options must be granted. There is also no maximum term for which the share option may subsist. However, investor guidelines state that options must not subsist for more than 10 years.

2.2.2 The ASOS is a broad based option plan, and options must be granted to all employees on similar terms, subject to certain exceptions. Employees can be nominated as "key employees" and receive options outside the similar terms, provided that the total number of options granted to key employees in each tax year does not exceed 30% of the total number of options granted to all employees under the scheme in the same tax year[6].

2.2.3 Apart from key employee provisions, there is scope to grant rights on non-similar terms to newly hired employees, in the year of assessment in which they commence to hold the office. The grants can also vary based on levels of remuneration, length of service or other similar factors, but it should be borne in mind that the Revenue are operating a strict interpretation of this[7].

2.2.4 The shares must be ordinary shares in the grantor, or in a company that controls the grantor, or in a company which is or has control of a company which a) is a member of a consortium which owns the grantor or company controlling the grantor, or b) beneficially owns at least 15% of the ordinary share capital of the company. The shares must also be quoted on a recognised stock exchange (we are not aware of any exchange that is not recognised for these purposes), or must be shares in a company not controlled by another company, or shares in a company

[5] All provisions in relation to ASOSs are contained in S519D and Schedule 12C of the Taxes Consolidation Act 1997
[6] Schedule 12C paragraphs 7 to 10 Taxes Consolidation Act 1997
[7] Schedule 12C paragraphs 8 and 9 Taxes Consolidation Act 1997

under the control of a company whose shares are quoted on a recognised stock exchange[8].

2.2.5 Any company can set up an ASOS, as long as the approval criteria are met.

2.2.6 Provided the key employee limits are adhered to there are no restrictions on the level of award[9].

2.2.7 Options must be granted at the Fair Market Value ("FMV") of the shares at the date of grant[10]. Unlisted companies must agree a valuation of their shares with Revenue as part of the approval process.

2.3 Irish Revenue Approved Savings-Related Share Option Scheme, or Save As You Earn ("SAYE")[11]

2.3.1 Under an SAYE an employee enters into a savings contract under which s/he agrees to make savings for a specified period of time. The savings contract can be for three, five or seven years. Under a three year contract the employee makes monthly savings for three years. Under a five or seven year contract monthly savings are made for five years, but in the case of a seven-year contract the savings are held for two more years. [12]

2.3.2 The minimum and maximum monthly savings permitted by law are currently €12 and €320 respectively. [13]

2.3.3 At the end of the savings contract a bonus payment is added to the savings. The bonus payments are subject to limits set by the Revenue. These are currently 2, 6 and 12.5 times a month's contribution, for 3, 5 and 7 year contracts respectively. The actual amounts paid are determined by the savings carrier at the outset of the contract and may be less than the maximum allowed. [14]

2.3.4 The savings and bonus are used to acquire the shares in the exercise of SAYE options. The total exercise price cannot exceed the amount of the savings and bonus.

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8 Schedule 12C paragraphs 11 to 16 Taxes Consolidation Act 1997

9 Schedule 12C paragraph 9 Taxes Consolidation Act 1997

10 Schedule 12C paragraph 19 Taxes Consolidation Act 1997

11 All legislative provisions in relation to SAYE are contained in S519A, S519B, S519C and Schedules 12A and 12B of the Taxes Consolidation Act 1997.

12 Specification by Minister for Finance made under S519C and Schedule 12B paragraph 2 Taxes Consolidation Act 1997

13 Schedule 12A paragraph 25 Taxes Consolidation Act 1997

14 S519C Taxes Consolidation Act 1997

2.3.5 The option exercise price is set by the company and cannot be less than 75% of the FMV of the shares at grant. The number of shares over which the option is granted cannot exceed

$$\frac{\text{savings + bonus}}{\text{option price}}$$

2.3.6 For example, if an employee entered a three year savings contract to save €100 per month, the savings carrier offered a two months' bonus and the option price was set at €1.50 (against an FMV at the time of €2), the maximum number of shares over which the option could be granted would be

$$\frac{(36 \times 100) + (2 \times 100)}{1.50} = 2{,}533 \text{ shares (fractions are rounded down)}$$

2.3.7 The options are exercisable in the six-month period following the end of the savings contract.[15] If the savings contract is not completed, or the option is not exercised within six months after the end of the savings contract, the option lapses[16].

2.3.8 The savings contract must be managed by an approved savings carrier.

2.3.9 All eligible employees must be offered the opportunity to participate. This includes every person who is an employee or full time director throughout a qualifying period set by the company (which cannot exceed three years), who is chargeable to Irish income tax under Schedule E (the charging schedule for employment income). The scheme is not open to individuals who have, or have had within the preceding twelve months, a material interest in a close company (generally, this is a company under the control of five or less individuals), where the "SAYE" scheme is to be used to acquire shares in that company[17].

2.3.10 All employees must be offered the chance to participate on similar terms, e.g. same option price, same grant date[18].

2.3.11 The shares must be ordinary shares in the grantor, or in a company that controls the grantor, or in a company which is or has control of a company which a) is a member of a consortium which owns the grantor or company controlling the grantor, or b) beneficially owns at least 15% of the ordinary share capital of the company. The shares must also be quoted on a recognised stock exchange (we are not aware of any exchange that is not recognised for these purposes), or must be shares in a company not controlled by another company, or shares in a company under the control of a company whose shares are quoted on a recognised stock exchange[19].

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[15] Schedule 12A paragraph 23(b) Taxes Consolidation Act 1997

[16] Schedule 12A paragraph 23(b) Taxes Consolidation Act 1997

[17] Schedule 12A paragraphs 8 and 9 Taxes Consolidation Act 1997

[18] Schedule 12A paragraph 9 Taxes Consolidation Act 1997

[19] Schedule 12A paragraphs 10 to 15 Taxes Consolidation Act 1997

2.3.12 Any company can set up an SAYE scheme as long as the criteria are met. Private companies need to agree a valuation of their shares with Revenue as part of the approval process.

2.4 Unapproved stock option plans (i.e. non-Revenue approved)

2.4.1 There is no minimum term for which the share options must be granted.

2.4.2 For listed companies, investor guidelines recommend that the life of an option is no longer than ten years. In addition, there may be adverse tax consequences where the life of an option is longer than seven years.

2.4.3 Eligibility to participate in an unapproved stock option plan is entirely at the company's discretion. This can include non-employees but consideration would have to be given to the guidelines of the Irish Association of Investment Managers ("IAIM").

2.4.4 There are no restrictions over the nature of the shares over which options may be granted under this plan nor is there any restriction on the type of company that may grant options under this type of plan.

2.4.5 There are no restrictions over the value of shares over which options may be granted to an employee.

2.4.6 Unlisted companies need to consider both valuation issues and suitable exit mechanisms to enable employees to measure and realise value from the award.

3. Taxation

3.1 Time of taxation

3.1.1 *ASOS*

3.1.1.1 There is no charge to income tax or social security contributions at grant or vesting provided all criteria for approval are met[20].

3.1.1.2 There is no charge to income tax or social security contributions at exercise provided that there has been at least three years between date of grant and date on which the shares are sold. If the shares are sold within three years of grant the options are to be taxed as unapproved options[21] and the spread (i.e the difference between the FMV at exercise and the exercise price paid) is subject to income tax. Capital gains tax will be payable on the difference between the sale proceeds and the FMV at exercise (see section 3.2 below).

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[20] S519D Taxes Consolidation Act 1997 and Schedule 12C

[21] S519D(3) Taxes Consolidation Act 1997

3.1.2 *SAYE*

3.1.2.1 There is no income tax or social security contributions at grant or exercise provides all criteria for approval are met[22] [23].

3.1.3 *Unapproved plan*

3.1.3.1 There will be a charge to income tax at the date of grant[24]if the option is capable of being exercised for more than seven years from the date of grant and it is granted at less than market value. No social security contributions are payable on grant.

3.1.3.2 No income tax liability or social security contributions arise at vesting.

3.1.3.3 There will be charge to tax at the date of exercise[25]. No social security contributions are payable at exercise.

3.1.3.4 The tax liability arising on exercise of an unapproved stock option can be deferred until either the sale of the shares or seven years from the date of exercise, whichever is earlier. An election to defer must be made on the individual's tax return for the year of exercise. If a deferral election is not made, the tax due on exercise must be paid by 31 October following the tax year of exercise although there may be a requirement to make a preliminary payment on 31 October in the year of exercise.

3.1.3.5 Income tax in relation to stock options is not collected through PAYE (withholding). Instead the employee is liable to account for his own tax, normally by 31 October of the year following the tax year (calendar year) in which the income arises. The employee may, however, have a preliminary tax obligation, depending on his/her level of non PAYE in the current and preceding tax years. Preliminary tax is due by 31 October in the tax year.

3.1.3.6 There is no wealth tax in Ireland

3.2 Taxable gain

3.2.1 *Unapproved plan*

3.2.1.1 If tax is payable at grant the income tax charge will arise on the difference between the market value at date of grant and the option price.

3.2.1.2 At exercise, an income tax charge will arise on the difference between the market value at date of exercise and the option price. If income tax has already been paid at grant, the amount already taxed can be deducted when calculating the taxable gain at exercise.

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22 S519A(2) Taxes Consolidation Act 1997
23 S519A(3) Taxes Consolidation Act 1997
24 S128(5) Taxes Consolidation Act 1997
25 S128(2) Taxes Consolidation Act 1997

3.3 Type of tax

3.3.1 Where income tax is payable (grant/exercise for unapproved, sale within three years for approved scheme) the taxable gain will be subject to income tax at the employee's marginal rate of tax which in Ireland, where applicable, varies from 20% to 42%.

3.3.2 The amount of tax payable varies depending on marital status and whether both spouses are employed.

- Single person €28,000 @ 20%; balance @ 42%.

- Married person, with two incomes, joint assessment€56,000 @ 20%; balance 42%.

- Married person, with one income, joint assessment €37,000 @20%; balance @ 42%.

3.3.3 A recharge of costs does not affect the employee's tax position.

3.4 Capital gains taxation

3.4.1 *ASOS*

3.4.1.1 There will be a tax charge at the date of sale[26].

3.4.1.2 Assuming that the three years' holding period between grant and sale has been met the sale proceeds less acquisition costs (i.e. exercise price) will be subject to Capital Gains Tax ("CGT"). Indexation of the gain applies where the shares have been held for longer than a year. Gains in excess of an annual exemption (€1,270 for 2002) are taxed at 20%[27].

3.4.1.3 If the shares are sold at a loss (i.e. for less than the price paid to acquire them at exercise) the loss can be offset in the following ways:

- All capital losses and capital gains in the tax year can be offset against each other[28].
- Where capital losses exceed capital gains in a tax year, the losses can be carried forward to future years and offset against future gains.
- Capital losses cannot be offset against other income.

3.4.1.4 No specific claim for loss relief needs to be made.

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[26] S28 Taxes Consolidation Act 1997

[27] S28(3) Taxes Consolidation Act 1997; S601 Taxes Consolidation Act 1997

[28] S546 Taxes Consolidation Act 1997

3.4.1.5 If the holding period was not satisfied the sale of the shares is taxed for an unapproved option (see sections 3.2.1 and 3.3 above).

3.4.2 *SAYE*

3.4.2.1 There will be a tax charge at the date of sale[29].

3.4.2.2 The sale proceeds less acquisition costs (i.e. exercise price) will be subject to Capital Gains Tax ("CGT"). Indexation of the gain applies where the shares have been held for longer than a year. Gains in excess of an annual exemption (€1,270 for 2002) are taxed at 20% [27].

3.4.2.3 If the shares are sold at a loss (i.e. for less than the price paid to acquire them at exercise) the loss can be offset in the following ways:

- All capital losses and capital gains in the tax year can be offset against each other[30].
- Where capital losses exceed capital gains in a tax year, the losses can be carried forward to future years and offset against future gains.
- Capital losses cannot be offset against other income.

3.4.2.4 No specific claim for loss relief needs to be made.

3.4.3 *Unapproved stock option plan*

3.4.3.1 There will be a tax charge at the date of sale[31].

3.4.3.2 The capital gain is calculated as the difference between the proceeds of sale and the sum of the price paid for the shares and any amount already subject to income tax. Indexation relief is available where the shares have been held for more than twelve months. Gains in excess of an annual exemption (€1,270 for 2002) are taxed at 20%[27].

3.4.3.3 If the shares are sold at a loss (i.e. for less than the price paid to acquire them at exercise) the loss can be offset in the following ways:

- All capital losses and capital gains in the tax year can be offset against each other[32].
- Where capital losses exceed capital gains in a tax year, the losses can be carried forward to future years and offset against future gains.
- Capital losses cannot be offset against other income

29 S28 Taxes Consolidation Act 1997

30 S546 Taxes Consolidation Act 1997

31 S28 Taxes Consolidation Act 1997

32 S546 Taxes Consolidation Act 1997

3.4.3.4 No specific claim for loss relief needs to be made.

3.5 Tax consequences for the granting company

3.5.1 *Social security contributions*

3.5.1.2 *ASOS*

3.5.1.2.1 There will be no employer social security contributions in relation to an ASOS.

3.5.1.3 *SAYE*

3.5.1.3.1 There will be no employer social security contributions in relation to an SAYE.

3.5.1.4 *Unapproved stock option plan*

3.5.1.4.1 There will be no employer social security contribution in relation to unapproved stock options.

3.5.2 *Corporate tax deduction*

3.5.2.1 ASOS

3.5.2.1.2 There is a statutory corporate tax deduction allowed for the costs actually incurred that are associated with setting up the ASOS. However, the legislation specifically disallows a deduction for any sum expended by a company, directly or indirectly, to enable a relevant body to acquire scheme shares[33].

3.5.2.1.3 The deduction is allowable for the accounting period in which the expenditure is incurred except where the scheme is approved by Revenue more than nine months after the end of that period. In this case the deduction is allowable in the accounting period in which approval is given.

3.5.2.1.4 The position is not affected by whether or not costs are recharged to/from another group company.

3.5.2.2 *SAYE*

3.5.2.2.1 There is a statutory corporate tax deduction allowed for the costs associated with setting up the SAYE scheme[34]. However, the legislation specifically disallows a deduction for any sum expended by a company, directly or indirectly, to enable a relevant body to acquire scheme shares[35].

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[33] S519D(6) Taxes Consolidation Act 1997

[34] S519B(1) and (2) Taxes Consolidation Act 1997

[35] S519B(2A) Taxes Consolidation Act 1997

3.5.4.2.2 The deduction is allowable for the accounting period in which the expenditure is incurred except where the scheme is approved by Revenue more than nine months after the end of that period. In this case the deduction is allowable in the accounting period in which approval is given.

3.5.4.2.3 There is no impact if costs are recharged to/from another group company.

3.5.4.2.4 The deduction must be for costs actually incurred.

3.5.2.3 *Unapproved stock option plan*

3.5.2.3.1 The employing company may be entitled to claim a deduction against its profits for corporation tax for the costs of an unapproved stock option plan. This deduction is non-statutory. For unapproved plans, there are no specific amounts allowed or disallowed. Companies may take a deduction in the accounting period in which the actual cost is incurred. The deduction claimed must relate to an actual cost incurred. There can be no corporation tax deduction if a company does not incur expenditure. Whichever company incurs the cost should be entitled to claim a deduction provided the costs are incurred wholly, exclusively in the course of the business as an employment/payroll cost. The Revenue Commissioners are not prepared to allow deductions in respect of notional costs. There must be real costs involved.

3.5.2.3.2 The existence of a recharge agreement makes a stronger case for taking the deduction.

3.5.3 *Other*

3.5.3.1 *ASOS*

3.5.3.1.2 Stamp duty / transfer tax does not have any impact on the operation of an ASOS, although stamp duty may apply on the sale or transfer of certain stocks and shares at 1%. This is not usually a major factor for companies operating an ASOS.

3.5.3.2 *SAYE*

3.5.3.2.1 Stamp duty / transfer tax does not have any impact on the operation of an SAYE, although stamp duty may apply on the sale or transfer of certain stocks and shares at 1%. This is not usually a major factor for companies operating an SAYE.

3.5.3.3 *Unapproved stock option plan*

3.5.3.3.1 Stamp duty / transfer tax does not have any impact on the operation of an unapproved stock option plan, although stamp duty may apply on the sale or transfer of certain stocks and shares at 1%. This is not usually a major factor for companies operating an unapproved stock option plan.

4. Issues for employees

4.1 Reporting obligations

4.1.1 *ASOS*

4.1.1.1 There is no reporting obligation at grant or exercise (assuming there is no taxable event at exercise, i.e. the shares are not sold within three years of grant).

4.1.1.2 There will be a reporting obligation at the date of sale[36].

4.1.1.3 The following should be reported on the income tax return for the year of sale (usually Form 12):

- Description of assets.
- Date of acquisition (i.e. date of exercise).
- Base cost (i.e. exercise price).
- Date of disposal.
- Proceeds of sale.

4.1.1.4 The tax return deadline is 31 October following the end of the tax year.

4.1.2 *SAYE*

4.1.2.1 There is no reporting obligation at grant or exercise.

4.1.2.2 There will be a reporting obligation at the date of sale[37].

4.1.2.3 The following should be reported on the income tax return for the year of sale (usually Form 12):

- Description of assets.
- Date of acquisition (i.e. date of exercise).
- Base cost (i.e. exercise price).
- Date of disposal.
- Proceeds of sale.

4.1.2.4 The tax return deadline is 31 October following the end of the tax year.

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[36] S951 Taxes Consolidation Act 1997

[37] S951 Taxes Consolidation Act 1997

4.1.3 *Unapproved stock option plans*

4.1.3.1 If there is an income tax liability at grant, the employee must report the income on his/her tax return (usually Form 12), showing the date of grant, exercise price, market value at grant and the number of shares under option

4.1.3.2 The tax return filing deadline is 31 October following the end of the tax year.

4.1.3.3 There will also be a reporting obligation at the date of exercise[38]. The employee must report the taxable amount on exercise on his/her tax return (usually Form 12), showing the date of grant, option price, market value at exercise and the number of shares acquired on exercise[39].

4.1.3.4 There will be a reporting obligation at the date of sale[40]. The following should be reported on the tax return for the year of sale (usually Form 12):

- Description of assets.
- Date of acquisition (date of exercise).
- Base cost (exercise price plus amount subject to tax at exercise).
- Date of disposal.
- Proceeds of sale.

4.2 Cashflow issues

4.2.1 *ASOS*

4.2.1.2 No cashflow issues arise.

4.2.2 *SAYE*

4.2.2.1 No cashflow issues arise in relation to SAYE options.

4.2.3 *Unapproved stock option plans*

4.2.3.1 There are no methods used to alleviate cash flow problems for employees as a result of incurring a tax liability at grant.

4.2.3.2 Employees do not normally pay for the grant of an option, but if consideration is paid for the grant and the employee does not subsequently exercise the option, the consideration will be a loss to the employee, which cannot be offset against other income or claimed as a capital loss.

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38 S128(2A)(b) Taxes Consolidation Act 1997

39 S951 Taxes Consolidation Act 1997

40 S951 Taxes Consolidation Act 1997

4.2.3.3 Payment of the income tax due on exercise can be deferred until the earlier of the sale of the shares or for seven years. An election to defer must be made on the tax return for the year of exercise. Cashless exercise can also be used to mitigate cash flow problems for employees.

4.2.3.4 If the tax due is not deferred, it must be paid by 31 October following the end of the tax year, subject to preliminary income tax obligations which the employee may have. Preliminary tax is due by 31 October in the relevant tax year.

4.3 Change in employee's residence status

4.3.1 *ASOS*

4.3.1.2 Participants who are not subject to Irish income tax (i.e. overseas employees) may still participate in the ASOS, if they are employees of a participating company, but there may be tax implications for them in the jurisdiction in which they reside.

4.3.2 *SAYE*

4.3.2.1 Participants who are not subject to Irish income tax (i.e. overseas employees) may still participate in the SAYE scheme, if they are employees of a participating company, but there may be tax implications for them in the jurisdiction in which they reside.

4.3.3 *Unapproved stock option plans*

4.3.3.1 Share options are subject to Irish taxation if the employee is resident in Ireland at the date of grant. Therefore if the employee is not resident at grant there is no income tax to pay in Ireland at exercise, even if s(he) is resident here at or before exercise provided the options are not granted in connection with the Irish employment and there is no tax planning or tax avoidance involved[41].

4.3.3.2 If the employee has left Ireland by the time the option is exercised, the exercise will be subject to Irish income tax if (s)he was resident at grant.

5. Issues for employers

5.1 Reporting obligations

5.1.1 *ASOS*

5.1.1.1 There will be a reporting obligation for the employer at the date of grant[42].

5.1.1.2 The following information must be reported:

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41 Revenue guidelines (non statutory) published in Tax Briefing 31, 1998

42 Schedule 12C paragraph 20 Taxes Consolidation Act 1997

- Date of grant.
- Name of company whose shares are under option.
- Company registration number in Ireland (if applicable).
- Nominal value and class of shares.
- Date on which market value taken to calculate the exercise price.
- Market value of shares on that date.
- Source of valuation (i.e. which stock exchange, or agreed with Revenue's share valuation division).
- Number of directors and employees who received a grant of options under the "all employee" element of the scheme.
- Number of directors and employees who received a grant of options under the "key employee" element of the scheme.
- Full list of each option holder, with name, Personal Public Service ("PPS") number (i.e. social security number), last known salary, duration of option and number of shares which can be acquired on exercise.
- Total number of eligible employees in the company and any other participating companies on the date of grant.

5.1.1.3 The Revenue will issue Form SOS1 to the company for completion in respect of grants made under the ASOS. The form must be returned within 30 days of receipt.

5.1.1.4 The following information concerning exercise must be reported by the employer for each tax year[43]:

- Name and PPS number of participant.
- Name of employing company, Irish PAYE tax district and reference.
- Date of grant.
- Date of exercise.
- Nominal value and class of share acquired.

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43 Schedule 12C paragraph 20 Taxes Consolidation Act 1997

- Number of shares acquired.
- Exercise price paid per share.
- Last known salary at date of exercise.
- Total number of participants who exercised rights during the year.
- Total number of shares transferred on exercise.

5.1.1.5 Form SOS1 is issued by Revenue to the company. The form should be completed within 30 days of receipt.

5.1.1.6 If the option becomes unapproved due to a sale of the shares less than three years from date of grant, the exercise is reported on a separate part of Form SOS1, and not on the standard share option form for unapproved options, Form SO2.

5.1.2 SAYE

5.1.2.1 There will be a reporting obligation for the employer at the date of grant[44].

5.1.2.2 The following information must be reported:

- Date of grant.
- Name of company whose shares are under option.
- Company registration number in Ireland (if applicable).
- Nominal value and class of shares.
- Date on which market value taken to calculate the exercise price.
- Market value of shares on that date.
- Source of valuation (i.e. which stock exchange, or agreed with Revenue's share valuation division).
- Exercise price.
- Total number of employees taking up respectively 3, 5 and 7 year contracts.
- Full list of each option holder, with name, PPS number, last known salary, duration of option and number of shares which can be acquired on exercise.
- Total number of eligible employees in the company and any other participating companies on the date of grant.

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[44] Schedule 12A paragraph 6 Taxes Consolidation Act 1997

5.1.2.3 The Revenue will issue Form SRSO1 to the company for completion in respect of grants made under the SAYE scheme. The form must be returned within 30 days or receipt.

5.1.2.4 There may be a reporting obligation for the employer at the date of exercise if the individuals exercises within three years of grant.[45] This is also the case if there has been a takeover, amalgamation, reconstruction, sale of the company, winding up of the company or sale of part of the company in which a participant worked, and individuals have exercised their options within three years of the grant of the option, these exercises must be reported with the following detail:

- Name and PPS number of participant.
- Name of employing company, Irish PAYE tax district and reference.
- Date of grant.
- Date of exercise.
- Nominal value and class of share acquired.
- Number of shares acquired.
- Exercise price paid per share.

5.1.2.5 This information goes on Form SRSO1. The form must be filed within 30 days of receipt.

5.1.3 *Unapproved stock option plans*

5.1.3.1 There will be a reporting obligation for the local employer in respect of the grant[46].

5.1.3.2 The local employer (including any branch or agency of the grantor, if the grantor is not resident in Ireland) must report the grant of options (regardless of whether there is a tax liability) to any of its employees during the tax year.

5.1.3.3 Form SO2 should be filed, listing the name of the employee, the PPS number, market value of shares at grant, exercise price per share, description and number of shares and whether it is a long option (i.e. has a life of over seven years).

5.1.3.4 For tax year 2001 the filing date is 30 June 2002, but this is being amended for tax year 2002 onwards, and going forward Form SO2 must be filed by 31 March following the end of the tax year.

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[45] Schedule 12A paragraph 6 Taxes Consolidation Act 1997

[46] S128(11) and (11A) Taxes Consolidation Act 1997 and (11A)

5.1.3.5 There will be a reporting obligation for the employer at the date of exercise[47].

5.1.3.6 The local employer (including any branch or agency of the grantor, if the grantor is not resident in Ireland) must report the exercise of options by any of its employees during the tax year.

5.1.3.7 Form SO2 should be filed, listing the name of the employee, the PPS number (i.e. social security number), market value of shares at exercise, exercise price per share, description and number of shares and whether they were long options.
For tax year 2002 onwards Form SO2 must be filed by 31 March following the end of the tax year. (For 2001, the deadline is 30 June 2002).

5.2 Withholding obligations

5.2.1 *ASOS*

5.2.1.1 There are no withholding obligations for the employer.

5.2.2 *SAYE*

5.2.2.1 There are no withholding obligations for the employer.

5.2.3 *Unapproved stock option plans*

5.2.3.1 There are no withholding obligations for the employer.

6. Legal issues

The comments below assume the grant of options over shares to employees in an employer company or an associated company.

6.1 Process/timeframe

6.1.1 The implementation time required for a stock option plan is difficult to judge, as it will depend on a number of factors, including whether a scheme requires Revenue approval. If the company is seeking Revenue approval for an ASOS or SAYE, it takes around 8 weeks from submission to obtain approval, with additional time required in discussion with the company to establish its requirements and any internal approvals. It is not possible to comment in general on the time involved in implementation as this can vary considerably depending on the following additional factors:

- The type of internal approval procedures at a company, e.g. whether clearance is needed by an overseas parent or shareholders.

- Number of parties (e.g. company lawyers, share scheme advisers) providing input on documentation.

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47 S128(11) Taxes Consolidation Act 1997

- Level of communication involved in granting options. This depends on the size of the company and the nature of the employee population to benefit from the plan.

6.1.2 The following implementation steps are typical:

- Having taken instructions from client, the memorandum and articles of association of the company and any shareholders agreement should be examined to ascertain that the company has the authority to establish the scheme and whether any particular shareholder approval (e.g. from venture capital investors) is required.

- Once the rules of the stock option plan have been drafted, the plan would need to be approved by the board. If necessary it will then need to be approved by the shareholders. Again, depending on the terms of the articles of association of the company, up to three weeks notice will be required to hold a shareholders meeting. In certain circumstances a written resolution (without the necessity of a shareholders meeting) will suffice.

- If the company is a listed company, it is usual to draft the scheme to comply with the guidelines of the IAIM. It is also usual to seek IAIM approval prior to shareholder approval. If the scheme complies with the guidelines, approval should be obtained from IAIM within two weeks. A circular, which complies with the rules of the Irish Stock Exchange must be issued to shareholders of a listed company prior to seeking their approval.

- If the company is seeking revenue approval for the scheme, the terms of approval by the board and by the shareholders will usually allow the company to make any amendments required by the Revenue Commissioners.

- The following must be submitted to Revenue to secure approval: draft scheme rules, all ancillary documentation (application form, covering letter to employees, handbook/summary of the scheme etc), memorandum and articles of association, various declarations regarding the shares and participants, the company board minute adopting the plan, etc. There may also be negotiations with Revenue to interpret or clarify points.

6.2 Employment law

6.2.1 If the company has a Works Council, the scheme will need to be notified to it. Larger companies will usually involve employee representatives at an early stage, though, unless there is a local bargaining agreement, this is not a legal requirement.

6.2.2 New legislation came into force on 20 December 2001 that outlaws discrimination against part time workers[48]. Any grading or allocation system could be viewed as discriminatory[49].

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[48] Part Time Work Act 2001.

[49] Employment Equality Act 1998

6.2.3 Usually the rules of the scheme will provide that the participant will not be entitled to claim damages for lapse of options on cessation of employment, for whatever reason. Any claim for compensation for lapse of options on dismissal will usually be determined by reference to the scheme rules. An employee may have a stronger claim for compensation in respect of an all employee share scheme, compared to a discretionary scheme where the company retains the right to determine who participates from time to time. A recent UK case has opened the possibility of a person wrongfully or unfairly dismissed to be compensated for loss of option. However this point has not been tested in Ireland[50].

6.2.4 The rules of the scheme should be very clearly communicated to the employees, especially if there is any vesting or exercise blocking period (as an employee who leaves during such a period may have a claim based on loss of option).

6.3 Data protection

6.3.1 The Data Protection Act ("DPA")[51] regulates data protection in Ireland. When data is collected for the purposes of administering a stock option plan consent of existing employees is not required provided when such data is collected each employee is informed of the purpose for which the data is being collected and the use to which it is intended to be put. Where new employees are to be included in the plan, their written consent to the collection of data will be required. The consent of all employees to the transfer of data to a third country (any country outside of the EU or not a "safe harbour" country) is required. In order for this to be a valid consent the employee must be notified of his rights under the DPA and must be given information on:

- The data that is to be transferred.
- The purpose for which the data is to be transferred.
- The individual to whom the data is to be sent.
- The use to which this data is going to be put to in the third (any country outside of the EU or not a 'safe harbour' country) country.
- Who is going to have access to it.
- Confirmation that the third (any country outside of the EU or not a 'safe harbour' country) country has the same or equivalent data protections as Irish data protection law.

6.3.2 The third country will have to confirm that it has the protection in place which is at least equivalent to the protection afforded to individuals in Ireland under the DPA. If the third country protection is less than the Irish protection, the Irish company (transferring the data) will have to enter into an agreement with the third country company where the third country company will undertake to put in place equivalent protections to the Irish protections and safeguards[52].

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50 Levett v Biotrace International plc 1999 IRLR 375

51 Data Protection Act 1988

52 European Communities (Data Protection Regulations) 2001

6.3.3 EC data protection regulations are due to come into force on 1 April 2002, to allow transfer of data outside the EEA only where adequate data protection is deemed to exist.

6.3.4 Failure to comply with these provisions leaves the company at risk of criminal prosecution with a maximum fine on indictment €63,487. In addition the employer has a duty of care to the employees concerned under the law of torts and could risk a civil claim by each employee for damages. Fines and civil claims are not commonly seen in practice.

6.4 Stock exchange issues

6.4.1 An Irish listed company wishing to implement a stock option plan will generally need shareholder approval[53]. A circular to shareholders in connection with the approval must include:

- Full text or description of the plan and its principal terms.
- If the plan includes trust provisions and the directors are trustees, details of such trusteeship.
- Details of participants /limitations/ maximum entitlements/basis of allocation (which can't be changed without further shareholder approval).
- Statement as to whether benefits are pensionable.

6.4.2 The Companies Act, 1963 imposes a general requirement to issue a prospectus when offering shares; however an offer of shares to employees is generally thought to be excluded from this requirement if the company offering the shares is incorporated in Ireland[54].

6.4.3 The position in relation to the requirement to issue a prospectus, if the company offering shares is incorporated outside Ireland is less clear as there is no Irish case law on this matter. Irish lawyers take differing views from each other on the matter.

6.5 Securities law

6.5.1 There are no securities law restrictions on the number of individuals who can participate in the plan.

6.5.2 If the company is listed in Ireland, the plan rules must be filed with the Stock Exchange at the same time as the notice of shareholders meeting is issued. Any circular issued should be filed with the Companies Registration Office, at the same time as it is filed with the Stock Exchange[55].

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[53] The Listing Rules of the Irish Stock Exchange (Rule 13.13), Section 44(4), Companies Act 1963

[54] Section 361, Companies Act 1963

[55] Investment Intermediaries Act, 1995 (which implements the Investor Services Directive in Ireland)

6.5.3 If the plan involves an intermediary structure (e.g. a collective investment vehicle is used whereby this vehicle purchases the shares in the company and the employees receive units in the vehicle as opposed to holding the company shares directly) authorisation may be required[56].

6.6 Financial assistance

6.6.1 Irish company law prohibits the provision by a company (directly or indirectly) of financial assistance for the purpose of or in connection with a purchase of or subscription for its shares. However, the provision of financial assistance to employees is exempted from this prohibition. There are no limits to this exemption.

6.7 Other

6.7.1 There are no foreign exchange control issues to consider in Ireland.

6.7.2 The terms of the scheme will usually set out the rights attaching to the options. The employee does not have any statutory shareholder rights prior to exercise and it is unusual for the scheme to give rights to an employee before exercise.

6.7.3 There are no restrictions on employees holding foreign shares (or options over foreign shares).

6.7.4 Stamp duty at 1% of the consideration is payable by the purchaser on the transfer of shares.

7. Sourcing shares for stock option plans

7.1 Irish companies may issue new shares on the exercise of options. New shares may not be issued at less than per value. The actual allotment of shares on receipt of a notice of exercise (part of the plan documentation) will require the approval of the board.

7.2 If a company is authorised by its articles, and subject to certain conditions, it may purchase its own shares and hold them as treasury shares. A special resolution (75%) of the company is required to approve any buy-back of shares. It is not possible to purchase shares if the result of doing so would bring the redeemable share capital of the company to a nominal value of over 90% of the nominal value of the total issued share capital of the company. The shares so purchased may be cancelled or held as treasury shares. The amount to be paid for the shares must be provided for out of profits available for distribution or, if they are to be cancelled out of a fresh issue of shares. The nominal value of treasury shares may not exceed 10% of the issued share capital of the company. The company may not exercise any voting rights in respect of treasury shares and no dividend shall be payable. Treasury shares may not be reissued unless the reissued price range is

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[56] Section 60, Companies Act 1963

determined by the same special resolution that gives the company the authority to buy-back the shares[57].

7.3 Subject to the following conditions, a subsidiary may acquire and hold shares in a company which is its holding company[58]:

- The consideration payable for the acquisition of such shares must be provided for out of the profits of the subsidiary available for distribution.
- Upon the acquisition of such shares and for so long as the shares are held by the subsidiary the profits of the subsidiary available for distribution are restricted by a sum equal to the total cost of the shares acquired;
- The subsidiary shall not exercise any voting rights in respect of the shares and any purported exercise of those rights is void.

7.4 Shareholder approval to such acquisition is required[59].

7.5 The name of the employee who has exercised an option and holds shares, should be registered in the company's register of members (which is maintained by the company). Capital duty of 1% of the consideration paid or nominal value of the shares (whichever is the higher) must be paid on allotment prior to entry in the register. The articles of association will determine the method and formalities of transfer. In order to transfer the shares registered in his name, the employee will have to execute a stock transfer form, which will usually require approval by the board. The articles of association may provide for restrictions on the transfer of shares and/or require certain offer-round procedures to be carried out.

8. Role and influence of existing shareholders

8.1 Shareholder approval may be required depending on whether the company is listed (see section 6.4), the terms of its memorandum and articles of association (constitution) and whether or not shares will be purchased in the market by the company (see section 8).

8.2 The IAIM issues guidelines relating to stock option schemes, which place particular emphasis on wider and deeper employee share ownership. The guidelines are designed to encourage long-term growth in shareholder value, and as such cover areas such as transparency, performance criteria, dilution, level of award etc. The guidelines are not requirements and companies may contact IAIM to discuss particular issues or concerns.

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[57] Section 211, Companies Act 1990

[58] Section 224 Companies Act 1990

[59] Section 224(2) Companies Act 1990

9. Accounting

9.1 Irish companies prepare their accounts in accordance with the provisions of Irish Generally Accepted Accounting Principles ("GAAP"). In relation to accounting for share option plans, Irish GAAP is identical to UK GAAP. Specifically the accounting rules set out in the Abstracts of the Urgent Issues Task Force ("UITF") of the UK Accounting Standards Board apply[60].

9.1.1 *Newly issued shares*

9.1.1.1 Under UITF 17 the grant of a stock option gives rise to a charge in the Profit & Loss ("P&L) account (in Operating Costs) to the extent that the FMV of the share, at the date of the grant, exceeds the exercise price (or other amount that the employee is required to pay for the shares). This is referred to as the 'intrinsic value' of the option[61].

9.1.1.2 Therefore if the option is granted at market value on the date of grant, there is no P&L charge, even if the share price rises after the options are granted.

9.1.1.3 The credit entry in the balance sheet is to shareholders' funds analysed appropriately between Nominal Value of Share Capital, Share Premium and Other Reserves.

9.1.1.4 For long-term incentive plans the charge is spread over the period to which the performance criteria relate.

9.2 Shares purchased in the market

9.2.1 Where the shares used to satisfy the award are to be purchased on the market, rather than issued by the company, the cash cost of purchasing the shares for the employees is charged to P&L. Estimates are made of the ultimate cash cost up to when the shares are purchased and a credit entry is made in the balance sheet to creditors or provisions until such time as the cash is paid to purchase the shares. The total P&L charge is spread over the performance period, where relevant, otherwise it is charged straightaway. Estimates are made of the number of shares likely to have to be purchased to fulfil the award. So while the principle of how the total cash cost is ultimately arrived at is clear, it is also necessary to make estimates during the period from the award to its ultimate settlement, of the number of shares to be purchased where that depends on the performance, and of the expected cash cost where the shares have not yet been purchased. If shares are purchased in excess of the amount actually needed, any falls in the share price will usually be charged in the P&L account. When the shares are purchased the balance sheet entry to creditors and provisions is reversed and the charge is made to the shareholder funds.

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[60] The Irish Companies (Amendment) Act, 1986 and the European Communities (Companies: Group Accounts) Regulations, 1992 provide the primary legislative sources for the preparation, form and content of company and group accounts.

[61] Urgent Issues Task Force Abstract 17

9.2.2 Companies listed on the Irish Stock Exchange are required to disclose details of the directors' share options, including number held, exercise prices and dates, and exercise price of options exercised in the year. The Irish Companies Act 1990 also requires disclosure of the interests of the directors in the shares of the company.

9.2.3 Before UITF 17 was issued in 1997, there was a diversity of practice in accounting for share option plans. In some instances, a charge was not made to P&L in respect of the intrinsic value of the option.

9.3 Shares purchased and held by a trust

9.3.1 Under UITF 13, trusts established to hold shares for an employee remuneration scheme will generally be under the de facto control of the sponsoring company. Consequently, until such time as shares held by a trust vest unconditionally in the employees, they should be recognised as assets of the sponsoring company. The charge to the Profit & Loss account when the awards are made should be the book value of the shares (usually the cost of the shares to the trust). When the shares vest unconditionally in the employees, they should no longer be recognised as assets of the sponsoring company, even if they are still held by the trust[62].

9.3.2 A simplified accounting regime may be applied in the case of a small company which meets at least two of the following conditions for at least two of the last three years[63]:

- Turnover of €3.8 million or less.
- Balance sheet total (gross assets) of €1.9 million or less.
- Average number of employees, 50 or less.

9.3.3 Such companies which choose to adopt Financial Reporting Standard for Smaller Companies ("FRSSE") are exempt from UITF Abstracts 13 and 17. FRSSE is not available to public limited companies or to certain companies in the financial sector.

9.3.4 Accounting for stock options is the subject of ongoing review, both in the UK and in conjunction with accounting standards setting bodies outside the UK. As the debate is ongoing, at present it is difficult in the context of this report to comment on the views of companies and shareholders.

10. Miscellaneous

10.1 The use of a trust is recognised in Ireland. Trusts would generally be used more often in respect of share awards, rather than stock option awards. However, some

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62 Urgent Issues Task Force Abstract 13

63 Financial Reporting Standard for Smaller Companies (FRSSE), November 1997

companies seek to use a trust structure as a warehouse for options or the underlying shares, either to ring fence the award or to defer entitlement and thus the tax point.

10.2 A trust must be established in the form of a deed, and executed by the relevant parties, usually the company and the trustees.

10.3 If the company is an Irish listed company it is advisable to consult with the IAIM and to comply with their guidelines.

10.4 Tax revenues from employee stock option plans are not used for a specific purpose.

10.5 There are no legal constraints on the remuneration of directors or employees that need to be taken into account when drafting stock option plans.

11. Special points of note

11.1 Mitigation of income tax

11.1.1 An abatement of the charge to income tax on exercise is available subject to prior written agreement from Revenue, where there are restrictions on the sale of shares acquired at exercise. The taxable amount can be reduced by 10% per year of the restriction on sale, up to a maximum of 55% for a restriction of over five years. Recent Revenue practice has been to only allow the abatement where the restriction on sale is total, except in the event of the death of the employee, i.e. no early release provisions for retirement, injury etc. would be allowed. However, the Revenue reviews applications on a case by case basis[64].

11.2 Mitigation of social security contributions

11.2.1 No social security contributions are payable.

11.3 Mitigation of tax on sale of shares

11.3.1 In respect of all types of stock option plan the following may be considered in relation to mitigating the tax on sale of the shares:

- The employee may wish to sell his/her shares over more than one tax year, to take full advantage of the annual CGT exemption of €1,270 on gains from all sources.

- Post exercise, shares can be transferred between spouses to utilise the annual allowance available to both. The annual allowance itself cannot be transferred[65].

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64 Revenue guidelines (non statutory) published in Tax Briefing 31, April 1998 and precedents/rulings obtained.

65 S1028 Taxes Consolidation Act 1997

- Losses made by one spouse should be transferred to the other spouse to offset against the latter's capital gains, unless an election is made not to do so by 1 April following the end of the tax year[66].

- An employee may also consider "bed and breakfasting" in respect of the sale of shares. This involves selling sufficient shares to utilise the annual gain, then purchasing the shares back 29 or more days later, which gives a higher base cost for the shares going forward.

11.4 Special provisions for SMEs

11.4.1 The European Company ("SE") will not have effect until October 2004. It may make stock option plans more attractive, but given that the location in which a company is registered is of less importance than, for example, where its shares are listed it is not expected radically to affect the operation of plans in Ireland.

Note: Individual country reports have been prepared covering employee stock options in the EU and the USA. These individual reports are of a general nature and subject to change based on individual circumstances. PricewaterhouseCoopers has also provided the EU with an overview report. This overview report sets out the basis on which the individual reports were prepared and should be referred to as necessary. In particular, it should be noted that the information in the reports is current as at 1 January 2002, unless otherwise stated. In the case of certain known subsequent changes, reference may be made on occasion but a full update exercise has not been carried out. Further information can be obtained from PricewaterhouseCoopers.

[66] S1028 Taxes Consolidation Act 1997