Get up to speed with ESOP changes for 2024 in Ireland

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In light of changes to the Employee Share Option Scheme, companies in Ireland with these schemes in place must be aware of their obligations in respect of their employees' tax liabilities. This briefing summarises some of the main unapproved share option schemes available to companies in Ireland.

The premise

As of 1 January 2024, where an employee exercises his or her share options or is issued shares pursuant to an Employee Share Option Scheme (**ESOP**) their employer is responsible to deduct through payroll the income tax, Universal Social Charge and Pay Related Social Insurance owed by the employee. This is a shift in responsibility from the employee who up until 31 December 2023 was responsible to self-assess his or her tax liabilities and pay the relevant taxes within 30 days of exercising the option. This change applies to unapproved share option schemes only.

Unapproved share option schemes

"Unrestricted" share option scheme (General ESOP)

Pursuant to a General ESOP, an employer grants the right to employees through the grant of an option, to acquire shares in the company at a future date and for a fixed price. The employee must exercise the option within a specified time period, usually seven years. On the exercise of an option, the employee is allotted the specified number of shares, in return for payment of the specified price. The shares are typically non-voting with no right to dividends.

The employee's right to exercise the option can be linked to performance criteria or a set period of time, or both. Sometimes, reverse vesting is utilised whereby the option vests immediately and the employee can exercise the option any time. However, if the employee leaves within a certain period or fails to meet set criteria, the company shall be entitled to buy back the shares at a reduced value or no value.

A General ESOP is a straightforward, basic structure which acts as a common set of rules for all employees. It does not require revenue approval or compliance, unless the company wishes to avail of the Key Employee Engagement Programme (**KEEP**)which we do not deal with here.

Restricted or clogged share option scheme (Clogged ESOP)

A Clogged ESOP must comply with certain requirements of the Taxes Consolidation Act, 1997 (as amended) (the **TCA**). In accordance with the TCA, the company first creates a trust (or such other arrangement as the Revenue Commissioners allows). The trustee of that trust then agrees to hold the scheme shares which are to be the subject of the Clogged ESOP. This usually requires the company to create a new class of shares. The trustee initially owns the legal title to and beneficial interest in all such scheme shares.

Under the terms of the Clogged ESOP and the TCA, the scheme shares must be acquired by each employee subject to a retention condition. Each retention condition prohibits the relevant employee from either holding the legal title to or disposing of or otherwise encumbering the relevant scheme share(s) for a certain period, typically between zero and five years and one month from the relevant acquisition date. At the end of this restricted period, the trustee will transfer the legal interest in the scheme shares to the employee. Any breach of the retention condition, will result in the employee's beneficial interest being forfeited to the trust.

Growth or flowering share option scheme (Growth ESOP)

Pursuant to a Growth ESOP, a unique class of ordinary "growth" shares are issued to employees at a nil or low value and with specific, limited economic rights. An employee therefore has no real value or share in the company, and will not unless a "hurdle" is surpassed or reached. An employee is therefore offered a stake in the future potential of the company.

The shares can "grow" or "flower" into more valuable shares upon the occurrence of a specified event(s) or the surpassing of a "hurdle". Such a hurdle may be where within a set period of time, the company reaches a set target or threshold in terms of business growth or valuation, or the employee shall reach specific targets in respect of his or her own individual performance. Once this hurdle has been surpassed, the rights attaching to the growth shares flower and the employee will be entitled to share in the company's value.

Typically there will be a restriction on transfer of the growth shares until the hurdle is reached. The growth shares are also typically subject to "good" or "bad" leaver provisions, where the employee may be required to surrender the growth shares back to the company or sell them for a low or discounted value. A Growth ESOP is complex, popular among companies who are planning an exit and is most suitable for senior staff.

Conclusion

In summary, the payroll obligation arises for employers as follows:

General ESOP: upon the issuance of shares to the employee, following the exercise of the option.

Clogged ESOP: upon the transfer by the trustee of the legal interest in the scheme shares to the employee.

Growth ESOP: upon the issuance of shares to the employee (the amount of tax payable dependent on the value of the shares/price paid on issuance).

Tax and revenue advice may be required for the company and the employees, in respect of the above, which is not provided by Ogier. For more information about ESOP and other related matters please contact a member of our Corporate team via their contact details below.

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