

ISME
17 Kildare Street,
Dublin 2
15th November 2017

Mr Paschal Donohoe TD,
Minister for Finance and Public Expenditure & Reform,
Department of Finance,
Upper Merrion Street,
Dublin 2

Key Employee Engagement Program

Dear Minister Donohoe,

It is ten years since ISME first campaigned for a share-based remuneration scheme for employees in SMEs or start-ups. We were therefore delighted to hear your announcement of the Key Employee Engagement Program ('KEEP') in your Budget 2018 speech. However, when the details of the program were published in the Finance Bill 2017 (the 'Bill'), it was very obvious that KEEP will not succeed in its stated policy goals to '*attract and retain key employees*' by '*providing for an advantageous tax treatment on share options.*' Below, we set out why, and offer solutions to the issues addressed.

The restrictions on a qualifying company are too broad.

ISSUE: The company must remain an SME under the Eurostat definition '*throughout the entirety of any relevant period.*' This makes no sense. A company which entered the scheme as an SME, but succeeded in expanding such that its headcount exceeded 250 persons, or its turnover exceeded €50m, or its balance sheet totalled in excess of €43m,

will have done what a share-based remuneration scheme is designed to achieve. It is illogical, and counter to Government policy to apply such a restriction.

SOLUTION: The restriction should apply to firms *entering* the KEEP program only.

ISSUE: The restrictions in company type listed in 10.(1) are excessive and illogical. It is easy to imagine innovative SMEs emerging among some of the activities and professional services excluded, such as financial activities, medical, dental, pharmaceutical, optical, aural or veterinary services, architecture or engineering, geological services or ship-building. Their exclusion is arbitrary and inconsistent with Government policy. 'Financial activities' are not defined in section 488 of the TCA 1997. Note that from a single company founded in Ireland in 1975, Ireland has become a global leader in aviation finance. Shuppa was set up in Ireland 2007 by two schoolboys. Unable to access EI support, they moved to the US, and founded Stripe in 2010. At time of writing, it is valued at \$9.2bn. SMEs in these sectors would appear to be excluded from KEEP under the Bill.

SOLUTION: Consult with relevant experts in Enterprise Ireland, Connect Ireland, third-level business schools, and elsewhere before excluding *any sectoral activities* capable of innovation, expansion, or export.

ISSUE: The company must remain unlisted '*throughout the entirety of any relevant period.*' This discourages a successful company from listing at a point where an IPO is possible. This is illogical. The listing of an SME should be recognised as a successful outcome for KEEP (and indeed would help the Revenue to objectively quantify capital gains).

SOLUTION: Only companies *entering* the KEEP program must be unlisted.

ISSUE: Limiting the value of the unexercised qualifying share option to €3m is another arbitrary restriction, lacking a logical or policy-based justification. Since the valuation of the share capital in an unlisted company is more problematic and less objective than that in a listed company, any such qualification is challenging. A percentage of turnover or balance sheet would be completely inappropriate for many technology start-ups. They might have very small balance sheets, and no revenue for several years, in spite of being valued at many millions by investors. A €2m company might disperse options on

30% of its equity to key employees; which shares might have a value of €3.3m in five years' time. Denial of the program to the employees of such a company makes no sense, and indeed penalises them for being successful. It could also lead to premature disposal of a successful SME solely for tax avoidance reasons.

SOLUTION: Since the applicability of the KEEP program is restricted to SMEs in any case, it would be preferable to base any restriction on the percentage of total, fully-diluted equity. Entrepreneurs are unlikely to wish to grant options on too much of their equity, therefore an upper threshold of say, 30%, would be an appropriate limit.

The restrictions on a qualifying individual are too broad.

ISSUE: The Bill restricts access to KEEP to grants of equity after 1st January 2018. We do not see any policy justification for this.

SOLUTION: KEEP should apply to any equity option in an SME demonstrably granted in the last five years.

ISSUE: The restriction on the value of granted share options to '*50 per cent of the annual emoluments of the qualifying individual*' fails to recognise that most early-stage SMEs can be highly curtailed in the quantum of salary they are able to pay. In such cases, their only attraction to some employees would be the grant of equity options. The restriction could mean that the value of this option would be set unreasonably or unrealistically low.

SOLUTION: Remove this restriction entirely. If an employee chooses to work for an SME for a low remuneration coupled with a substantial equity option in the business, this should be their right.

ISSUE: The market value restrictions of €100,000 in any one year of assessment, or €250,000 in any 3 consecutive years of assessment, are arbitrary and nugatory.

SOLUTION: Subject to the overall limits set in KEEP for qualifying share options, SMEs should be free to allocate equity as they wish.

ISSUE: 'Qualifying individuals' for the purposes of KEEP are required to be full-time employees or full-time directors of the company, or working a minimum of 30 hours per

week. The policy objective for this restriction is not set out. In any case, it fails to acknowledge that an SME might wish to avail of the services of a key individual who might not be an employee or director of the company. It is very important that grants to non-executive directors and advisors are allowed (which is another reason ISME objects to salary-based restrictions).

SOLUTION: SME owners should be free to allocate equity options in their business as they see fit, subject only to the restriction on total value of the unexercised qualifying share options.

ISSUE: The share option under KEEP cannot be exercised more than 10 years from the date of grant.

SOLUTION: The KEEP program should not be subject to any temporal restrictions not in place for the purpose of assessment of capital gains tax.

ISSUE: An individual cannot be a qualifying individual unless their employment or office lasts at least 12 months from the issue of the qualifying share option. An SME might require the services of a key consultant or external expert, but not require their services for more than a few months.

SOLUTION: SME owners should be free to allocate equity options in their business as they see fit, subject only to the subject only to the restriction on total value of the unexercised qualifying share options.

There seems to be a fundamental misunderstanding by the drafters of the conceptual basis of share-based remuneration. The most infrequent viewer of 'Dragon's Den' would understand that entrepreneurs will part with equity in their business only very reluctantly. The greatest guardian against abuse of any share-based remuneration scheme is the business owner themselves, since the equity in any business, no matter how valuable, is fixed. It is unfortunate, therefore, that the great work done by the [Entrepreneurship Forum](#) established by DBEI, which reported in January 2014, has been ignored. The Forum Report stated simply in Section 5.1 that '*Government policy in facilitation of share ownership programmes should enable the growth of employee ownership in an effective and tax-efficient manner.*' The Forum recommended that Government:

- *Enable Employee stock ownership without creating taxable events until the time of sale of the stock.*
- *Enable companies to repurchase share options for the benefit of their employees (from departing employees, etc.) without requiring positive retained earnings.*

While KEEP provides for the former, it does so in a totally impractical manner, and it does not apparently provide for the latter.

The notion, therefore, that a share-based remuneration scheme could function as some sort of tax avoidance scheme is fundamentally misguided. 52% of zero is zero. NO tax will be foregone as a result of a functioning KEEP program, since no capital gain (or income) is available to employees of SMEs now in the absence of a functional scheme. To the objective outsider, it appears that the Department of Finance is terrified the KEEP program might actually prove to be a success in the policy objectives set by Government.

In summary, the failures of Section 10 of the Finance Bill 2017 to implement a practicable share-based remuneration scheme for SMEs are so thoroughly comprehensive that one is forced to the conclusion that the Bill's drafters (a) have no operational understanding of the nature, function, equity, or valuation of small and medium enterprises, or (b) are not committed to Government policy on the extension of share-based remuneration schemes to the SME sector. We ask you to address these shortcomings prior to the Bill reaching Report Stage.

Yours sincerely,



Neil McDonnell
Chief Executive
ISME, the *independent* business organisation