

## 5.5.28 Tax treatment of restricted and forfeitable shares acquired by directors and employees

### Sections 128D and 128E TCA 1997

#### 1. Introduction

The Finance (No.2) Act 2008 inserted two new sections into the Taxes Consolidation Act 1997 which sets out specific rules for the tax treatment of restricted shares (**section 128D**) and forfeitable shares (**section 128E**) acquired by directors and employees. These sections 128D and 128E apply to shares acquired on or after 20 November 2008.

Prior to this, by way of administrative practice:

- In the case of restricted shares acquired by directors and employees (i.e. where there was a restriction put on the disposal of the shares by the director or employee), the amount of income chargeable to tax under Schedule E on the acquisition of the shares was abated by between 10% and 55% depending on the period of restriction.
- In the case of forfeitable shares (i.e. share subject to forfeiture) acquired by directors or employees, where the shares were forfeited the income tax charge imposed on the acquisition of the shares was removed.

Sections 128D and 128E put these administrative practices on a legislative basis in addition to increasing the 55% rate of abatement to 60% in the case of restricted shares.

#### 2. Restricted Shares

##### 2.1 Shares

To qualify for the abatement, the shares acquired by the director or employee must:

- be shares in the company in which the employee or director is employed or in a company that controls (within the meaning of section 432 TCA 1997) that company, and
- be restricted shares.

Shares are restricted shares if all of the following conditions are satisfied—

- (a) there is a bona fide written contract or agreement in place under the terms of which there is a restriction on the freedom of the director or employee by whom the shares are held to assign, charge, transfer or otherwise dispose of the shares for a **specified period** of not less than one year,

- (b) the shares cannot be assigned, charged, transferred or otherwise disposed of during that specified period, except in limited circumstances. The limited circumstances are:
- (i) on the death of the director or employee,
  - (ii) where there is a change in control or a reorganisation of the share capital of the company in which the shares are held,
- (c) the shares are held in a trust established by the employer (e.g. employee benefit trust) or held under such other arrangements as the Revenue Commissioners may allow (e.g. secure stockbroker account). With effect from 4 February 2010, the trust must be established in the State or in an EEA State and the trustees must be resident in the State or in an EEA State.

## 2.2 ***Income tax charge on acquisition of shares***

A director or employee may acquire shares under an employee share award scheme, an employee share purchase plan, or an employee share option scheme.

An income tax charge will arise under Schedule E where the employee acquires the shares for less than market value. A charge to income tax may arise in accordance with:

- **Section 112** in respect of shares acquired under an employee share award scheme, where for example, the shares are given free of charge to the director or employee, or under an employee share purchase plan where the director or employee can purchase the shares at a discount, or
- **Section 128 TCA 1997**, where the director or employee acquires the shares on the exercise of a right (share option).

## 2.3 ***Abatement of income tax charge***

Section 128D provides for an abatement of the income tax charge on the acquisition of the shares. The charge is to be computed by reference to the market value of the shares at the date of acquisition without regard to the restriction on disposal.

The rate of abatement depends on the number of years for which the restriction on the disposal of the shares remains in place. The Table below sets out the rates of abatement that apply.

Number of years restriction	Rate of Abatement
1	10%
2	20%
3	30%
4	40%
5	50%
More than 5 years	60%

**Example**

On 30 January 2014, an employee is awarded 1,000 ordinary shares in his employing company for nil consideration. The market value of the shares at that date is €10 per share. The employee is prohibited from disposing of the shares for 4 years. All of the conditions outlined in 2.1 are met.

**Income Tax Charge on acquisition**

Market Value	€10,000
Amount paid by employee	<u>nil</u>
Gain to the employee	€10,000
Abatement (40%)	<u>€4,000</u>
Amount chargeable to income tax for 2014	€6,000

**2.4 Removal or variation of restriction**

Where the original restriction on the disposal of the shares is subsequently removed or varied during the **specified period**, the income tax charge on the acquisition of the shares must be adjusted to take account of the actual period the restriction was in place.

A claw back of the abatement is necessary to collect any additional income tax that may be due as a result of the removal or variation of the restriction.

**Example**

On 1 February 2013, an employee is awarded 1,000 ordinary shares in his employing company for nil consideration. Under the terms of the award, the shares cannot be disposed of for a period of 5 years and 3 months. The market value of the shares at 1 February 2013 is €3 per share. All of the conditions outlined in 2.1 are met.

On 30 June 2015, the restriction on the disposal of the shares is lifted.

**Income Tax Charge on acquisition**

Market Value of shares	€3,000
Amount paid by employee	<u>nil</u>
Gain to the employee	€3,000
Abatement (60%)	<u>€1,800</u>
Amount chargeable to income tax for 2009	€1,200

**Removal of restriction - Revision of Income Tax Charge on acquisition**

Market Value of shares	€3,000
Amount paid by employee	nil
Gain to the employee	€3,000
Abatement revised (20%)	<u>€ 600</u>
Revised amount chargeable to income tax for 2013	€2,400
Amount previously charged	<u>€1,200</u>
Additional amount chargeable for 2013	€1,200

**2.5 Disposal of shares in limited circumstances**

Where shares are disposed of in any of the limited circumstances outlined in **paragraph 2(1)(b)(i) or (ii)** before the end of the specified period of restriction, then, as in the case of a removal or variation of a restriction, the income tax charge on the acquisition of the shares must be adjusted to take account of the actual period the restriction was in place.

**2.6 Capital Gains Tax**

Where an income tax charge on the acquisition of shares by a director or employee is to be treated under **section 552 TCA 1997** as forming part of the acquisition costs of the shares for Capital Gains tax purposes, then the amount to be so treated is the abated amount brought into charge on the acquisition of the shares plus any additional amount charged as a consequence of the lifting or variation of the restrictions or in the event of a permitted disposal.

**2.7 Returns of information**

With effect from 1 January 2011, PAYE applies to restricted shares acquired by a director or employee and there is no current obligation on the company to give details of the restricted shares acquired to Revenue. However, where the restricted shares are acquired on the exercise of a share option, in accordance with the provisions of section 128, full particulars are returnable on form RSS1 on or before 31 March in the year following the year of exercise of the option.

**2.8 Non-application to shares acquired under approved employee share schemes**

The abatement does not apply to shares acquired by a director or employee under approved schemes approved under **Schedule 11** (profit sharing scheme), **Schedule 12** (employee share ownership trust), **Schedule 12A** (savings-related share option scheme), or **Schedule 12C** (approved share option scheme) to the Taxes Consolidation Act 1997.



### 3. Forfeitable Shares

#### 3.1 Introduction

Section 128E sets out the tax treatment of shares acquired by directors and employees where the shares are subject to a risk of forfeiture. Where the shares are forfeited any income tax charge imposed on the acquisition of the shares will be reduced.

#### 3.2 Shares

To qualify for the treatment outlined in the previous paragraph, the shares acquired by the director or employee must:

- be shares in the company in which the employee or director is employed or in a company that controls (within the meaning of section 432 TCA 1997) that company, and
- be forfeitable shares.

Shares are forfeitable shares if there is a bona fide written contract or agreement in place under the terms of which—

- there will be a forfeiture of the shares, if certain circumstances arise or do not arise (e.g. if the employee ceases employment before the expiry of a specified period, or if the employee fails to reach certain performance targets),
- as a result of the forfeiture, the director or employee will cease to have any beneficial interest in the shares, and
- the director or employee will not, on forfeiture of the shares, be entitled to receive, directly or indirectly, consideration in money or money's worth in respect of the shares in excess of the consideration given by the director or the employee for the acquisition of the shares.

Shares are not forfeitable shares by reason only that the shares are unpaid or partly paid shares which may be forfeited for non-payment of calls.

In the case of private companies it is often a requirement under the Articles of Association of the company or under a Shareholders Agreement that employees who cease employment with the company must offer their shares for sale. These are not forfeitable shares for the purposes of section 128E.

#### 3.3 Income Tax charge on acquisition of shares

A director or employee may acquire shares under an employee share award scheme, an employee share purchase plan, or an employee share option scheme.

An income tax charge will arise under Schedule E where the employee acquires the shares for less than market value. A charge to income tax may arise in accordance with:

- **Section 112** in respect of shares acquired under an employee share award scheme, where for example, the shares are given free of charge to the director or employee, or under an employee share purchase plan where the director or employee can purchase the shares at a discount, or
- **Section 128 TCA 1997**, where the director or employee acquires the shares on the exercise of a right (share option).

Section 128E provides that the charge is to be computed by reference to the market value of the shares at the date of acquisition without regard to the risk of forfeiture.

### 3.4 Forfeiture of shares

If the shares are forfeited, any income tax charge already imposed in respect of the acquisition of the shares should be reduced to nil and any tax overpaid should be repaid on foot of a claim from the director or employee. The claim must be made within 4 years from the end of the year of assessment in which the forfeiture takes place.

#### Example

On 1 March 2013, an employer awards 1,000 shares to an employee for €500. Under a bona-fide written contract, the shares are subject to forfeiture if the employee ceases employment with the employer before 28 February 2015. The market value of the shares at the date of the award, ignoring the risk of forfeiture, is €1,000. The employee ceases employment with the company on 1 July 2014 and the shares are forfeited. The employer refunds the employee the €500 paid for the shares.

#### Income Tax charge on acquisition

Market value of the shares ignoring the risk of forfeiture	€1,000
Consideration paid by the employee	€ 500
Amount chargeable	€ 500
Tax paid (€500 x 41%)	€ 205

#### Forfeiture of shares

Revised income tax charge	Nil
Refund due	€205

A claim for a refund of the tax overpaid must be made within 4 years from the end of the year of assessment in which the shares are forfeited i.e. 31 December 2018.

### 3.5 Capital Gains Tax

Any loss arising on the forfeiture of shares should be restricted to the amount of consideration given by the director or employee for the shares less any amount subsequently recovered by him or her on the forfeiture.

### **3.6 Returns of information**

With effect from 1 January 2011, PAYE applies to restricted shares acquired by a director or employee and there is no current obligation on the company to give details of the forfeitable shares acquired to Revenue.

A more recent version of this manual is available.