Private and confidential

Taxation of Share Based Remuneration Consultation
Tax Policy Department
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2 D02 R583

1 July 2016

Dear Sirs

FinTech and Payments Association of Ireland – response to Consultation on Taxation of Share Based Remuneration

The FinTech and Payments Association of Ireland (FPAI and www.FPAI.ie) welcomes the opportunity to respond to the Department of Finance's request for submissions to its public consultation on the taxation of share based remuneration. We have set out within this document our responses and observations on the questions asked in the consultation document.

We believe that the mechanisms through which SMEs can reward key employees is a vital pillar of Ireland's overall tax offering and should provide an opportunity for both employees and directors to participate in the growth and performance of the business. A best in class tax regime should encompass a range of share based remuneration schemes which will attract, motivate, retain and encourage key employees and entrepreneurs alike.

In July 2015 we submitted a response to the Department of Finance's request for submissions to its public Consultation on Tax and Entrepreneurship[1]. Highlighted in our response to this review was our goal for Ireland to become one of the global centres of FinTech and that in order for Ireland to achieve such goal, it is important to retain Irish entrepreneurial talent and create an environment to attract mobile talent and investment to Ireland. Our submission today reemphasises some of our responses and observations made in our July 2015 submission, to the extent we believe they are relevant and applicable to the Consultation on Taxation of Share Based Remuneration.

[1] FinTech and Payments Association of Ireland – response to Consultation on Tax and Entrepreneurship Review, July 2015

FINTECH & PAYMENTS ASSOCIATION OF IRELAND

1. Background to the FinTech and Payments Association of Ireland

The FPAI is a not for profit organisation established to further the interests of the stakeholders in the Irish FinTech ecosystem who comprise its members. The Association was publically launched in September 2015 and has a Board consisting of:

Morgan Lynch (Senddr)
Colm Lyon (Fire Financial Services)
Colm Rafferty (Maples and Calder)
Anna Scally (KPMG)

Richard Walsh was appointed acting CEO earlier this year.

The Association aims to develop a vision promoting Ireland as a global leader in FinTech and payments innovation.

Fintech in its broadest articulation comprises every area of technology and innovation in the financial services arena, from payments, trading and foreign exchange, big data, risk, compliance and business intelligence to consumer-focused currency exchanges and peer to peer lenders. In Ireland we have a deep heritage in growing financial services businesses in the International Financial Services Centre and an equally strong history in establishing and scaling Irish technology companies focused on foreign markets. We are lucky to have a diverse range of market participants who see Fintech as the context for their own innovation or at least a source of innovation from which they can benefit.[2]

2. Context of our Submission

In our response to the Department of Finance's request for submissions to its public Consultation on Tax and Entrepreneurship we set out that our ambition is to ensure that Dublin (and Ireland) can become a FinTech hub. By that we mean a location where FinTech companies (both early stage and much later stage) can grow and thrive and serve markets globally.

While our proximity to the UK gives FinTech companies in Ireland great opportunity to access a market in very close proximity, having London so close is also a threat and this was explicitly called out in a KPMG report produced in late 2014 where it states "What may prove costly to the city's Fintech growth story is its close proximity with London's Fintech cluster" [3].

Given the number of cities and countries which are also specially targeting opportunity in the FinTech area, securing Ireland as the hub will be a challenge. Indeed, our near neighbour, the UK,

[2] http://fpai.ie/about.aspx
[3] https://www.kpmg.com/AU/en/IssuesAndInsights/ArticlesPublications/Documents/fintech-opportunity-sydney-oct-2014-full-report.pdf

has arguably some potential natural advantages in this area, which include a large and vibrant financial services community, well developed capital markets and a very large domestic market among other factors. The UK has also very deliberately developed a number of its tax policies to become more attractive for entrepreneurial led companies and for key employee attraction and retention. Whether or not the recent Brexit decision has an immediate or longer term effect, has yet to be seen. Irrespective, it is important that Ireland positions itself as an attractive location for FinTech companies.

In our view, in order for Ireland to become one of the global centres of FinTech, it is important to retain Irish entrepreneurial talent and create an environment to attract mobile talent and investment to Ireland that can compete on a global scale.

3. Ireland's taxation of share based remuneration – Employees/Directors

3.1 Context of review

In response to the consultation document issued by the Department, we set out below our specific comments and observations on the Irish tax system of share based remuneration. We believe that in order to help establish Ireland as a FinTech Hub, and to support and encourage the attraction and retention of talent to Ireland throughout the industry, it is essential that share based remuneration can be used as an effective tool.

The Minister for Finance, Michael Noonan commented at the launch of the public Consultation on Taxation of Share Based Remuneration that, "*international research has shown that when employees share in the profits of the company, this can be effective in fostering partnership, increasing competitiveness and in helping companies to attract and retain staff in a competitive international labour market. This can then support employment and economic growth. Now is a good time to review the tax treatment of share based remuneration.*" [4]

We believe that the opportunity to link the establishment of Ireland as a hub for FinTech and to help companies to attract and retain talent to Ireland should not be missed, as both objectives ultimately seek to support economic growth.

3.2 Current system of taxation

We recognise and agree with the acknowledgement in the Consultation paper that "*the rationale for the use of share-based remuneration may vary depending on the age or size of the company and it may not be the case that a single solution would be optimal for every company",* therefore, in reviewing the aspects of the current system of taxation of share based remuneration, we have considered the view from a start-up, medium sized enterprise and large established enterprise.

Start-ups, in general, lack cash resources, have no readymade market for their shares and are often clouded by uncertain future outcomes. This places start-ups at a competitive disadvantage when seeking to attract the talent required to grow the business. Under the current regime, unapproved share options are taxed on exercise, and share awards are taxed on the vesting of the award (income

[4] http://www.independent.ie/business/small-business/latest-news/taxfree-stock-options-on-the-way-to-boost-irish-startups-34734107.html

tax including PRSI and USC being up to 52%). This puts pressure on employees to sell their shares in order to fund the ensuing tax liability and, as such, the benefit of the share options/awards – to promote commitment and a sense of ownership in the company - is lost.

According to the Irish Government's Summer Economic Statement, released last week, the Government will continue to work to ensure an economic environment that promotes and rewards both entrepreneurship and work, stating that, "*income tax reform will be a key element in supporting employment growth.*"[5]

Such reform is much needed particularly in the context of Ireland's current system of income taxation. Ireland's marginal tax rates, which kicks in at very modest income levels compared to other international locations are not conducive to attracting and retaining talented employees and do not compare well with competing international jurisdictions. What's more, significant changes introduced in Budget 2011 to the tax and social security treatment of share based payments have made such schemes more expensive for employees from a tax perspective and the administrative burden on employers has also increased regardless of the age or size of the company.

We agree that employee share incentive schemes can be an effective way to attract employees and encourage participation and loyalty.

We firmly believe that introducing targeted changes to the current system of share based remuneration in Ireland would make it easier to both attract and retain skilled and key employees to be ambitious and continue to build and scale their employers business in Ireland.

Taking the above into account, we set out below some suggested scheme changes which we believe would make a real difference.

3.3 Our proposals

1. **Share option scheme for start-ups and SMEs**

We suggest the introduction of a new share option scheme, available to start-ups and SMEs, with capped levels of awards, where the taxing point is deferred to the sale of the share, and the resulting gain is subject to capital gains tax.

Early stage start-ups and SMEs seeking to preserve cash to build up the business and compete with more established business for talent often look to share awards to attract and retain employees as they have the advantage of not creating an immediate cash outflow for the business. However, under Ireland's current approach the employee is taxed on the exercise of (unapproved) share options. Listed entities and MNCs can be at a competitive advantage over start-ups and SMEs as they can offer a readymade market in which the employees can sell their shares in order to fund their resulting vesting or exercise tax liability. That said - even where there is a market for the shares, there can also be difficulties here where employees are forced to sell to discharge tax liabilities – removing part of the rationale for holding shares in the company in the first instance.

[5] "Summer Economic Statement", Department of Finance, June 2016

We therefore recommend the introduction of a share option scheme targeted at start-ups and SMEs. To address the inherent differences in risk and reward for employees participating in these smaller scale business ventures, **we suggest that the tax point for the employee is triggered only at the point in time where the shares are sold and that the tax rate applicable should be the capital gains tax rate.**

In order to manage the cost of such a scheme, we suggest that the value of options granted and maximum value that is delivered under such awards is capped at an appropriate level.
In the UK, for example, a similar scheme exists which is referred to as the Enterprise Management Incentive (EMI). This scheme permits employees to be granted options up to £250,000 per employee and a maximum level of £3 million that can be given by an employer to employees. An Irish equivalent might be a limit per employee of €300,000 and employer limit of €4 million.

This scheme has been in operating in the UK for over 15 years with great success and is familiar to a number of our member companies. We believe that a scheme modelled on the UK EMI, simplified somewhat to address some of the complexities which have been identified in the UK scheme, could be a very powerful tool to attract and retain employees and motivate them to drive their companies success.

2. Restricted Share awards

We suggest the scope of restricted share awards is broadened to include share options, Restricted Stock Units (RSUs) and phantom share awards.

For start-ups and SMEs seeking to attract and retain key employees, being able to offer a broad and varied compensation package to compete with a compensation packaged by listed companies and MNCs is invaluable. We believe the current tax relief for employees under section 128D, TCA 1997 which operates to abate the market value of the shares on award by 10% for each year of restriction subject to a maximum abatement of 60% where the restriction is more than 5 years can be attractive. However, it is limited in its application in that it currently only applies to shares.
We therefore recommend this relief is extended to include RSU, phantom stock plans and options over shares. We believe such extension would allow start-ups and SMEs to offer much more competitive and varied compensation packages that could compete on a global scale.

3. Loans advanced from employer to employee

We suggest that loans advanced by employers to employees to assist in funding the take up of share based awards be exempt from taxation as a benefit-in-kind (BIK).

Start-ups and SMEs seeking to attract and retain key employees face strong competition from listed companies and MNCs in their capacity to offer share incentives and awards. Under the current tax regime, where an employer provides a loan to an employee which is used by the employee to fund the purchase of employer shares, the loan is taxed as a “preferential loan” and the employee is deemed to earn annually a BIK amount of 13.5% of the loan. The current systems of taxing such a loan as a BIK acts as a barrier to employee participation in a number of the current schemes.

We suggest such barrier could be removed by a legislative change to remove employer loans which are used to acquire employer shares from the scope of the preferential loan BIK provisions. Such loans would ultimately be repaid on disposal of the relevant shares.

We believe that the changes presented above will go some way towards companies being able to meaningfully use share based compensation to attract and retain employees.

4. Ireland's taxation regime for Entrepreneurs/Founders

4.1 Context of review

In addition to our comments on share based remuneration, we set out below our specific comments and observations on the Irish tax system for entrepreneurs and founders in order to support and encourage the attraction and retention of talent to Ireland throughout the industry.

Entrepreneurs should be viewed as national assets; they create new business, which in turns creates new employment and which ultimately results in economic growth. While there are a number of existing tax expenditures and schemes in place to encourage entrepreneurial activity in the Irish economy, we believe there is still room for improvement and the opportunity to incentivise entrepreneurs in Ireland should not be missed.

4.2 Current System of taxation and proposal

Ireland introduced an improved "Entrepreneurs Relief" in Finance Act 2015. While this relief is more attractive than the relief introduced by Finance Act 2014, we believe the relief is still restrictive and a tax rate of 20% is not competitive in international terms.

As set out in our response to the Department of Finance's consultation on Tax and Entrepreneurship, we suggested that a relief similar to that available in the UK would incentivise entrepreneurs to be ambitious and continue to build and scale their business in Ireland. We therefore set out below a suggested improvement to Ireland's regime which we believe would make it more competitive internationally and provide greater incentive locally.

Terms and conditions would of course have to apply to any such regime but these should be commercial and workable.

The suggested features of the regime would be:

> The first €15 million of qualifying capital gains realised by an entrepreneur would be subject to CGT at an effective rate of 10%. This is a lifetime limit such that excess gains over this limit remain taxable at the standard rate.
>
> For a period of at least one year before disposal, the individual making the disposal must own or have held options over at least:
>
> - 5 percent of the ordinary share capital and 5 percent of the voting rights, and
> - Be an officer or employee (full or part time) of the company.

It is intended that this rate would also apply to deferred gains under “earn-out” arrangements.

The company must be either a trading company or a holding company of a trading company or companies.

Eligible trading activities might exclude typical investment holding activities but should include activities offering high growth potential sectors, such as FinTech.

As also set out in our response to the Department of Finance’s consultation on tax and entrepreneurship, we are aware that the Government, and indeed the Department of Enterprise, Jobs and Innovation have expressed their concern that entrepreneurs in Ireland can be considered to have “sold-out” too early, in that they have sold their business prior to that business having scaled–up or grown to a significant economic scale. While there are many good examples of companies that have been sold and continued to grow in Ireland, there are others which may not have gone on to fulfil their full potential in terms of creating economic value here in Ireland.

In this context, one could consider the introduction of an “Entrepreneurs Scaling Dividend” concept, where subject to conditions similar to those set out above, qualifying entrepreneurs would be able to extract dividends from their companies at the 10% tax rate, rather than selling the business to realise some economic gain. This might be a very useful tool to enable entrepreneurs to continue to stay focussed and ambitious and continue to build and grow companies in Ireland. To the extent that an entrepreneur accessed the “Entrepreneurs Scaling Dividend”, that would erode their lifetime cap, e.g. the €15m suggested above which would be available on any future disposal of this business.

We appreciate that there may be concerns in introducing this type of regime (CGT and entrepreneurs scaling dividend), but if structured properly, these concerns would be addressed and it could serve as a very powerful message that Ireland is serious about retaining and growing entrepreneurial talent here.

5. Conclusion and Opportunity for Ireland

We believe there is real opportunity for Ireland in securing a leadership role in the FinTech and payments area. However, we believe it is critically important that we address a number of the current short falls in the existing tax regimes set out above in order to achieve such opportunity. This falls hand in hand with securing a best in class tax regime which will attract, motivate, retain and encourage key employees and entrepreneurs alike. The tax landscape is competitive and as other countries fight to become the number one it is vital that Ireland undertakes some fundamental changes to the taxation of employees through share based remuneration and entrepreneurs through incentivising CGT rates. Ireland has transformed its economy from one in crisis to recovery in just a few short years. Incentivising tax regimes and the attraction and retention of key talent to Ireland are what will transform Ireland’s economy to one that is booming.

We hope that you find our response useful as your Department continues its important work in shaping Ireland’s tax regime into the future. We would welcome the opportunity to meet with you as part of the consultation process to discuss further how Ireland's tax system can help build a culture of entrepreneurship.

For follow up in relation to this submission, please contact Anna Scally, anna.scally@kpmg.ie or 01 4101240.

Yours faithfully

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