

## Chapter 5 - Convertible Securities

This document should be read in conjunction with section 128C of the Taxes Consolidation Act 1997

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## 5.1 Introduction

Section 128C Taxes Consolidated Act 1997 sets out specific rules for the tax treatment of securities acquired by an employee/ director by reason of his or her employment/ office which are convertible into securities of another description or into money or money's worth.

The section applies to securities acquired by an employee/ director on or after 31 January 2008. Prior to this an income tax charge was imposed on the acquisition of this form of security by reference to the market value of the security at the date of acquisition. No further income tax charge was imposed on the conversion of the securities.

Under the provisions of section 128C TCA 1997, the income tax charge imposed at the date of acquisition will, generally, be calculated by reference to the market value of the securities at that date ignoring the right of conversion, and a further income tax charge will be imposed on the conversion of the securities.

An income tax charge will also arise in certain circumstances other than conversion – release of the entitlement to convert the securities; disposal of the securities while they are still convertible; and receipt of a benefit in connection with the entitlement to convert the securities.

## 5.2 Securities

To come within the scope of section 128C TCA 1997, the employee/ director must acquire the securities by reason of his or her employment/ office. Such securities are known as “employment related securities”. An income tax charge also arises where the securities are acquired by a person other than the employee/ director, where they are so acquired by reason of the director's or employee's employment/ office (including a former or prospective employment/ office).

“Securities” are widely defined and includes all of the following:

- (a) shares,
- (b) securities within the meaning of section 135 TCA 1997,
- (c) debentures,
- (d) debenture stock,
- (e) loan stock,
- (f) bonds,
- (g) certificates of deposit, and
- (h) other instruments (including certificates and warrants) creating or acknowledging indebtedness, including certificates and other instruments providing for a share in the profits of a company,
- (i) options (other than options to acquire securities, except where such options are acquired under arrangements of which the main purpose or one of the main purposes is the avoidance of income tax, corporation tax or capital gains tax),

- (j) financial and commodity futures within the meaning of the Investment Intermediaries Act 1995,
- (k) warrants and other instruments entitling their holders to subscribe for securities,
- (l) certificates and other instruments conferring rights in respect of securities held by persons other than persons on whom the rights are conferred and the transfer of which may be effected without the consent of those persons, and
- (m) units in a collective investment scheme.

The following are not securities:

- cheques or other bills of exchange,
- bankers' drafts or letters of credit,
- statements showing balances in current, deposit or savings accounts, or
- leases and other dispositions of property.

### 5.3 Convertible Securities

The securities must be "convertible securities". This means that they must be capable of conversion into securities of another description or into money or money's worth. Securities are convertible securities if:

- the securities confer an entitlement on the holder (immediate or deferred), to convert them into securities of a different description (this would include shares which have no voting rights or rights to dividends which subsequently acquire such rights) or into money or money's worth (notwithstanding that such entitlement may be subject to the satisfaction of certain conditions),
- an entitlement to convert is, or may be, by way of a contract, an agreement, arrangement or condition, granted at some time after the convertible securities were acquired,
- a contract, agreement, arrangement or condition allows the securities to be converted by someone other than the holder of the securities.

The right to convert:

- might be automatically built into the securities. For example, it may be specified in the Articles of Association or Constitution of the company that issued the securities that they carry a right of conversion, or
- might be provided for in a contract, agreement, arrangement or condition, in the event that certain circumstances arise or do not arise. For example, an agreement may state that the employee is required to remain employed by the employer for a specified period.

## 5.4 Income Tax Charge on the Acquisition of Convertible Securities

On the acquisition of convertible securities, an income tax charge may arise under Schedule E. Depending on the circumstances, the charge may be computed in accordance with:

- Section 112 TCA 1997 (general Schedule E computational rules),
- Section 128 TCA 1997 (taxation of share options and other rights), or
- Section 122A TCA 1997 (notional loans in relation to shares).

For the purposes of computing this charge, the entitlement to convert the securities into securities of another description or into money or money's worth is ignored.

### Example 1

On 21 February 2017 an employee is awarded 100 "A ordinary" shares which have a nominal value of €100. The "A ordinary" shares are convertible into 100 "B ordinary" shares in three years. The market value of the shares taking account of the entitlement to convert is €150. The employee is given the shares free of charge. The market value of 100 "B ordinary" shares on 21 February 2017 is €3,000. The amount chargeable to income tax on acquisition of the shares is €100. The entitlement to convert the securities into securities of another description worth €50 is ignored.

## 5.5 Anti-Avoidance

Where the securities are acquired under an arrangement of which the main purpose or one of the main purposes is the avoidance of tax, the income tax charge on acquisition is to be calculated on the basis that the securities are "immediately and fully convertible", unless the market value ignoring the right to convert would be less than or the same as the market value taking account of the right to convert.

"Immediately and fully convertible" means convertible immediately after acquisition so as to obtain the maximum gain that would be possible without allowing for any consideration given for the conversion or for any expenses incurred in connection with the conversion.

### Example 2

An employee is awarded, under certain conditions, a "B ordinary" share which is convertible into an "A ordinary" share. At the date of the award, the market value of the "A ordinary" share is €200 and the market value of the "B ordinary" share ignoring the right of conversion is €20. Section 128C (5)(c) ensures that the real benefit passing to the employee will be taxed (i.e. €200) by treating the "B ordinary" share as having immediately and unconditionally converted into the "A ordinary" share.

If however, under a tax avoidance scheme an attempt is made to exploit this treatment, for example, if the employee is awarded a “B ordinary” share which has a market value of €500 with a right to convert it into the “A ordinary” share (which has a market value of €200), Section 128C(5)(c) TCA 1997 ensures that the market value of the “B ordinary” share - €500 is used to calculate the benefit arising to the employee.

## **5.6 Income Tax Charge on the Occurrence of a “Chargeable Event”**

In addition to any income tax charge that may arise on the acquisition of convertible securities, a further income tax charge is imposed when a “chargeable event” occurs in relation to those securities. The charge is under Schedule E and is imposed in the year of assessment in which the “chargeable event” occurs.

There are four circumstances that give rise to a “chargeable event”. These are:

- the conversion of the employment related securities into securities of another description, where the employee/ director (or any other person who acquired the securities by reason of the employee’s or director’s employment/ office) has a beneficial interest in those securities before the conversion occurs and in the securities into which they are converted,
- the release of the entitlement to convert for consideration, where the employee/ director (or any other person who acquired the convertible securities by reason of the employee’s or director’s employment/ office) has a beneficial interest in the securities,
- the disposal for consideration of the convertible securities by the employee/ director (or any other person who acquired the convertible securities by reason of the employee’s or director’s employment/ office) while they are still convertible, and
- the receipt of a benefit in money or money’s worth by the employee/ director (or any other person who acquired the convertible securities by reason of the employee’s or director’s employment/ office) in connection with the entitlement to convert (for example, the receipt of compensation for the loss of the entitlement).

## **5.7 Amount Chargeable on the Occurrence of a “Chargeable Event”**

### **5.7.1 Formula**

The formula for calculating the amount chargeable on the occurrence of a chargeable event is -

**A – B**, where:

**A:** the amount of any gain realised on the occurrence of a chargeable event.

This amount is computed differently for each of the chargeable events:

- see [section 5.7.2](#) for conversion of securities;
- [section 5.7.3](#) for the release of an entitlement to convert;
- [section 5.7.4](#) for the disposal of the securities while they are still convertible; and,
- [section 5.7.5](#) for receipt of a benefit in connection with the entitlement to convert).

**B:** the aggregate of the amount of any consideration given for the entitlement to convert and any expenditure incurred by the holder in connection with each chargeable event (see [section 5.8](#) in relation to the meaning of consideration).

## 5.7.2 Calculation of the Gain on the Conversion of Securities

### 5.7.2.1 Calculation

The formula for calculating the amount chargeable on the conversion of securities is-

**C - (D + E)**, where:

**C:** the market value, at the time of the chargeable event, of the securities into which the securities are converted and where those securities are themselves convertible, the market value is determined as if they were not convertible.

Where the securities are an interest in securities (i.e. an interest less than the full holding), then a proportion of this market value, which is equivalent to the proportion of the interest held, is to be used, (e.g. 50% of the full holding held, then 50% of the market value at the time of the chargeable event, of the securities into which the convertible securities are converted is to be used).

**D:** the market value of the convertible securities at the time of the chargeable event, determined as if they were not convertible securities or an interest in convertible securities.

**E:** the amount of the consideration given for the conversion of the securities.

### Example 3

An employee is awarded “A ordinary” shares which are convertible into “B ordinary” shares after 5 years. The market value of the “A ordinary” shares at the date of acquisition, ignoring the right of conversion, is €1,000. On conversion, the employee receives “B ordinary” shares that have a market value of €3,000, for a consideration of €100.

The market value at the date of conversion of the “A ordinary” shares (ignoring the right of conversion) is €1,100

Income Tax charge on acquisition

Market value of the “A ordinary” shares ignoring the right of conversion	€1,000
Consideration paid by the employee	<u>Nil</u>
Amount chargeable	€1,000

*Income Tax charge on conversion*

Market value of “B ordinary” shares	€3,000
Less	
Market value of the “A ordinary” shares	€1,100
Consideration paid	<u>€ 100</u>
Amount chargeable	€ 1,200
	€1,800

### 5.7.2.2 Prevention of a Double Charge

Where the income tax charge on the acquisition of the convertible securities is based on the market value of the securities as if they were immediately and fully convertible (see [section 5.5](#)), in order to prevent a possible double charge, the amount chargeable computed in accordance with the previous section is reduced by an amount determined by the formula -

**H – I**, where:

**H:** the amount by which the market value of the convertible securities computed as if they were immediately and fully convertible exceeds the market value of the convertible securities ignoring the right of conversion.

**I:** the aggregate of any amount by which the amount chargeable on any previous chargeable event relating to the convertible securities has been reduced.

#### Example 4

An employee is awarded, under certain conditions, a “B ordinary” share which is convertible into an “A ordinary” share. At the date of the award, the market value of the “A ordinary” share is €1,000 and the market value of the “B ordinary” share, ignoring the right of conversion, is €20. On conversion, the employee receives an “A ordinary” share that has a market value of €3,000, for a consideration of €100. The market value at the date of conversion of the “B ordinary” share (ignoring the right of conversion) is €25.



*Income Tax charge on acquisition*

Market value of the "B ordinary" share treated as if it is immediately and fully convertible	€1,000
Consideration paid by the employee	<u>Nil</u>
Amount chargeable	€1,000

*Income Tax charge on conversion*

Market value of "A ordinary" share	€3,000
Less	
Market value of the "B ordinary" share	€25
Consideration paid	€100
Excess charged on acquisition (€1,000 – 20)	€980
Aggregate amounts previously charged under Section 128C	<u>€ 0    €1,105</u>
Amount chargeable	€1,895

### 5.7.3 Calculation of the Gain on the Release of Entitlement to Convert for Consideration

The gain is the consideration (money or money's worth) received for the release of the entitlement to convert.

**Example 5**

An employee is awarded "A ordinary" shares which have a right of conversion after 4 years attaching to them, for nil consideration. The market value of the shares at the date of acquisition, ignoring the right of conversion, is €1,000. The right to convert the shares is released and the employee receives €5,000 in connection with the release.

*Income Tax charge on acquisition*

Market value of the "A ordinary" shares ignoring the right of conversion	€1,000
Consideration paid by the employee	<u>Nil</u>
Amount chargeable	€1,000

*Income tax charge on release of right of conversion*

Consideration received	€5,000
Less	
Consideration paid for release	<u>€ Nil</u>
Amount chargeable	€5,000

### 5.7.4 Calculation of the Gain on the Disposal of the Securities while they are still Convertible

The gain is determined by the formula -

$$F - G, \text{ where}$$

**F:** is the amount of consideration received on disposal of the securities.

**G** is the market value of the convertible securities at the time of the chargeable event, determined as if they were not convertible securities or an interest in convertible securities.

#### Example 6

An employee is awarded "A ordinary" shares which have a right of conversion after 5 years attaching to them. The market value of the shares at the date of acquisition, ignoring the right of conversion, is €1,000. The employee sells the securities (while they are still convertible) after 3 years for €3,000.

The market value of the "A ordinary" shares (ignoring the right of conversion) at the date of sale is €1,100.

#### *Income Tax charge on acquisition*

Market value of the "A ordinary" shares ignoring the right of conversion	€1,000
Consideration paid by the employee	<u>€Nil</u>
Amount chargeable	€1,000

#### *Income Tax charge on disposal*

Consideration received	€3,000
Less	
Market value of the "A ordinary" shares ignoring the right of conversion	<u>€1,100</u>
Amount chargeable	€1,900

### 5.7.5 Calculation of Gain on the Receipt of a Benefit in Connection with the Entitlement to Convert

The gain is the amount or market value of the benefit received in connection with the entitlement to convert. This is calculated in a similar manner to Example 5 in [section 5.7.3](#).

## 5.8 Consideration Given for the Securities or for the Entitlement to Convert the Convertible Securities

For the purposes of calculating B in the formula outlined in [section 5.7.1](#), consideration is to be treated as given for the entitlement to convert the securities only if the amount of any consideration given for the acquisition of the securities exceeds the market value of such securities (determined as if they were not convertible securities) at the time of their acquisition.

This allows for relief to be given for any amount of consideration not previously allowed against any amount chargeable on the acquisition of the convertible securities in computing the amount of the gain on the conversion of the securities.

For example, if an employee paid €30 for a convertible share, which was valued at €10 ignoring the right to convert. The charge on acquisition (provided there was no tax avoidance scheme involved) would have been nil (€10-€30). If the shares are subsequently converted, the employee will be entitled to a deduction for the unrelieved amount, €20, in calculating the income tax charge on the conversion of the securities.

In calculating the amount chargeable under section 128C TCA 1997, the performance of the duties in connection with the employment/ office is not regarded as part of any consideration given by the employee or officer for the acquisition of convertible securities or part of any consideration given for the entitlement to convert such securities. In addition, only one deduction can be allowed in respect of any consideration given.

## 5.9 Exclusions from Section 128C TCA 1997

Section 128C TCA 1997 does not apply where **all** of the following conditions are satisfied:

- the securities are shares in a company,
- the entitlement to convert applies to all shares in the same class as the employment related securities,
- an event similar to that which effects the convertible securities also effects all the other shares of the same class, (shares are converted into securities of a different description; the entitlement to convert is released; shares are disposed of; a benefit is received in respect of the entitlement to convert, as the case may be), and
- the majority of the shares so affected are not securities acquired by directors and employees by reason of their employment/ office.

In addition, no charge to income tax arises where, at the time of acquisition of the employment related securities, the emoluments from the employment/ office are not within the charge to tax under Schedule D or E.

## **5.10 Chargeable Persons**

Any person chargeable to tax under section 128C TCA 1997 is a chargeable person for the purposes of Part 41 TCA 1997 (Self Assessment) other than where the person is exempted from the requirement to make a tax return under self-assessment.

## **5.11 Capital Gains Tax**

Any amount charged to income tax under 128C TCA 1997 is to be added to the costs of acquisition of the securities in computing the amount on which capital gains tax is chargeable on the disposal of such securities.

## **5.12 Return of Information**

Companies must provide details of all awards of convertible securities made to employees and directors and details regarding the occurrences of chargeable events to the Revenue Commissioners not later than 31 March in the tax year following the year in which the awards are made or the chargeable events occur, as the case may be.