Chapter 7 – Shares Acquired at Less than Market Value (Undervalue), Notional Loans and Disposals for Greater than Market Value

This document should be read in conjunction with sections 112,122 and 122A of the Taxes Consolidation Act 1997

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Table of Contents

7.1 Overview

Legislation was introduced in Section 15(1) of the Finance Act 1998 to combat a tax avoidance scheme whereby companies allowed directors and employees to acquire shares without having to pay the entire amount due on the allotment of the shares. The employee/director would pay a small portion of the purchase price, with the balance of the purchase price remaining outstanding. The unpaid balance, known as a "call" might never be called for.

Under the provisions of section 122A TCA 1997, the unpaid balance is treated as an interest-free "notional loan" in the hands of the employee/director. The interest-free loan is deemed to be a preferential loan for benefit-in-kind purposes and the provisions of section 122 TCA 1997 apply to it. Where the interest-free loan is written off by the company in favour of the employee/director, the amount outstanding on the loan is deemed to be a taxable emolument. For provisions relating to preferential loans - see Tax & Duty Manual Part 05-04-01 on the Revenue website.

Section 122A 1997 also covers a situation where shares are disposed of for a price that is greater than the market value of the shares. Where an employer pays an employee an inflated price for shares, the difference between the market value and the sale price is deemed to be an emolument.

7.2 Scope of the legislation

Section 122A applies in two situations:

(a) where a employee/director (or a person connected with the employee/director) by reason of his or her employment/office, acquires shares at less than market value (i.e. at undervalue) in any company (i.e. the employing company or any other company), or

(b) where an employee/director (or a person connected with the employee/director) by reason of his or her employment/ office acquires shares (whether at undervalue or not) and disposes of those shares for consideration above the market value of the shares.

The reference to shares in (a) and (b) above also includes a reference to stock and securities within the meaning of section 135 TCA 1997, and it does not matter how the shares are acquired – allotment, assignment, or in any other manner.

7.3 Shares acquired at undervalue

To the extent that the undervalue is not otherwise chargeable to income tax as an emolument of the employment/ office (for example, in accordance with section 112 TCA 1997 or section 128 TCA 1997), the employee/director is chargeable on the notional loan under section 122 TCA 1997.

The amount chargeable is the full undervalue on acquisition of the shares, reduced by any amount otherwise chargeable to tax under any other section (e.g. section 112 TCA 1997 or section 128 TCA 1997).

The notional loan remains outstanding until it terminates. Subsequent payments made by the employee/director in respect of the shares reduce the amount of the loan.

7.4 Termination of notional loan

The notional loan terminates on the happening of any of the following events:

(a) the amount of the call outstanding is fully paid by the employee/director;
(b) the employee/director is released from the obligation to account for the uncalled amount (balance outstanding);
(c) the employee ceases to have a beneficial interest in the shares; or
(d) The employee dies.

When the notional loan terminates by virtue of (a) or (d), no further charge arises under section 122 TCA 1997 in any period subsequent to the termination.

However, where either of the two events mentioned in (b) and (c) occur, an income tax charge will arise if there remains, at the time of the event in question, any balance of the initial amount outstanding.

7.5 Release of uncalled amount

In the case of (b) above, the employee/director will be treated as having received a perquisite (chargeable in accordance with section 112 TCA 1997) of an amount equal to the outstanding balance of the notional loan immediately before the release. The amount of the perquisite is, in effect, the initial amount outstanding on the notional loan as reduced by any further payments for the shares made following the date the shares were acquired but before the release of the outstanding balance.

7.6 Cessation of beneficial interest in shares

In the case of (c) above, if before the outstanding balance of the notional loan is reduced to nil (by a payment by the employee/director for the shares), he or she surrenders or otherwise disposes of his or her beneficial interest in the shares, the employee/director will be treated as having received a perquisite of an amount equal to the outstanding balance of the notional loan immediately before the surrender or other disposal. If only part of the shares acquired at undervalue are surrendered or sold, the amount chargeable is limited to the appropriate proportion of the outstanding balance.

7.7 Examples

The following examples demonstrate how the legislation works in practice.

Example 1

On 1 January 2016, an employee is given 10,000 shares by his employer for a purchase price of €2.50 per share. The market value of fully paid-up shares of the same class on that date is €4.25 per share. The employee is obliged to pay €1.00 per share on allotment of the shares and the company reserves the right to call up the outstanding €1.50 per share at a future date. The shares are allotted to the employee partly paid. The company calls for the outstanding balance on 1 January 2019 and the employee pays €15,000 on that date.

Income Tax Charge – 2016

An income tax charge arises under Schedule E and is computed in accordance with section 112 TCA 1997 on the acquisition of the shares. The amount chargeable is the difference between the market value of the shares and the amount payable by the employee. An income tax charge also arises in respect of the notional loan. The amounts chargeable are:

On acquisition of the shares

Market value of the shares on 1 January 2016 (€4.25 x 10,000)	€42,500
Less Purchase price for shares (€2.50 x 10,000)	€25,000
Amount chargeable	€17,500

On notional loan

Market value of shares acquired by employee		€42,500
Less		
Actual price paid by employee (€1.00 x 10,000)	€10,000	
Amount charged to income tax in accordance with section 112 TCA 1997	€17,500	€27,500
Notional Loan (undervalue on acquisition)		€15,000
Amount chargeable (€15,000 @ 13.5%*) (*specified interest rate)		€ 2,025
Total amount chargeable for 2016 (€17,500 + €2,025)		€19,525

Income Tax Charge – 2017

An income tax charge arises on the notional loan.

The amount chargeable is calculated as follows:

Notional Loan	€15,000
Amount chargeable (€15,000 @ 13.5%)	€ 2,025

Income Tax Charge – 2018

An income tax charge arises on the notional loan. The amount chargeable is calculated as follows:

Notional Loan	€15,000
Amount chargeable (€15,000 @ 13.5%)	€ 2,025

Example 2

On 1 January 2016, an employee is awarded 5,000 shares by his employer for a purchase price of €3.50 per share. The market value of fully paid-up shares of the same class on that date is €6.25 per share. The employee is obliged to pay €2.00 per share on allotment of the shares and the company reserves the right to call up the outstanding €1.50 per share at a future date. The shares are allotted to the employee partly paid. The employee makes a further payment of €1.00 per share on 1 January 2017. On 1 July 2017 the company released the employee from his obligation to pay the outstanding amount of €0.50 per share.

Income Tax Charge – 2016

An income tax charge arises under Schedule E, computed in accordance with section 112 TCA 1997 on the acquisition of the shares. The amount chargeable is the difference between the market value of the shares and the amount payable by the employee. An income tax charge also arises in respect of the notional loan. The amounts chargeable are:

On acquisition of the shares

Market value of the shares on 1 January 2016 (€6.25 x 5,000)	€31,250	
Less Purchase price for shares (€3.50 x 5,000)		€17,500
Amount chargeable		€13,750

On notional loan

Market value of shares acquired by employee		€31,250
Less		
Actual price paid by employee (€2.00 x 5,000)	€10,000	
Amount charged to income tax in accordance with section 112 TCA 1997	€13,750	€23,750
Notional Loan (undervalue on acquisition)		€ 7,500
Amount chargeable €7,500 @ 13.5%* (*specified interest rate)		€1,012

Total amount chargeable for 2016 (€13,750 + €1,012) €14,762

Income Tax Charge – 2017

An income tax charge arises on the notional loan under section 122 TCA 1997 for the period from 1 January 2017 to 1 July 2017. A charge also arises in respect of the release on 1 July Year 2017 of the then outstanding notional loan balance. The amounts chargeable are calculated as follows:

On notional loan

Notional Loan (undervalue on acquisition)	€7,500
Amount chargeable (€7,500 @ 13.5%*x 181/365)	€ 502

On release of obligation to pay outstanding amount

Notional loan initially outstanding 1 January 2016	€7,500
Less payment made on 1 January 2017 (5,000 @ €1)	€5,000
Outstanding balance at 1 January 2017 (5,000 @ €0.50)	€2,500
Amount chargeable on release of obligation	€2,500
Total amount chargeable in Year 2 (€2,500 + €502)	€3,002

7.8 Shares disposed of for more than market value

Where an employee/director is by reason of his or her employment/office allowed to acquire shares at market value or for less than market value and is then given the opportunity to sell those shares either back to the employer or to a third party for a consideration that exceeds the market value of the shares at the time of disposal, a charge to income tax arises under Schedule E in accordance with section 122A TCA 1997 on the difference between the disposal proceeds and the market value of the shares.

The charge also arises where the arrangement is made with any person connected with the employee/ director.

Example 3

On 1 January Year 2013, an employee is awarded 5,000 shares by his employer for a purchase price of €3.00 per share. This price represents the market value of the shares. On 1 January 2018, the employer enters into an arrangement with the employee to buy back the shares for €5 per share. The market value of the shares at that date was €3.50 per share.

Income Tax Charge 2013
No charge as the employee pays the full market value of the shares.

Income Tax Charge 2018

Disposal Proceeds	€25,000
Market value of shares	€17,500
Amount chargeable	€7,500

Capital Gains Tax Charge 2018

Disposal Proceeds	€25,000
Less	

Cost of acquisition	€15,000
Amount chargeable to income tax	€7,500
Net chargeable gain	€2,500

7.9 Shares acquired under approved schemes

The income tax charge in respect of a notional loan or the deemed write off of a notional loan does not apply to shares acquired at undervalue by directors or employees under:

- a profit sharing scheme approved under Schedule 11 TCA 1997 (Approved profit sharing scheme); or
- rights obtained under a savings-related share option scheme approved under Schedule 12A TCA 1997 (SAYE scheme).

However, if shares acquired under any of these schemes are disposed of for more than their market value, an income tax charge will arise on the difference between the market value and the disposal price under section 122A.