

Share related incentives

Enterprise Management Incentive Schemes (EMI)

Summary

EMI is a tax advantaged share scheme aimed at entrepreneurial companies. It has been designed to assist companies to recruit and retain high quality employees, and offers opportunities for equity participation by employees in recognition of the fact that medium and small sized companies may not be able to match salary levels paid by much larger businesses.

EMI is flexible enough to allow for the option shares to be linked to future capital growth and performance targets.

What are the key benefits?

Provided that the options granted to employees qualify as EMI options, the following tax benefits are available.

- No corporation tax or income tax charge should arise for the company or the option holder on the grant of the option.
- Provided that the exercise price for the option (this is the price the option holder will pay to acquire the share) is equal to or greater than the market value of the share on the date the option is *granted*, there will be no income tax or corporation tax charge when the option is exercised. This is regardless of the market value of the option share on the date of exercise.
- On a sale of the shares, the option holder will pay capital gains tax ("CGT") on the difference between the sales proceeds and the tax base cost. Broadly, the tax base cost will be the higher of the exercise price and the market value at the date of the grant.
- Shares received through EMI options will qualify for CGT Entrepreneur's Relief ("ER") without the option holder having to satisfy the normal requirements for the relief. ER reduces the rate on capital gains from 20% to 10% on qualifying gains within the £10 million lifetime limit. Normally, for ER to apply, a shareholder must hold at least 5% of the ordinary share capital and 5% of the voting power for 12 months prior to sale. The 5% requirements do not apply to EMI shares and the option holder must simply hold the options for 12 months from the date of *grant* in order to qualify.
- Corporation tax relief for the company is available on the difference between the option exercise price and the market value of the share on the day when the option is exercised. This has the potential to result in a significant tax deduction.

What are the qualifying criteria?

There are a number of qualifying criteria relating to the company, the employee, and the options. These must be satisfied at the time the options are granted; however, the conditions do not need to be met at the time of exercise.

General requirements

- The options must be granted for commercial reasons in order to recruit or retain an employee and not as part of a tax avoidance scheme.
- An individual employee may not hold unexercised options with a market value of more than £250,000.
- The company may only have options in issue with a maximum total market value of £3,000,000.

Requirements relating to the company

- The company must not be controlled by another company or by another company and persons associated with that company.
- The company's gross assets must not exceed £30 million at the date of the grant of the options. This is measured according to the company's accounts so that unrecognised goodwill and intellectual property can be ignored.
- The company must have fewer than 250 full time equivalent employees.
- At least one group company must exist wholly for the purposes of carrying on a qualifying trade and the group as a whole must not have more than 20% non-trading activities.
- The trade must not be an excluded activity. Excluded activities are generally low risk businesses.

Requirements relating to the employee

- An individual must be an employee of the company issuing the options or one of its qualifying subsidiaries.
- To be eligible, an employee must work an average of at least 25 hours per week for the company or, if less, he must commit at least 75% of his working time to the company.
- The option holder must have no material interest in the company. A material interest means the ability to control 30% of the ordinary share capital or the right to receive more than 30% of the company's assets available to shareholders on a winding up.

Requirements relating to the options

- The options must be over ordinary shares (i.e. not fixed rate preference shares) that are fully paid up and not redeemable.
- The options must be capable of exercise within 10 years - the employee should have the option of exercising the shares within 10 years of the date of grant; however, the agreement should not prevent the employee from exercising the option after this date
- The option must be set out in a written agreement and must set out any conditions such as performance conditions affecting the options.
- Non-assignability of rights - the employee should be prohibited from transferring any of the rights of the option.

The above provides an outline of the basic criteria which must be fulfilled and there are a number of other conditions that must be satisfied. Care must also be taken to avoid disqualifying events, which can result in the tax benefits being lost if these occur prior to options being exercised, although relief can still be retained if exercise occurs within 90 days following the disqualifying event.

How do I implement an EMI scheme?

The valuation of the shares to be issued under an EMI share option scheme will usually be agreed with HM Revenue & Customs prior to the options being granted in order to provide certainty over the tax treatment. This requires the submission of a share valuation report to HMRC for their agreement and the process usually takes around 30 days.

Administration of the EMI scheme has generally been kept to a minimum. Employers do not need formal approval of a scheme but must notify HMRC within 92 days of the options being granted. The notification must be done online within the PAYE area of HMRC's online services. Employers must register for the share scheme reporting part of online services before being able to notify the grant of any new options. It is important to allow sufficient time to sort out the registration of the scheme before the 92-day time limit is reached to avoid losing the EMI tax benefits. The notification will also confirm that EMI option holders meet the working time requirement.

For every option granted there must be a written agreement between the company and the employee, including:

- o the date of the grant and that the options are granted under the provisions of the EMI
- o the number, or maximum number, of shares under the EMI option
- o when and how the option is to be exercised

What are the reporting requirements?

Neither the initial grant nor the exercise of the options (so long as they remain qualifying options) will need to be reported by the employee.

Any capital gain on the sale of the shares acquired through exercise of the option will need to be recorded on the employee's self-assessment tax return in the normal manner.

As long as the options were not issued at a discount and the options meet the qualifying conditions throughout the period, there should be no income tax or NI issues for the company.

An annual return must be submitted by the employer within three months of the end of the tax year (even if no further options were granted or options exercised during the year), i.e. the annual return must be submitted online by 6 July. Any amendments to the scheme must also be reported and a failure to declare changes could result in the scheme being disqualified.

This factsheet has been carefully prepared, but it has been written in general terms and should be seen as broad guidance only. The factsheet cannot be relied upon to cover specific situations and you should not act upon the information contained therein without obtaining specific professional advice.