Share Options: Enterprise Management Incentive (EMI)

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What are 'EMI' Options?

Share options have been around for a very long time in 'unapproved' forms. They give the employee the right to buy shares in the future but at an exercise price determined at the date the option is granted. From a tax perspective, when an employee exercises an unapproved option (i.e buys the shares), the difference between the exercise price and the market value of the shares at the date of exercise is subject to income tax and typically employee and employer NICs. So if an employee was granted unapproved options over 10,000 shares with an exercise price of £1 per share, and the market value of the shares at the date of exercise is £10 per share, the notional gain of £90,000 will be subject to income tax and employee and employer NICs regardless of whether or not the shares are then sold. For the additional rate taxpayer, the employee would pay £42,300 in income tax and NIC, and the company would pay £12,480 employer NIC. Following on from that, the employer company would then be entitled to claim relief against corporation tax on the tax paid. Assuming the shares were then sold at £10 per share, no CGT will be payable as the base cost for CGT tax purposes will be deemed to be £10 per share.

EMI was introduced in 2000 to assist qualifying independent companies with gross assets of less than £30m and fewer than 250 full-time employees in attracting and retaining key employees, and to incentivise those employees for taking the risk to work for such companies. It did this by removing the tax charges mentioned above and therefore differentiating EMI from unapproved options.

The EMI allows a qualifying company to grant options over shares with a value of up to £250,000 per employee (up to a maximum of £3 million per company) on very flexible terms but at the same time allows the employee an exemption from income tax and NICs on any gain provided the exercise price is not set at a discount to the market value as it was at the date of grant of the option. In addition, the company is exempted from employer NICs on such gains.

The only tax payable is on the date of sale of the shares where an employee will pay capital gains tax on the difference between the exercise price and the sale value of the shares at the automatic rate of 10% (after deduction of his annual exempt allowance) provided the shares are sold at least 12 months after the date of grant of the EMI option.

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Using the example mentioned above, under EMI the employee's tax bill will be reduced from £42,300 to £0, the company's employer NIC bill will be reduced from £12,480 to £0, and the CGT payable by the employee will be increased from £0 to £9,000.

From the company's perspective, relief against corporation tax is still permitted on the amount which would otherwise have been subject to income tax had the option not been an exempt EMI option. There is therefore no downside for the company and every possible upside for the employee.

What companies qualify for EMI?

- The gross assets of the company (or the group of companies if a parent company) must not exceed £30 million. Gross assets broadly comprise all assets shown in the balance sheet.
- The company must have fewer than 250 employees.
- The company must be independent and not under the control of any other company. Shares in a subsidiary cannot be used in an EMI option, i.e. the shares must be in the parent company.
- Companies may be quoted or unquoted.
- There is no requirement that the company be resident or incorporated in the UK but the company must have a 'permanent establishment' in the UK. Group companies can offer EMI share option schemes to employees throughout the group, provided that all of the subsidiaries in the group are qualifying subsidiaries. Broadly, this means that the parent (or another subsidiary) must own at least 51 per cent of the share capital and fully control that subsidiary.
- Certain trades are excluded from the EMI. Excluded trades include leasing, financial activities and property development. For a group, the activities of all group companies will be treated as a single business.

What employees qualify?

To qualify, employees must:

- Work for the company (or, if relevant, any group company) for at least 25 hours a week or for at least 75 per cent of their paid working time (which in cludes time spent in self-employed work);
- Not have a 'material interest' in the company i.e. more than 30 per cent of that company.

The EMI allows a qualifying company to grant options over shares with a value of up to £250,000 per employee (up to a maximum of £3 million per company) on very flexible terms.

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Are there any restrictions on the grant of options?

Each employee can only hold a maximum of unexercised options worth £250,000 in any 3-year period under the EMI. Any further options granted to an employee over and above this sum would not qualify for EMI relief.

Companies are free to set their own option period, but options must only be capable of exercise within 10 years of being granted and be exercised within that period. After 10 years the tax benefits of EMI will no longer apply to the exercise of any outstanding options.

Companies are also free to set the option price, which may be more or less than the market value of the shares on the date the option is granted. The shares over which options are granted must be fully paid up ordinary shares.

It is not possible to grant an EMI option over redeemable or convertible shares.

Does HMRC supervise the operation of the EMI?

There is no need for prior approval of EMI share option schemes from HMRC – the company must simply notify HMRC online within 92 days once an option has been granted. A company can, however, seek advance informal assurance from HMRC that it is a qualifying company.

A valuation of shares in connection with the EMI will need to be agreed with HMRC. This is important – it means that the market value of the shares is agreed by HMRC as at the date of the granting of the options and avoids any arguments when the employee eventually sells the shares on an exit.

Companies who grant EMI options will need to make an online annual return to HMRC by 7 July each year.

What other requirements are there?

The employee must be prohibited under the terms of the grant of the option from transferring any of his rights under the option. If the option is capable of being exercised after the employee's death, it must not be capable of being exercised more than one year after his death. There are provisions in the legislation for dealing with the EMI options if the company that granted them is the target of a successful take-over. In certain circumstances the holder of the option can agree with the acquiring company to surrender his option in return for a replacement option to acquire shares in the acquiring company.

Can the tax advantages be lost?

If at any time prior to the exercise of an option a 'disqualifying event' occurs then, on a subsequent exercise of the option, an employee will be subject to income tax in the usual way as on the exercise of an unapproved share option. However, the gain will be calculated by reference to the market value of the shares on the date of the disqualifying event. Examples of disqualifying events include:

- The employee ceasing to be a qualifying employee
- The company ceasing to be a qualifying company

We hope you found this useful, but if you would like further information about EMI Share Options please contact Share Plan Partners for a FREE consultation.

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