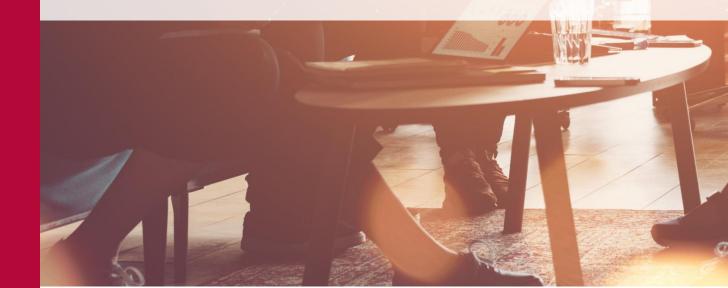


EMI share options

An introduction



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Share options granted under the Enterprise Management Incentive Scheme (usually referred to as EMI options) are a popular choice for SME and start-up companies who want to reward and incentivise employees in alternative ways to simply paying them more amounts of cash.

EMI share options are an HM Revenue & Customs approved share option arrangement, offering tax advantages without using aggressive tax planning.

It's a share option scheme

Under an EMI scheme, employees are granted options enabling them to acquire shares in their employer company (or its holding company) at some pre-arranged point in the future, rather than being issued with shares straight away. The point at which the option holders can exercise their options may be agreed as a future exit event, such as a sale or listing of the company, but EMI options can allow flexibility in deciding when the options can be exercised and the shares acquired.

Which companies can use EMI options?

The EMI scheme is aimed at companies in the start-up and SME sector, and so has various limits and qualifying conditions as to which companies can use them. These include the following:

- the company must have fewer than 250 employees (full time or part time equivalent) at the date of grant of the options;
- it must have less than £30 million of gross assets, again at the date of grant of the options;
- it must be a trading company (or the holding company of a trading group), and not carry on to a substantial extent one or more "excluded activities"; and
- it must not be a 50%+ subsidiary of, or under the control of, another company.

If the company has any subsidiaries, then some of the qualifying conditions (including those referred to above on numbers of employees and gross assets) will need to be applied to the group overall.

*The legislation sets out a list of trading activities which it calls "excluded activities". Before proceeding with setting up an EMI scheme, the company should take advice on whether its business falls within one or more of these excluded activities. We can provide further advice if required, but please note that this includes among others banking and certain financial activities, property development, dealing in land, and providing insurance.

These are just some of the qualifying conditions which a company should check that it satisfies, before going ahead with setting up an EMI scheme.

Which individuals can be granted EMI options?

Again, there are conditions set out in the legislation as to whether individuals can or cannot qualify for EMI options. These include the following, which are just some of the relevant qualifying conditions:

• the option holder must be a full-time employee of the company (or one of its subsidiaries if there is a group of companies involved) - full-time in this context means 25 hours a week, or (if less) at least 75% of the option holder's working time;

- the employee option holder must not have more than a 30% shareholding in the company granting the options (including any shares held by the option holder's "associates"); and
- an option holder cannot hold unexercised EMI Options over shares which are worth more than £250,000, using the market value applicable at the time the EMI options are granted.

What are the tax advantages of EMI options?

The main tax issues in using EMI options are as follows:1

- no income tax or Class 1 National Insurance Contributions on grant of the options;
- when the option holder exercises his/her EMI options and acquires the option shares, there will be no income
 tax or Class 1 National Insurance contributions provided that the exercise price paid to acquire the shares
 under option is not less than the market value of those shares, as at the date of grant of the options, and
 that there has not be any "disqualifying event" in the meantime;
- when the option holder goes on to sell his/her EMI option shares, he/she would be subject to capital gains tax (CGT) in the usual way on any chargeable gain in relation to the sale of those shares, subject to any reliefs or exemptions which he/she may qualify for from capital gains tax. N.B: business asset disposal relief (previously known as entrepreneurs' relief) from CGT can potentially apply to shares acquired under a qualifying EMI option, even if the employee has less than a 5% shareholding in the company (but subject to meeting all the other qualifying conditions for business asset disposal relief); and
- the company may be able to obtain some corporation tax relief on the exercise of the EMI options.

Broadly speaking, the tax efficiency for EMI options is that the growth in value of the option shares, from the date of grant to the exercise of the option, can be subject to CGT rather than income tax and Class 1 National Insurance. So while rates of CGT remain materially lower than income tax rates for individuals, there can be considerable tax benefits in using EMI options as a way of rewarding management or other key employees of the company.

Dealing with HM Revenue & Customs ("HMRC")

The company can apply to HMRC for advance assurance that it meets the EMI qualifying conditions for companies, although often a company chooses not to do this unless it has a particular concern on one or more of the qualifying conditions. It's not a requirement of the EMI scheme that the company has to get advance assurance from HMRC.

We would, however, recommend that the company agrees a share valuation with HMRC in advance of granting EMI options, to give both the company and the option holder some comfort on the tax position.

Going forwards following the grant of EMI options

The company must notify HMRC online of the grant of the EMI options within 92 days of the date of grant, and will have certain ongoing annual reporting obligations in relation to the EMI options as well.

The legislation sets out various disqualifying events which can result in the EMI status of the options, and the related tax advantages, being withdrawn in whole or in part before the options are exercised. The employer company should check with its advisors what these disqualifying events are and monitor the position going forwards between grant and exercise of the EMI options.

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¹ Please note this is not intended to be specific advice for any particular employee or company, or an exhaustive list of all the tax issues which may be involved, and we would recommend that an option holder and the company granting the options take advice on the tax treatment of the EMI options in their specific circumstances.

If you would like to speak to us regarding any aspects of EMI options, you can contact a member of the team as follows:



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