

# Enterprise Management Incentives

Enterprise Management Incentives (EMIs) are approved share options which are available for many smaller trading companies. There are significant tax advantages in granting share options as EMIs. EMIs are much more flexible than other tax favoured share schemes.

## Main features of EMI Options

- EMI options can only be granted by companies with gross assets of £30million or less and which meet various statutory conditions. A company can obtain advance assurance from HM Revenue & Customs (HMRC) that it qualifies.
- EMI options may be granted to employees who work for 25 hours a week or, if part-time, work 75% of their working time.
- The maximum value of shares that can be granted to a single employee is £120,000 and on aggregate to all employees is £3 million (both determined at the date of grant).
- Optionholders will not be subject to income tax or national insurance contributions (NICs) on grant.
- Optionholders will generally not be subject to income tax or NICs on exercise except:
  - (1) if EMI options are granted at a discount to market value at grant, optionholders will be liable to income tax and possibly NICs on the discount (or the difference between market value on exercise and the exercise price if less); and
  - (2) there may be a charge to income tax and possibly NICs if there is a disqualifying event and the statutory conditions are no longer met before the EMI option is exercised.
- When the underlying shares are sold, there will be a charge to capital gains tax (CGT) on the difference between the sale price of the shares and the price paid for them. If income tax was payable on exercise, the amount charged to income tax will reduce the gain chargeable to CGT. From 6 April

2008, the maximum rate of CGT is 18%, although entrepreneurs' relief may be available to reduce this to 10%.

- Provided conditions are met, a corporation tax deduction should be available to the employing company in the period in which the employee realises a gain.
- EMI options can be subject to performance and/or time conditions.

## Qualifying companies

EMI relief is potentially available to both quoted and unquoted companies with gross assets of £30million or less. In a group, the gross assets test is applied to the group (excluding certain intra group transactions).

The company must also carry on a qualifying trade or be preparing to. Examples of trades which do not qualify include leasing, farming, financial activities and property development. The trading activities of the company must be carried on wholly or mainly in the UK. In a group, EMI share options can be granted over shares in the parent company provided that at least one of the trading subsidiaries carries on a qualifying trade wholly or mainly in the UK and the group's trading activities as a whole do not consist to any substantial extent in carrying on non-qualifying trades.

The company must also be independent – i.e. not under the control of another company (whether on its own or together with other persons). Companies with private

equity/ venture capital funding need to be careful of the detailed rules relating to independence.

### **Qualifying shares**

EMI options must be granted over ordinary shares that are fully paid and not redeemable. The shares themselves can, however, be subject to restrictions, including the normal types of restrictions one would expect to see in private companies.

### **Eligible employees**

EMI Options can only be granted to employees who are required to work for the company (or group) for at least 25 hours a week, or, if less, at least 75 per cent of their working time. Employees who have a 'material interest' of more than 30 per cent of the share capital before the EMI Options are granted are excluded from participation. Directors are also eligible to participate but non-executive directors cannot participate.

### **Employee taxation**

The tax benefits available are very generous. There is no charge to income tax or NICs on grant. If the EMI Option is granted at a discount there will be income tax and potentially NICs payable at exercise on the amount of the original discount or the difference between the market value on exercise and the exercise price if less. It is possible for the employer to transfer its NIC liability to employees.

On sale of the underlying shares, there will be a charge to CGT. From 6 April 2008, the maximum rate of CGT is 18%, although entrepreneurs' relief may be available to reduce this to 10%.

Where the company or individual do not meet the qualifying criteria throughout the life of the option prior to exercise, income tax is payable on the gain during the non-qualifying period. This is because there is a so-called "disqualifying event" which will trigger a short time limit for action to protect the tax benefits.

Disqualifying events include:

- the company coming under the control of another company,

- the company ceasing to meet the trading activities test,
- the employee ceasing to be an eligible employee,
- a variation in the terms of the option,
- a non-commercial alteration to the share capital of the company that increases the value of the shares under option.

If there is a disqualifying event the option must be exercised within 40 days of that event to ensure the full income tax and NIC benefits are maintained.

It is essential that companies and option holders keep EMI arrangements under review to determine if there are any potential disqualifying events.

### **Administration**

Although EMI plans are not approved in advance by HMRC, the options must be reported within 92 days of grant. The employing company and the employee must sign a notification of grant.

Annual reporting is also required.

The market value of shares in unlisted companies (including AIM companies) should be agreed in advance with HMRC Shares and Assets Valuation.

### **How can we help?**

We can help with all aspects of the design and implementation of your EMI options, including participation policy, performance measures, communication and ongoing compliance requirements.

If you would like more information about EMI share options or if you have any other issues in relation to employee incentive arrangements please contact Bryan Rickman on 01273 808182 or [br@dermotscully.com](mailto:br@dermotscully.com).

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Whilst every care and attention has been taken to ensure the accuracy of this information, it is intended for general guidance only. It is assumed for all purposes in this flyer that optionholders are UK tax resident and ordinarily tax resident at all relevant times. NICs will apply where the shares are deemed to be "readily convertible assets". Please call us if you would like specific advice on any matter.