



HRC Law's Brief Guide to Enterprise Management Incentive (EMI) Option Schemes

This guide highlights some of the more important elements associated with EMI option schemes.

It is not an exhaustive guidance note, nor does it constitute legal advice, on EMI option schemes; rather is intended to outline the more usual provisions only. Parties wishing to establish an EMI option scheme should seek specific advice on their own circumstances. Should you require such advice, William Ngan at HRC Law would be happy to assist further. William can be contacted on T: 0161 358 0182 or at E: williamngan@hrclaw.co.uk.

What is an EMI option scheme and why are they used?

An EMI option scheme is a tax advantaged share option scheme approved by HM Revenue and Customs (**HMRC**).

It is a form of employee incentive and share option whereby an employee is granted the right to acquire a certain maximum number of shares in the company.

EMI schemes are designed to help small, higher risk companies to recruit and retain employees who have the skills to help them grow and succeed.

Individuals who participate in the EMI option scheme do not need to have cash resources available to purchase the shares at the time when the EMI option is granted. The cash cost only arises when the option is exercised, generally being the date on which the shares are purchased.

EMI options have become a popular choice with both employees and employers because of the favourable tax treatment that they receive, as explained below.

What are the requirements which a company must satisfy to qualify?

To qualify to grant EMI options:

- the company must be an independent trading company in the UK (i.e. the company must not be a 51% subsidiary of another company);
- all of the company's subsidiaries must qualify (i.e. the company must hold 50% of the share capital of each subsidiary);
- the value of the gross assets must not exceed £30 million (as shown in the company's balance sheet (at the date of the grant of the options));

- the number of full time employees of the company (including those employed by the qualifying subsidiaries) must be less than 250 (at the date of the grant of the options);
- the company must be carrying out a commercial trade; and
- the company must be permanently established in the UK.

The company can seek advance clearance from HMRC that it meets the requirements. This may be helpful if the company is uncertain that it meets all the requirements.

Who can be granted an option?

To be eligible to be granted an EMI option, an employee must work for the company for at least 25 hours per week (or at least 75% of his or her working time).

EMI options over shares worth up to £250,000 (**Individual Limit**) at the time of grant can be granted to employees in the company. There is no limit on the number of employees that can hold EMI options, subject to the cap that the total value of shares under EMI options cannot exceed £3m (**Total Limit**).

EMI options cannot be granted to non-executive directors or consultants. In addition, an employee will not be eligible if he or she has a material interest in the company, i.e. he or she has beneficial ownership or control of more than 30% of the shares in the company.

How do I determine the exercise price and the value of the shares?

The exercise price for the shares can be set at any level; however, it is usual for the exercise price to be the market value.

It is strongly advisable to agree the market value of the shares with HMRC in advance. Although this is not a requirement, the valuation determines the tax treatment at exercise, as well as determining whether the Individual Limit or the Total Limit have been exceeded. Agreeing the value of the shares at the time of grant therefore gives greater certainty.

Setting an exercise price which is lower than market value can have consequences for the tax treatment of EMI options. The company should seek independent tax advice in this regard.

What are the tax implications of an EMI option?

Subject to the EMI options being granted at the market value of the shares at the date of grant, there will normally be no charge to income tax on grant of the option, nor will there be any charge to income tax or National Insurance when the EMI options are exercised.

The company will qualify for corporation tax relief on the practical costs of setting up an EMI option scheme and should also qualify for a corporation tax deduction for the notional cost of providing the shares to an employee when he or she exercises the EMI options.

When shares acquired on exercise of the EMI options are disposed of, any gain will be subject to capital gains tax. The current higher rate of capital gains tax is 20% which is charged on the

amount of the gain. In most cases the gain will be the difference between the exercise price for the shares and the proceeds of sale.

Entrepreneurs' relief may be available to an individual disposing of their shares following exercise of their EMI option to reduce the capital gains tax charge from 20% to 10%.

In order to qualify for entrepreneurs' relief, the individual needs to be a director or employee of the company for at least 12 months prior to the exercise of the EMI option and to have held the EMI option for at least 12 months.

When can the EMI option be exercised?

To qualify as an EMI option and to benefit from the favourable tax treatment, the option must be capable of being exercised within 10 years from the date of grant. Other than this, there are no restrictions.

This flexibility means that EMI schemes are frequently used in an "exit-only" arrangement (such as a sale of the company).

However, this need not be the case. It is possible to stipulate further conditions, whether or not linked to a sale. Given that the overarching intention of using such schemes is to recruit and retain key employees, other common conditions include:

- performance criteria for the company and/or employee; or
- remaining in employment past a certain date.

Are there any other issues to consider?

There are certain further specific issues which you may wish to consider, but general ones include the following:

- in the event of death, the EMI option would ordinarily lapse without any right to compensation;
- the EMI option is personal to the individual concerned, and, as such, is not ordinarily assignable or transferable;
- in the event that the individual ceases to be employed by the company, the EMI option would ordinarily lapse without any right to compensation.

How we can help you

William Ngan, Associate at HRC Law, is a corporate tax solicitor with extensive experience on EMI schemes, having helped companies of different sizes to implement them for the last 10 years. William can be contacted on T: 0161 358 0182 or at E: williamngan@hrclaw.co.uk. He'd be happy to chat to you about your requirements.