Enterprise Management Incentives: UK Shares scheme

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for UK based small and medium-sized enterprises (SMEs), the most popular of the tax advantaged arrangements is EMI options. These are available to most UK trading companies or groups of companies with gross assets of not more than £30 million and less than 250 full-time equivalent employees. Some trading activities, such as banking and property development, prevent a company from participating. The maximum value of all unexercised options per company/group cannot exceed £3 million and the maximum value of unexercised options held by an individual cannot exceed £250,000. This guide will provide you with all the information about this relevant UK share scheme

A UK employer can offer to an employee company shares and both can have related tax advantages.

Tax advantages only apply if the shares are offered through the following schemes:

1. Share Incentive Plans
2. Save As You Earn (SAYE)
3. Company Share Option Plans
4. Enterprise Management Incentives (EMIs)

This guide will provide you with relevant details about the EMI scheme.

The Enterprise Management Incentive (EMI) is a tax-advantaged share option scheme designed for smaller companies. A company may grant options to selected employees to allow them to acquire its shares over a prescribed period and provided that certain qualifying conditions are met.

The opportunities and the requirements

Many companies have either set up EMI schemes or are now doing so.

This factsheet provides an overview of the scheme's benefits and conditions. As with most tax legislation, the rules are detailed and it is important to obtain professional advice.

Key features:

• A qualifying company may grant qualifying options over its shares to an unlimited number of eligible employees subject to an overall limit of £3 million at any one time.

• Each eligible employee may hold options worth up to £250,000 (valued at the date of grant of the option).

• The option must be granted for genuine commercial reasons in order to recruit or retain employees in a company, and not to avoid tax.

• If a company is part of a group only the parent company may grant EMI options.

Tax relief for employer company

Where a company grants an EMI option then, in most circumstances, on the exercise of that option by the employee, the company will be entitled to a corporation tax deduction equal to the market value of the option shares exercised, less any payment made by the employee to the company.

Tax relief for employee

When the option is granted, no Income Tax, PAYE or NIC liability arises, even if the option is granted at a discount to the current market value.

There will be no Income Tax, PAYE or NIC liability when the option is exercised, unless the option was originally granted at a discount. In such cases there will be an Income Tax and possible NIC liability based on the initial discount.

For qualifying EMI options exercised after 5 April 2012, there is no need to hold 5% or more of the company's shares and voting rights and the 12 month holding requirement starts on the date the option is granted rather than the date of exercise when deciding if Entrepreneurs' Relief is available.

If Entrepreneurs' Relief is available then the rate of CGT will only be 10% on the first £10m of gains (including any other gains qualifying for Entrepreneurs' Relief) rather than, potentially, CGT at 20%.

Qualifying company

The gross assets of the company must not exceed £30 million on the date the option is granted. If it is part of a group the entire group assets are taken into account.

The company (or group as appropriate) must have less than 250 employees when the option is granted. The company may be quoted or unquoted, but it must not be under the control of another company. It must be a trading company or the holding company of a qualifying trading group.

Most trades qualify, but some (including leasing, financial activities and property development) are excluded, unless they are incidental to the main areas of activity.

Eligible employees

The option holder must be employed by the company or a qualifying subsidiary, and cannot control more than 30% of its ordinary share capital. Shares under option (other than EMI options) count towards this limit. Individuals must be employed by the company or group for at least 25 hours per week or, if less, 75 per cent of their working time.

An employee can hold EMI options alongside HM Revenue & Customs-approved SAYE options but only alongside a Company Share Option Plan (CSOP) option in certain circumstances (see Disqualification from EMI regime below).

Options qualifying for EMI

The option must be capable of exercise within 10 years of grant and, in fact, be exercised within 10 years of grant.

• Options can be issued at a premium, market value, discounted or nil cost. However, on exercise, discounted or nil cost options will be subject to Income Tax and, possibly, NIC on the difference between the exercise price and market value at grant.

• Options must be granted over fully paid-up ordinary shares – not redeemable shares.

• It is possible to impose conditions and limits on the shares (they can be non-voting and/or conditional shares, for example) but any conditions must not be taken into account when valuing them.

• EMI relief is available on shares worth up to £250,000 (per individual) at the date of grant. Additional optioned shares will not render the shares under the limit ineligible, but will not themselves benefit from the EMI tax reliefs.

• Employees who have been granted the maximum £250,000 of EMI options cannot receive further EMI options for three years after the last grant, even if options have subsequently been exercised to bring them below that limit.

Disqualification from an EMI regime

A variety of events would make the option non qualifying. These include:

• The Company ceases to carry on a qualifying trade.

• The Company grants an employee an approved CSOP option resulting in that individual holding EMI and CSOP options valued in excess of £250,000.

• The employee ceases to be employed by the company or to contribute the required amount of time to the company.

• Any alteration is made to the terms of the option which is not made for commercial reasons or the purpose of which is to increase the market value of the optioned shares and which is not made for commercial reasons.

• Any alteration in the share capital of the company which affects the value of the optioned shares and which is not made for commercial reasons.

• The conversion of any of the option shares into shares of a different class, except in certain limited circumstances.

• The Company becomes a subsidiary of another company or comes under its control.

Administration

Each grant must take the form of a written agreement between the employee and the person granting the option.

The company must notify HMRC within 92 days after the grant is made. It is not necessary to obtain prior approval, but the Revenue have up to 12 months to ensure that the grant satisfies the rules. Any share valuation can be agreed with HMRC's Share Valuation Office.

Within three months of the end of each tax year the company must make an Annual Return to HMRC.

Frequently asked questions

Employers

Do I need to agree a value of the Company Shares with HMRC?

If you are a quoted company, HMRC will accept the mid-market price of the shares on the date of grant. If you are an unquoted company the share valuation can be agreed with HMRC.

Do I need a new valuation each time I wish to grant options?

A value agreed with HMRC is valid for 60 days. After that period a new application must be made although this does not necessarily mean a different value will need to be agreed.

When else might I need a valuation?

If a disqualifying event occurs, it will be necessary to agree a valuation at that date so that the gain up to that date can be determined.

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Can an investment company issue EMI shares?

No. The company must be a trading company or the parent of a trading group.

What trades are excluded?

A variety of trades are disallowed, most commonly:

- Dealing in land, commodities, shares or securities
- Banking, insurance, debt factoring and hire purchase
- Leasing or receiving royalties (subject to certain exceptions)
- Provision of legal or accounting services
- Property development

Employees

Do I need to work for the company issuing the shares?

No. If the company issuing the shares is the parent company of a group, you can work for any group company.

Can I exercise my options whenever I like?

This will depend on the Option Agreement. Conditions can be included such as a certain length of service being attained or profit targets reached.

What happens if the company is taken over?

You will normally be able to exercise your options at that time, if you wish. Alternatively, you may be able to exchange your options for new EMI options in the acquiring company.

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