



# Enterprise Management Incentives (EMI)

## Background and structure

EMI options are one of the most tax efficient share option arrangements worldwide, providing for the grant of options over shares with a value, at grant, of up to £250,000. Designed as an incentive for smaller companies (being those with gross assets not exceeding £30m and fewer than 250 full time-employees), EMI options have proved to be both a flexible and effective form of incentivisation.

Unlike other HMRC approved option schemes, there are few constraints on structure and provided that the EMI options are granted with a market value exercise price, no tax liabilities should arise on the exercise of the EMI options and the recipient should only be taxed at 10% when he or she sells the shares acquired on exercise.

Companies and their employees can only utilise EMI options if they satisfy certain qualifying conditions. Qualification is a self-certification process.

## Qualification

In the main, a company will qualify to grant EMI options provided that it:

- is a trading company or is the holding company of a trading group and doesn't operate in farming, property development, legal or accountancy services, the hotel trade, leasing, banking or investments;
- owns gross assets of less than £30 million;
- is a single or parent company and is independent (ie not the subsidiary of, or controlled by, another company). A company is treated as independent for EMI purposes if the company is owned by an employee ownership trust;
- has a permanent establishment in the UK; and
- has fewer than 250 full-time equivalent employees.

Employees will qualify to receive the grant of an EMI option if they spend at least 25 hours a week, or if part-time, 75% of all their working time, on the business of the company or group of companies. An employee must give a written declaration to the company granting the EMI option confirming that those requirements are satisfied.

## How do EMI options work?

EMI options operate by the company granting the employee a share option (being a right to buy shares in the company in the future at a specified exercise price). It is common for the exercise price to be equal to the market value of the shares (as agreed with HMRC) at the date of grant of the EMI option. The company must notify the grant of EMI options to HMRC on or before 6 July following the tax year of grant of the EMI options.

The employee has no initial outlay when the EMI option is granted and, subject to the terms of the EMI option, can exercise the option (and acquire the underlying shares) if and when they choose. EMI

option arrangements are often exit based, so that the employee only has a right to exercise the EMI option and become a shareholder immediately prior to a sale of the company (meaning that EMI arrangements can be simple to operate from an administrative and corporate finance perspective).

Typically, leaver provisions will apply to the EMI options with the result that an employee's EMI option will lapse if they leave employment (there may be differentiation for good leavers to allow them to exercise early, or retain, part, or all, of their option).

## Example

The example below shows how an EMI option can work:

Company A grants an EMI option to Employee Z over 500 shares. It is agreed with HMRC that the market value of the shares is £2 per share and that amount is used as the option exercise price. The terms of the option allow it to be exercised at any time.

Four years later, Company A is sold and Employee Z exercises the EMI option, acquires the underlying shares, and, together with the other shareholders, sells shares to the buyer. The shares are sold for £200 each.

Overall, Employee Z's return is £99,000.

That return is taxable to capital gains tax so Employee Z is liable to pay capital gains tax at 24%. However, because the shares were acquired through the exercise of an EMI option and there was more than two years between the grant of the option and the sale of the shares, Employee Z qualifies for business asset disposal relief and therefore pays capital gains tax at a rate of 10%.

Company A has no tax to pay. In fact, Company A is legally entitled to deduct the option gain of £99,000 from its profit to materially reduce its corporation tax bill.

As a result, the employee receives £99,000 in cash and pays tax to HMRC of £9,900 (ignoring the CGT annual allowance). The Company can claim (as of right) a corporation tax saving of around £24,750 (on the basis that the 25% corporation tax rate applies).

## Contact TLT

If you would like more information on EMI options or any other type of incentive arrangement, please contact a member of the team:



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