



Enterprise Management Incentive Schemes (“EMI”)



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Enterprise Management Incentive Schemes (“EMI”)

1. What is the “EMI”?

The Enterprise Management Incentives Scheme (the “EMI”) was introduced in the Finance Act 2000. It aims to assist small high-risk trading companies in attracting and retaining key employees and to reward those employees for taking the risk to work for such companies.

The EMI allows a qualifying company to grant options over shares with a value of up to £120,000 per employee (up to a maximum of £3million) on very flexible terms. The EMI offers favourable tax treatment making it attractive to both companies and employees.

2. What companies qualify?

Broadly, the EMI is aimed at companies which satisfy conditions similar to those under the Enterprise Investment Scheme (EIS) and the Venture Capital Trusts (VCT) scheme:

- The gross assets of the company (or the group of companies if a parent company) must not exceed £30million. Gross assets broadly comprise all assets shown in the balance sheet when drawn up in accordance with standard accounting practice.
- The company must have fewer than 250 employees.
- The company must be independent and not under the control of any other company. Control for these purposes is defined as the ability of a person to secure that a company acts according to his wishes, whether through share ownership or provisions in the Articles of Association of that company. Shares in a subsidiary cannot be used in an EMI option.
- Companies may be quoted or unquoted.
- There is no requirement that the company be resident or incorporated in the UK but the company’s trading activities must be carried out wholly or mainly in the UK.

- Group companies can offer the EMI to employees of both the parent and the subsidiary companies, provided that all of the subsidiaries in the group are qualifying subsidiaries. Broadly, this means that the parent (or another subsidiary) must own at least 75 per cent of the share capital and that no other person or entity should control (as defined above) that subsidiary.
- Certain trades are excluded from the EMI. Excluded trades include leasing, financial activities and property development and from the date of Royal Assent of the Finance Bill 2008, shipbuilding, steel and coal producing companies. For a group, the activities of all group companies will be treated as a single business. Any excluded trade which is merely incidental to the trade carried on by the company or the group of companies will be disregarded.

3. What employees qualify?

To qualify, employees must:

- work for the company (or, if relevant, any group company) for at least 25 hours a week or for at least 75 per cent of their working time (which includes time spent in self-employed work);
- not have a “material interest” in the company (or, if relevant, any group company) (defined very widely by reference to a holding of more than 30 per cent of that company).

Employees may hold options over shares under a savings-related share option scheme and under a Company Share Option Plan (CSOP) in addition to EMI options. However, CSOP options are taken into account in determining the limit of £120,000 per employee.

4. Are there any restrictions on the grant of options?

Each employee can only hold a maximum of unexercised options worth £120,000 in any 3 year period under the

EMI. Any further options granted to an employee over and above this sum would not qualify for EMI relief. The 3 year period will begin to run from the date of the grant of the last option that took the total held to £120,000.

Companies are free to set their own option period, but options must only be capable of exercise within 10 years of being granted and be exercised within that period. After 10 years have elapsed the tax benefits of EMI no longer apply to the exercise of any outstanding options.

Companies are also free to set the option price which may be more or less than the market value of the shares on the date the option is granted.

The shares over which options are granted must be fully paid up ordinary shares. It is not possible to grant an EMI option over redeemable or convertible shares.

5. How is the EMI operated?

A separate agreement will be required in respect of each option granted to an employee. This enables the company to tailor each grant of an option to the particular employee.

6. Does HM Revenue & Customs supervise the operation of the EMI?

There is no need for prior approval of the EMI from HM Revenue & Customs - the company must simply notify HM Revenue & Customs within 92 days once an option has been granted.

A company can seek advance informal assurance from HM Revenue & Customs that it is a qualifying company.

HM Revenue & Customs has a period of 12 months from the expiry of the 92 day notification period in which to check whether the grant is within the EMI rules. The company will have a right of appeal against any HM Revenue & Customs decision that this is not the case.

HM Revenue & Customs has a power to require the company to provide it with information to enable it to carry out an investigation into the grant of options.

Any valuation of shares in connection with the EMI will need to be agreed with the Shares Valuation Division of HM Revenue & Customs. It is intended that this process will be streamlined as much as possible.

Companies who grant EMI options will need to make a return to HM Revenue & Customs within three months of the end of each tax year

7. What other requirements are there?

The employee must be prohibited under the terms of the grant of the option from transferring any of his rights under the option.

If the option is capable of being exercised after the employee's death, it must not be capable of being exercised more than one year after his death.

There are provisions in the legislation for dealing with the EMI options if the company which granted them is the target of a successful take-over. In certain circumstances the holder of the option can agree with the acquiring company to surrender his option in return for a replacement option to acquire shares in the acquiring company.

8. What are the tax advantages of EMI options?

No income tax or national insurance contributions (NICs) are payable on the grant of an EMI option.

Where the option price is equal or greater than the market value of shares on the date that the option is granted, then no income tax or NICs (including employer's NICs, currently at 13.8 per cent) are payable on the exercise of the option.

Companies may set the option price at a discount (or even at nil). However, where this is the case then, on exercise of the option, income tax will be payable on the discount (the excess of the market price of the shares on the date the option is granted over the exercise price paid by the employee). Where the shares can be readily converted into cash when the option is exercised, any such income tax must be accounted for under PAYE and NICs (employer and employee) will also be payable on the taxable amounts.

When shares obtained on exercise are eventually sold the employee will be liable for capital gains tax (CGT).

This means that an EMI-compliant option exercised will give rise to no income tax charge and capital gains tax of either 18% or 28% (depending upon total amount of taxable income) on the gain to the employee. In addition the annual CGT exemption (currently £10,600) will be available.

The costs of setting up and administering the EMI will be deductible expenses for the company when calculating its profits for the purposes of corporation tax.

9. Can the tax advantages be lost?

If at any time prior to the exercise of an option a "disqualifying event" occurs then, on a subsequent exercise of the option, an employee will be subject to income tax in the usual way as on the exercise of an unapproved share option. However, the gain will be calculated by reference to the market value of the shares on the date of the disqualifying event. Examples of disqualifying events include:

- the employee ceasing to be a qualifying employee;
- the company ceasing to be a qualifying company.

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November 2011

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