Enterprise Management Incentive Scheme

BUSINESS TAX GUIDE

October 2015

OVERVIEW

The Enterprise Management Incentive ('EMI') Scheme allows an employer to issue share options to employees in a tax efficient manner as a method of attracting, incentivising, and retaining high calibre staff. The EMI Scheme is flexible, and options can be offered to employees on a selective basis and the option vesting conditions tailored to the desired business objectives.

The scheme is targeted at small and higher risk trading companies, and there are a number of conditions that the company and employees must fulfil to qualify, including the size of the company and the nature of its trade.

There is no income tax liability on the grant of the options, and the capital gains tax on the sale of the shares can be as low as 10%.

What is EMI?

The EMI Scheme is an HM Revenue and Customs ('HMRC') approved share option plan designed to encourage employees to own shares in their employer company and participate in its future growth. At any time the employee can hold options over shares to the value of £250,000 at the date of grant, and the total value of unexercised options that a company can issue is £3m.

Why use EMI?

Employees enjoy the opportunity to participate in the growth of the company which can have a positive impact on their motivation. They also value the tax efficient nature of the EMI Scheme.

There are a number of tax benefits of implementing the EMI Scheme including:

- The employee can acquire shares in the company without incurring an income tax liability;
- The employee can participate in the increase in value of the shares at capital gains tax rates which could be as low as 10%; and
- There may be no national insurance liability ('NIC') on grant or exercise of the options.

Income Tax and NIC Position of the Employee

No liability to income tax or NIC will arise on the grant of the option.

Where the exercise price is equal to (or greater than) the market value of the shares at the date of grant, no income tax or NIC charge will arise on the exercise of the option if exercised in an approved manner.

Where the option has been granted at a discount to the market value at the date of grant, the income tax and NIC charge (where applicable) on the exercise is based on this discounted amount less the exercise price and any amounts paid by the employee for the grant of the option.

Capital Gains Tax for the Employee

A capital gains tax liability will arise on the sale of the shares at 10% if the option and/or shares have been held, in aggregate, for 12 months. The gain will be based on the sale proceeds less the price paid to exercise the option and the amount on which any income tax liability arose on exercise.

Corporation Tax Relief for the Employer

The employer should qualify for a corporation tax deduction when the employee exercises the options equal to the difference between the exercise price paid by the employee and the market value of the shares on exercise.

EMI in Practice

The employer can agree a share valuation in advance of the grant of the EMI options, so that the employee has certainty of their tax position at grant.

The employer must register their EMI scheme online with HMRC, and crucially notify HMRC of the grant of the EMI option within 92 days, failure to do so will result in the loss of the EMI tax advantages. The employer must also file an annual EMI return online by 6 July following the end of the year.

The option agreement will stipulate specific conditions that must be satisfied before the option is able to vest, such as performance conditions for the employee or that the options can only be exercised on an exit event, such as a float. It will also specify the earliest date on which the options can be exercised (which must be within a ten year period).

Disqualifying events can restrict the EMI tax advantages in practice. These can include the company becoming under the control of another company, the company ceasing to carry on its qualifying trade, or the employee ceasing to satisfy the minimum working time requirement. On a disqualifying event the employee has 90 days to exercise their option to retain the tax benefits.

How can Rawlinson & Hunter help?

We have a great deal of experience in advising on each stage; from set up and the grant of advanced clearance from HMRC, through potential disqualifying events to ultimate sale by the employee.

If you are interested in further information in this regard, please call the Rawlinson & Hunter partner who normally acts for you. Where you are not one of our regular clients, please contact Craig Davies or Andrew Shilling, who would be delighted to discuss this with you in more detail.

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