

Share Ownership for Employees—EMI

Enterprise Management Incentives (EMI)

Retaining and motivating staff are key issues for many employers. Research in the UK and USA has shown a clear link between employee share ownership and increases in productivity. The government has therefore introduced a variety of ways in which an employer can provide mechanisms for employees to obtain shares in the employer company without necessarily suffering a large tax bill. Provided the company meets the qualifying conditions, EMI can be one of the most tax efficient and flexible means available.

EMI allows selected employees (often key to the employer) to be given the opportunity to acquire a significant number of shares in their employer through the issue of options. Whilst an EMI can offer significant tax advantages, the key driver for any incentive arrangement should be the commercial objectives of the business.

This factsheet outlines the rules for EMI.

Tax problems under normal rules

If shares are simply given to an employee the market value of the shares will be taxed as earnings from the employment. This is expensive for the employee as he may not have any cash to pay the tax arising.

In order to avoid this immediate charge, options could be granted to an employee. An option gives the employee the right to obtain shares at a later date. Provided that the terms of the option are that it must be exercised within ten years, any tax liabilities will be deferred until the time the options are exercised.

This may still be expensive for the employee if he is not then in a position to sell some of the shares in order to pay the tax arising.

What does EMI offer?

EMI allows options to be granted to employees which may allow the shares to be received without any tax bill arising until the shares are sold.

How does it work?

Selected employees are granted options over shares of the company. The options should be capable of being exercised within ten years of the date of grant.

In order to qualify for the income tax and national insurance contribution (NIC) reliefs, the options awarded need to be actually exercised within ten years of the date of the grant. There is also a statutory limit of £250,000 in respect of options granted on or after 16 June 2012, which maximises the value of the options which may be granted to any one employee. No employee may hold unexercised qualifying EMI options with a market value of more than £250,000. The market value is taken at the date of grant.

What are the tax benefits to employees?

The grant of the option is tax-free.

There will be no tax or NICs for the employee to pay when the option is exercised so long as the amount payable for the shares under the option is the market value of the shares when the option is granted.

Share Ownership for Employees—EMI

The EMI rules allow the grant of nil cost and discounted options. However, in these circumstances, there is both an income tax and an NIC charge at the time of exercise on the difference between what the employee pays on exercise and the market value of the shares at the date of grant.

Following the acquisition of the shares, when the option is exercised, an employee may immediately dispose of, or may retain the shares for a period before selling them. At such time there will be a chargeable gain on any further increase in value. The CGT liability will depend on the availability of any reliefs and annual exemption.

- CGT at the rate of 10% applies to gains where net total taxable gains and income are below the income tax basic rate band
- CGT on any part of gains above this limit will be charged at 20%.

In certain circumstances, in respect of shares acquired through exercising EMI options, Entrepreneurs' Relief may be available to reduce the CGT liability to 10%. Although the Entrepreneurs' Relief conditions have to be satisfied they are modified so that:

- the 5% minimum shareholding requirement does not apply
- and the 12 month minimum holding requirement is allowed to commence on the date the option is granted.

These rules apply to shares acquired on or after 6 April 2012.

What are the benefits to employers?

- Employees have a potential stake in their company and therefore retention and motivation of these employees will be enhanced.

- Options will not directly cost the employer any money in comparison to paying extra salary.
- There will normally be no NICs charge for the employer when the options are granted or exercised or when the employee sells the shares.
- A corporation tax deduction for the employer company broadly equal to employees' gains.

EMI: Points to consider

There are a number of issues to consider in deciding whether EMI is suitable for your company.

- Does the company qualify?
- Which employees are eligible and who should be issued options?
- What type of shares will be issued?
- When will the rights to exercise options arise?
- The costs of setting up the option plans are not tax deductible.

Does the company qualify?

EMI was introduced by the government to help small higher risk companies recruit and retain employees with the skills that will help them grow and succeed. The company must therefore:

- exist wholly for the purpose of carrying on one or more 'qualifying trades'
- have gross assets of no more than £30 million
- not be under the control of another company (so if there is a group of companies, the employee must be given an option over shares in the holding company).

Share Ownership for Employees—EMI

The main trades excluded from being qualifying trades are asset backed trades such as:

- property development
- operating or managing hotels
- farming or market gardening.

Which employees are eligible and who should be issued options?

An employee cannot be granted options if they control more than 30% of the ordinary share capital of the company. They must spend at least 25 hours a week working for the company or the group, or if the working hours are shorter, at least 75% of their total working time must be spent as an employee of the company or group.

Subject to the above restrictions, an employer is free to decide which employees should be offered options. The sole test is that options are offered for commercial reasons in order to recruit or retain an employee.

What type of shares will be issued?

EMI provides some flexibility for employers. For example, it is possible to limit voting rights, provide for pre-emption or set other conditions in respect of shares which will be acquired on exercise of an EMI option. The shares must, however, be fully paid ordinary shares so that employees have a right to share in the profits of the company.

When will the rights to exercise options arise?

The options must be capable of being exercised within ten years of the date of grant but there does not have to be a fixed date.

Examples of circumstances in which the options could be exercised include:

- fixed period
- profitability target or performance conditions are met
- takeover of company
- sale of company
- flotation of company on a stock market.

Options can be made to lapse if certain events arise, for example the employee leaves the employment.

How we can help

Whilst an EMI can offer significant tax advantages, the key driver for any incentive arrangement should be the commercial objectives of the business. There are a variety of alternative arrangements which can be used each with their own conditions and advantages. We can help you decide whether EMI is appropriate for your business and whether the business will qualify. Please contact us for advice on the best options available for your business.

Rycroft Glenton is registered to carry on audit work by the Institute of Chartered Accountants in England and Wales. Portland Financial Management is authorised and regulated by the Financial Conduct Authority, FCA firm reference number 114370. Tax treatment depends on the individual circumstances of each client and may be subject to change in future. Please remember the value of investments and the income from them can go down as well as up. You may not get back the full amount you have invested.

NEWCASTLE

32 Portland Terrace
Newcastle upon Tyne
Tyne & Wear
NE2 1QP

Tel: 0191 281 1292
Fax: 0191 212 0075

MORPETH

55 Newgate Street
Morpeth
Northumberland
NE61 1AY

Tel: 01670 512102
Fax: 01670 510385

ROTHBURY

Barclays Bank Chambers
Rothbury
Northumberland
NE65 7SS

Tel: 01669 620360
Fax: 01669 622854

WHITLEY BAY

189 Park View
Whitley Bay
Tyne & Wear
NE26 3RD

Tel: 0191 252 1849
Fax: 0191 297 1204

PFM

29 Portland Terrace
Jesmond
Newcastle upon Tyne
NE2 1QS

Tel: 0191 281 6074
Fax: 0191 281 5396

This material is published for the information of clients. It provides only an overview of the regulations in force at the date of publication, and no action should be taken without consulting the detailed legislation or seeking professional advice. Therefore no responsibility for loss occasioned by any person acting or refraining from action as a result of the material can be accepted by the authors or the firm.