

Accounting resource: Enterprise management incentives (EMI).



In brief:

EMI has now been with us for over 20 years and remains one of the most attractive equity based incentives for owner managed limited companies. It has significant tax advantages, which have been enhanced over the years. It is designed to help small and medium sized companies attract, retain and reward employees.

“EMI allows small businesses the opportunity to compete for talent with large companies by allowing them to give shares in the company to employees in a tax efficient way, which should help to motivate and retain them.”

“The option terms can be tailored to meet the needs of the business. It is common to have options only exercisable on a sale of the company or to include individual performance criteria for exercise”

Alan Ross, Tax Director, Wilson Partners Ltd

Enterprise management incentives (EMI)

Tax reliefs:

The key reliefs and benefits of the scheme are:

1) No income tax or National Insurance Contributions will be payable upon the grant or exercise of the option provided that:

a) the options are granted at market value;

b) the options are exercised within 10 years of grant;

c) there are no disqualifying events in relation to the company, the employee or the terms of the option.

On a normal unapproved option, income tax (and perhaps National Insurance) will be payable on exercise on the difference between the market value of the shares at that time (which may have increased substantially since grant) and the price paid. At this time the employee may have no funds to pay the tax and also the rate is high - up to 60% income tax.

2) Business Asset Disposal relief with a 10% CGT rate is likely to be available on a sale on the whole uplift in value from the price paid, provided the sale is more than two years after grant. Also the CGT annual exemption (currently £12,300) may be available.

3) Corporation Tax deduction should be available in the year the EMI options are exercised for the aggregate difference between the open market value of the shares on the date of exercise and the amount paid by the option holder.

Conditions:

1) There is no limit on the number of employees who may participate and the Company is free to decide which employees are to be granted options and the terms of exercise for each option, however:

a) The employee must not have control of more than 30% of the company's share capital.

b) The employee must work at least 25 hours per week (or 75% of their "working time") for the company.

c) Each employee may not hold options over shares with a market value on grant in excess of £250,000 at any one time.

d) The total market value of shares over which unexercised options exist may not exceed £3 million.

2) Limits have been set on the type of qualifying company:

a) At grant, the company must be an independent company with gross assets not exceeding £30 million.

b) The trade must be a qualifying trade (there is a list of exclusions, many of which relate to trades involving financial services or those which are property backed).

c) It or a group company must have a permanent establishment in the UK.

d) There must be no more than 250 employees (full-time equivalent).

3) If the options are granted at below market value, Income Tax (and possibly National Insurance Contributions) will be due on the grant discount at the time the option is exercised. This is collected by via the payroll if the shares are "readily convertible assets", otherwise via the employee's tax return.

4) A gain liable to capital gains tax may arise on the disposal of any shares acquired following the exercise of the option.

5) Options must be capable of being exercised within 10 years of the date of grant and relate to fully paid up ordinary shares. Further options may not be granted within a 3-year expiry period where the £250,000 maximum has previously been held.

6) There is no formal HMRC approval process - effectively a selfcertification applies.

7) Each grant must be covered by a written agreement setting out the terms of the option and HMRC must be notified electronically within 92 days of the date of grant.

8) In certain circumstances (e.g. where the company is unquoted) HMRC will agree a share valuation at the time of the option grant. There is a fast-track valuation procedure for EMI schemes.

Conclusion:

EMI is often the share scheme of choice when looking for a way to motivate and retain key employees.

This note is a brief summary of the position at 10/05/21. Professional advice should be taken before any action is taken.