

EMI Fact Sheet

Background

The Enterprise Management Incentives (EMI) scheme, which was first introduced under the 2000 Finance Act, is specifically targeted at small higher risk trading companies.

The scheme is designed to help small companies attract and retain the people they need and to reward these employees for taking a risk and investing their energy and skills in helping the company achieve its potential.

Over 10,000 companies are operating EMIs costing the government £240m in tax relief (source: HMRC June 2010).

General Features

The main features of EMI are:

- A qualifying company can grant EMI options up to a maximum of £3 million.
- Each employee can hold options over shares worth up to £120,000 (with effect from 6 April 2008) at the time of grant - this is the maximum limit in a three-year period starting with the date of grant of the options, which took the employee to the limit. Employees with £120,000 of EMI options who exercise those options within three years of that date are not able to 'top up' their EMI options until the three year period has expired.
- To qualify, the company must be an independent company trading in the UK, with gross assets not exceeding £30 million and, from 6 April 2008, with fewer than 250 employees. There is no requirement for the company to be resident in or incorporated in the UK, but to qualify for EMI the company's trading activities must be carried on wholly or mainly in the UK, and must not be substantially one of a number of excluded activities such as land dealing, farming, leasing, banking, and, from 2008, shipbuilding, coal and steel production.
- The company can be quoted or unquoted
- There is no scheme approval procedure - companies enter into individual EMI share option agreements with each employee, which are then notified to HMRC. However, at the company's request HMRC will offer advanced consultation on whether or not it would qualify to use EMI.

- There will normally be no income tax or National Insurance (NICs) for the employee to pay when the options are exercised; nor will there normally be any NICs charge on the employer.
- The gain will be subject to Capital Gains Tax. From 22 June 2010 the flat rate of 18% only applies to basic rate tax payers. Higher rate tax payers will now have to pay a new rate of 28% CGT. Any gains less than the annual exempt amount (AEA) - £10,100 for the 2009/2010 tax year - are free from CGT.

Eligibility

A qualifying company must have fewer than 250 (w.e.f. 21 July 2008) full time equivalent employees but can grant EMI options to any number of those employees

EMI options can be granted to any employee who controls less than 30% of the ordinary share capital of the company. In arriving at the percentage, shares that are still under an EMI option can be disregarded.

Employees are eligible for EMI options if they are employed by the company or group for at least 25 hours a week, or, if less, for at least 75% of their working time.

The Qualifying Options and their Tax Treatment

There is no income tax or NICs to pay when an EMI option is granted. A company is able to set its own exercise period, although to qualify for the income tax and NICs relief companies must ensure that the options they award are capable of being exercised within 10 years of the date of grant and are actually exercised within that period.

As long as companies grant options over shares with an exercise price set at the market value of the shares at the time the options are granted, there will be no income tax or NICs charge when the employee exercises the options (provided the exercise takes place within 10 years of the grant).

To provide extra flexibility to employers, it is possible to limit voting rights, provide pre-emption or set other conditions in respect of shares which will be acquired on the exercise of an EMI option.

There is one significant limitation on the types of shares over which an EMI option can be granted. The shares must be fully paid up ordinary shares so that employees have a right to share in the profits of the company. Redeemable and convertible shares cannot be used for EMI.

Companies can award options over restricted and conditional shares to provide flexibility regarding performance conditions and ensure that they can manage what becomes of their shares.

Details of the restrictions and conditions must be set out in the employee's EMI option agreement. The normal tax and NICs rules applicable when conditions or restrictions are lifted apply in respect of shares acquired under an EMI option, however.

At any one time employees may hold EMI options over shares with a value of up to £120,000 at the date of grant. An employee who is granted options above that limit will still be able to obtain relief under EMI on options up to the limit.

Companies which provide EMI options to their employees can deduct the cost of setting up and administering the necessary arrangements when computing their corporation tax profits. The government is also proposing to make option gains of employees deductible against corporate tax.

Disqualifying event

Certain disqualifying events can remove the EMI scheme tax benefits, such as the issuing company ceasing to be a trading company, the employee ceasing to meet the working time requirements, or the grant of a CSOP option which takes the combined EMI/CSOP options over £120,000 in total.

Disqualifying events can result in a loss of tax relief on any increase in share values from that point forward, HMRC do however allow a period of 40 days grace before tax relief is removed.

How to operate EMI

The administrative arrangements for EMI have been kept to a minimum in order to keep costs down for employers - no approval arrangements are in place for EMI, instead employers notify HMRC of the grants of EMI options that they make. HMRC has up to 12 months to check whether the grants meet the EMI rules.

Each grant must be covered by a written agreement between the company and the employee specifying:

- The date of the grant.
- That the shares were granted under the provisions of EMI.
- The number or maximum number of shares under the EMI option.
- The market value of the shares at the date of the grant.
- The exercise price.
- When and how the option is to be exercised.
- Details of any restrictions or conditions attaching to the shares.
- Details of any performance requirements.
- Companies must notify HMRC of the grant of EMI options within 92 days of the grant being made. HMRC are considering how best to enable employers to provide this information electronically.

Any share valuations required in connection with EMI will normally have to be agreed with the Shares Valuation Department at HMRC.