MOORE Kingston Smith

ENTERPRISE MANAGEMENT INCENTIVES (EMI)

The continued growth and success of your business is dependent on your workforce. It is, therefore, important to ensure that you are recruiting, incentivising, and retaining the right people. A share based incentive scheme can help you to achieve these goals.

Share schemes can be split into two broad categories: HM Revenue & Customs (HMRC) approved schemes that offer tax benefits, but sometimes lack flexibility, and unapproved schemes that offer increased flexibility, but without the same tax advantages. This briefing focuses on the most attractive form of approved share incentive scheme, the Enterprise Management Incentive (EMI) scheme.

How does an EMI scheme work?

Under an EMI scheme, employees are given the option to acquire ordinary non-redeemable shares in their employer company (or their employer's parent company, if it is a member of a group). The option to acquire shares can be conditional, perhaps on the employee meeting certain performance targets, but must be exercisable within ten years of grant.

Typically, there will be no income tax or national insurance contributions (NICs) to pay when the employee exercises the option and acquires the shares (although as described below this does depend on the option price).

The option to acquire shares must be granted for commercial reasons and for the purpose of recruiting or retaining an employee of the company. It must not be granted as part of a tax avoidance scheme or arrangement.

Can any company run the scheme?

There are certain qualifying conditions that must be met in order for a company to implement an EMI scheme and the main conditions are set out below.

Firstly, it should be noted that the company, whose shares are subject to an option, must not be under the control of another company. In a corporate group, therefore, the parent company must be the one to grant the options.

If the company is a standalone company it must carry on a qualifying trade on a commercial basis. A qualifying trade does not consist, wholly or to a substantial part, in the carrying on of "excluded activities". If the company is a parent company of a group, at least one group company must carry on a qualifying trade on a commercial basis, and the business of the group as a whole cannot consist substantially of non-trading and/or excluded activities.

The key "excluded activities" are as follows:

- Dealing in land, commodities, futures, shares, securities or other financial instruments;
- Dealing in goods, otherwise than in the course of an ordinary trade of wholesale or retail distribution;
- Financial activities, such as banking, insurance, money-lending, debt-factoring, hire purchase financing or other financial activities;
- Leasing;
- Receiving royalties or other licence fees (except, broadly, where the greater part of the value of the associated intellectual property was created by the company);
- Providing legal or accountancy services;
- Property development;
- Operating or managing hotels or comparable establishments;
- Operating or managing nursing homes or residential care homes; and
- Providing services to certain associated persons whose trade consists substantially of excluded activities.

The total gross assets of the company (or group) must not exceed £30 million at the date of grant. "Gross assets" are all the assets which would be shown on the balance sheet, without any deduction in respect of liabilities.

The company (or group) must have fewer than 250 full-time equivalent employees at the date of grant.

If the company has any subsidiaries, they must all be "qualifying subsidiaries" (being, broadly, companies in which it holds 51% or more of the shares).

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The company must have a permanent establishment in the UK, or, in the case of a parent company, at least one company in the group must carry on a qualifying trade through a permanent establishment in the UK.

Can all employees participate?

In order to be granted qualifying options, employees must work either for the company granting the options, or one of its qualifying subsidiaries, and they must be required to work for the employer for at least 25 hours per week or, if less, for 75% or more of their working time.

Employees with an interest in more than 30% in the share capital of the company granting the options, or any group company, cannot participate in the scheme. In assessing whether employees breach this threshold of 30%, any interests held by "associates" (broadly includes relatives and business partners) must be included.

The maximum value of shares (valued at the date of grant) over which an employee can hold EMI options is £250,000, and the total value of shares in the company subject to EMI options cannot exceed £3 million.

What are the tax benefits of an EMI scheme?

The main benefit of an EMI scheme is the beneficial tax and NIC treatment which applies on the acquisition of shares, the key points of which are explained here.

Employee

Where the exercise price for the options is no less than the actual market value of the shares at the time of grant, there will be no income tax or NICs to pay when the options are exercised.

If the exercise price is less than the market value of the shares at the time of grant, income tax (and possibly NIC) will generally be charged on the discount.

This contrasts with the position for unapproved share options where, on exercise, income tax (and possibly NICs) will arise on the difference between the market value of the shares at the date of exercise and the amount paid for the shares.

Capital gains tax may arise when the employee eventually sells the shares. Any capital gain will be calculated as the difference between the sale proceeds and the "cost", with the cost being the amount paid for the shares, plus any amount charged to income tax on exercise.

Gains made on shares acquired through exercising EMI qualifying options can be eligible for Business Asset Disposal Relief (BADR) (formerly known as Entrepreneurs' Relief), meaning that capital gains tax will be charged at 10% rather than 20% for higher rate tax payers. This is the case even where the employee held less than 5% of the shares of the company. Perhaps the key condition for BADR to be available is that the employee held the option and the shares for a combined period of at least 24 months. There is a lifetime limit of £1 million of gains that can qualify for BADR.

Company

A UK company should qualify for corporation tax deductions for the costs of setting up and running an EMI scheme.

In addition, a UK company should qualify for a deduction when an employee acquires shares under an EMI scheme, equal to the difference between the market value of the shares at exercise over the amount paid for the shares.

Where options are granted with an exercise price below the market value of the shares at the date of the grant, employer's NICs may arise on the exercise of the option.

How will I know the market value of the shares at the date of grant?

There is a facility for an unquoted company to agree the market value of its shares for EMI purposes with HMRC.

What is involved in setting up and running an EMI scheme?

An informal advance assurance facility exists whereby HMRC will provide confirmation as to whether or not it considers that a company meets the conditions to grant EMI options. Seeking advance assurance is not mandatory but is usually advisable, particularly in cases where there may be any doubt over whether any of the conditions are met.

The documentation relating to the share options must meet certain specific requirements in order for the options to qualify, and specialised legal support should be used to draw up this documentation.

Once EMI options have been granted, employers are required to notify the grant of EMI options to HMRC electronically, within 92 days of the grant (although this is being extended to 6 July following the tax year of grant for options granted from April 2024 onwards). An annual return must then be submitted after the end of each tax year.

How can Moore Kingston Smith help?

We can:

- Assess whether an EMI scheme matches your commercial objectives;
- Advise on setting up an EMI scheme where appropriate;
- Apply to HMRC for advance assurance to determine whether the company meets the qualifying conditions;
- Prepare share valuations and send these to HMRC for agreement;
- Draft the scheme and share option documentation;
- Manage the option notification and annual return process.

The above provides a brief summary of EMI and should not be relied upon without taking further advice. Please get in touch with our team if you would like to discuss aspects of EMI in greater depth or other related topics.

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