The EMI Share Scheme

A tax efficient arrangement for employees

A brief guide

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Share Ownership for Employees - EMI Schemes

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 introduced a number of tax advantaged schemes that enable an employer to provide mechanisms for employees to obtain shares in the employer company without necessarily suffering a large tax bill.

What Does an EMI Scheme Offer?

The EMI scheme allows options to be granted to employees, which for these purposes includes officers of the company i.e. Directors and Company Secretary, and may allow the shares to be received without any tax or national insurance liability arising on the recipient.

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.

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 at least the HMRC agreed market value of the shares when the option is granted.

The EMI rules allow for the use 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.

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 NIC charge for the employer when the options are granted or exercised or when the employee sells the shares. The costs of setting up the option plans should be tax deductible.

On exercise of the options the employer company obtains a corporate tax deduction based on the difference between the exercise price and the open market value of the shares at the date of exercise.

Points to Consider

There are a number of issues to consider in deciding whether an EMI scheme is suitable.

- 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?

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 the company 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).
- Be carrying on a qualifying trade

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?

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 although the shares can be of a different class which gives some flexibility.

The employer may wish to issue growth shares which relies on the company's value increasing in the future before the employee gains any benefit from the shares over which they hold options.

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.

What is the position on the sale of shares

A liability to capital gains tax (CGT) will arise on any gain made as a result of the sale.

Any gain chargeable to capital gains tax may be reduced by Business Asset Disposal Relief (formerly 'entrepreneurs relief').Business Asset Disposal Relief relief reduces the amount of capital gain to be charged to tax on the first £1m gain to an effective tax rate of 10%.

It Is not necessary for employees who have acquired their shares under an EMI scheme to hold least 5% of the shares nor is it necessary for them to have held the shares for at least two years but the options and subsequently the shares must together have been held for two or more years. Additionally If the employee ceases to be an employee before he sells his shares then for the period between the date he leaves and the date of the disposal of the shares less favourable rates may apply.

Any gains over £1m will be taxed without the benefit of entrepreneur relief.

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