

Introduction

Enterprise Management Incentives ("EMI") options are a tax-advantaged form of discretionary share incentive award which can provide significant tax benefits for UK tax-paying employees.

EMI options are specifically designed to be operated for the benefit of trading companies with growth potential and are intended to help such companies recruit and retain employees. They provide individuals with significant tax benefits and are more flexible than the other tax advantaged share arrangements in the UK, being Company Share Option Plans ("CSOP"), Save-As-You-Earn ("SAYE") plans, and Share Incentive Plans ("SIP").

Main features

- The EMI tax reliefs can be very generous, so that:
 - there is no income tax or social security on grant;
 - there is no income tax or social security on exercise providing certain conditions are met; and
 - capital gains tax ("CGT") will only arise on the sale of the option shares with no minimum holding period.
- A company or group must have fewer than 250 full-time equivalent employees at the point of grant.
- To be eligible to be granted EMI options, employees must work at least 25 hours a week or 75% of their total working time for the company.
- Up to £250,000 worth of shares can be granted to each eligible employee.
- The limit on the total value of options that can be granted by any company (or Group as the case may be) under EMI is £3m.
- CGT at 20% will be payable on sale of the shares on the increase in value above the higher of actual market value ("AMV") of the underlying shares on

grant and the exercise price unless the period between the date of grant and the sale is at least 24 months and then the option holder should qualify for Business Asset Disposal Relief (formerly known as "entrepreneurs' relief"). In which case, a 10% tax rate will ordinarily apply on the first £1m of gain.

- The UK employing company will generally qualify for a corporation tax deduction equal to the spread for the accounting period in which the option is exercised (even where participants are relieved from income tax).

Flexibility

Although the EMI legislation is complicated in certain respects, there are very few requirements of the EMI legislation relating to the option terms. The main ones are that:

- the options cannot be transferred (other than to personal representatives);
- they cannot be exercised after ten years;
- they must lapse within 12 months of death; and
- it must be clear that the option is a right to acquire shares (so cannot contain excessive discretion).

EMI options must be granted using a set of plan rules and/or an option agreement which comply with the EMI legislation. The purpose of the plan must be to provide benefits in the form of shares or options and it must not provide benefits otherwise than in accordance with the legislation.

Qualifying companies

EMI is available to private and public companies with gross assets at the point of grant of £30m or less. In a group, the gross assets test is applied at group level.

The company must carry on a qualifying trade and there are detailed provisions in this regard. Examples of trades which do not qualify include financial activities, leasing and property development.

In a group, EMI share options must be granted over shares in the parent company and at least one of the trading subsidiaries must carry on a qualifying trade.

A company granting EMI options must not be under the control of another company. However, the parent company of a qualifying group can grant EMI options to group employees.

Qualifying options

Options must be granted to employees or directors over ordinary shares that are fully paid and not redeemable. The shares can, however, be subject to restrictions.

Only EMI options over not more than £250,000 worth of shares per individual, valued by reference to unrestricted market value ("**UMV**") at the date of grant, will qualify for EMI treatment. It is possible for the limit "go further" by granting EMI options over separate classes of ordinary shares (such as so-called "growth shares"). A separate fact sheet growth shares is available.

Options can be granted at a discount or nil price although there are tax consequences. Options must be capable of being exercised within 10 years.

Eligible employees

EMI options can only be granted to employees who are required to work for at least 25 hours a week, or, if less, at least 75% of their working time must be for the company.

Employees who have a 'material interest' of more than 30% of the share capital before the options are granted are excluded from participation.

Employee taxation

The tax benefits are very generous with no income tax or national insurance contributions ("**NIC**") at the date of grant; and none on exercise where the exercise price is not lower than the AMV at the time of grant. If the option is granted at a discount to AMV, there will be income tax and, possibly, employer's and employee's NIC payable at exercise on the amount of the original discount or the gain on exercise if that is lower. It is not unusual for the employer to transfer its NIC liability to employees.

On a disposal of the shares the increase in value from the market value at date of grant will usually be liable to CGT at the Business Asset Disposal Relief 10% rate

of tax (on the first £1m of capital gain). If the sale takes place within 24 months from the date of grant (or the £1m lifetime limit for Business Asset Disposal Relief has been utilised), the standard rate of 10% and/or 20% will apply depending on whether the individual is a standard or higher rate taxpayer.

Where the company or individual option holder does not meet the qualifying criteria throughout the life of the option, income tax is payable on the gain during the non-qualifying period (see disqualifying events below).

Disqualifying events

EMI provides generous tax and NIC reliefs for qualifying options. However, there are a number of disqualifying events which will limit these reliefs. Disqualifying events include:

- the company coming under the control of another company;
- the company ceasing to meet the trading activities test;
- the employee ceasing to be an eligible employee; and
- a significant variation in the terms of the option (see below)

If the option is exercised within 90 days following a disqualifying event, full income tax and NIC benefits are maintained up to that point. If the option is exercised more than 90 days after a disqualifying event, then relief is only given up to the date of the disqualifying event. It is essential that companies and option holders keep EMI arrangements under review. On a sale or takeover it is possible to have an exchange of options which will protect the tax reliefs. This should be provided for in EMI option agreements.

Administration and valuation

As with other employee share plans in the UK, there is a requirement to register and then make annual filings under HMRC's employment related securities ("**ERS**") regime. The good news is that, with effect from 6 April 2024, EMI option grants are no longer required to be notified within 92 days of grant.

Whilst not a statutory requirement, we recommend that the AMV and the UMV of shares to be granted under EMI option in private companies (and also

companies admitted to trading on AIM) is agreed in advance with HMRC Shares Valuation.

Next steps

Many EMI plans are bespoke to the company with individual rules and performance targets. Wedlake Bell can help with all aspects of the design, drafting and implementation of your EMI Plan, including communication, valuation and ongoing compliance requirements.

JUSTIN MCGILLOWAY

Partner

T: +44 (0)20 7395 3076

E: jmcgilloway@wedlakebell.com



EUAN FERGUSON

Consultant

T: +44 (0)7795 618102

E: eferguson@wedlakebell.com

