

SHARE INCENTIVES: EMI OPTIONS – OVERVIEW OF CONDITIONS AND TAX TREATMENT

This note outlines the key conditions which need to be met and the tax treatment of EMI options. It is not designed to be a definitive statement of the qualifying conditions and tax treatment but instead is intended to provide an overview for discussion. It is based on the laws and judicial interpretation in force at the date of writing and is therefore subject to any changes in applicable tax laws and HMRC interpretations occurring after the date of this document.

Enterprise Management Incentive (EMI) options are specifically targeted at small and medium sized trading companies. EMI options have the potential to attract very favourable tax treatment. Under EMI, employees are able to hold tax efficient options with a value at the date of grant of up to £250,000 each (subject to an overall limit on the value of options for all participating employees of £3 million) by reference to the unrestricted tax market value of shares at the date of grant.

Whilst there are a set of qualifying conditions which need to be fulfilled, EMIs remain a very flexible tool for recruiting, retaining and incentivising employees as the terms on which the option may be exercised are not specified by statute.

If, having considered this guide, you would like to know more or to discuss your own circumstances in greater detail, please speak to your usual contact at Stevens & Bolton or a contact listed at the end of this guide.

Qualifying companies

Amongst other things, a company (or group) must:

- be independent (i.e. not under the control of another company);
- have gross assets (as shown in the balance sheet) of £30m or less;
- have only “qualifying subsidiaries” (50%+1 share subsidiaries);
- have a permanent establishment in the UK;
- carry on only qualifying trades (certain types of trade are not allowed); and

- have fewer than 250 full-time employees (calculated by adding to the number of full-time employees a just and reasonable fraction for each part-time employee).

Eligible employees

EMI option holders must satisfy three tests:

- Employment – must be an employee of the company or one of its subsidiaries (may also be a director).
- Working time commitment – an employee must

work for the relevant company:

(a) at least 25 hours a week (excluding meal breaks); or

(b) if less, 75% of his/her "working time".

"Working time" means time spent on remunerative work i.e. general earnings for tax purposes.

- No material interest – employee must not have a material interest in the company i.e. ownership of, or the power to control, directly or through the medium of other companies or by any other indirect means, more than 30% of the ordinary share capital of the company.

Qualifying options

Options must:

- be granted over fully paid up non-redeemable ordinary shares (may be subject to restrictions);
- be capable of exercise within 10 years from grant;
- be granted pursuant to a written option agreement which qualifies under the EMI legislation;
- not be assignable; and
- lapse within one year of the death of the option holder.

Qualifying options can be granted under one or more EMI agreements, but once the £250,000 individual limit is reached (regardless of whether options have been exercised or released) no further options granted to the option holder within three years of the last qualifying grant will be qualifying EMI options.

There is also an overall limit of £3 million on the total value of shares (based on the value at the date of grant) in the granting company which may be subject to unexercised qualifying EMI options.

Grant of an emi option

Value of shares

For private companies the market value of the relevant shares is required to determine:

- that the £250,000 and £3 million limits referred to above are not exceeded; and
- whether the option is being granted at a discount to market value which will result in a tax charge on

exercise.

The market value of any shares for the purpose of the above limits is the price they might reasonably be expected to fetch on a sale in the open market, free from any restrictions or risk of forfeiture to which they may be subject (called the "unrestricted value").

If the shares are subject to restrictions, the exercise price can be set at the lower "restricted value" without incurring tax on exercise.

Both the restricted and unrestricted values should be agreed with HMRC prior to grant (although it is not obligatory to do so).

Notices

The employer company must notify HMRC within 92 days of the grant of an EMI option. Companies must notify HMRC of the grant of the option electronically through their online PAYE portal and also retain a copy of a declaration from the employee that he/she satisfies the working time commitment.

Failure to notify HMRC invalidates the EMI status of the option.

Tax and National Insurance Contributions (NIC) treatment of EMI options

The tax advantages of EMI are that there:

- is no income tax or NIC chargeable on grant of the option;
- is no income tax or NIC chargeable on the exercise of the option provided:
 - (a) the option is capable of exercise within 10 years of grant and there have been no disqualifying events between grant and exercise; and
 - (b) the exercise price is not less than the market value of the shares at the date they are granted (if this is not the case the discount is chargeable to income tax, and potentially NIC, on exercise).

The disposal of the resulting shares to a third party purchaser is charged to capital gains tax. Ordinarily, capital gains tax is payable at a flat rate of 10% for basic rate tax payers or 20% for higher and additional rate tax payers (after the annual allowance (currently £11,300 for tax year 2017/18) and losses). However, the disposal of shares acquired upon the exercise of

an EMI option may qualify for Entrepreneurs' Relief (10% rate of CGT). To qualify, the period between the date of grant of the option and the date of disposal of the resulting shares must be at least 12 months and the participant must have remained an employee or director throughout that period.

Disqualifying events

The EMI legislation contains a wide range of "disqualifying events". There are broadly two types: disqualifying events which relate to the company over whose shares the option has been granted and disqualifying events which relate to the employee.

If an option is exercised within 90 days of a disqualifying event, it has no effect on the tax treatment.

If an option is exercised more than 90 days after a disqualifying event, **this may result in an income tax, and potentially NIC, charge when the option is exercised.** Tax is charged on the amount (if any) by which the market value of the shares, when the option is exercised, exceeds their market value immediately before the disqualifying event (the gain made before the disqualifying event escapes income tax and NIC).

The main disqualifying events are:

- the company ceasing to satisfy the independence test (i.e. becoming a 51% subsidiary of another company);
- the company ceasing to meet the trading activities test;
- the employee's employment being terminated; or
- the employee ceasing to satisfy the working time commitment.

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FIND OUT MORE

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