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Enterprise Management Incentives for employees

Companies often introduce an Enterprise Management Incentive Share Option Plan ("EMI") to help recruit, retain and motivate employees. An EMI allows a company to grant highly tax-effective incentives to employees in the form of EMI options.

What is an option?

An option is a right to acquire shares in the company. The employee does not have to pay anything at the time they are granted an option.

Employees do not become shareholders until they exercise the option and pay the pre-determined exercise price. Once they have exercised the option, they will become a shareholder and have access to all the rights of a shareholder, including the right to vote at shareholder meetings and to receive dividends on their shares.

It is possible to impose a variety of conditions which need to be satisfied before the employee is permitted to exercise their option. These can vary from personal performance targets to company KPIs (Key Performance Indicators).

It is commonplace under EMI arrangements for employees to be able to exercise their options in the event of the sale of the issuing company. EMI's arranged in this way are used to motivate key employees to help build the value of the business, as they have a vested interest in that growth in value where a sale is intended. Other scenarios can include exercise when a company becomes listed or when the trade and assets of a business are sold.

Exercising EMI options

When the exercise conditions of the options are fulfilled, the option holder will issue an exercise notice to the issuing company, pay the pre-determined exercise price, and receive shares in the company.

If the exercise price is below the market value of the shares on the date the option was granted, an income tax (and potentially national insurance) liability will arise for the option holder at the exercise date.

It is commonplace for the option to represent a future minority shareholding in the company and as such discount factors are applied when calculating the market value of the option at the time it is granted.

Qualifying conditions for EMI

There are numerous conditions which the issuing company, and where relevant its qualifying subsidiaries, need to meet to come within the EMI regime including conditions associated with the size of the company – only smaller companies may grant EMI options. Those conditions are not covered within this factsheet.

The EMI option tax benefits can only last for a maximum period of 10 years. If an exercise event (e.g. the sale of the company) does not occur within that 10 year window the option can continue as an unapproved option, i.e. without the tax benefits offered under EMI.

In addition, there are conditions which must be met in relation to the employee receiving the options, these include:

- They must work a minimum of 25 hours per week for the company or spend at least 75% of their working time on the business of the issuing company.
- They cannot have a "material interest" in the issuing company. Broadly speaking an individual has a material interest if they, together with people associated with them, hold more than 30% of the company's share capital.
- They must not hold unexercised EMI options over shares worth more than £250,000 as at the grant date of those options.

- They cannot be granted EMI options worth more than £250,000 in any three-year period. Again the value is calculated as at the option grant date.

If the employee leaves the company's employment, their EMI options will often lapse as they will fail to meet the working time requirement. However, where they leave under certain conditions, often death or ill health, the options may not lapse but will likely be subject to specific timeframes in which an exercising event must take place after the employee's exit.

Tax consequences of EMI options

Grant of EMI options

Employees have no tax or national insurance liabilities at the time of the grant of an option. There are no reporting obligations at this time on the employee, although the employer company must report the grant to HMRC within 90 days of the grant date.

Exercise of EMI options

Where an employee exercises options under EMI and:

- no disqualifying event has taken place, and
- the exercise price is not less than the market value of the option shares at the date it was granted

there will be no tax or national insurance liabilities for the employee. The employee has no reporting obligations on exercise.

If the option was granted at below its market value, the employee will be liable to pay income tax, and potentially national insurance, on the difference between the price they pay and the market value of the option at the date it was granted. This will be collected either through payroll deductions or through reporting on the employee's P11D benefits statement for the tax year, depending on the circumstances present at the time of the exercise of the options.

Sale of shares acquired through EMI options

When an employee sells shares they acquired through an EMI option, they will normally be liable to capital gains tax (CGT). The amount charged to CGT is calculated as follows:

- the proceeds received on sale
- less any costs associated with the sale transaction (e.g. legal fees)
- less any amounts the employee has suffered income tax on
- less the exercise price the employee paid
- less any remaining CGT annual exemption the employee has

Employees will normally be entitled to Entrepreneurs' Relief which means that the amount subject to CGT is taxed at a rate of 10%. This will be dependent upon the individual's circumstances, how long they have held the options and whether they have previously utilised their lifetime allowance under Entrepreneurs' Relief.

Any gain that is not covered by Entrepreneurs' Relief will be taxed at the normal CGT rate, the rate of which (10% or 20%) depends on the amount of the employee's other income for the year.

The share sale must be reported on the employee's tax return.

how can McBrides help?

The team at McBrides are experienced in assisting companies in implementing an EMI scheme and the meeting the EMI reporting requirements.

We also assist individuals with reporting their sale of shares acquired under EMI options on their tax returns and advising on the tax implications for individuals and their employing company.

Please speak with a McBrides adviser on how an EMI scheme could benefit you or your business.