

EMI OPTION SCHEMES

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The benefit of granting EMI Options

Options to acquire shares which qualify for the Enterprise Management Incentives tax regime ("**EMI Options**") are extremely attractive to qualifying employees, and are a useful management tool for qualifying companies wishing to attract, incentivise and retain such employees.

If granted and managed properly, an EMI option recipient will pay no income tax or NICs on the exercise of the option.

The value of EMI options is dependent on the increase in ordinary share value from date of grant to date of exercise. As such, they are attractive to companies with high growth potential, and to employees who are brought in at an early stage.

On the sale of shares acquired on the exercise of an EMI option, any difference between the market value at the time of sale and the base cost of the shares will be a chargeable gain for the purposes of CGT. Entrepreneurs' relief may be available to option holders disposing of EMI option shares but the rules here are complicated and independent tax advice will be required by the recipient on exercise.

EMI options should be seen as an incentive when hiring employees at a senior level. Such options give the recipient an immediate interest in the growth of the share value of the company and a significant and tax-efficient additional investment income from that employment.

Option exercise can be made dependent on a trade sale; this encourages loyalty and commitment to the company during the intervening years, provides the greatest chance of a significant payout on the shares for the employee at a sale, and focuses all parties on the growth and exit strategy.

Note that EMI options do not have to be exercisable on a sale. For particular classes of employees (e.g. sales professionals or project workers) it may be appropriate to make the exercise of options target or performance driven.

Lastly, from the point of view of the founders of a company, EMI options are attractive as they provide a method for generating interest in the share value of the company amongst key employees without diluting the equity held by them prior to exercise of the options.

EMI Options restrictions

EMI options can only be granted by 'qualifying companies' to 'qualifying persons' for particular purposes. Such grants are subject to further restrictions as to purpose, exercise period, and value.

There is no requirement to get HMRC approval of the market value of the shares at grant in advance of that grant, but our view is that it is best practice to do so. Each option is notifiable to HMRC after it has been granted.

Qualifying company

In order for a company to qualify, it must meet certain criteria. In practice, it is unlikely that a start-up or spin-out wishing to incentivise its key employees, and carrying on a commercial venture, would not meet these criteria. The criteria are:

Independence: the company must not be controlled by another company

Gross Assets: must not exceed £30 million.

Number of Employees: must not exceed 250.

Trading activities: the company must trade on a commercial, profit making basis. Note that certain activities are specifically excluded.

Permanent establishment: the company must have a permanent UK establishment.

Qualifying person

Each person who is to receive EMI Options must also qualify. The criteria here are:

Employment: the person must be employed by the company. Directors are classed as employees for this purpose provided they meet the time requirements below.

Working time commitment: the person must be required to spend at least 25 hours per week, or, if less, 75% of their working time, working for the company.

No material interest: EMI Options cannot be granted to a person who holds 30% or more of a company's shares (or has indirect control of its shares or assets of an equivalent level).

Purpose

EMI Options must also be granted for commercial reasons to recruit or retain employees within a company, and not as part of an arrangement, one of the main purposes of which is to avoid tax.

Exercise period

An EMI Option only obtains tax relief if it is exercised within ten years of the date of its grant and an EMI Option must be capable of being exercised within ten years of the date of grant. This means any performance conditions included in the grant must be capable of being satisfied within this period.

Individual limits

A person may not hold EMI Options over shares with a market value of more than £120,000. Any excess of Options granted above that limit will be non-qualifying (non EMI Options), and there are time restrictions on when further EMI Options can be granted if this level has been reached.

Company limit

There is an overall £3 million limit on the value of shares in a company (valued at the relevant dates of grant and ignoring certain restrictions over the shares) that can be subject to unexercised EMI Options.

Shares under option

The shares under option in an EMI Option must be part of the ordinary share capital of the company, and must be fully paid and non-redeemable.

Non EMI Options

Non-EMI qualifying options can be granted to people such as consultants or employees who don't meet the EMI working time requirements, or who otherwise aren't qualifying persons. It is important to note that any such options granted by a company will not enjoy the tax reliefs available to EMI Options, but can still represent a flexible and attractive incentive.

There is, however, more flexibility as to the terms on which those options can be granted, and they can still represent a useful alternative to releasing equity in companies.

For further information contact:

You may have some questions about your situation. Our team are on hand to help, so get in touch.



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