PKF FRANCIS CLARK
Shared Ambition

Share Ownership for Employees

EMI

Enterprise Management Incentives (EMI)

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 therefore introduced a variety of ways in which an employer can provide mechanisms for employees to obtain shares in the employer company without necessarily suffering a large tax bill. Provided the company meets the qualifying conditions, EMI can be one of the most tax efficient and flexible means available.

EMI allows selected employees (often key to the employer) to be given the opportunity to acquire a significant number of shares in their employer through the issue of options. Whilst an EMI can offer significant tax advantages, the key driver for any incentive arrangement should be the commercial objectives of the business.

Tax problems under normal rules

If shares are simply given to an employee the market value of the shares will be taxed as earnings from the employment. This is expensive for the employee as they may not have any cash to pay the tax arising.

To manage the upfront cost, the employer could grant the employee an option. An option gives the employee the right to obtain shares at a later date, thereby deferring the employment income tax liability until the time the option is exercised.

This may still be expensive for the employee if they are not then in a position to sell some of the shares in order to pay the tax arising.

What does EMI offer?

EMI allows options to be granted to employees which may allow the shares to be received without any tax bill arising until the shares are sold.

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. No employee may hold unexercised EMI options with a market value of more than £250,000. There is also a £3 million overall company limit on the value of shares that can be subject to unexercised EMI options. For both the individual limit and the company limit, the market value is taken at the date of 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 the market value of the shares when the option is granted.

The EMI rules allow the grant of nil cost and discounted options. However, in these circumstances, there is both an income tax and 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. Once the option is exercised, the employee may be able (or indeed required) to immediately dispose of the shares. Alternatively, they may be able to retain the shares and sell them later.

The difference between the exercise price and the market value at disposal will be subject to capital gains tax (CGT). The CGT liability will depend on the individual's personal tax position.

- *Each individual has an annual exemption of £6,000 to set against the gain (£3,000 from 6 April 2024)*
- *If the individual is a basic rate taxpayer, the part of the gain covered by the unused portion of their basic rate band will be subject to CGT at 10%*
- *The part of the gain above the basic rate income tax threshold will be subject to CGT at 20%. However, business asset disposal relief (BADR) may be available to reduce all of part of this slice to just 10%.*

BADR reduces the CGT rate from 20% to 10% on the first £1m gain (lifetime limit) realised on qualifying disposals. The BADR conditions must be satisfied, but they are modified in respect of shares acquired under an EMI option such that:

- *There is no minimum shareholding requirement (ordinarily 5%)*
- *The two-year minimum holding period starts from the date the option is granted rather than the date the shares are actually acquired.*

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 NICs charge for the employer when the options are granted or exercised or when the employee sells the shares*
- *A corporation tax deduction for the employer company broadly equal to employees' gains.*

EMI:
Points to consider

There are a number of issues to consider in deciding whether EMI is suitable for your company.

- *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*
- *Have fewer than 250 full time equivalent employees*
- *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).*

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 and who should be issued options?

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?

The options must be granted over non-redeemable, non-convertible ordinary shares. For company law purposes the shares must be 'fully paid up.'

There is significant flexibility for the employer. The shares can have bespoke or restricted rights, for example, they could be non-voting or entitled to a fixed percentage of capital proceeds and/or dividends.

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*
- *Sale/takeover 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.

How we can help

Whilst an EMI can offer significant tax advantages, the key driver for any incentive arrangement should be the commercial objectives of the business.

There are a variety of alternative arrangements which can be used each with their own conditions and advantages. We can help you decide whether EMI is appropriate for your business and whether the business will qualify.

Please contact us for advice on the best options available for your business.

PKF FRANCIS CLARK
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Here at PKF Francis Clark we have a dedicated specialist reward team with many years of experience in designing the right solution for your business.

We can help

- *Design plans focused on your commercial needs*
- *Advise on the tax treatment of awards*
- *Carry out valuations*
- *Implement share plans, either in house or conjunction with your usual legal adviser*

Contact us

If you have any questions on any matter in this brochure please contact your usual PKF Francis Clark contact. Alternatively, call our head of reward, Kate Culley, on 01803 221818 or via email at: kate.culley@pkf-francisclark.co.uk

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