# EMI share option schemes

## An employer's guide

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**A share option gives someone the right to buy shares in the future, but at a price that is fixed now. Share options are very useful for entrepreneurial companies who wish to incentivise and retain key employees and an EMI share option scheme can provide significant tax advantages to those employees, by boosting their cash returns when they sell their shares.**

A company can grant options over its shares to individuals, based on a specific plan for how and when they can exercise the options and buy the shares, i.e. an option holder is not automatically a shareholder of the company, but will become a shareholder once they exercise their options.

**Glossary** – *grant* is when the options are awarded to someone. *Vest* is when those options can actually be *exercised* i.e. the options can be used to buy the shares.

EMI ('Enterprise Management Incentive') is a popular model in startup and early stage companies, who want good staff but who don't necessarily have the cash to pay full market level salaries. Many established companies also use EMI schemes to reward staff in anticipation of a disposal of the company, so that they can sell their shares and make a capital gain. Companies can structure the timing of when staff can buy their shares in all sorts of ways, for example they could vest immediately; or they could vest 25% of their options each year over four years; or they could be exercisable only when an "exit event" occurs i.e. when the business is sold. In fact EMI structures can be very flexible. Most schemes provide that if an employee leaves the company, then they would automatically lose their options.

### How we can help

We have set up hundreds of EMI share option schemes (both for clients and on behalf of other accounting firms) and we are able to offer realistic fee rates that suit growing entrepreneurial companies. The preparation of EMI schemes is one of our core activities and our approach is highly efficient. Typically, we can deal with the documentation by phone, post and email but if you would like face-to-face meetings (which can encompass presentations to staff for example) we can do that.

We take care of all the legal documents you need, and your share valuation agreement with HMRC too: in other words, you get a one-stop service. Fees – a typical EMI scheme, all-inclusive, would cost a fixed fee of £3495 + VAT.

### An illustration

As an example, if Jim was gifted shares or options worth say £10k today, without using an EMI scheme, he would be charged PAYE immediately at up to 45%. However, under an EMI scheme, if he were granted £10k of options today, he would be charged 10% capital gains tax on any profit only when he eventually sells them. If that £10k of shares increased to say £50k on their eventual sale, and Jim makes a £40k gain, he might have to pay out as little as £3k in tax (after utilising his annual CGT allowance). The non-EMI employee, in contrast, could pay out over £22k in total.

So the main tax benefit of EMI share option schemes is that instead of paying the high rates of income tax and NI that employees would normally be charged the profit on selling shares, they are only charged 10% capital gains tax on the increase in value over the amount they pay for their shares (the option exercise price), so long as that price is at least the value of the shares on the original date of grant, as agreed upfront with HMRC.

**We make setting up a scheme as easy as possible for you.**
We send you a short questionnaire to complete, with everything explained very simply. The sort of information we will need includes -

- The names of employees to be included in your scheme
- The number of share options to be granted to each individual
- The design of your scheme: the period over which the options will vest and the structure for the vesting (we will discuss this with you in detail)
- When an employee can exercise options and buy actual shares (e.g. any time after vesting, or only on a sale of the company)
- The price of the options, and the basis for that price (valuation)
- Your Articles and any shareholders' agreements

*'We used the Mill Consultancy when relaunching our EMI option scheme -we were looking for a sensibly priced and personal service with practical, tailored advice. We got all this and more - Jerry was highly competent and quick to understand what we were after. He has always been very helpful and responsive to subsequent queries and we will certainly use the company again for other services.' Clare Capstick-Dale, X4i*

**What is the "EMI"?**
EMI was introduced in 2000 to assist companies in attracting and retaining key employees and to reward those employees for taking the risk to work for such companies.

The EMI allows a qualifying company to grant options over shares with a value of up to £250,000 per employee (up to a maximum of £3 million per company) on very flexible terms. EMI options are eligible for 'entrepreneurs' relief' with capital gains tax at only **10%** rather than 20%. Outside an EMI scheme, employees would instead pay income tax on gains, at up to **45%** (and possibly NI on top as well).

**What companies qualify?**

- The gross assets of the company (or the group of companies if a parent company) must not exceed £30 million. Gross assets broadly comprise all assets shown in the balance sheet.
- The company must have fewer than 250 employees.
- The company must be independent and not under the control of any other company. Shares in a subsidiary cannot be used in an EMI option, i.e. the shares must be in the parent company.
- Companies may be quoted or unquoted.
- There is no requirement that the company be resident or incorporated in the UK but the company must have a 'permanent establishment' in the UK. Group companies can offer EMI share option schemes to employees throughout the group, provided that all of the subsidiaries in the group are qualifying subsidiaries. Broadly, this means that the parent (or another subsidiary) must own at least 51 per cent of the share capital and fully control that subsidiary.
- Certain trades are excluded from the EMI. Excluded trades include leasing, financial activities and property development. For a group, the activities of all group companies will be treated as a single business.

**What employees qualify?**
To qualify, employees must:

- Work for the company (or, if relevant, any group company) for at least 25 hours a week or for at least 75 per cent of their paid working time (which includes time spent in self-employed work);
- Not have a "material interest" in the company i.e. more than 30 per cent of that company (<u>not</u> including any EMI options).

**Are there any restrictions on the grant of options?**
Each employee can only hold a maximum of unexercised options worth £250,000 in any 3-year period under the EMI. Any further options granted to an employee over and above this sum would not qualify for EMI relief.

Companies are free to set their own option period, but note that after 10 years the tax benefits of EMI will no longer apply to the exercise of any outstanding options.

Companies are also free to set the option price, which may be more or less than the market value of the shares on the date the option is granted. The shares over which options are granted must be fully paid up ordinary shares. It is not possible to grant an EMI option over redeemable or convertible shares.

**How is the EMI operated?**
A separate signed agreement will be required in respect of options granted to each employee. This enables the company to tailor each grant of an option to the particular employee. It's fine to have different vesting periods and option numbers for different employees.

**Does HMRC supervise the operation of the EMI?**
There is no need for prior approval of EMI share option schemes from HMRC - the company must simply notify HMRC within 92 days once an option has been granted. A company can however seek advance informal assurance from HMRC that it is a qualifying company.

A valuation of shares in connection with the EMI will need to be agreed with HMRC. This is important – it means that the market value of the shares is agreed by HMRC as at the date of the granting of the options and avoids any arguments later on when the employee eventually sells the shares on an exit.

Companies who grant EMI options will need to make an annual return to HMRC by the 6 July after each tax year. We can provide this service if required.

**What other requirements are there?**
The employee must be prohibited under the terms of the grant of the option from transferring any of his rights under the option. If the option is capable of being exercised after the employee's death, it must not be capable of being exercised more than one year after his death. There are provisions in the legislation for dealing with the EMI options if the company that granted them is the target of a successful take-over. In certain circumstances the holder of the option can agree with the acquiring company to surrender his option in return for a replacement option to acquire shares in the acquiring company.

**What are the tax advantages of EMI options?**

No income tax or national insurance contributions (NICs) are payable when EMI options are granted.

If the option's exercise price is set at the same or a higher price than the HMRC-agreed market value of shares on the date that the option is granted, then no income tax or NICs are payable when the option is exercised.

Companies may set the option price at a discount to the agreed market value. However, where this is the case then, on exercise of the option, income tax will be payable on the discount (the excess of the market value of the shares on the date the option is granted over the exercise price paid by the employee).

When shares obtained on exercise are eventually sold the employee will be liable for capital gains tax (CGT), currently at the entrepreneur's relief rate of 10%. The employee can also use their annual CGT exemption (currently the first £12k of gains is tax-free).

The costs of setting up and administering the EMI will be deductible expenses for the company against corporation tax. Also, after exit, the net market value of the options exercised by employees may be an allowable expense, similar to expensing normal employee remuneration.

**Can the tax advantages be lost?**
If at any time prior to the exercise of an option a "disqualifying event" occurs then, on a subsequent exercise of the option, an employee will be subject to income tax in the usual way as on the exercise of an unapproved share option. However, the gain will be calculated by reference to the market value of the shares on the date of the disqualifying event. Examples of disqualifying events include:

- The employee ceasing to be a qualifying employee (e.g. going part-time)
- The company ceasing to be a qualifying company (e.g. its business changes and becomes ineligible)

**Other points** - there are **other types of option schemes** available but for most growing SMEs we consider that EMI is definitely the best. There are other forms of scheme, such as the CSOP (company share ownership plan) if your trading activity is ineligible for EMI, or an 'unapproved' scheme for non-executives and non-employees, that we can help you with.

Sometimes it will make sense for a company to have new **Articles of Association** drafted, for two main reasons - first, the company may require that it can buy back shares from an employee who has bought shares under their option agreement but who later leaves employment, so 'buy back' provisions will be needed, and second, a number of companies require that option shares are a different class e.g. non-voting, so the Articles will need to cover different class rights for A shares, B shares etc. If new Articles are required, we can draft them for you.

**To discuss your requirements please call or email Jerry Davison: 01392-432654 or jerry@millconsultancy.co.uk**

*'Jerry set up our EMI scheme and I can't recommend him highly enough, Jerry provided us with all the advice, documentation and dealt with HMRC to get us heavily discounted options.' – Paul Thomas, Cupris Software*

*'We chose the Mill Consultancy to create our share scheme based on the all-inclusive package (i.e. including the company valuation and having no hidden extras) and the price which was extremely competitive. We were very happy with our decision. Jerry at Mill Consultancy was fast and effective whilst always maintaining great communication and being happy to help with any questions we had. What to a small company had seemed a daunting task turned out to be a very smooth procedure indeed and all thanks to Jerry for that. It is very easy to recommend the Mill Consultancy to you for your EMI share scheme.' - Rodney Higgins - CEO - VSR2 Limited*

## Pricing matrix – fixed fees

**Full EMI option scheme service – £3495**

- EMI Option Agreement providing for the grant of EMI options exercisable either based on time vesting, performance measures or on an exit/sale of the company and incorporating standard leaver provisions.
- Review of your Articles to assess conformance with the EMI scheme
- HMRC Share Valuation Application consisting of the letter to HMRC requesting agreement to the proposed share valuation, compiling supporting documentation and then any dialogue or negotiation with HMRC if required.
- Help sheets and discussions to guide you through every step of the process.
- A briefing document for employees showing the key terms of the EMI agreement including the tax implications.
- Board minutes approving the terms of the EMI Option Agreement and the grant of EMI options.
- Formal notice of the grant of the EMI options to HMRC.

**Add-ons if required**

Annual returns for EMI – we take care of your annual HMRC reporting, required after the end of each tax year. Fees are £105 or £225 depending on the information required to be reported.

New Articles – if you need to change your Articles of Association e.g. to create a separate class of shares, or provide for share buy back from leavers, you will need new Articles - £295

Visit by us to your premises e.g. to explain scheme to your staff - £750

All fees are plus VAT