Charles Russell Speechlys

Guide to *EMI* Share Options

2024

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What is an EMI scheme?

An EMI scheme is a tax-advantaged discretionary share option scheme which has proven popular as an incentive in recruiting and retaining key employees of private and AIM listed companies.

EMI options align the interests of shareholders and key employees whilst providing significant tax savings for both the employer company and the employee.

An EMI option scheme is simple and easy to understand, offers flexibility in designing relevant features that may be tailored for a specific business, and can be implemented and administered at reasonable cost.

"CRS take a partner led approach to Employee Share Schemes which is essential due to their complexity, and multiple variations that one can have in a scheme. That coupled with easy access to the partners separates them from their competitors."

CFO of growth company client

EMI qualifying companies

Most small- and medium-sized companies should qualify for EMI provided the following requirements are met:

- the gross assets of the company/group must not exceed £30 million at the time of grant of the EMI options;
- the company/parent must not be controlled by another company or another company and any person connected with that company (e.g. family investment companies or corporate trustees);
- the company/parent must only have qualifying subsidiaries (broadly >50% shareholding) – joint ventures can be problematic in this respect;
- the company/parent must be a trading company carrying on a qualifying trade (which specifically excludes, amongst others, dealing in land, financial instruments, banking, insurance, other financial activities, legal or accountancy services, farming or market gardening);
- the company/group must have fewer than the equivalent of 250 full-time equivalent employees; and
- the company (or a subsidiary with a qualifying trade) must have a UK permanent establishment.

Companies can seek advance clearance from HMRC as to whether or not they meet these requirements.

Option shares and limits

Shares subject to EMI options must be non-redeemable, fully paid up, ordinary shares.

EMI options can be granted over a new or special class of shares with different rights to existing shares (for example, shares with no voting rights or different dividend entitlements).

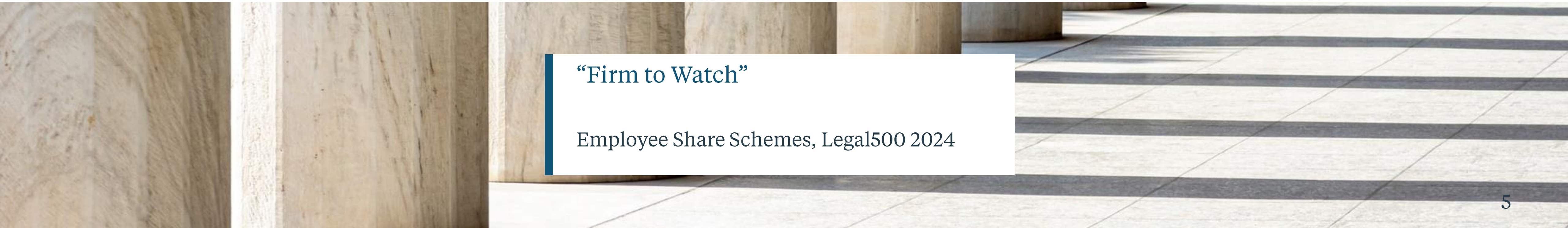
In the case of a group of companies, only the parent company's shares can be subject to EMI options.

EMI options limits

- There is a £3 million overall limit on the value of shares in the company that can be subject to unexercised EMI options.
- There is no limit on the number of employees that can hold EMI options.
- An employee may not hold EMI options over shares having a value (at the date of grant) of more than £250,000.

Valuation

The valuation of EMI option shares can be agreed with HMRC in advance of the option grant, providing greater certainty on the likely tax treatment on exercise of the option and sale of the option shares, as well as ensuring that any EMI options granted do not exceed the statutory limits.



Eligible employees

EMI options can be granted to employees who, broadly, do not hold 30% or more of the company's share capital (including any shareholding held by the employee's relatives, such as parents or children) and either:

- are required to spend at least 25 hours a week working for that company or a subsidiary; or
- if less, at least 75% of their total working time (including any self-employment) working for the company or subsidiary.

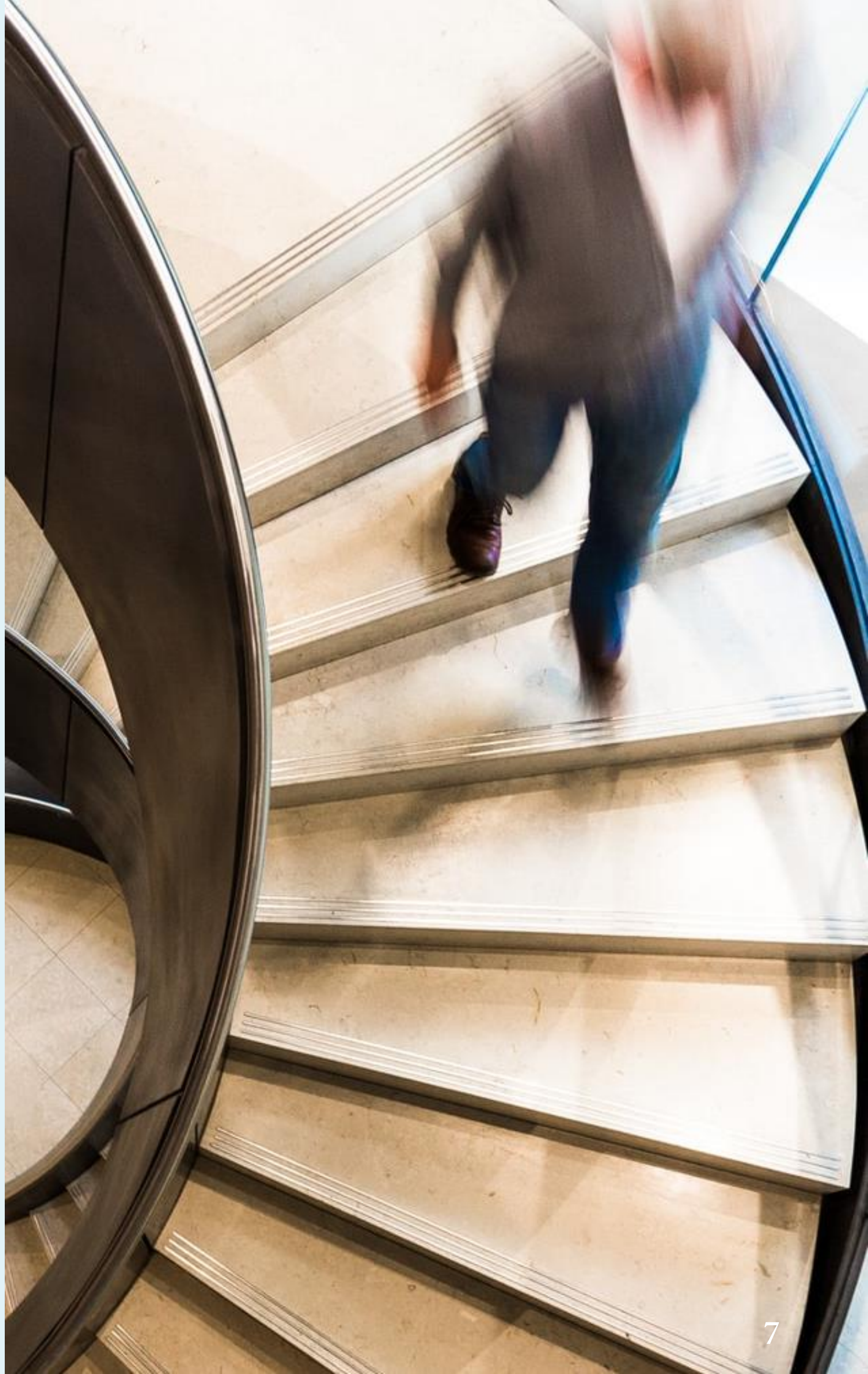
EMI options cannot be granted to individuals who are not employees (such as non-executive directors or consultants).

Flexibility in scheme design

Assuming the general conditions are met in respect of the company/group, shares and employees, there is wide freedom in designing and tailoring the terms of an EMI scheme to suit the needs of a particular business.

Common considerations on appropriate structures and key scheme rules include:

- setting up a new class of shares (such as non-voting shares) over which to grant the options;
- options to be satisfied by the issue of new shares or the transfer of shares from existing shareholders (including an employee benefit trust);
- whether the EMI scheme should be "exit-only" (i.e. exercise of options is conditional on the occurrence of an 'exit' or liquidity event, such as a sale of the company/parent resulting in a change of control or an IPO);
- the inclusion of time-based vesting of option shares or performance conditions to be satisfied; and
- any "leaver" provisions that should apply on the cessation of employment by an option holder (e.g. whether option holders should be entitled to retain or exercise their options in these circumstances, and whether 'good' or 'bad' leavers will be treated differently).



Beneficial tax treatment

*For the **company***

A corporation tax deduction should be available on the exercise of EMI options in the accounting period when the option is exercised. The deduction is broadly equal to the difference between the market value of the option shares on exercise and the amount paid by employee to acquire the shares.

*For the **employee***

There are three key stages as follows:

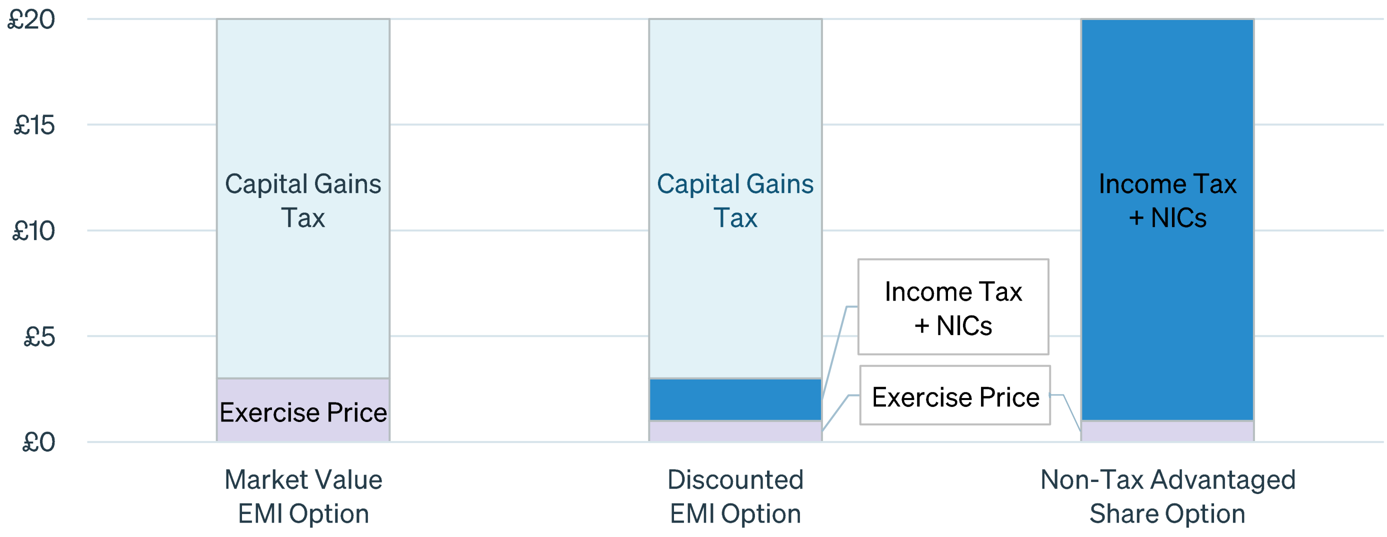
On grant: there are no tax charges when an EMI option is granted.

On exercise: if the option exercise price is equal to or greater than the market value of the option shares on the date of grant, no tax liability arises on exercise of an EMI option. However, exercise of an EMI option with discounted exercise price below market value will give rise to a tax liability based on that discount. If the option shares are “readily convertible” assets (which would typically apply in an ‘exit’ scenario or if there are trading arrangements in place for the option shares) any income tax (and NICs) is collected under PAYE.

On sale: the difference between the proceeds of sale and the exercise price paid by the employee for the option shares (plus, if applicable, any amounts treated as employment income) would typically give rise to a chargeable gain subject to capital gains tax (currently 24% for higher/additional rate taxpayers). The employee may be eligible to claim Business Asset Disposal Relief (BADR) (formerly known as Entrepreneurs’ Relief) to reduce the applicable rate of capital gains tax to 10% (increasing to 14% from 6 April 2025 and again to 18% from 6 April 2026).

Illustrative examples

If three different options (one an EMI option with a market value exercise price, one an EMI option with a discounted exercise price, and one a non-tax advantaged ("unapproved") option) were granted at the same time over shares with an actual market value of £3 per share and the options are subsequently exercised (with the underlying shares being immediately sold) in connection with the same 'exit' delivering value of £20 per share, the illustrative tax treatment of each option (on a "per share" basis) is summarised below:



In an 'exit' scenario, the exercise price and any income tax/NICs liabilities can usually be satisfied by deducting these amounts from the proceeds of sale received by the employee.

Losing tax benefits

The principal tax benefits are lost, either in whole or in part, if:

- the grant of the EMI option is not notified to HMRC by 6 July following the end of the tax year of grant;
- HMRC decide that the option does not qualify as an EMI option (subject to appeal); or
- a "disqualifying event" occurs and the EMI option is not exercised within 90 days of the disqualifying event, such as:
  - the company becomes a subsidiary of, or otherwise comes under the control of, another company;
  - the company/group ceases to meet the trading activities requirement;
  - the employee ceases to satisfy the working time requirement;
  - the employee ceases employment with the EMI company or any subsidiary of it; or
  - certain variations are made to the terms of an existing EMI option or the share capital.

Our firm at a *glance*

Services we provide:

Banking & Finance
Commercial (including IT outsourcing)
Construction, Engineering & Projects
Corporate (including public company M&A & ECM)
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Data Protection
Employment
Immigration
Family
Financial Services, Regulation & Funds
Intellectual Property
Litigation & Dispute Resolution
Personal Tax & Succession Planning
Real Estate

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Recommended in 8 categories in The Times Best Law Firms 2022

Tier 1 in 21 work type/ Geographical categories (Legal 500 UK 2023)

+300 referrals and introductions made via our Global Network in 2022

"They want to *work with you* rather than for you. They want to understand your business, *what the real issues are* and how those issues really impact it."

"I find the firm to be *more pragmatic* than certain of its competitors in the legal advice market. In-house lawyers need *clear, concise, and commercial advice* from external legal counsel; they do not have time to deal with ambiguity or an overly-academic approach."

The Legal 500 — Legal 500 UK 2022

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