



## Employment issues (tax)

# Share Ownership for Employees - EMI

### EMI and SIPs

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 two ways in which an employer can provide mechanisms for employees to obtain shares in the employer company without necessarily suffering a large tax bill.

The two routes are:

- Enterprise Management Incentives (EMI) and
- Share Incentive Plans (SIPs).

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.

A SIP is designed to allow all employees to participate in their business and to encourage long-term shareholding by them.

This factsheet outlines the rules for EMI.

### 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 he may not have any cash to pay the tax arising.

In order to avoid this immediate charge, options could be granted to an employee. An option gives the employee the right to obtain shares at a later date. Provided that the terms of the option are that it must be exercised within ten years, any tax liabilities will be deferred until the time the options are exercised.

This may still be expensive for the employee if he is 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.

### 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 for the use of nil cost and discounted options. However, in these circumstances, there is both an income tax and an 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.

The only other possible occasion of charge to tax will be when the shares are sold and a liability to capital gains tax (CGT) may arise. The CGT bill should be low as:

- the shares will constitute business assets for the purposes of taper relief and
- when the shares are eventually sold, CGT taper relief will run from the date of grant of the options.

For most employees therefore the maximum tax bill will be 10% of the gain made on sale.

### 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.
- The costs of setting up the option plans should be tax deductible.



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### 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 them 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
- 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?

EMI provides some flexibility for employers. For example, it is possible to limit voting rights, provide for pre-emption or set other conditions in respect of shares which will be acquired on exercise of an EMI option. The shares must, however, be fully paid ordinary shares so that employees have a right to share in the profits of the company.

#### 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
- takeover of company
- sale 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

We can help you decide whether EMI is appropriate for your business and whether the business will qualify.

We are also able to help you with the necessary documentation required to establish and operate EMI and advise on the costs.