

# Enterprise Management Incentive (EMI)

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**Designed as a flexible and tax efficient employee share option scheme, the EMI was introduced in recognition of the difficulties often experienced by smaller higher risk companies in the recruitment and retention of key members of staff.**

## What is EMI?

An EMI is a discretionary share option scheme which can produce tax savings for both the employer and employee. It can be an attractive addition to the overall remuneration package for both existing and future employees. An EMI is used to reward individuals for devoting their skills, time and energy to a smaller company with the potential for growth rather than a larger more secure company.

The EMI scheme enables qualifying companies to grant share options up to a maximum of £3 million to all or any of its “eligible” employees. An individual employee is allowed to hold an EMI option over shares worth up to £250,000. The option must be capable of being exercised within 10 years of the date it is granted.

## EMI qualifying companies

To qualify for the EMI scheme, a company must:

- Be independent and not controlled by another company.
- Have gross assets which do not exceed £30 million (with no account being taken of liabilities).
- Not carry on any substantial “non-qualifying activities” (this predominantly affects “land rich” companies and investment companies).
- Carry on a qualifying trade.
- Have qualifying subsidiaries (if applicable).
- Have less than 250 full time equivalent employees.
- Not be in financial difficulty.

A trade is a “qualifying trade” if it is conducted on a commercial basis and for profit, with a permanent establishment in the UK.

## EMI eligible employees

There is no limit on the number of employees who can be granted an EMI option, although the £3 million limit on the market value of unexercised options must not be exceeded. In order to qualify for an EMI option, an employee must:

- Work for the company at least 25 hours per week or, if less, at least 75% of their working time.
- Not control or beneficially own more than 30% of the shares in the company.
- Not hold options under the EMI scheme or the HM Revenue & Customs Company Share Option scheme with a value in excess of £250,000.

## EMI option shares

The option shares can be voting or non voting but must be fully paid up ordinary shares which aren't redeemable or convertible or subject to any restrictions other than those which attach to all shares of the same class.

## Tax treatment of EMI options

### Income tax and National Insurance contributions (“NICs”)

There is no income tax or NICs payable on the grant of the option.

There is no income tax or NICs payable on exercise of the option provided the option price is at least equal to the market value of the shares at the date of grant of the option. If the option price is less than market value at the date of grant of the option, the option is said to be granted at a discount and income tax will be payable on exercise in respect of the difference between the market value of the shares at the date of grant and the option price.

### Capital gains tax

When the employee eventually disposes of his EMI shares, capital gains tax is payable on the amount by which the disposal price exceeds the market value of the shares at the date the option was granted.

The rate of capital gains tax varies as follows:

- A basic rate tax payer pays capital gains tax at 10%. So to the extent that a capital gain, when aggregated with the employee's total income, falls below the threshold for higher rate income tax, it is charged to capital gains tax at 10%.
- Higher rate and additional rate tax payers pay capital gains tax at 20%.

- A shareholder can qualify for the 10% rate of capital gains tax by claiming Business Asset Disposal. Business Asset Disposal is available if the shares were owned for at least 24 months prior to sale and constitute at least 5% of the ordinary share capital and voting rights in the company share capital, economic value of the company and voting. Shareholders who acquire shares under an EMI option do not have to satisfy the 5% test. In addition, the time between the grant of the option and its exercise will count towards the 24 month period. This means that an EMI option holder may qualify for Business Asset Disposal Relief if he has held the option for at least 24 months before the exercise of the option and sale of the shares.

The capital gains tax treatment outlined here may be lost if a disqualifying event occurs and the option is not exercised within 90 days (the “grace” period granted by HM Revenue & Customs (“HMRC”)).

## Disqualifying events

The following have the effect of making an unexercised EMI option lose its qualifying status:

- The company ceases to be independent because it becomes a 51% subsidiary of another company or comes under the control of another company.
- The company ceases to be a trading company for statutory purposes.
- The option holder ceases to be an employee or ceases to meet the working time requirements.
- The grant of a further share option which means the value of options held by that employee exceeds the £250,000 threshold.
- The terms of the option are varied or the share capital is altered, which in either case has the effect of increasing the market value of the option shares.

## Operation and administration of the EMI

The EMI is designed to be simple in terms of its administration and operation in order to keep the costs low for companies. While no formal rules are required, it is recommended that rules are put in place to maintain consistency between different option holders and in order to ensure that certain statutory requirements are satisfied.

Qualifying companies do not need to seek approval from HMRC before implementing an EMI scheme. However, there is a requirement to notify HMRC online within 92 days of the grant of an EMI option (and to provide annual returns within 3 months of the end of each tax year). The notification usually includes a share valuation, which is normally agreed with HMRC’s Shares and Assets Valuation division up to 90 days before the grant of the option.

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