

Enterprise Management Incentives (EMI) are tax-advantaged share options designed to help smaller companies to recruit, retain and incentivise employees.

EMI options may only be granted over shares in an independent trading company whose gross assets do not exceed £30 million and which has fewer than 250 employees.

The company can select which employees will be granted options and the size of award to be made to each individual, up to a maximum of £250,000 per person. The exercise price of the option can be lower than the share price at grant (or even zero), though this will affect the tax position (see below).

An EMI option may be granted through a formal share plan or by a written agreement between the grantor and the employee. There is no need for HM Revenue & Customs (HMRC) to approve the arrangement. However, HMRC must be notified online within 92 days each time an EMI option is granted to an employee in order for the tax advantages to apply.

Tax advantages

Employee

No income tax or national insurance contributions (NICs) are payable on the grant of an EMI option. Similarly, there is no tax or NICs liability when it is exercised, provided that the exercise price is not set at a discount to the share price at the date of grant.

If the exercise price is lower than the share price at the date of grant, there will be an income tax and possibly a NICs charge on this discount at the time of exercise.

If certain "disqualifying events" occur, for example the company comes under the control of another company or ceases to carry on a qualifying trading activity, the EMI option must be exercised within 90 days of the event to preserve the favourable tax treatment.

On sale of the shares, there is a potential capital gains tax (CGT) liability on the difference between the sale proceeds and the amount which the employee paid for the shares (plus any amount which was taxed at exercise). It may be possible to reduce or eliminate the chargeable gain through the individual's annual CGT exemption (£11,700 in 2018-19).

The CGT rate for higher and additional rate taxpayers is currently 20% (28% on gains on property and carried interest). Any employees who have held at least 5% of the company's ordinary share capital and 5% of the voting rights for at least a year before disposing of the shares may qualify for a 10% CGT rate under Entrepreneurs' Relief.

Finance Act 2013 extended Entrepreneurs' Relief to shares acquired through EMI options exercised after 5th April 2012, regardless of the number of shares held. The one-year holding period starts from the date of grant of the EMI option.

Employing company

The employing company can claim a deduction for corporation tax purposes for the difference between the market value of the shares at the exercise date and the amount paid by the employee. The employing company is exempt from employer's NICs in the same way as the employee.

Main conditions for qualifying options

The main conditions which must be met for options to qualify as EMI options are set out below.

Purpose of granting the option

The option must be granted for commercial reasons in order to recruit or retain an employee in the company, and not as part of a scheme or arrangement whose main purpose is the avoidance of tax.

Maximum individual entitlement

An employee can only hold unexercised EMI options at any time over shares with a total value of up to £250,000 (based on the share price at grant). Any options granted to the employee under an approved Company Share Option Plan (CSOP) count towards this limit. If an employee has already been granted EMI options over shares with a total value of £250,000, he cannot be granted another EMI option for the next three years.

Overall grant limit

The total value of shares over which unexercised EMI options exist at any time for all employees cannot exceed £3 million (calculated at the respective grant dates for each option).

Qualifying companies

The company whose shares are subject to an EMI option must not be under the control of another company.

The gross assets of the company and its subsidiaries must not exceed £30 million. The full-time equivalent number of employees of the company and its subsidiaries must be less than 250.

The company must not carry out certain excluded activities, which include financial services, property development, farming, shipbuilding and producing coal or steel.

Eligible employees

An employee of the company or its subsidiary is eligible to be granted an EMI option if the employee:

- is required to spend at least 25 hours per week on the company's business or, if less, 75% of his working time; and
- does not have a material interest (30% or more) in the company (including any interest held by the individual's relatives and other associates).

Requirements for the options

The shares to be acquired on exercise of an EMI option must be ordinary shares in the company which are fully paid up and not redeemable.

The option must take the form of a written agreement which sets out its terms and conditions. It must be non-transferable. The option must be capable of being exercised within 10 years of its grant date. If the option holder dies, the option cannot be exercised more than one year after the date of death.