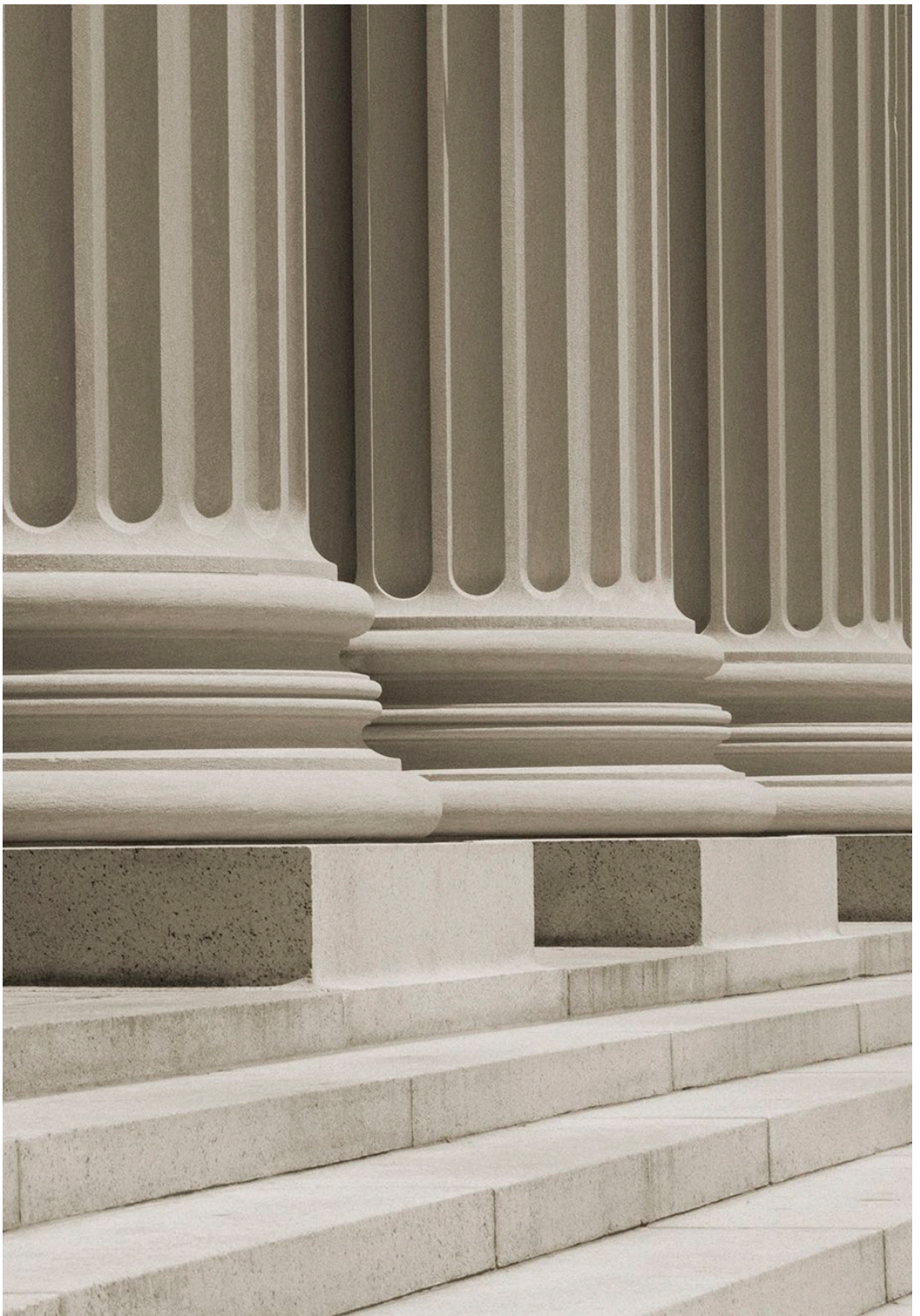




TaylorWessing

# Enterprise Management Incentive options

November 2024



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## Overview

### **Enterprise Management Incentive options ('EMI options') are granted for commercial reasons in order to recruit and retain employees in a company.**

They are ideal for small companies, for example, in the technology sector, wishing to incentivise management and/or staff using equity arrangements as they can be highly tax-efficient and easy to implement. Companies have a high level of flexibility in choosing how the terms of the options will operate.

The total value of shares in a company which may be subject to unexercised EMI options at any time is £3 million. The maximum entitlement of an individual EMI option holder at the date of grant of the EMI option is £250,000.

Below is set out a brief summary of the main terms required to be satisfied in order for there to be a valid grant of an EMI option.

As noted above, EMI is a very tax advantageous option plan, however, the quid pro quo of this is that it is hedged around by complex rules set out in Schedule 5 ITEPA 2003, which have to be examined in detail each time an EMI option is granted.

There are a number of different qualifications which have to be satisfied, and these relate to:

- the company whose shares are to be placed under the proposed EMI option
- the individual to whom the option is granted, and
- the terms and circumstances under which the option is granted.

These are for the most part ongoing tests and it is not usually sufficient to satisfy these tests only at the time at which the option was granted.

There is no advance clearance or approval procedure for an EMI option plan although HM Revenue & Customs ('HMRC') may comment in advance on whether the company is a qualifying company or not. If the option fails to qualify as an EMI option at any time during its lifetime then it becomes a non tax-favoured option and will be taxed as such. It is therefore advisable to include the usual tax indemnities in an EMI option plan and consider entering into an agreement with employees granted EMI options to transfer any employer's national insurance liability arising to such employees.

## Qualifying company

### A qualifying company must:

- be independent
- have qualifying subsidiaries, if it has subsidiaries
- satisfy a gross assets test
- satisfy tests as to its trading activities
- satisfy the test as to having a UK permanent establishment, and
- satisfy the test regarding 250 employees.

### Independent

An EMI option cannot be granted over shares in a company which is either a 51% subsidiary or under the control of another company (or of another company and any other person connected with that other company) without being a 51% subsidiary. There must be no arrangements in place by virtue of which the company could become a 51% subsidiary or come under the control of another company.



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### Qualifying subsidiaries

If the company has subsidiaries, then every subsidiary must be a 'qualifying subsidiary'. For EMI purposes, a subsidiary is any company which the company controls, either on its own or with a connected person.

If a subsidiary is to be a 'qualifying subsidiary' it must be a 51% subsidiary of the company and no person other than the company (or another of its subsidiaries) can have control of the subsidiary. There must be no arrangements in place whereby the subsidiary would cease to be a 51% subsidiary of the company or come under the control of another company (other than another subsidiary of the company).

Essentially, this means that the company can have minority shareholdings as they would not be regarded as a subsidiary, but it cannot have a joint venture holding as a subsidiary.

Further, a company will not be a qualifying EMI company if any of its subsidiaries is a 'property managing subsidiary' which is not a 90% subsidiary of the company. A property managing subsidiary would be a qualifying subsidiary of the company whose business consists wholly or mainly in the holding or managing of land or any property deriving its value from land.

### Gross assets

In order to satisfy this test, the value of the group assets in aggregate (without deduction of any liabilities) must not exceed £30 million.

For EMI purposes it is possible to disregard any assets that consist in rights against, or shares in or securities of, another company in the group. HMRC will also take the value of the assets at their amortised or depreciated value in calculating this limit.

### Trading activities

A single company must exist wholly for the purpose of carrying on, and carry on, one or more qualifying trades. In general, a 'tech company' will fulfil the trading activities requirement, even if it is not yet trading, but is preparing to trade.

A trade is a qualifying trade if it:

- is conducted on a commercial basis with a view to the realisation of profits, and
- does not consist wholly or to a substantial part in the carrying on of 'excluded activities'.

Excluded activities include the following:

- dealing in land, in commodities or futures or in shares, securities or other financial instruments
- dealing in goods otherwise than in the course of an ordinary trade of wholesale or resale distribution
- banking, insurance, money-lending, debt factoring, hire-purchase financing or other financial activities
- leasing (including letting ships on charter or other assets on hire) or receiving royalties or licence fees
- the provision of services or facilities for a business carried on by another person where the business consists of excluded activities and one person holds a controlling interest in both businesses
- property development
- providing legal or accountancy services
- farming or market gardening
- holding, managing, or occupying woodlands, any other forestry activities or timber production



- operating or managing hotels or comparable establishments, or managing property used as a hotel or comparable establishment
- operating or managing nursing homes or residential care homes, or managing property used as a nursing home or residential care home, and
- shipbuilding, steel and coal production.

In the case of a parent company (as opposed to a single company), the trading activities requirement will be satisfied if:

- the business of the group as a whole does not consist wholly or substantially of non-qualifying activities i.e. excluded activities as listed above, and
- at least one group company exists wholly (ignoring any insubstantial activities) for the purposes of carrying on one or more qualifying trades and is carrying on a qualifying trade or preparing to do so.

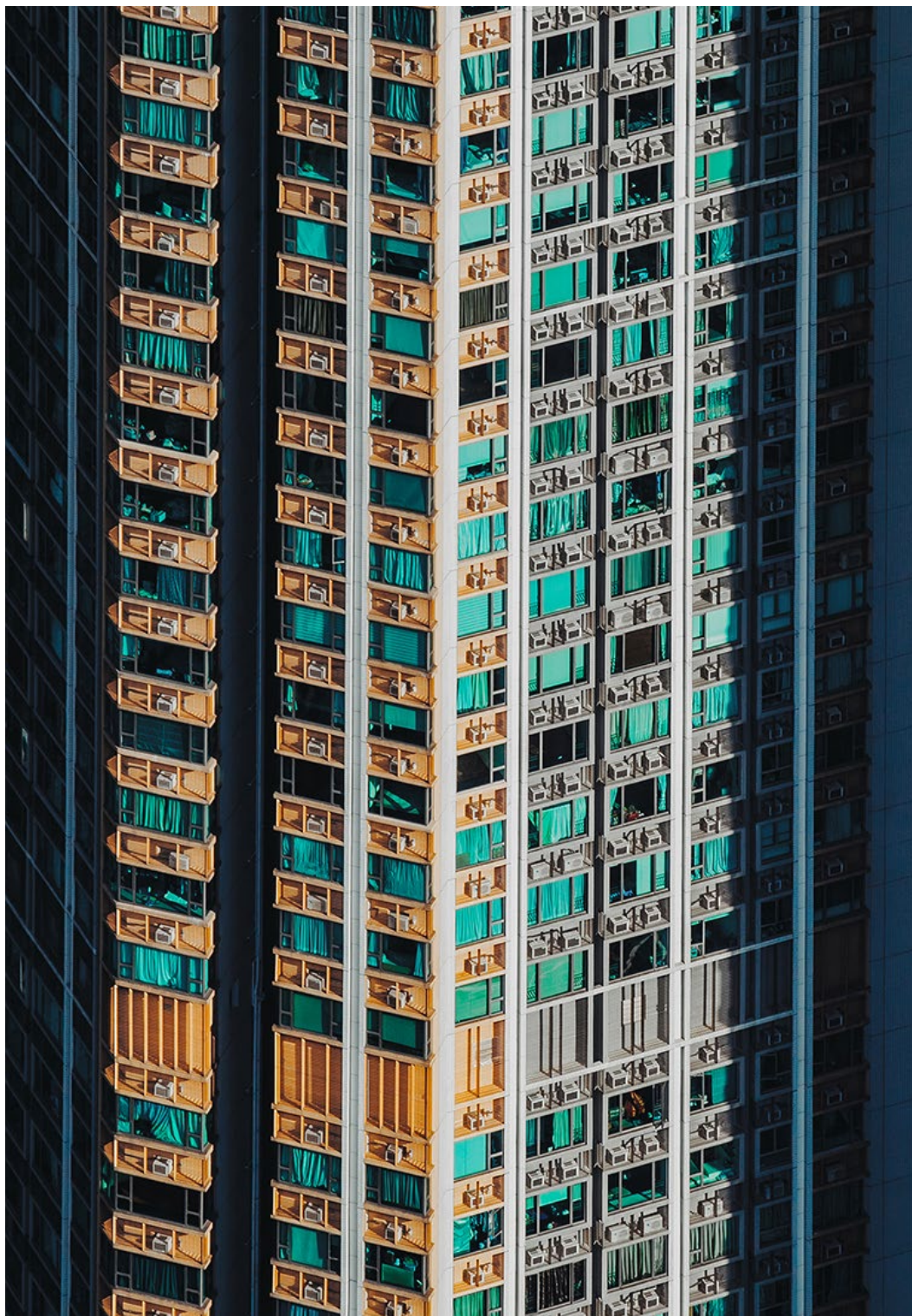
### UK permanent establishment

A company must have a UK permanent establishment. This requirement is met if:

- the company has a permanent establishment in the United Kingdom, or
- the company is a parent company and any other member of the group exists: (i) wholly for the purpose of carrying on one or more qualifying trade and is carrying on a qualifying trade or preparing to do so; and (ii) has a permanent establishment in the United Kingdom.

### Fewer than 250 employees

A company will also only qualify if the number of employees in the company and its subsidiaries is lower than 250. There are certain rules about calculating this number where there are part-time employees.



# Eligible employees

**An individual will be an eligible employee with respect to the qualifying company if the following requirements are satisfied:**

- employment
- commitment of 'working time', and
- no material interest.

## **Employment**

The employee will satisfy this condition if he or she is an employee of either the qualifying company or one of its qualifying subsidiaries. There is no requirement to be employed in the UK, but this will normally be the case as non-UK individuals would not obtain much benefit from EMI options.

## **Commitment to 'working time'**

The employee must be committed to working at least 25 hours a week or, if less, 75% of their working time. Committed time in this context means time that he or she is required as an employee to spend on the business of the qualifying company or, if any, of any qualifying subsidiary or would have been required to spend but for some specific narrow exceptions such as, for example, injury or maternity leave. Working time also has a specific statutory meaning which may be summarised as time spent in remunerative work (either as an employee or as a self-employed person).

## **Material interest**

The employee on their own or together with their associates must not have ownership of, or the ability to control, directly or indirectly more than 30% of the ordinary share capital of the qualifying company or any group company.



## Terms and circumstances under which the option is granted

### The shares under option must be:

- part of the ordinary share capital of the qualifying company
- fully paid up, and
- not redeemable.

The option must be capable of being exercised within 10 years.

The terms (as specified in the legislation) of the option must be set out in writing at the time of grant of the option.

The option must not be assignable.

It is important to remember that the above tests in relation to a qualifying company, eligible employee and terms and circumstances of the option grant are not a 'snapshot' and that these are for the most part ongoing tests which must be satisfied throughout the term of the option.

### Discretion

Provisions allowing for board discretions (such as those giving the board discretion to waive performance conditions) can be included in an EMI option plan but these must be set out in the terms at the time of grant and their use carefully considered. HMRC guidance states discretion must not be exercised so as to cause a fundamental change to the terms of an option. This could result in the deemed regrant of the option and result in the loss of beneficial tax treatment.

Broadly, it is permissible to exercise discretions on a fair and reasonable basis to determine, for example, the applicable leaver category for a particular individual or to increase the level of vesting provided this does not impact on the timing of exercise. Any use of a discretion which would bring exercise forward to a time not specified in the option terms, for example, would not be permissible. Specific advice should be taken prior to the use of a discretion.

## Disqualifying events

### The EMI legislation limits the favourable tax treatment applying to EMI following a 'Disqualifying Event'.

Where an EMI option is not exercised within the statutory time limit after a Disqualifying Event any gain arising on the eventual exercise of the EMI option from the date of the Disqualifying Event will be subject to income tax rather than capital gains tax ('CGT'). The statutory time limit is currently 90 days.

The following is a summary of the EMI Disqualifying Events:

- the relevant company: (i) becoming a 51% subsidiary of another company; or (ii) coming under the control of another company (or of another company and any other person connected with that other company) without being a 51% subsidiary of that other company
- the relevant company ceasing to meet the relevant trading activity requirement (as at the time the option was granted) or potentially the UK permanent establishment requirement (see above)
- the employee ceasing to be an eligible employee by reason of:
  - (i) ceasing to be an employee of the company or one of its subsidiaries; or (ii) failing to meet the commitment of 'working time' requirements (see above for more details); or (iii) if, in any tax year, the employee's relevant working time amounts to less than 25 hours a week or, if less, 75% of their working time
- the variation of the terms of the option which: (i) causes an increase in the market value of the shares which are the subject of the option; or (ii) are such that the requirements of Schedule 5 are no longer met

- any alteration to the share capital of the company where shares are under option the effect of the alteration being: (i) that the requirements of the type of share to be held under option are no longer satisfied (see above); or (ii) to increase the market value of the shares that are subject to the option, where the alteration may have created, varied or removed a right, or imposed or lifted a restriction in relation to any shares in the company and the alteration is not carried out for any commercial reason, and
- the grant to an employee of a Company Share Option (CSOP), where immediately after it is granted, the employee will hold unexercised employee options with a total value of more than £250,000.





## Notice of option to be given to HMRC

**From 6 April 2024, for an option to be a qualifying EMI option, notice of the option must be given to HMRC by 6 July following the tax year in which grant occurred. HMRC has confirmed that notifications can still be made during the tax year.**

All EMI options must be notified using HMRC's online reporting system linked to the Pay As You Earn ('PAYE') online service. HMRC does not provide copies or confirmation of EMI options notified online. It is therefore up to the company to keep a detailed record of the EMI options notified. It is strongly recommended that you should print or save screenshots of the 'summary' and 'confirmation' pages of the details being provided during the EMI option notification as well as the acknowledgement page for your records. This is because they will be requested in any due diligence undertaken for an investment in or sale of the company. If you do not have such evidence an investor or buyer will not regard the options as being qualifying EMI options.

The notice to HMRC on the online system must: (i) be given by the employer company; and (ii) contain, or be supported by, such information as HMRC may require for the purposes of determining whether the requirements of Schedule 5 are satisfied.

The notice to HMRC on the online system must also contain a declaration by a director or the company secretary of the employer company that: (i) in their opinion the requirements of Schedule 5 are satisfied in relation to the option; and (ii) the information provided is to the best of their knowledge correct and complete.

## Tax treatment of EMI options

### On grant of the options

There is no tax chargeable in respect of the grant of an EMI option for either the employee or the employer.

### On exercise of the options (provided a Disqualifying Event has not occurred or if it has that exercise takes place within 90 days of it occurring)

Where the option is to acquire shares at not less than their market value at the time the option is granted there is no tax charge in respect of the exercise of the option for either the employee or the employer.

There will be an income tax charge on an exercise of an option to acquire shares at less than market value. The amount subject to income tax will be the amount by which the chargeable market value, exceeds the aggregate of: (i) the amount paid for the option (if any); and (ii) the exercise price.

Chargeable market value means:

- the market value of the shares at the time the option was granted (or, if a replacement option, at the time the original option was granted), or
- if lower, the market value of the shares at the time the option is exercised.

Where there is a charge to tax on the exercise of a nominal price option or discounted EMI option and the shares acquired pursuant to the option are Readily Convertible Assets ('RCAs'), there will be a corresponding national insurance contribution ('NIC') liability for the employer (@ 13.8% (increasing to 15% from April 2025) of the amount subject to income tax) and for the employee (@ 8% of the amount subject to income tax). The employee's NIC liability will be 2% if their earnings already exceed the Upper Earnings Limit (which is £967 per week for 2024/25).

In summary, an RCA is an asset for which there are trading arrangements in place or where there are arrangements for them to come into existence.

The parties may agree that any employer's NIC liability arising on the exercise of an option will be transferred to the employee.

**On sale of shares (provided a Disqualifying Event has not occurred or, if it did, that exercise took place within 90 days of it occurring)**

On the disposal of any shares acquired pursuant to the exercise of an EMI option there will be a charge to CGT on the difference between the disposal proceeds and the aggregate of the exercise price of the option and any amount which was subject to an income tax charge on exercise.

Gains on shares which are acquired on exercise of a qualifying EMI option can qualify for Business Asset Disposal Relief (formerly Entrepreneurs' Relief). This means that the first £1 million of lifetime gains can be taxed at a 10% rate

(increasing to 14% from April 2025 and to 18% from April 2026). The usual 5% holding and voting Business Asset Disposal Relief requirements do not need to be met. However, there is a two year holding requirement between the grant of the EMI option and the disposal of the shares.

Where Business Asset Disposal Relief is not available, the gain in excess of the annual CGT allowance (£3,000 for the tax year 2024/25) is taxed at CGT rates (which are currently 24% for higher and additional rate taxpayers and 18% for taxpayers whose income and gains do not exceed the higher rate threshold of £50,270).

**Corporation tax deduction**

The employing company may be able to claim a corporation tax deduction for the amount of the option gain in certain circumstances.

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