

employee incentives

"EMI is ideally suited to small companies looking to provide incentives to their key employees either in place of an annual cash bonus or so that they can share in the capital gains enjoyed by the shareholders on exit."

Q: Who should be interested in this?

A: Small companies that want key employees to share in the gain on exit or that want to provide incentives to key employees but are short of cash

Q: What is a share option?

A: The right but not the obligation to subscribe in the future for new shares at a price agreed now.

Q: What is an EMI share option?

A: An option granted to employees under the EMI tax code that offers certain tax advantages.

There are a number of Government sponsored tax-efficient share schemes. The most flexible that can be offered to all or selected employees only, EMI employee share options are ideally suited to small companies looking to provide incentives to their key employees either in place of an annual cash bonus or so that they can share in the capital gains enjoyed by the shareholders on exit.

Tax benefits of EMI options

- No income tax liability on the grant or exercise of the option.
- Corporation tax relief for the costs of administering the scheme and of issuing shares below market value at the date of issue.

How does it work?	
Day 1	Company's shares are worth £1 each.
Day 1	Co issues options to employee to buy shares at today's market value of £1 each. The option may be exercised at any time after the end of the third year.
Day 2000	Shareholders receive offer to sell all the company's shares at £10 each.
Day 2001	Employees exercise options and acquire shares for £1 each with funds borrowed from bank.
Day 2002	Shareholders accept offer to sell shares for £10 each.
Day 2003	Employees repay the bank loan of £1 and make profit of £9 per share.
Day 2003+	Employees pay tax liability of £1.62 or possibly £0.90 per share.
	Employee pockets more than £7 per share and it costs the employer nothing.

Summary of the main conditions for options to qualify for EMI code

- The company issuing the shares must not be under the control of any other company.
- Limited to companies or groups with less than 250 employees.
- Limited to companies or groups that have total gross assets not exceeding £30 million.
- The company must carry on trade mainly in the UK. There are detailed rules defining excluded trades but, broadly, qualifying activities are all business activities other than financial, property, agricultural and other land-based activities and those involving the provision of accommodation.

Valuation

"This valuation will normally be agreed with HMRC by accountants experienced in preparing such valuations."

- Eligible employees are all those who, at the time of grant of the option, are:
 - (a) employed by the granting company or its qualifying subsidiary
 - (b) work a minimum of 25 hours per week for the company
 - (c) either alone or with associates do not have an interest in 30% of the shares or the assets of the company.
- The shares must be ordinary, fully paid and not redeemable.
- The option must be capable of being exercised within ten years of grant.
- Rights under an EMI option may not be assigned to any other person.
- The maximum market value of the company's shares that may be the subject of outstanding options held by one individual at any time is £120,000.
- The total maximum market value of the company's shares that may be the subject of outstanding options at any time is £3 million.

£120,000

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Practical matters

Legal documentation

The EMI option agreement will need to be drawn up by a solicitor experienced in such matters.

Valuation

In order to demonstrate that no income tax arises on the exercise of an option, the company will agree the current market value of the shares with HMRC prior to each grant of options. This valuation will normally be agreed with HMRC by accountants experienced in preparing such valuations.

HMRC notification

Notice of the option must be given to HMRC within 92 days of grant.

Further advice

The legislation is complex but the benefits are significant and worth the effort. If your company is considering how it may provide valuable benefits to incentivise and retain key employees without drawing on its stretched cash resources, it should consider such share options. We should be pleased to provide the detailed, specific tax advice that you require. Please speak to either your usual contact at Winter Rule or

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The rules covering EMI tax relief are detailed and complex. Whilst we have taken due care in the preparation of this statement of the benefits and requirements for qualification, it is of necessity abbreviated and does not address some of the conditions in sufficient detail to provide assurance that any particular offer of options will qualify for relief. Any company or other interested party should take specialist advice in relation to its own circumstances before proceeding. Winter Rule LLP, its members and employees accept no responsibility for any loss arising to anyone acting or failing to act in reliance of the statements in this note.