



ENTREPRENEURIAL BUSINESS LAWYERS

ENTERPRISE MANAGEMENT INCENTIVE OPTION SCHEMES

Enterprise Management Incentive Option Schemes ('EMI Options') are an excellent and widely used method to incentivise both employees and senior management. They are regulated by the Income Tax (Earnings and Pensions) Act 2003, in particular Schedule 5. The key features of an EMI option scheme are as follows:-

QUALIFYING COMPANIES

In order to be eligible to grant EMI options, the Company must be a "Qualifying Company" on the date of grant of such an EMI option. A Qualifying Company is an independent trading Company with gross assets not exceeding £30 million.

A Qualifying Company must also perform a "Qualifying Trade" in the UK, on a commercial basis. Non-qualifying activities include banking, insurance, money-lending, dealing in land and hire purchase. Where the Company is part of a group, the group's business must not consist wholly or mainly of non-qualifying activities.

As of 21 July 2008, a Qualifying Company must have fewer than 250 full time- equivalent employees at the date on which an option is granted. This requirement applies to employees of the Company and all its qualifying subsidiaries, whether or not they are based in the UK. Options granted prior to 21 July 2008 are not affected by this.

QUALIFYING EMPLOYEES

In order for an individual to qualify for the grant of an EMI option, that person must work for the Company (or for a qualifying subsidiary of the Company) for at least 25 hours a week or 75% of his or her total working time. Non-employees are not eligible for EMI options.

The employee, together with any person connected to the employee, must not have a material interest (more than 30%) in the Company or any member of the Company's group. Any EMI options held by the employee are excluded from this calculation.

QUALIFYING SHARES

Shares under an EMI option scheme must be ordinary shares, fully paid up when issued and non-redeemable. Restrictions (e.g. compulsory transfer provisions) may be placed on the shares to be issued under an EMI option scheme, provided that such restrictions are clearly stated in the option agreement or any document incorporated into the option agreement by reference, e.g. the option scheme rules or the Articles of Association of the Company.

QUALIFYING OPTIONS

In order for an option to qualify as an EMI option, the option must be granted to recruit or retain an employee. The terms of the option must be in writing and must contain certain statutory information (date of grant,

maximum number of shares under option, exercise price, and so on). An EMI option must be capable of being exercisable within 10 years after being granted. Where an option continues after such a 10 year period, the option may still be exercised after expiry of the 10 years, although it will no longer be eligible for EMI tax benefits.

Conditions (such as performance criteria over time or the achievement of a given price per share on exit) may be imposed on the options, provided that such conditions are clearly stated in the option agreement or any document incorporated into the option agreement by reference.

An EMI option is not assignable, and the terms of an option must prohibit the option holder from transferring any of his or her rights under it. However, an EMI option may be exercised by the personal representatives of an option holder if the terms of the options specifically allow its exercise after the holder's death. If such exercise is permitted, the relevant option agreement must also state that the personal representatives must exercise the option within 12 months of the date of death, otherwise the option lapses.

Once an EMI option has been granted, any changes to the terms of the option that cause the market value of the shares subject to that option to increase or result in the option no longer qualifying as an EMI option will be considered disqualifying events.

An eligible employee may not hold more than £250,000 (£120,000 prior to 16 June 2012) in unexercised options at any time. Once this limit is reached, any options granted within the following 3 years will not be qualifying options. Options granted after 3 years may qualify but only if some or all of the earlier options have been exercised or have lapsed, and subject always to the overall £250,000 limit. The £250,000 limit is calculated on the basis of the

market value of the options on the date of grant.

The aggregate value of all unexercised EMI options granted by the Company may not exceed £3 million (based on the market value of the options on the date of grant).

DISQUALIFYING EVENTS

There are a number of events which may disqualify an option from EMI tax relief, including:-

- loss of independence by the Company (e.g. through a re-organisation or take over)
- the Company no longer meets the trading activities requirement
- the employee is no longer eligible
- changes to the terms of the option
- certain alterations to the share capital of the Company
- a conversion of the shares under option into a different type of share; or
- grant of a CSOP option that takes the option holder over the £250,000 limit

If the EMI option is exercised within 90 days of the disqualifying event, the tax advantages are preserved. If the EMI option is not exercised within 90 days (including occasions when the option is not capable of exercise within this time limit) there will be a tax charge on exercise. The period in which an EMI option previously required to be exercised following a disqualifying event was 40 days. Companies should take steps to review their EMI option agreements and update this.

If the terms of the option permit, an EMI option may convert into an unapproved option upon occurrence of a disqualifying event. Replacement options may be granted in the event of a company re-organisation or take over, provided that such replacement options

satisfy the relevant requirements

TAXATION

There is no income tax or National Insurance contributions charged on the grant of a qualifying EMI option. Income tax or National Insurance contributions are not normally chargeable on the exercise of the options as long as the EMI option is exercised within ten years of grant, there has been no disqualifying event and the employee buys the shares at a price at least equal to the market value of the shares at the date of grant of the option. If the exercise price of the option is less than the market value of the shares at the date of grant, then there will be an income tax and National Insurance charge on the difference between the market value of the shares at the date of exercise and the amount paid for them.

The market value of the shares under option may be agreed in advance with the Shares and Assets Valuation division of HMRC.

In addition, on the sale of shares acquired thanks to the exercise of an EMI Option on or after April 6 2013, an individual may be able to claim Entrepreneur's Relief such that Capital Gains Tax may only be charged at 10% of the gain realised, rather than 18% or (more commonly), 28%. This applies even if the individual does not hold 5% of the voting rights in the relevant company. Likewise, the 1 year requirement for holding shares no longer applies from the date of *exercise* of the option but now applies from the date of *grant* (this change is particularly good for exit based EMI option schemes). So, provided the exercised option has been granted at least 12 months prior to an option holder selling his or her shares, then he or she may be able to benefit from a 10% CGT rate in relation to any gain made on the sale of their shares.

ADMINISTRATION

Every EMI option must be notified to HM

Revenue and Customs within 92 days of such option being granted. Failure to do so results in the option ceasing to qualify for EMI tax relief. Previously notification was made by paper form, but in relation to any options granted on or after 6 April 2014 notification must now be made online.

In addition, any company with an EMI scheme is required to register the scheme with HM Revenue and Customs (no later than 6 July 2015) and from 6 April 2015 they will be required to submit an annual return setting out the status of any EMI options. Registration of the scheme and submission of any annual returns must also be done electronically.

While all reasonable care has been taken in the preparation of this guide, no responsibility is accepted by MBM Commercial LLP for any errors it may contain, whether caused by negligence or otherwise, or for any loss, howsoever caused, occasioned to any person by reliance on it. Individual advice should be sought before considering any of the matters detailed in this guide.

For further details, please contact:

Stuart Hendry

Kenny Mumford

Tracey Ginn

Michael Arnott

Tel:

Edinburgh: 0131 226 8200

London: 0203 962 1796

E-Mail:

stuart.hendry@mbmcommercial.co.uk

kenny.mumford@mbmcommercial.co.uk

tracey.ginn@mbmcommercial.co.uk

michael.arnott@mbmcommercial.co.uk