A Guide to EMI Schemes

Enterprise Management Incentive Schemes (EMIs) are employee share options that enjoy favourable tax treatment.

EMI Schemes are specifically designed to incentivise employees and retain talent within a business.

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How does an EMI Option work?

An EMI Option is an option granted to employees (which may be all employees, or select employees within a company) to acquire shares in a company in the future, but at today's value.

The relevant employees do not receive shares on grant of the option, but only receive shares when they actually exercise their option.

On exercise of their option, the relevant employee buys their shares at the purchase price based on the company's value (per share) at the date of grant of the option. Therefore, if on grant of option the shares are worth £10.00 per share, but on exercise of the option the shares are worth £30.00 per share, the employee still only pays £10.00 per share. Therefore, the employee benefits from the £20.00 increase in value by being in a position to buy the shares at less than their market value.

When and how do employees exercise the option?

When an option 'vests' and becomes exercisable (i.e. when the employee can actually buy the shares) will depend on the terms of your individual EMI Scheme. Typically, there are various hurdles before the option can be exercised which may include:

1. Length of service – usually the option cannot be exercised immediately but will become exercisable after a period of time. An option may be structured in 'tranches' so that an employee acquires shares in incremental stages rather than in one go.
2. Performance criteria – the ability to acquire shares may be subject to certain performance criteria first being satisfied. This may include, for example, certain turnover or profit targets being met by the relevant individual or the company.
3. Specific exit events – certain events such as a sale by the majority of shareholders of the entire share capital may trigger an ability to exercise the EMI Option and give the relevant employees a right to acquire shares and participate in the sale.

How do I pay for an EMI Option?

You do not pay for the option to be granted to you. However, you will need to pay the purchase price for the shares when you exercise the option itself. How this is funded will depend on the circumstances of exercise of the option.

In the event of sale of the company, an EMI Option may be drafted so that it is a 'cashless' exercise and the exercise price you are due to pay is deducted from your proceeds of sale and paid back to the Company. However, this will only cover exercise of the option on sale. You may need to consider funding of your EMI Option if you are acquiring the shares in any other circumstances.

Do I qualify for an EMI Scheme?

There are specific requirements to qualify for an EMI Scheme, both for the company issuing the EMI Options and the individuals involved.

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Company criteria for effecting an EMI Option:

1. The company must be ‘independent’ of other companies. This means that it cannot be a subsidiary company under the control of another. In a group structure, an EMI would need to be issued in the ultimate parent company and the subsidiaries must operate a qualifying trade
2. The gross assets of the company cannot exceed £30 million
3. The company must have less than 250 full-time employees
4. The company, or its group if a parent company, must be a trading company and that trade must be a ‘qualifying trade’ (certain trades such as property investment, banking, insurance, leasing, accountancy or financial services are not qualifying trades)
5. The company must have a permanent UK establishment.

Employee criteria for effecting an EMI Option:

1. They must be a genuine employee of the company
2. They must either:
    - **a.** work at least 25 hours per week for the company/its group;
    - **b.** dedicate at least 75% of their working time to the company/its group if they do not work at least 25 hours for the company/its group;
    - **c.** have no other form of employment or remuneration other than the income from the company, where they do not work at least 25 hours per week for the company.
3. They cannot hold more than a 30% interest in the company or be entitled to more than 30% of assets on winding up of the company or any distribution.

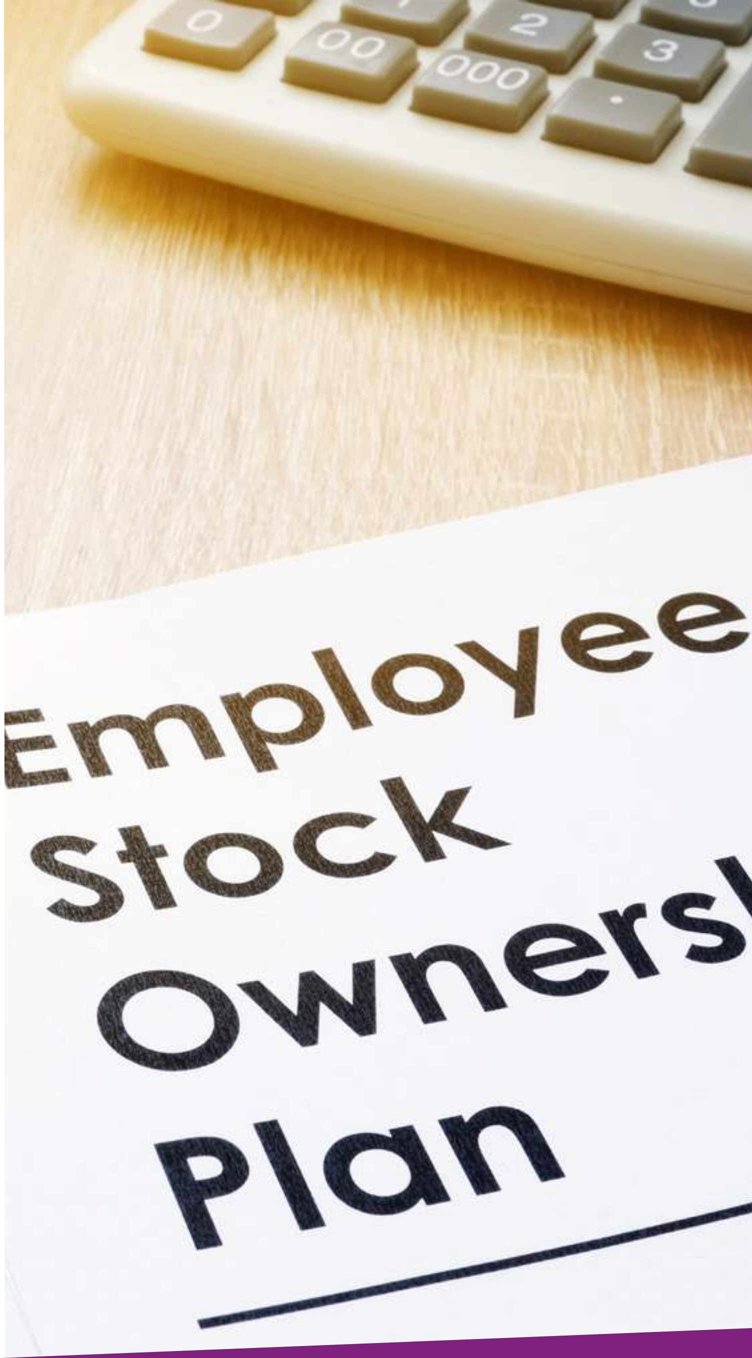
What shares are subject to an EMI Scheme?

EMI Options can only be granted in respect of fully paid up, non-redeemable ordinary shares. This means that:

1. The shares have to be paid for before they are issued to the relevant employee (see above on paying for the EMI Option)
2. The shares cannot be redeemed/brought back at the option of the Company
3. They must be ordinary shares; ultimately they must be ‘full risk’ shares and not carry any preferential rights e.g. a right to receive dividends at a fixed rate.

You should note that shares subject to an EMI Option may have limited or varied rights in relation to voting and distributions. This will depend on the particular scheme and arrangement with the Company. However, any rights variations do need careful consideration to ensure that the shares continue to satisfy the criteria as ‘Ordinary Shares’ or they fail to qualify for the scheme.

It is worth noting that a company can only issue a maximum of £3,000,000 worth of shares at any point.



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What documents can I expect?

There are various documents which will be needed to effect the EMI Scheme. These will include:

1. Articles of Association – these will establish the rights attached to the shares subject to the option

2. An EMI Option Deed – this will detail the terms of the option including the number of shares to be subject to the option, the purchase price for the shares and when the option can be exercised. This will be accompanied by an explanation letter detailing more information on your specific option

3. Shareholders Agreement or Deed of Adherence – before you can acquire shares in a company it is common that you are required to enter into a Shareholders Agreement or Deed of Adherence to an existing Shareholders Agreement which prescribes what you can or cannot do when you become a Shareholder. The terms of this agreement will vary from company to company

4. Ancillary Documents – these are procedural documents required to effect the EMI Scheme including board minutes and resolutions.

Reporting requirements

The company will need to be valued before grant of the Option and it is advisable to first obtain clearance from HMRC.

There are specific registration requirements for both the scheme and the grant of an option under it. This involves notifying HMRC within certain deadlines which if missed can compromise the tax treatment of the option.

Who effects the EMI Scheme?

To effect an EMI Scheme, you would usually work with both an accountant and a solicitor.

The company's accountant will prepare the valuation, HMRC clearance application and attend to registration of the scheme. Either an accountant or a specialist tax advisor should also advise on the tax implications of the scheme including the position on Capital Gains Tax, Income Tax and National Insurance. This may be the company's accountant or you may need to speak with an independent advisor as required.

A solicitor will prepare the legal documents required to effect the scheme itself (see above). They will typically act for the company and the individual employees can of course seek independent legal advice if they would like to do so before proceeding.

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