



EMI Schemes Share Options



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EMI Share Options

EMI's are a highly favoured employee incentive mechanism among eligible small and medium-sized trading companies.

This preference stems from the unparalleled tax advantages they offer and the flexibility allowed in defining their terms.

Employees who choose to exercise share options meeting the full criteria for EMI option status stand to benefit from capital gains tax treatment on any increase in the value of their option shares beyond the market value at the time of grant. They have an enhanced likelihood of qualifying for Business Asset Disposal Relief, which entails a favourable 10% capital gains tax rate on the resulting gains compared to possibly other shareholders.

Nevertheless, the legislation governing EMI options is well-known for its extensive set of qualifying conditions and numerous pitfalls for those not well-versed in its intricacies.

Errors are likely to surface when employees attempt to exercise these options during a company sale, particularly when subjected to thorough scrutiny in a buyer's rigorous due diligence process.

Ambiguity regarding the tax treatment of EMI options can introduce complications into the sale proceedings and potentially result in unforeseen tax obligations for the option holders.

Here are ten commonly encountered issues during due diligence on EMI options just before a company sale (Sale), along with some tips to avoid them.

1. Grant Near the Time of Sale:

EMI options cannot qualify if granted when arrangements for the Sale are in place. Determining this moment requires careful assessment by advisers based on progress of discussions with the prospective buyer.

Additionally, any preparations for a Sale or approach by a prospective buyer typically raises the share valuation for EMI option grants. Early EMI option grants often result in a lower justifiable market value, leading to better tax outcomes.

2. Unreliable Valuation of Shares upon Granting:

Valuation disagreements with HMRC are common, especially when exit plans evolve between valuation agreement with HMRC and grant. This mismatch can create uncertainty about tax withholding at exercise, causing delays and unexpected tax liabilities for option holders.

Transparent communication with HMRC during valuation may make the process more challenging but is preferable to dealing with uncertainty later of the valuation letter from HMRC being valid or not.

3. Fail to register Option Grants within 92 Days:

Failing to notify HMRC of the EMI option grant within 92 days may disqualify it from tax advantages unless HMRC accepts a reasonable excuse. Proper record-keeping, including screenshots of the submission, is crucial for evidencing compliance.

Starting April 6, 2024, companies have until July 6 after the end of the tax year of grant for the notification.



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4. Not Meeting the Minimum Work Time Requirement:

Ensuring that option holders meet the EMI option working time requirement is essential. Overlooking employees who fall short of this can jeopardize EMI qualification.

The requirement for employees to sign a declaration, which was applicable until April 5, 2023, has been removed. However, companies must still monitor adherence to the working time rule.

5. Neglecting to Inform Option Holder of Restrictions at Grant:

Not properly disclosing restrictions on shares at grant can lead to complications. Although requirements seem to have eased post-April 6, 2023, HMRC still expects a partial disclosure. It is advisable to confirm compliance with advisers.

6. Modifying EMI Option Terms Post-Grant:

Making material changes to EMI option terms after grant risks invalidating EMI status. Even exercising discretion in option terms requires caution to avoid creating a new non-qualifying option. Discussion with advisers before grant is advisable.

7. Inadequate Record Keeping and Procedural Shortcomings:

Comprehensive record-keeping is crucial for a future due diligence on a sale. Missing or incomplete documents can raise concerns during a Sale, and poor record-keeping may deter buyers from accepting options as qualifying EMI options.



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8. Mistakes in Documentation:

Mismatches in grant documentation can lead to uncertainty about employees' fundamental rights and increase the risk of claims. Careful drafting and avoidance of cost-cutting measures in document preparation are essential.

9. Challenges regarding Dealing with Departing Employees:

EMI option holders leaving employment face tax consequences, especially if they fail to exercise within 90 days of leaving. Delays in exercising options are common, and companies must assess the value of shares at the time of the employee leaving.

Reporting lapses of EMI options, even for no consideration, to HMRC in the annual share plan return is essential.

10. Other Potential Issues:

Understanding and adhering to the extensive conditions for granting EMI options is crucial. Missteps can occur due to the complexity of rules related to business size, type, share characteristics, structure, and option terms. Seeking proper guidance is key to ensuring EMI qualification and employee satisfaction during a Sale.



EMI FAQs

What companies are eligible to give their employees EMIs?

To be eligible for EMI, a company must

- Be independent and not controlled by another entity;
- Have gross assets less than or equal to £30 million;
- Employ fewer than 250 employees;
- Carry on a 'qualifying trade';
- Have a permanent establishment in the UK.

I work part-time in a company or less than 25 hours a week. Can I qualify for EMI share options?

Yes, if the amount of time you work for your primary company – where you would receive EMI share options – is greater than or equal to 75% of your total working time.

Are there any drawbacks to EMI?

The qualifying conditions of both employers and employees may be a discouragement to some companies. Meticulous structuring and oversight are required to ensure the share options adhere to HMRC guidelines. It is also important to notify HMRC within 92 days from the end of the tax year of granting an EMI option to ensure its EMI qualification.



If you would like to know more, please get in touch and let our experts help.

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