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EMI share options boost

By far the most tax-efficient incentive

EMI share options (the Enterprise Management Incentive scheme) were given a huge boost in the 2012 Budget, and they are by far the most tax-effective incentive available to unquoted companies to reward and incentivise employees. Most importantly for the majority of participants, Entrepreneur's Relief – an effective 10% rate of capital gains tax – will now apply to some options exercised after 6 April 2012. That restores the attractions of the EMI scheme before the abolition of taper relief a few years back.

Participants with no other relevant gains could receive up to £10m of gains at a 10% tax rate. The overall tax rate is actually *negative*: the corporation tax relief, at (say) 22%, exceeds the tax the employee pays at 10%. So the Treasury is subsidising the benefit.

It seems the usual one-year holding period before shares qualify for entrepreneurs' relief will not be waived for EMI option shares. If maintained, this stance will significantly reduce the value of the relief and impose significant burdens on businesses offering EMI options, and they will come under pressure to design schemes which allow exercise at least a year before sale of the shares, including providing finance to the employee to fund the exercise price.

The limit on the value of options that can be granted to any one employee is also to be more than doubled, from £120,000 to £250,000. The limit applies to the value of the shares at the date of grant of the option. This change is not yet in force, because it requires EU approval as "state aid".

As a reminder, EMI options give an employee a right to acquire shares at a future date at a fixed price, often the current market value. The right can be conditional: it can be exercisable only on sale of the company, so that the owners do not lose and control or suffer dilution until an exit. Or it can depend on meeting performance targets. The usual tax treatment will be:

- No tax of any kind on grant of the option
- No income tax or NI (including employer's NI) on exercise of the option, if the option is granted at market value

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- The company gets corporation tax relief (say 22%) on the notional gain made by the employee at the date of exercise, even though the company has paid nothing out
- When the employee sells the shares he or she pays 10% CGT on the gain above the annual CGT exemption (with Entrepreneur's Relief).

In most cases exercise of the option, issue of the shares and sale of the shares are more or less simultaneous, though a one-year delay before selling is likely to be needed to attract entrepreneur's relief.

The Office of Tax Simplification recently published [recommendations for simplifying employee share schemes](#), including merger of the CSOP into EMI and the introduction of self-certification instead of HMRC prior approval of scheme rules (which is already the process in EMI schemes, greatly reducing cost). But merging the two could bring restrictions on the current freedom of EMI, so it may be wise grant EMI options before that happens.

With private company share values still low in a depressed M&A market, there has never been a better time to grant EMI options. Anyone about to exercise an option should consider deferring until after 6 April. If your company has granted unapproved options to key staff because you had used the £120,000 EMI limit, it may be worth considering cancelling the unapproved option and re-granting it within EMI, especially if the share price has not increased much – but only after the new rules come into force.

I have been advising on employee share schemes for 30 years. If I can help with EMI schemes, give me a call.

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