DON'T LET THE HEAD-HUNTERS POACH YOUR KEY STAFF

More companies than ever are actively targeting and poaching staff from their competitors. As a result, entrepreneurial companies wanting to recruit and retain high calibre staff are using tax efficient Enterprise Management Incentive Schemes (EMIs). Available to qualifying UK and non-UK resident companies, the EMI is a creative method of remunerating employees and providing those employees who fall within the scope of UK tax, the opportunity to avail of generous tax benefits.

The last few years have witnessed a surge in the number of companies seeking to incentivise employees by establishing Enterprise Management Incentive Schemes. Key staff know their value and if companies only offer standard remuneration packages it is often difficult to keep those employees who are important to the business. It is widely acknowledged that EMIs help innovative and growing companies attract and retain the best talent.

The EMI is a share scheme which enables many companies, both UK resident and non-UK resident, to grant eligible employees the opportunity to acquire shares in their employing company on advantageous terms. From an employee's perspective, the potential to share in the future capital growth of the company is a powerful incentive to remain focused on the goals and targets of the business and a chance to share in the rewards of their own efforts. For the employer, the alignment of the employee's interests with those of the shareholders can only have a positive impact on employee motivation and loyalty. Where smaller businesses do not have the cash resources to provide competitive salaries and bonuses, the ability to offer tax efficient share-based remuneration has proven to be most successful in retaining those vital to the future of the Company.

The Basics

Broadly speaking, a company can select whoever they want to join the scheme provided the employee works for at least 25 hours a week and does not already own more than 30% of the equity in the business.

Unlike other share schemes, it does not require advance Inland Revenue approval and is a great deal more flexible than other favoured schemes. Companies will often have unique requirements and it is possible to tailor each scheme to the particular design requests of the company. The EMI options must be granted over Ordinary Shares that are fully paid and not redeemable. The equity can be subject to certain restrictions or risk of forfeiture, for example, if performance conditions are not met. Each option must be capable of being exercised within 10 years and there is a limit of £250,000 on the market value of options granted to each participating employee. There is, however, a limit on the total value of options that can be granted by any one company under EMI of £3 million.

For companies to qualify they must have maximum gross assets of no more than £30 million, and for groups, this applies to the assets of the group as a whole. The company, whose shares are the subject of the option, must be independent and the company (or group) must be trading. However, care must be taken as certain trades may not qualify and there are strict requirements in connection with the level of trading activity which must be carried on in the UK.

Tax Benefits

The tax benefits available under the EMI legislation are extremely generous for those employees falling within the scope of UK tax. (Non-UK employees will be taxed according to the legislation which applies in their specific tax jurisdiction).

For UK employees, no Income Tax or National Insurance Contributions are due either at the date of grant or on exercise of the options (provided the option is not granted at a discount). In fact, EMI options generally only give rise to Capital Gains Tax (“CGT”) when the shares are eventually sold.

Importantly, unlike other share schemes the tax favoured business asset disposal relief period for CGT starts on the date the option is ‘granted’ (rather than the date the shares are ‘acquired’) resulting in employees benefiting from tax rates as low as 10%. With bonuses often resulting in overall effective tax rates in excess of 50% it is not surprising therefore that so many companies have opted to introduce equity or options as a means of rewarding valuable staff.

In addition, the tax implications for the employer are very favourable as the employing company may be entitled to a corporation tax deduction equal to the difference between the price paid for the shares and the market value. This valuable corporate tax benefit is often used in negotiations, particularly when agreeing the deal value in a transactional exit from the business by the owners.

EMIs bring several significant tax advantages to the business and the employees participating in the scheme, who fall within the scope of UK tax. Nevertheless, events could occur after the grant of the option which would trigger a time limit for action to protect the available tax benefits. It is essential therefore that both companies and option-holders keep arrangements under review.

So, if you have talented employees who are vital to the success of the business and you are looking for a cost effective way of creating loyalty and securing the long term services of your core team, should you be considering an EMI too?

If your business does not fulfil the conditions required to qualify for an EMI scheme, there are a range of alternative share option or equity reward arrangements which can be used. The next article in our Reward and Retain series will focus on Growth Share Employee Incentives.

Example

Stick-With-Us Limited, is owned by managed by John and David. John has exciting growth plans for the business over the next 10 years and wants to encourage his key employees to have enthusiasm to make the business profitable. He is worried, however, as one of his management team moved to a competitor recently and it is becoming extremely difficult to recruit high calibre staff. David, on the other hand, is worrying about their exit plan and has started to believe that they should be making plans to retire or even sell the business within the next 10 years.

John and David's advisors have suggested implementing an EMI scheme, to help secure their exit plans for the future and also as an incentive for key employees to stay with the company for the foreseeable future.

So, in August 2022, the commercial director Joe is granted an EMI option over 4000 shares in Stick-With-Us Limited, at a market value of £5. Joe does not pay for the EMI option and there is no tax or national insurance payable on this award. John and David remain in full control of the company. In August 2030 the Company is sold, and Joe exercises his option and sells his shares for £50 a share. The tax position for Joe is as follows:

Proceeds on sale of shares (£50 x 4,000)	£200,000
Exercise Price (£5 x 4,000)	(£20,000)
Capital Gain	£180,000
Annual Exemption Estimated	(£15,000)
Chargeable Gain	£165,000
Capital Gains Tax @ 10%	£16,500
Proceeds on the disposal of shares	£200,000
Less: Exercise Price	(£20,000)
Less: Capital Gains Tax	(£16,500)
After tax receipt by Joe	**£163,500**
Effective tax rate	10%

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