Enterprise Management Incentives

An enterprise management incentives (EMI) scheme is a highly flexible and tax-efficient share option scheme designed specifically for small/medium-sized companies (i.e. companies with assets of under £30m and which employs less than 250 people). They are generally used as a way to incentivise selected key employees to either join or stay within a business by rewarding them with a tax efficient way of acquiring shares in the company.

Overview

An EMI option would entitle selected employees to purchase shares in a company at an agreed price per share if certain circumstances, referred to as "vesting criteria", arise. The most common circumstance under which an EMI option can be exercised is after a specified amount of time has elapsed. This is commonly where a company is looking to incentivise an employee to stay with the company for a minimum period.

EMI options can also be prepared where they are intended to be exercised upon an "Exit" event (i.e. where there is a sale of a controlling interest in the company, a sale of the whole or a substantial amount of the company's assets or the shares in the company are to be listed on a recognised stock exchange). The advantage of having an EMI option that is exercisable upon an Exit is that the employee effectively pays for the shares out of the proceeds of sale, so the employee is never out of pocket.

Generally, if a selected employee leaves their employment with the company and ceases to be an "eligible employee" before the EMI option is exercised, the EMI option would lapse. There are certain circumstances under which an EMI option can still be exercised within a small window after a selected employee ceases to be an eligible employee without losing its tax-efficient status, but only at the company's discretion.

An EMI option can offer a selected employee significant tax advantages in relation to any gains which are realised when the EMI option is exercised and the shares are then subsequently sold.

As an EMI scheme is, if implemented correctly, a very tax efficient way for selected employees to acquire shares in a company, the criteria to qualify to grant and be granted EMI options is very strict.

Criteria

In summary, in order to be eligible to benefit from an EMI option an individual must meet four main criteria:

1) The individual must be an employee of an eligible EMI company or a qualifying 51% subsidiary of that company.

In order to qualify for EMI purposes, the company granting the options must not, itself, be a 51% subsidiary of another company or be under the control of another company.

The company (or its qualifying trading subsidiary) must also have a permanent base in the UK and carry on a trade on a commercial, profit-making basis. Therefore, property investment or development companies are not eligible, nor are investment companies, as they are not deemed to carry on a "trade".

2) The employee must satisfy the working-time requirements in respect of the company which they work for.

This means that, in an average week, the employee must be committed to work at least 25 hours a week for the company or, if their weekly working hours are less, at least 75% of their total weekly working time.

3) The employee does not already have a beneficial ownership of, or the ability to control directly or indirectly, more than 30% of the ordinary share capital of the company.

4) The shares to be acquired by the employee must be ordinary, fully paid, non-redeemable shares.

Financial Parameters

There are also certain financial parameters which may apply.

The terms and structure of any EMI scheme are changeable and vary considerably based on the company and its objectives.

The legal work on a "typical" scheme where a small number of employees are being awarded options that are all on the same terms, where each employee gets their own standalone EMI Option Agreement, would include:

1) Reviewing the Articles of Association of the company and any existing Shareholders' Agreement to ensure that the granting company has the necessary powers to allot the options and ultimately the shares.

2) Drafting and advising on the terms of the EMI Option Agreement. Typically, the terms of a "standard" agreement would include:

> **a)** The option is not subject to any vesting criteria other than time;
>
> **b)** The option can be exercisable either at any time after a specified amount of time has elapsed or immediately prior to a sale or listing; and
>
> **c)** The option terminates on the employee leaving the employment of the company for any reason.

More complex exercise conditions for the vesting of the option which are sometimes included in an EMI Option Agreement include the option vesting:

- Upon an "Exit" event with no financial targets.
- Upon an "Exit" event where a set financial target has been met.
- Upon an "Exit" event where certain financial targets within a sliding-scale have been met, i.e. the greater the value of the "Exit" event the more shares the employee receives through the option.
- Upon the achievement of a set accounts-based target.
- Upon the achievement of certain accounts-based targets on a sliding-scale.

3) Drafting and advising on all necessary board and shareholder approvals in accordance with the Company's constitution and the Companies Act.

In addition to creating the EMI documents it is necessary to also consider:

1) Where necessary, updating the Articles of Association or amend any existing Shareholders' Agreement (in particular to ensure appropriate drag along and other minority shareholder issues are addressed); and

2) Creating additional classes of shares.

What do I do now?

If you are a business owner and are looking to incentivise selected key employees to either join or stay within your business by rewarding them with a tax efficient way of acquiring shares in your company then contact us for an initial no obligation discussion.

More information

To discuss how we can help you, please contact us:

E: enquiry@ashtonslegal.co.uk
T: 01284 762331