EMI share options - Frequently Asked Questions

Here are some questions that you may have about EMI share options. These FAQs and other information will be available on your individual dashboards once the EMI share option scheme has been set up.

What is an option?

An option is a right for you to buy the company's shares at a fixed price (this purchase price is known as the exercise price). Assuming that the exercise price is less than the sale price for the shares, you earn a profit when the shares are sold.

Options are designed to reward employees for growth of the company and to better align employees interests with those of management and shareholders.

What is the exercise price?

The exercise price is the price at which the shares can be bought by exercising the option. For EMI share options, usually the exercise price is agreed with HMRC at a substantial discount to the value of the shares at the time that the options are granted. Upon exercise of the option, if the exercise price is lower than the market value of the share, the difference will be your profit.

Why not give me shares instead of an option?

Shares are a long-term stake in the business giving the holder the right to receive dividends, to vote at shareholders' meetings, and if the company is sold, to receive a proportion of the sale proceeds.

Shares are generally given to individuals after they have made cash or other contributions to the business, and shares aren't usually an appropriate reward for someone before that.

Shares also result in tax liabilities in that income tax and National Insurance contributions (for both employees and the company) will be charged on the value of the shares. These will need to be paid by you when the shares are given. Income tax will be at 40% of the share value for higher rate taxpayers (taxable income above £50,270). Additional rate taxpayers (taxable income above £125,140) will pay 45% income tax. The tax-free annual personal allowance will also be lost if the income is higher than £125,140. Further tax will be due when shares are sold, generally at 20% on any capital gain above the annual exempt amount of £6,000 for higher and additional rate taxpayers. EMI share options have considerable tax advantages.

What are the tax advantages of EMI?

EMI stands for Enterprise Management Incentive, a UK government scheme with generous tax breaks to encourage growing companies to incentivise and reward their employees with equity.

When shares from an EMI option are sold, any capital gain above the annual exempt amount (which is currently £6,000) is taxed at 10% (on the first £1 million of lifetime gains) provided the EMI option has been held for at least two years. This is lower than the 20% tax rate normally payable on capital gains as EMI option holders receive Business Asset Disposal Relief (BADR, formerly called Entrepreneur's Relief).

There are no other taxes nor National Insurance contributions to pay, provided the price that the shares are bought at (ie the exercise price) is not lower than the EMI share valuation which was agreed with HMRC. For this reason, most companies seek to agree the lowest EMI valuation possible with HMRC.

What about giving more money instead of an option?

Giving money doesn't give employees the opportunity to share in the growth of the company. From the company's perspective, increasing salaries or bonuses will also hinder investment plans by immediately increasing the cash burden on the business.

Salaries and bonuses are also not tax efficient. Higher rate taxpayers (taxable income above £50,270) pay 40% income tax and additional rate taxpayers (taxable income above £125,140) pay 45% income tax, as well as National Insurance contributions (for both employees and the company). The tax-free annual personal allowance will also be lost if the income is higher than £125,140.

Do I need to pay for an option?

No payment is required to receive an option.

The exercise price will need to be paid to buy the shares when you exercise the option. Our EMI scheme rules allow for a 'cashless exercise' procedure where shares are sold immediately after exercise. The important point to note here is that you must acquire the shares subject to the option, prior to sale of the shares. It is not acceptable under the EMI rules if shares are sold before exercise, or if the option itself is sold.

What does 'exercise' the option mean?

The term 'exercise' refers to buying the shares under the option by paying the exercise price. This is the point at which you become a shareholder.

Many EMI options are exit only, meaning that the option can only be exercised on an 'exit event' such as the business being sold.

The option agreement may also state that the option can be exercised:

- after a particular time (say, after five years); or
- if a particular performance target is met (say, if the business has achieved an agreed valuation).

In a business sale, employees often receive just the net cash proceeds rather than paying to exercise the options, then receiving the shares, and then selling the shares later. The paperwork is arranged so that the exercise price is paid from the proceeds of the business sale, and the shares are sold to the buyer of the company alongside the sales by the other shareholders.

In other cases, employees will need to pay the exercise price and receive the share certificate representing the option shares. Those shares can then be sold at a later date.

What is vesting, and when does vesting occur?

Vesting refers to a right to buy a particular number of shares. The option agreement could, for example, set out that shares vest:

- over time, say, one-third of the option shares every year for three years; or
- if a particular performance target is met, say, the company achieves a particular revenue target.

The option agreement will show the number of shares that will vest under the heading 'Vesting Schedule'.

How much is my EMI option worth?

The monetary worth of an option is the value of all the shares that can be bought less the exercise price for all the shares that can be bought.

Your individual dashboard contains a calculator in which an estimated company valuation can be input to see how much the option would be worth once exercised.

Is there a minimum time I need to hold my option?

An EMI option has to be held for at least two years for the employee to enjoy the tax benefit. If the EMI option is exercised before the two years, it is treated as a non-qualifying option without the tax benefits.

The option may also have a 'cliff' period, which is the time that must pass before any shares become vested.

What happens to my EMI option if I leave the company?

Options are generally lost on leaving the company.

The exception is if the company option plan rules contain a good leaver provision. In that case, good leavers are generally allowed to exercise their options within 90 days of departure and have their shares. The shares could then be held by leavers until the business is sold, or could be bought back by the company or other shareholders. As far as taxes are concerned:

- leavers don't pay any tax when the option is exercised, provided the exercise price is not less than the share price which was agreed with HMRC

- if the shares are sold more than 90 days after departure, leavers pay 20% tax on any profits (above the annual exempt amount, which is currently £6,000). This is higher than the 10% that would be payable by employees, or leavers who sell within the 90 days.

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