



Jam today, jam tomorrow?

As the economy improves, attracting the best staff can be difficult even for established companies, often leading to demands by existing and potential employees for their remuneration “package” to include shares in their employer company. Start-up companies often find it especially difficult to recruit the best talent, but retaining key staff can be just as problematic. In this article we focus on an established tax approved scheme that can overcome these issues depending on your specific situation.

Why not simply give employees shares now? Well, sometimes this might be appropriate, but it can result in heavy up front tax bills without cash to pay, compliance issues and in extreme cases, a loss of control for the majority shareholder. Understandably, employers (especially of smaller privately owned companies) often shy away from this.

As an employer, are you torn between allowing employees to hold shares in your company and the potentially unpleasant tax and commercial issues that could follow? Fortunately there is a solution in the form of Enterprise Management Incentives (EMI) – a statutory, tax favoured, highly flexible arrangement designed for smaller trading companies. This can act as a powerful tool to attract or retain key staff. Essentially, it is a share option arrangement that allows selected individuals to buy some of the company’s shares at a future date but at a price that is fixed now (up to a value at grant of £250,000 per individual, subject to an overall cap of £3 million). Usually that price is heavily discounted so if the value of the company increases over time, employees could make a significant capital profit when they sell their shares. But this hope of “jam tomorrow” comes with other benefits too:

No income tax or National Insurance charges arise when options are exercised (turned into real shares). Instead capital gains tax will apply when the shares are actually sold. This can result in attractive cash flow benefits because if there is a tax bill, there are sale proceeds out of which to pay it. That is not

always the case with other types of share schemes!

The capital gain - which is the difference between the sale price and how much it cost the employee to exercise the option - is currently taxed at a very favourable 10% tax rate.

A deduction is available in calculating your corporation tax bill if the company has increased in value between grant and exercise of the options.

Although EMI options (a legal promise to award shares) have to be capable of being exercised within 10 years (and often lapse after that), exactly when they are exercised can be designed to suit you. This opens up the possibility of “jam today” – an immediate exercise of some options, giving you the choice to reward staff with dividends if the company has a good year but based on a slightly different sort of ordinary share, reserving control of the company’s affairs to you.

Exercising a share option can be determined by a host of pre-set factors decided in advance such as profitability, net assets, meeting appraisal targets or typically a sale of the company. At the same time protection can be built into the scheme to address what happens if an option holder dies, is sacked or leaves. Even if targets are not met, a discretionary ability to permit the exercise of options reinforces just how flexible EMI can be.

Of course, not all companies prosper and grow in value but your employees have no obligation to exercise options granted to them. Therefore, if the company falls in value, even if pre-set targets are met, the option holders may decide not to exercise their EMI options. For many growing companies though, the ability to share in the proceeds of the company when it is sold is very appealing, as is the special 10% capital gains tax rate, but underpinning an arrangement like EMI is the expectation that the company will be sold at some point in the future.

Most companies employing less than 250 employees will qualify for EMI but there are other tests to meet, which do not have to be as daunting as they might seem. We have a lot of experience advising on share schemes generally and can help you through the following processes:

- deciding if your company meets the basic requirements
- work with you through all stages of creating and implementing a tailored scheme
- meet with prospective option holders to answer any questions

EMI schemes are a great way for employees to share in the growth in value of your company that they help to achieve and if you would like to chat through how one might work for you, or if a different form of share scheme might be more appropriate, then please phone us for a free no obligation meeting.



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