

## *WING TIPS*

### *TAX EFFECTIVE REWARD MECHANISM FOR SMEs Enterprise Management Incentive Scheme*

The SME market is often faced with the dilemma of how to recruit and retain high calibre managers that it recognises that it will need in order to ensure that its business succeeds.

An extremely useful tax efficient tool to assist in both recruiting and rewarding key employees is the Enterprise Management Incentive Scheme (EMI). This is an Inland Revenue approved share option scheme, which as we will see offers benefits in terms of tax savings both to the employer and the employee.

An SME, for the purposes of EMI, is a company whose gross asset value is below £30 million, and by setting the limit at this level it affords a significant number of companies the opportunity to set up and benefit from an EMI scheme.

EMI allows options to be granted to eligible employees to acquire shares in the company up to the market value of £100,000 per employee. The shares in question must be ordinary fully paid shares that are not redeemable. The company must have no more than £3m of its shares under EMI options. The options must be exercised within 10 years of grant.

#### **Benefits to the Employee**

Grant - There will be no income tax or National Insurance Contributions due when the options are first granted.

Exercise - Provided that the option price is not less than full market on grant there will normally be no income tax or NIC due when they are exercised.

Sale - Capital Gains Tax will be payable on any chargeable gain made when the shares are sold. However provided that the company remains a qualifying trading company throughout, business asset taper relief will have accrued from the time the option was granted. Full business asset taper relief is available where there is a gap of at least 2 years between the grant of the option and the subsequent sale of shares acquired under exercise. This effectively means that if the employee is a higher rate tax payer they will only pay tax at 40% on 25% of the gain, which equates to an effective rate of tax of 10%.

#### **Benefits to the Employer**

The costs of setting up and administering the scheme will be deductible from a company's corporation tax profits.

## Conditions

As you would expect there are a number of conditions, which need to be met by the company and the employee.

Company/Group:

- Gross Assets of the company or group must not exceed £30 million.
- Company must be independent and not under the control of another company.
- Any subsidiaries must be at least 75% owned.
- The company or at least one company in the group must be a trading company and at least one group member must carry on its trading activities wholly or mainly in the UK.
- The trade of the company must not consist of dealing in land, leasing, property development and financial activities.

If you are already a qualifying company for Enterprise Investment Scheme or Venture Capital Trust purposes then you will already have met a significant number if not all of the conditions outlined above.

Employees:

- Must not own 30% or more of the issued share capital of the company
- Be employed by the company or group for at least 25 hours a week, or, if less, for at least 75% of their working time.

## Disqualifying Events

There are certain disqualifying events, which can trigger a withdrawal of tax relief previously given and these include:

- Where the company ceases to carry on a qualifying trade
- Employee ceases to be an eligible employee

## Set up and Reporting Requirements

An EMI Scheme does not require direct Inland Revenue approval.

However before the scheme can start:

- Ideally the market value of the shares at the date the option is granted must be agreed with Inland Revenue Shares Valuation Division unless the shares are of in a company which is listed on AIM or OFEX.
- a set of scheme rules need to be drawn up.
- notification must be made to the Inland Revenue within 92 days of the grant of an option.

There are also separate reporting requirements in the event that a disqualifying event of the type outlined above takes place.

**Sharon Keown and Rhona Neil can be contacted at Vantis Tax Limited which is a subsidiary of Vantis plc. Contact them on 0207 549 8052/5 or email: [sharon.keown@vantispplc.com](mailto:sharon.keown@vantispplc.com) or [rhona.neil@vantispplc.com](mailto:rhona.neil@vantispplc.com)**