



Quoted Companies Alliance

6 Kinghorn Street
London EC1A 7HW

T +44 (0)20 7600 3745
mail@theqca.com

www.theqca.com

HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

emiconsultation@hmtreasury.gov.uk

Wednesday 26 May 2021

To whom it may concern,

Enterprise Management Incentives: Call for Evidence

We welcome the opportunity to respond to your call for evidence on Enterprise Management Incentives (EMIs).

The Quoted Companies Alliance *Share Schemes Expert Group* has examined the proposals and advised on this response from the viewpoint of small and mid-sized quoted companies. A list of Expert Group members can be found in Appendix A.

If you would like to discuss our response in more detail, please do not hesitate to contact us.

Yours sincerely,

A handwritten signature in blue ink, appearing to read "T. Ward".

Tim Ward
Chief Executive

Q1 If you are a business owner or manager, what is your business activity, when was your company created, what is the value of your company's gross assets and how many employees do you have?

Q2 If you are a business owner have you used EMI? If so, how many employees did you offer it to and why?

Q3 If your business does not qualify for EMI, are you using any other tax-advantaged employee share scheme?

Q4 Has your company benefitted from other forms of government support, such as R&D tax credits or investment schemes? Where does EMI rank in terms of importance of government support?

Q5 If you are responding on behalf of a representative body or think tank, please describe briefly the body, its objectives and its members.

For Questions 1 – 5, this is a response from an organisation representing companies.

We are the independent membership organisation that champions the interests of small to mid-sized quoted companies. We campaign, inform and interact to help our members do business better and grow. Through our activities, we ensure that our influence creates impact for our members.

The value of our members to the UK economy is vast – as is their potential. There are around 1,250 small and mid-sized quoted companies in the UK, representing 93% of all quoted companies¹. They employ approximately 3 million people, representing 11% of private sector employment in the UK, and contribute over £26bn in annual taxes².

More information about the QCA may be found at [About Us | The Quoted Companies Alliance \(theqca.com\)](https://www.theqca.com/about-us).

Our *Share Schemes Expert Group* has prepared this response. The Share Schemes Expert Group is a multi-disciplinary committee that brings together experts on share scheme issues for small and mid-caps, including solicitors, accountants, share plan administrators, remuneration consultants and tax advisers. See Appendix A for a full list of members. The Group's terms of reference may be found at [QCA Share Schemes Expert Group Terms of Reference \(theqca.com\)](https://www.theqca.com/share-schemes-expert-group-terms-of-reference).

Q6 To what extent do you agree/disagree that the EMI scheme is fulfilling its policy objective of helping SMEs recruit employees? Please explain your answer.

We agree that the EMI scheme is fulfilling its policy objective of helping SMEs recruit employees, for most companies.

Smaller companies making use of an EMI scheme generally need to offer share interests to senior hires to be competitive as part of the recruitment process.

¹ QCA and Hardman & Co., 2019, How small and mid-cap quoted companies make a substantial contribution to markets, employment and tax revenues, available at: <https://www.hardmanandco.com/wp-content/uploads/2019/05/How-small-and-mid-cap-quoted-companies-make-a-substantial-contribution-to-markets-employment-and-tax-revenues.pdf>

² Ibid

Employment by a smaller company can be perceived as a greater risk for individuals, so SMEs are disadvantaged where job security and opportunities for career progression are desirable. SMEs cannot match significant equity interests that may be held by the prospective employee in their existing role with larger companies, but the inducement of having capital gains taxed in the same manner as the founders, as capital on a sale, is a balancing factor enabling SMEs to attract the talent required to grow.

In addition, the base salary that is able to be offered by SMEs will generally be lower and the lure of sharing in equity growth is required for many joiners to justify what will typically be a salary reduction.

A further observable trend is companies wishing to promote the employee ownership experience and the perceived benefits of engagement of employees with the broader aspects of ownership and responsibility. Many growth companies consider this is a unique selling opportunity to recruit employees.

Q7 To what extent do you agree/disagree that the EMI scheme is fulfilling its policy objective of helping SMEs retain employees? Please explain your answer.

We agree that the EMI scheme is fulfilling or has fulfilled its policy objective of helping SMEs retain employees, for most companies.

In our collective experience, most EMI options are prepared such that they will only become exercisable following a significant corporate event such as an IPO, takeover, or similar. The aim here is to seek to retain talent within an organisation through these corporate events and beyond to ensure that the business can continue to thrive and grow. Typically, participants' options will lapse on cessation of employment, even for good reasons such as retirement or another 'good leaver' scenario.

Q8 To what extent do you agree/disagree that the EMI scheme is fulfilling its policy objective of helping SMEs grow and develop? Please explain your answer.

We agree that the EMI scheme is fulfilling or has fulfilled its policy objective of helping SMEs grow and develop, for most companies.

The recruitment and retention of talent provides a strong basis for stability and growth. We would comment that it is the combination of a flexible business plan and good management that allows for growth and development of companies. Shares schemes, and EMIs with their tax advantages, are, however, a valuable management tool if carefully designed and communicated to participants, creating engagement and loyalty.

The high prevalence of EMI options being scrutinised as part of due diligence on sales of companies and on an IPO, shows that growth companies have used EMI options.

Q9 In your views, what aspect of the EMI scheme is most valuable in helping SMEs with their recruitment and retention objectives? Please explain your answer.

The flexibility of an EMI scheme is attractive to growth companies. In particular, the ability to grant options over any share class is compatible with the need for growing companies to be able to offer shares to investors or other shareholders with different rights and obligations to enable fundraising.

Additionally, the practical approach of the Shares and Assets Valuation team within HMRC agreeing share values for AIM-quoted companies and non-quoted companies, generally enables a speedy implementation, as timescale can be critical in the recruitment process.

However, there is anecdotal evidence that many of the EMI options that are granted are never exercised. This is often as a result of:

- disqualifying events causing the options to cease to be EMI options, though they may continue to provide capital growth and incentives to the participants.
- over ambitious or poorly designed performance/exercise conditions preventing vesting of awards.

Q10 Is there evidence to suggest that high growth companies that are no longer eligible for EMI are finding it difficult to recruit or retain employees? Please explain your answer. If your answer is yes, what in your view causes these difficulties and which jobs and kinds of companies are affected?

High growth companies no longer eligible for EMI, for example due to employee numbers exceeding the 250 limit or a fundraising that causes the gross assets to exceed £30m, may continue to recruit and retain employees but the cost of doing so rises exponentially and so becomes dependent on their ability to obtain funding or have appropriate cash flows.

Where employee ownership has become a standard, expected opportunity, new joiners and existing employees are accustomed to annual performance awards through an EMI. The cost and cash flow of matching the staff expectations rises. For example, employees may be given the opportunity to buy shares but as the cost might be too much for the employee, the company seeks to lend or facilitate borrowing for the employee, which may require additional company law and consumer credit compliance in addition to a further tax liability for the company, such as a tax charge under section 455 Corporation Tax Act 2010. Such a tax charge would be unusual for a quoted company, but financial assistance for the purchase of own shares is more difficult for a public company meaning that awards may need to involve a cash bonus to facilitate the acquisition of shares, which is more costly grossing up any payment for income tax and national insurance contributions payable under PAYE. This is a significant cost for an SME.

Where a company remains an SME, even if the current limits are slightly breached, the costs of designing, implementing and maintaining an SAYE, SIP and CSOP plan (which combined might replicate the incentive of an EMI) would be difficult to justify for most SMEs.

Q11 If your answer to the previous question is yes, in your view, would expanding EMI help with these issues? Please explain your answer. If your answer is yes, do you think that other forms of remuneration or employee benefits could achieve similar results?

See above.

Q12 Are you aware of the other tax-advantaged employee share schemes offered by the Government (CSOP, SIP, SAYE)? Do you use or have you previously used any of these schemes? If the answer is no, please explain why.

The members of the Share Schemes Expert Group of the QCA are familiar with the other tax advantaged share plans. In addition, many corporate members of the QCA have adopted such plans.

Q13 In your view, do the other tax-advantaged employee share schemes offered by the government (CSOP, SIP, SAYE) provide enough support to high growth companies that no longer qualify for EMI to recruit and retain employees? Please explain your answer.

CSOPs, SAYEs and SIPs have limited value for high growth companies:

1. Given the low upper limits for these plans, very high levels of growth would be required to motivate participants to join and remain with an SME. For example, if an individual is granted a CSOP option over the maximum value of £30,000, even 50% growth would give a return of just £15,000, or £12,000 after capital gains tax. In addition, if that option becomes exercisable on an IPO within three years, which is very common for a growth company, the gain would be subject to income tax and national insurance (employer and employee) payable under PAYE potentially reducing the value of the incentive to £6,811.50.
2. CSOPs are not too onerous to adopt, especially for a quoted company, compared with the flexibility of an EMI but for private companies with investors it may not be possible to use a qualifying share class.
3. SIPs and SAYEs require companies to employ an administrator/savings provider. Where SMEs have limited administrative staff, appointing an external administrator might be cheaper than hiring an employee to manage the plan but it remains a significant, and off-putting, cost for SMEs.
4. The requirements attached to SIPs, SAYEs and CSOPs are less flexible than EMI schemes. It is easier for SMEs who might be saving costs by trying to manage such plans in-house to err and lose tax advantages. The plans therefore move quickly from being a staff incentive to a disincentive.

Q14 In your view, how could the government improve the other tax-advantaged employee share schemes to help support high growth companies?

We consider that continuing to simplify procedures would support SMEs, reduce their administration requirements and consequential costs, and allow management to focus on business growth instead of administration. We have the following suggestions regarding the improvements the Government could make:

1. Limits such as the number of employees and gross assets can change daily. A simplification would be to fix the limit as applicable for, say, a 12-month or 18-month period during which the SME could continue to qualify.
2. Share valuations of non-quoted shares for EMI options have been agreed for the longer period of 120 days as a result of Covid-19. Valuation agreements for SIP shares have been normally fixed for six months. These are subject to significant changes. A simplification would be to allow values to be agreed for 12 months (this is the US tax approach) or at least six months for all plans. This helps growth companies making multiple annual awards as their employees grow and should save review time for HMRC.
3. Remove the requirement to report an EMI option within 92 days. There is no longer the approval process difference between EMI, CSOP and SAYE that was the original justification for the additional requirement and the grants may be reported on the annual returns through the normal online portal. Whilst there is a reasonable excuse provision, the removal avoids companies making genuine mistakes needing to rely on this. In addition, it saves HMRC time dealing with errors.
4. Review and simplify the excluded activities for EMI options in Schedule 5 ITEPA. For example, hotels and residential care homes have been excluded on the basis that they may be capital intensive businesses, but as they have suffered due to Covid-19 this might be reviewed. Computer software and game development companies find the limitations imposed by the restriction on licensing are out of line with common practices where, for example, businesses with intellectual property are bought by other growth businesses such that the exemption for such IP created 'in-house' will not apply.

5. For a SIP, reduce the holding period to three years, in line with the three-year period for CSOP options and the minimum saving period for SAYE contracts. This encourages broader employee participation, particularly for younger staff members with weaker finances for whom a five-year commitment would be too difficult.
6. For a CSOP, to ease the cliff-edge when growth companies grow:
 - a. remove the prohibition on having an option exercise price less than market value but replace that with an income tax charge on the discount; and
 - b. allow options to be exercised on a takeover within three years without the complex conditions imposed by section 524 ITEPA.
7. An increase in certain limits would reflect current values (taking account of inflation) and understanding of 'SME'. In particular, the limits for certain schemes fail to reflect the developments within, and the maturing of, the growth company ecosystem which has occurred in recent years. For example:
 - a. For an EMI, increasing the gross assets test to £50m and employee numbers to 350 (which would help many hospitality businesses with high staff levels that are suffering from the combination of Brexit hampering recruitment and Covid-19, recruit the staff they need). The criteria for EMI – which was set in 2000 – is outdated and no longer fit for purpose.
 - b. For a CSOP, the £30,000 limit is no longer fit for purpose and we suggest increasing this to £50,000. The individual limit for CSOP has remained unchanged, at £30,000 per eligible employee, since 1996. As 25 years have elapsed (and noting that SAYE and SIP have all benefited from increases in limits in recent years), it would be appropriate to increase this limit.

Q15 In your view, how does the tax-advantaged employee share schemes' offer in the UK compare with other countries?

The UK appears to have a wider range of tax advantaged share schemes than most comparable companies, but the rules are significantly more complex. Inbound companies seeking to replicate awards to UK employees frequently make errors that can unfairly tax UK employees.

Q16 In your view, should the EMI scheme criteria be extended to include more companies? Please explain your answer. If your answer is yes, which eligibility criteria would you change and why?

Following the response to Q14, we would suggest that the eligibility criteria for an EMI option should be reviewed to reflect current values, inflation, the needs of business post-Brexit/Covid-19 and current business models.

In addition to the outdated 92-day rule, there are a number of areas where accidental breaches of the EMI rules give rise to the requirement to approach HMRC's share scheme team for their confirmation that this does constitute a surrender and regrant. In the main, all this does is cause uncertainty and delay for the taxpayer and increase administrative costs for HMRC. We would suggest these areas be addressed as follows:

- It is a legislative requirement that the EMI share option paperwork must provide that there cannot be an exercise by the Optionholder's personal representatives more than one year after death. The simple absence of this provision results in the EMI option losing all its tax advantages. We cannot see the policy reason for this provision (relating to death) but if there is a desire such that this to be

retained it would be better to legislate that no EMI option can be exercised more than one year after death of the Optionholder.

- It is extremely common for the exercise price for all options (and EMI ones in particular) to be paid by what is known as a cashless exercise. This is acceptable by HMRC so long as the option contract/plan rules make reference to this. This is an area not always perfectly addressed in the original paperwork, and given the prevalence of this, often requires the original paperwork to be amended. Bearing in mind HMRC appears to have no objection to this manner of exercise we would suggest it be acceptable regardless as to whether the paperwork refers to it or not.
- We can see no advantage to Optionholders of the company granting the option or HMRC of requiring the Company to notify the Optionholder of any restrictions applying to the shares under options. This should be removed. In our experience, this does not assist the Optionholder in any way, and by contrast, we only ever see it harming their position. If the Company forgets to send the summary of restrictions the Optionholder's tax bill commonly goes up 4 or 5-fold.
- We recognise that it is sensible for only full-time employees to benefit from the EMI advantages (with the sensible alternatives of 25 hours per week or 75%+ of time). When Optionholders used to have to physically sign the EMI notice form, having this Optionholder confirmation was not onerous. Now this notification is done on-line, the Optionholder (by omission) does not always suitably confirm their working hours. This can have the perverse effect that an Optionholder can be working Monday to Friday 9 to 5 yet not be considered to be working full-time. We would suggest it be acceptable if they give this working time confirmation any time before exercise.

There are two statutory provisions for which our members do not fully understand the legislative rationale. We would suggest these are either altered or some explanation from HMRC is offered. The two statutory provisions are:

- (a) The rule whereby an EMI option cannot be granted in a company which is controlled by another company (consider for example a company owned by a limited partnership where the general partner is itself a company but has little economic interest in the underlying company)
- (b) The trap which can arise if you have a 50/50 deadlock JV company owned by the company which wants to grant EMI options.

Q17 In your views, do the current EMI scheme criteria have a distorting effect on companies' growth insofar as the companies try to remain within the scheme's limits? If your answer is yes, could you provide examples or quantitative data to support your views?

This Group is not aware of companies seeking to restrain growth to remain within scheme limits, but two particular incidents have been observed:

1. Waiting until year-end bonuses have been paid out before awarding EMI options, as a result of which the gross assets of company will have fallen.
2. Waiting until certain employees have been made redundant so that employee numbers fall below 250, enabling qualifying options to be granted.

Q18 In your view could widening the current eligibility criteria to support larger companies affect smaller companies' ability to recruit and retain employees? Please explain your answer.

In our view, a proportionate increase in limits would have minimal impact on larger companies, such as FTSE 100 or FTSE 350 companies, but would significantly support quoted SMEs by reducing the additional burden and unnecessary cost of establishing alternative arrangements to encourage employee ownership.

Appendix A

The Quoted Companies Alliance Share Schemes Expert Group

Fiona Bell (Chair)	RSM
Tristan Adams	Link Asset Services
Barbara Allen	Stephenson Harwood
Emma Bailey	Fox Williams LLP
David Baxter	Stephenson Harwood
Danny Blum	Eversheds Sutherland
Ian Brown	Slaughter & May
Michael Carter	Osborne Clarke
Sara Cohen	Lewis Silkin
Louise Delamere	Bright Grahame Murray
Stephen Diosi	Mishcon De Reya
John Dunlop	DAC Beachcroft
Suzy Giele	Lexis Nexis
Andy Goodman	BDO LLP
Ellisavet Grout	Travers Smith LLP
Juliet Halfhead	Deloitte LLP
Caroline Harwood	Crowe UK LLP
Lea Helman	Lexis Nexis
Catherine Heyes	PKF Littlejohn LLP
Liz Hunter	KPMG LLP
Stuart James	MM&K
Graham Muir	CMS
Isabel Pooley	Grant Thornton UK LLP
Jennifer Rudman	Prism Cossec
Neil Sharpe	Mishcon De Reya