

How to give your employees EMI Options, by the experts

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EMI Options are a common in the startup world because they are a way for founders to reward staff who joined the company very early on by giving them a stake, here is a brief Q&A from [iHorizon](#) to explain how they work.

Jerry is the ops manager at The Start Up LTD (TSU)

Tom the founder walks in very excited – *“Congrats Jerry, we’ve set up an EMI option scheme and you’ll be getting options!”*

Thanks dude, what does that mean?

It is a process that gives you the opportunity to own a chunk of this business in return for all the hard work you’ve put in and will continue to do so over the coming years!

Are you giving me shares in TSU? That would be great ;)

Not quite, if we just gave them to you we’d both get a big tax bill, so instead you are being given (or granted as it’s normally known) an opportunity (known as an option) to buy shares in the future for a set price.

Thanks a lot, but how much is it going to cost me?!

To start with, it’s not going to cost you anything. If in the future if you decide that you want to exchange (known as exercising your option) some of these ‘options’ into real shares, you’ll be paying some money for them then (though it’s usually not a huge sum).

What if I don’t want them in the future?

No big shakes, you don’t have to exchange (exercise) them and it won’t cost you a penny if you decide not to. And no, you won’t get anything else for them or be able to give them to anyone else!

How will I know if it's worth me exchanging them or exercising them as you say?

It goes like this Jerry. Let's say that the price (known as a strike price) of one of these options when you are granted them is £1 and you were given 1,000 options. After a period of time, say 4 years, you could exercise them into a 1,000 shares by paying us £1,000. Before you make that decision though you would want to know what the current 'price' of the shares were and what the future expectation of the business is so you can decide.

For example, we are rocking and in 4 years the value of the shares are £9/each and we are thinking about a big exit down the line – this would be a no brainer and you should cough up the £1,000 – deal done. You would be a shareholder with 1,000 shares and sitting pretty for the future.

On the other hand, if in 4 years things were looking a little sketchy and the price was in fact closer to 50p/each – you would most likely choose not to exercise your option and that would be that. Nothing lost.

So can I give you £1,000 now and have my shares?

Not usually. The options have a lock in period (known as the vesting) so that until you have completed that designated time as an employee you don't have the right to exercise them. This vesting time varies from company to company and often employee to employee.

So If I leave in two years what happens?

If your 1,000 options had a 4 year vesting period and you complete 2 years successfully and are a 'good leaver' (more about this another time) you would be able to exercise 500 of those 1,000 options at £1. You then write us a cheque for £500 and you will then own 500 shares and be sitting pretty.

Can I be given more options?

If all is going well and your work is proving invaluable it's a definite possibility.

Can I exchange my options for money?

No exchanging options for money, love or beer – they are yours and yours only. Different matter once you've exercised them into 'real' shares but as options they live, exercise and die with you.

What will the taxman take?

This is the really clever part. Going back to our earlier example; you are granted £1 options and after the 4 years of vesting you decide to exercise those options, you pay us £1,000 and you have 1,000 shares. A year or so after that we are bought out by a TSU INC in the US for £9/share. As a shareholder you will receive a £9,000 cheque in the post. The tax you pay on that will be capital gains tax only. You'll be taxed at 18% and maybe even 10% depending on how many shares you have & pending changes in the new finance act.

For example, you sell 1,000 shares for £9/each > You have made a £9,000 'capital disposal'

You paid £1,000 for the shares > So you have made a taxable Capital Gain of £8,000
Here, as you have an annual exemption (i.e. what capital gain you can make in a year without paying any tax) of £10,600 – this particular sale isn't going to cost anything. If over the £10,600 it will be taxed at 18% or 10%. Good news is, nothing else to pay, no NI, no income tax.

If in this example you had 10,000 shares sold for £9/each, your total disposal would be £90k, your gain would be the £90k less the £10k you paid to 'acquire' the shares when you exercised them i.e. an £80k taxable gain. To work out what you pay tax on and assuming you had no other capital gains in that particular tax year – takeaway the £10.6k annual capital gain allowance you would be taxed at 10% or 18% on c.£70k