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# White Paper Conference 2025

## EMI Options – Tax Status Pitfalls

**26 November 2025**

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# EMI Options tax benefits

- No income tax or NIC at grant
- Options granted at market value:
  - no income tax or NIC on exercise
- Options granted at a discount:
  - no income tax or NIC on growth in value over market value at grant, but
  - income tax and NIC at exercise on discount to market value at grant
- CGT on sale with potential for Business Asset Disposal Relief (BADR) provided two year holding period (combination of option period plus share holding period) met
  - 14%, increasing to 18% from 6 April 2026
- Deemed section 431 election

# When errors are picked up

- Most commonly, at the point of an exit event as part of a tax or commercial due diligence exercise
- In connection with an investment (primary) or secondary sale
- Ad hoc reviews
- After attending a conference and hearing about issues that can arise!
  
- Income tax and NIC benefits can be lost:
  - entirely if the option is effectively regranted after exercise
  - for growth in value after a disqualifying event
  
- Often employer NIC has been passed, resulting in an aggregate 55.25% charge on the taxable amount
  
- BADR is lost if option is exercised after a disqualifying event

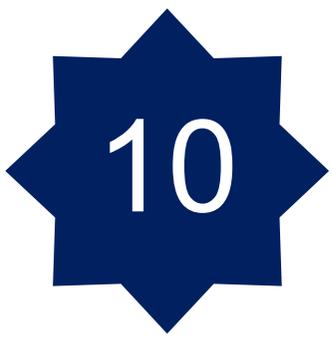
# What's the impact of getting it wrong?

- Look to the tax indemnity
- Is there an exclusion clause?

*“Nothing in this Scheme nor anything said or done by the Company or its agents may be taken as representing that the Option qualifies or will continue to qualify under the EMI Legislation.*

*The Company will not be liable to the Option Holder for any loss whatsoever, arising from or in connection with its failure to qualify to grant EMI Options under the EMI Legislation, the occurrence of any Disqualifying Event or any failure to notify the Option Holder of any Disqualifying Event either in relation to the Company, its business, its shareholders or the Option Holder personally, or through changes in the EMI Legislation.”*

- Impact on employees: incentive effect, need to compensate, potential claims
- Delays to transaction timetable
- Additional costs: legal/tax advice, price chip



## Errors in documents

- The least commonly seen issue as documentation has generally been prepared by a professional adviser
- Self-drafted schemes and the use of precedents or recycled documents
  - Requirement to state that the option is a Sch 5 option (para 37)
  - Grant by agreement rather than unilaterally by deed
  - Missing exercise triggers
  - Exercise triggers that are too late
  - Mismatch between terms of options and other documents
- Implementation is generally more problematic

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## Failure to notify EMI Options

- Requirement to notify grant by 6 July following the end of the tax year
  - Increased from 92 days (pre 6 April 2024 options)
- Possibility to apply to HMRC for a “reasonable excuse” code
  - forgetting is not a reasonable excuse!
  - scheme must be registered with HMRC ERS
  - request by email to [shareschemes@hmrc.gov.uk](mailto:shareschemes@hmrc.gov.uk)
- Examples may include:
  - IT issues (company’s or HMRC’s)
  - illness/death of the individual tasked with making the filing, or similar personal reasons
  - “you were unaware of or misunderstood your legal obligation”



## Granting outside agreed valuation window

- HMRC agreed valuations are generally valid for 90 days
- Granting outside this window is not fatal to the EMI option
- Most EMI-qualifying companies will not have significant changes to their value unless there has been annual accounts published or a significant event has occurred
- Review and revise valuation



## Changes to terms and discretion

- Amendments to fundamental terms
  - number of shares
  - exercise price
  - time when the option becomes exercisable
- Extended and lapsed options
  - options which have been extended past their normal lifespan
  - options which have lapsed and are treated as remaining in effect
- Exercised by discretion
  - options exercised by discretion rather than in specified circumstances
  - revised HMRC guidance on the exercise of discretion



## EMI Options and non-UK taxpayers

- Consider treatment that could apply in other jurisdictions
  - US tax-payers taxed on worldwide income
  - internationally mobile employees
- Valuations
  - 409A
- Tax indemnity and withholding
  - employer social security



## Leavers and change to employment status

- Failure to exercise within 90 days of leaving
- Ceasing to meet the working time requirements
  - certain types of leave are ignored
- Change in employment status when employee becomes consultant
- Grants to former employees or employees on notice
  - grants must be to recruit or retain
- Valuation on leaving for later disqualifying event tax charge



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## Grants before an exit and valuation

- Even if a sale is not sufficiently progressed to fail the independence test, HMRC may still look back at the valuation
- Provision of all relevant information to HMRC in relation to valuation
  - approach information may have been confidential when liaising with HMRC
- Expected returns valuation model where actual returns are known shortly thereafter
- Risks for the buyer



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## Exceeding plan limits

- £250,000 individual limit on subsisting options
- Rolling £250,000 individual limit in any three-year period
  - once £250,000 options have been granted, any option granted within the next three years cannot be a qualifying option
  - £249,999 “loophole”
  - cancelled options count towards this limit
- Granting CSOP options
  - CSOP options count towards the individual option limit
  - breach of the combined limit is a disqualifying event



## Independence test

- Independence at grant
  - preparations for a sale
  - mutual understanding as to share sale
- Deadlock provisions and deciding votes.
- Investor director casting vote
- Swamping rights and distress provisions
  - share issuances on corporate failure
- Becoming under the control of another company after grant
  - sales between shareholders
  - funds and General Partners



# Poor record keeping

- Missing documentation
  - Failure to print screen shots of grant notifications
  - Board and shareholder resolutions
  - Exercise notices
  - Section 431 elections for discounted options
  - Correspondence with HMRC on valuations
  - Annual returns
- Missing signatures
- Without all documentation there is not a complete paper trail to tax relief!
  - Red flag for buyer and assumption that options do not qualify

**Questions?**

# Disclaimer

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