

TAXREP 1/00

Enterprise Management Incentives

Memorandum submitted to the Inland Revenue in January 2000 in response to a consultation paper issued in November 1999.

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ENTERPRISE MANAGEMENT INCENTIVES

Introduction

1. We welcome the opportunity to comment on the Revenue's Technical Note, published in November 1999, on a new scheme for Enterprise Management Incentives (EMI).

Summary response

2. Although broadly supportive of any new incentive for business, we are still firmly of the opinion that when it comes to enabling private companies to retain and motivate senior managers it is better to allow a variety of methods to achieve this end. This may be via bonus arrangements or with shares, where circumstances permit. We believe it would be better to allow companies to continue to choose their own methods of rewarding key staff rather than to force them into a regulatory straitjacket which would be accompanied with a lot more complex legislation along the lines of an Enterprise Investment Scheme.
3. The proposed new scheme appears to be little more than a gimmick that is unlikely to achieve its aim of encouraging high quality managers to move to and stay with small high-risk companies. As we set out in our earlier representations on this issue (see TAXREP 11/99) we believe that if such assistance is needed for smaller companies it would be better to review section 77 onwards in the Finance Act 1988. This would involve making it easier for companies to offer worthwhile employee share schemes rather than to go down the route of EMI.

General comments on the scheme

4. We welcome the extension of the scheme to cover 10 rather than the originally proposed 6 key employees.
5. We also welcome the improved position regarding the capital gains tax treatment which makes the scheme more attractive to potential users.

Detailed comments on the Technical Note

6. Below are set out our detailed comments on the EMI draft legislation as set out in the Technical Note. All paragraph references are to that Note.

Paragraph B2

7. We believe it is not acceptable, in paragraph B2, to use the phrase 'a small high-risk company' without defining either 'small' or 'high-risk'. It appears that what the draftsman actually meant was nothing more than 'a qualifying company'. If this is the case it would assist everyone if that was the wording used in the legislation. We would be grateful if you would confirm that this is the intended meaning of the legislation.

Paragraph B4(2)

8. The phrase 'the grant of the last of the ten' in paragraph B4(2) does not appear to be correct. The phrase 'the ten' refers to the number of employees, which is not

necessarily the same as the number of options.

9. It is also not clear whether the six months referred to in this paragraph is intended to run from the time when the number of option-holding employees reaches ten, i.e. from the first grant to the tenth of them, or on a rolling basis from the most recent grant of an option to any of the ten. We would be grateful for clarification of this point.

Paragraph C11(3)

10. It is noticeable that the definition of intellectual property in paragraph C11(3) does not include 'know-how' (in the sense of confidential information not protected by patent or copyright) for use in service industries. In view of their commercial importance, we believe computer (including Internet) applications and programming techniques, at least, should be included explicitly.

Paragraph C11(4)

11. The two year period in paragraph C11(4) seems unreasonably short. In a climate of constant technological improvement the product which is licensed today may only have been created in its present form within the last two years. However, it may well have been developed from an earlier version so that the licence fee relates at least in part to the original patent. We would suggest that ten years would be a more realistic marker.

Paragraph D5

12. We believe it is unfair to exclude an employee from the new scheme solely because he holds options (even if only a few) which he acquired under a CSOP before the proposals for the new scheme were announced.

Paragraph F6(1)(c)

13. We believe that it appears strange that an alteration, such as is mentioned in paragraph F6(1)(c), requires the approval of the Revenue, when the original grant of the option does not. It may be reasonable for the Revenue to pay particular attention to proposed changes in existing options, but requiring prior approval for every change in the share capital of the company, most likely made for commercial reasons totally unconnected with the options, seems contrary to the stated intention to avoid unnecessary administrative burdens.
14. It also seems strange that in the case of a disqualifying event the income tax relief is frozen at that point, but the individual can retain the option without suffering any further disadvantage; whereas for capital gains tax (CGT) purposes the tax advantages are withdrawn altogether unless he exercises the option within 30 days. Since under paragraph G3 the disqualifying event will in any event cause the option to lose its advantageous deemed business asset status, we believe there seems to be no adequate reason for further penalising the employee by effectively compelling him to exercise the option early.

Paragraph H1

- 15.** In paragraph H1(a)(ii) it would appear that the reference should be to a general offer to acquire all the shares of that class which the bidder does not already own.
- 16.** Paragraph H1(1) is expressed as if it were a definition of the phrase ‘replacement option’ - which it is not, since an option granted as described would not necessarily satisfy the further requirements of subparagraph (3).

Paragraph H3

- 17.** We think paragraph H3 should be qualified, like paragraph H2, so as to apply only to information necessary to allow the Revenue to perform their functions under the Schedule.

Conclusion

- 18.** We remain to be convinced that the introduction of EMI will significantly add to the armoury of an entrepreneurial company. However, we hope the suggested amendments to the legislation set out above will help clarify certain aspects of the scheme.
- 19.** We are happy to discuss further any of the points raised in this consultation document if required. We would also welcome details of the feedback which you receive on this consultation.