Share-based rewards for key employees

Key points

Share-based rewards can be a powerful and tax-efficient way to attract, retain and incentivise key people, which are often more valuable than an equivalent cash bonus. The four most common routes for private companies are: Enterprise Management Incentives (EMI), growth (or hurdle) shares, unapproved share options, and direct share awards structured as restricted securities.

EMI is the most tax-favoured route and should be considered first where the company and employees qualify. Where EMI is not available, growth shares can deliver capital gains tax (CGT) treatment on future growth at a low up-front cost.

A section 431 election (signed within 14 days of acquisition) is nearly always advisable when employees acquire actual shares, to lock in the tax position. Reporting to HMRC is required annually by 6 July following the end of the tax year — missing this can trigger penalties.

Enterprise Management Incentives (EMI)

EMI is a statutory tax-advantaged share option scheme aimed at smaller, independent trading companies. It is the most generous UK share scheme.

Who can use it (from 6 April 2026):

- Gross assets of the company or group must not exceed £120m.
- Fewer than 500 full-time equivalent employees.
- Must be an independent trading company (not controlled by another company) carrying on a qualifying trade.
- Employee must work at least 25 hours a week, or 75% of their working time, for the company or group, and must not hold a material interest of more than 30%.

Limits (from 6 April 2026):

- Up to £250,000 of shares under option per employee (measured at grant).
- Up to £6m of shares under option across the whole company.
- Options must be capable of exercise within 15 years of grant.

Tax treatment:

- No income tax or NIC on grant.
- No income tax or NIC on exercise**,** provided the exercise price is at least equal to the market value of the shares at grant.
- On sale, gains are subject to CGT. Business Asset Disposal Relief (BADR), 18% from 6 April 2026, is available if the options were granted at least two years before the sale, potentially reducing the CGT rate.

Practical points:

- The share valuation should be agreed with HMRC in advance (typically valid for 90 days).
- HMRC must be notified of the grant, and annual returns filed online by 6 July following the tax year.
- Care is needed to avoid "disqualifying events" (e.g. loss of independence, employee leaving) which can trigger income tax on later growth.

Growth (or hurdle) shares

Where EMI is not available — for example because the company is too large, in an excluded trade, or the £3m/£6m limit has been used — growth shares are often the next best route.

How they work:

- A new class of shares is created with rights that only "switch on" once the company exceeds a set value or performance target (the *hurdle*).
- At issue, these shares have a very low market value, so the employee can subscribe at a modest up-front cost.
- All future growth above the hurdle accrues to the employee and is taxed as a capital gain rather than as employment income.

Tax treatment:

- The employee subscribes at market value (supported by an independent valuation).
- A section 431 election should be made jointly with the employer within 14 days of acquisition, so that any subsequent lifting of restrictions does not trigger further income tax.
- On sale, growth is subject to CGT; BADR may apply if the qualifying conditions are met.

When to use them:

- Family companies passing value to a non-family management team.
- Companies preparing for a future sale or exit and wishing to align senior staff with shareholders.
- Where the current company value is too high for employees to buy in on ordinary terms.

Points to weigh:

- Requires amending the articles of association and creating a new share class.
- Not suitable for listed companies.
- The up-front tax cost is small but is not refundable if the shares are later forfeited or the company does not grow.

Unapproved share options

A flexible, off-the-shelf option arrangement with no statutory qualifying conditions — but with a less favourable tax profile than EMI.

Tax treatment:

- No tax on grant.
- On exercise, income tax is charged on the difference between the exercise price and the market value of the shares at that date. Employer's and employee's NIC also arise if the shares are "readily convertible assets" (broadly, listed shares or where a market exists to sell them).
- On sale, further growth is subject to CGT.

When to use them:

- Where EMI is not available and growth shares are not appropriate.
- To top up awards where the £250,000 individual EMI limit is exhausted.
- For non-employees such as consultants or non-executive directors (who cannot participate in EMI).

Points to note:

- The company can usually claim a corporation tax deduction equal to the employee's option gain.
- The employer's NIC liability can be transferred to the employee by joint election, if agreed.

Restricted securities and the section 431 election

Most private company shares carry some form of restriction — for example, good/bad leaver clauses, transfer restrictions, or forfeiture provisions. These make them *restricted securities* for tax purposes.

Why it matters:

- Without protection, later events (such as restrictions falling away, or the shares being sold) can trigger unexpected income tax and NIC charges on part of the growth in value.

The section 431 election:

- A joint election signed by the employer and employee within 14 days of acquisition.
- It fixes the income tax charge at acquisition by reference to the shares' *unrestricted* market value, so that all future growth falls within CGT rather than income tax.
- The election is irrevocable and cannot be reversed if the shares later fall in value or are forfeited.
- It is standard practice — and often a condition of the share award — to make this election.

Choosing the right route

Priority	Route
Best tax outcome, if company and employee qualify	EMI
Company doesn't qualify for EMI, or limits exhausted	Growth shares
Non-employees, or top-up awards	Unapproved options

Any share award should be documented carefully, valued properly, reported to HMRC by 6 July following the tax year, and — where actual shares are acquired — supported by a section 431 election.

Further Information

If you would like to know more, please get in touch with us to discuss all the above areas in relation to your business.