

**APPENDIX TO REGULATORY IMPACT ASSESSMENT
ENTERPRISE MANAGEMENT INCENTIVE
NOVEMBER 2001**

Introduction

This is an appendix to the Regulatory Impact Assessment produced in March 2000. It updates the costs and benefits of increasing the gross assets test for qualifying companies, proposed in June 2001, and effective for options issued on or after 1 January 2002.

Background

Enterprise Management Incentives were introduced to help higher risk small companies recruit and retain employees. Independent companies with gross assets not exceeding £15 million can grant EMI options to any number of employees within an overall limit of £3 million worth of shares. EMI options do not normally attract a liability to Income Tax or National Insurance contributions (NICs) on either grant or exercise. Capital Gains Tax (CGT) business assets taper relief applies from date of grant.

Finance Act 2001 introduced three improvements to EMI, namely:

- Removal of 15 employee restriction on granting EMI options ;
- Employees no longer have to be 'key' employees;
- The notification period was extended from 30 to 92 days.

Purpose and intended effects of the measure

In June 2001, as part of the Enterprise and Productivity Challenge the Chancellor proposed that EMI should be extended to more companies by doubling the gross assets limit to £30 million.

The current gross assets limit is considered too restrictive because it often excludes small manufacturing companies. Small companies that currently participate in EMI and experience growth may also be excluded from future participation in EMI.

By extending the gross assets limit to £30 million about 6000 more companies would potentially qualify for EMI. Of the 6000 it is estimated that 800 to 1000 companies may take advantage of EMI.

Risks & Benefits

EMIs have proved popular with over 1700 companies granting some 14,000 EMI options (November 2001). The Government believes now is the right time

to make improvements to EMI by allowing more small higher risk enterprises to qualify. Essentially, the risks and benefits identified in the original Regulatory Impact Assessment remain unchanged.

Compliance Costs

This Appendix does not repeat the compliance costs covered in the original Regulatory Impact Assessment. However, it is important to note that participation in EMI is not compulsory and one of the key features of EMI is that administration costs are kept to the minimum.

Total compliance costs depend on how companies set up arrangements to take advantage of EMI. The original RIA shows compliance costs in the region of £3,500 to £5000 for simple arrangements, and £8000 to £15000 for more complex arrangements.

Additional one-off start up costs are summarised below:

ADDITIONAL COMPANIES	COST PER COMPANY	TOTAL COSTS
800	£3500	£2,800,000
1000	£3500	£3,500,000
800	£15000	£12,000,000
1000	£15,000	£15,000,000

Total compliance costs are likely to be in the region of £3,000,000 to £15,000,000 depending on the complexity of the arrangements. Recurring costs are not considered significant.

Overall, compliance costs have not been a significant issue. The benefits of participation in terms of increased growth and productivity, retention of highly skilled employees, tax and NIC savings and simplicity of administration would out weigh the initial start up costs.

Other Costs

The cost to the Exchequer of raising the gross asset limit summarised below. The figures are based on the assumption that an additional 800 to 1000 companies will take part in EMI:

Financial Year	2002/03	2003/04	2004/05
Gross Asset Limit £30m	£25m	£30m	£40m

The gains from this change will more than cover the costs. The widening of EMI will help to promote microeconomic activity in a simple way, encouraging

firms to be innovative and enterprising, and provide employment to skilled employees in higher risk ventures.

There will no significant additional cost to monitor the expected increase in EMI notifications.

Consultation

Consultation on the proposal to double the gross assets limit to £30 million was conducted during the period 18 June 2001 to 14 September 2001.

Although there was a limited response there was unanimous support for an increase in the limit. The proposal is a positive step supported by many advisers, representative bodies and small companies.

Recommendation

EMI has provided, and continues to provide, a valuable tool to enable small companies to recruit, retain and reward skilled employees. Allowing more companies to join EMI will further encourage the small dynamic enterprises to take on the right entrepreneurs and maximise their growth potential. Increased productivity and growth aided by the removal of recruitment barriers will also be reflected in the increase equity share price. This increase in share value will provide rewards free of Income Tax and NICs charge to the employees directly contributing to the growth of their company.

Comments

Comments on this Appendix 5 to the main Regulatory Impact Assessment should be sent to:

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