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**Subject: State Aid SA.47789 (2018/N) – United Kingdom
Prolongation of Enterprise Management Incentives scheme (ex.
NN32/2009)**

Sir, /Madam,

1. PROCEDURE

- (1) On 16 March 2018, following pre-notification contacts and exchanges, the UK authorities notified electronically, according to Article 108(3) of the Treaty on the Functioning of the European Union (the "TFEU"), the prolongation to the above-mentioned measure ("the notified measure").
- (2) On 17 April 2018 the UK authorities submitted additional clarifying information following questions from the Commission.

2. DETAILED DESCRIPTION OF THE PROLONGED MEASURE

2.1. Objective of the measure and duration

- (3) Enterprise Management Incentives (EMIs) is a tax advantaged share options scheme designed to enable smaller, higher risk growth companies in the UK to recruit and retain qualified employees needed to achieve their growth potential. Under the measure, the companies can provide key employees with a financial reward the value of which is directly linked to business success and which may be taxed at a significantly lower rate than a cash bonus.

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- (4) The scheme is part of the UK Government's integrated approach to tackling the SME labour market and capital market failures. The scheme has been under implementation since 2000 and approved by the Commission decision NN 32/2009 - *Enterprise Management Incentives (EMI)*¹. The scheme expired on 6 April 2018. However, the UK authorities confirmed that all State aid eligibility conditions and obligations laid down in the Commission's decision NN 32/2009 remain applicable to the notified measure which aims at extending the scheme covered by the NN 32/2009 decision for a period of 5 years.

2.2. Legal basis and granting authority

- (5) The legal basis is:
- (a) The Income Tax (Earnings and Pensions) Act 2003 (Sections 527 to 541, Schedule 5), as amended: provisions related to the general structure of the scheme and income tax relief;
 - (b) The Taxation of Chargeable Gains Act 1992 (TCGA) at TCGA (Section 238A and Schedule 7D), as amended: provisions relating to capital gains tax;
 - (c) The Social Security Contributions and Benefits Act 1992 (SSCBA92) and Statutory Instrument 2001/1004, as amended: provisions relating to National Insurance Contributions.
- (6) HM Revenue & Customs is the aid granting authority.

2.3. Tax relief granted under the measure

2.3.1. Standard tax treatment of share options in the UK

- (7) Since employee share options are granted as additional remuneration for work under an employment contract, they fall under the definition of employment income (i.e. income earned as remuneration for work under an employment contract). Employment income is subject to personal income tax and social contributions. Normally, the same taxation applies regardless whether the income is given in cash or in kind (ex. in the form of a financial asset).
- (8) Regardless of the price at which the options are granted, the standard tax treatment of employee share options is as follows:
- (a) Grant of option: no income tax liability or employee and employer national insurance contribution (NIC) liability arise;
 - (b) Exercise of option: income tax and employee and employer NIC liabilities arise (only NIC liability in case of readily convertible assets – see below) on the difference between the market value of the option shares at the exercise date and the total exercise price paid for those shares;
 - (c) Sale of shares: capital gains tax (CGT) liability arises for the seller of the shares, on the difference between the value realised on selling the shares and the value of the shares at the exercise date (subject to availability of the annual CGT allowance of specific CGT reliefs).

¹ C (2009) 5082 final

- (9) Under the standard tax treatment, if shares acquired under the option are readily convertible assets (i.e. if they are listed on a stock exchange or otherwise tradable), they are treated like employment related income and therefore are subject to employee income tax as well as to employee and employer NICs when an employee exercises the option. Profits from the sale of shares acquired by exercising the option are subject to CGT.
- (10) However, for shares acquired under the option that are not readily convertible assets (not listed or otherwise tradable), their value is not easily determined and therefore they are not treated like employment related income. Consequently, they do not attract NIC liability under the standard tax system. According to the UK, in the majority of cases, the shares under options granted by SMEs are not listed and therefore would not attract NIC liability².

2.3.2. *Description of the tax relief*

- (11) EMI provides for an advantageous tax treatment on growth in share value between the dates when the option was granted and when exercised. Presuming the EMI qualifying requirements are met throughout the option period, EMI share options are only taxed when the shares are sold and are subject only to capital gains tax (CGT):
- (a) Exercise of option: if the shares acquired under the EMI option are readily convertible assets and are subject to income tax and NIC, there is no income tax liability for the employee and no NIC liability for the employee and employer on any financial gain (the increase in the value of shares acquired) made on the exercise of the option, provided the exercise price is fixed at or above market value at the time the EMI option is granted.³ If the shares under the EMI option are non-readily convertible assets, there is no income tax for the employee under the EMI;
- (b) Sale of shares: when shares obtained on exercise are sold, the employee will be liable for CGT on the taxable gain (the difference between the value of the shares realised on sale and the exercise price)⁴.

2.3.3. *Qualifying options*

- (12) The shares under option may be quoted or unquoted and must be ordinary shares, fully paid up and non-redeemable. The option must be capable of exercise within 10 years from the date of grant. After 10 years have elapsed, the EMI tax benefits no longer apply to the exercise of any outstanding options. There is no statutory minimum period before EMI shares can be exercised.
- (13) EMI options must be granted for commercial reasons to recruit and retain key employees in a company. EMI option with a maximum share option market value of GBP 250 000 may be granted to a qualifying employee in a qualifying company, subject to a total share value of GBP 3 million under EMI options to all

² See footnote 4 of the Commission decision NN 32/2009

³ If EMI options are granted with an exercise price less than fair value, then income tax and employer and employee NICs is payable. However, the tax is not payable until the options are exercised. The taxable amount will be the difference between the exercise price and the lower of the actual market value at the date of exercise and the actual market value at the date of grant.

⁴ Since 2012 a policy change enables EMI option holders to benefit from the 10% CGT compared to 20% standard rate on the disposal of shares gained through EMI, where the options and shares have been held for a minimum 12 months.

employees. No employee may hold EMI options over shares worth more than GBP 250 000⁵ within any 3 year period.

- (14) As summarized in recitals (20) – (24) of the Commission decision NN 32/2009 the scheme's operational modalities offer flexibility to ensure that the options granted under the scheme can be designed in such a way as to meet a company's specific requirements and business objectives. Terms of options are the result of bargaining/negotiation between SMEs and employees agreed in a written agreement between the employer and employee.

2.4. Beneficiaries

- (15) In order to qualify for the EMI tax relief, both the grantor company and the employee option holder must fulfil certain qualifying criteria. Provided the legal qualifying conditions have been fulfilled, the EMI status is accorded automatically upon the grant of options. The employer must notify HMRC after the grant of the option certifying that the option agreement satisfies the legislation and the option holder has to certify that he/she satisfies the working time requirements.

2.4.1. Direct beneficiaries – qualifying employees

- (16) Qualifying employees must be employed by the qualifying company (at least 25 hours a week). They must have no material interest in the company, which is controlling 30% or more of the ordinary share capital of the company. The option holder must remain employed by the company or its group at all times during the duration of the option. On employee resignation and termination, in case the option has not yet been exercised, the EMI tax relief will no longer apply⁶. There is no limit on the number of employees who may participate in the EMI.
- (17) As explained in recital (10) in the majority of cases, the shares under options granted by the qualifying company are not listed and therefore would not attract NIC liability. Accordingly, the NIC liability exemption foreseen under this scheme would in a majority of cases not apply to the eligible companies, and thus the tax advantage covered by the scheme could only affect the eligible employees.

2.4.2. Indirect beneficiaries⁷ – qualifying companies

- (18) A company whose shares are the subject of EMI options must be a qualifying company at the time the options are granted:
- (a) The gross assets must not exceed GBP 30 million at the date of grant;
 - (b) The company must have fewer than 250 full time-equivalent employees;
 - (c) The company must be independent;
 - (d) The company must carry on qualifying trades that are trades carried on a commercial, profit making basis and excludes leasing, financial activities

⁵ This limit on the overall market value of share options which could be held by an individual employee was increased from GBP 120 000 up to GBP 250 000 in 2012.

⁶ The employees however will have 90 days to exercise the options after he has left the company and keep the tax relief.

⁷ In cases where the eligible company will benefit from the NIC liability exemption, the eligible company will be considered as a direct beneficiary of aid.

and property development as well as coal mining; the steel and shipbuilding sectors;

- (e) The company must have an establishment⁸ in the UK.
- (19) In line with recital (16) of the Commission's decision NN 32/2009, the qualifying companies comply with the SME definition⁹.
- (20) In line with recital (17) of the Commission's decision NN 32/2009, enterprises in difficulties¹⁰ are excluded under the scheme.

3. NOTIFIED MODIFICATION TO THE MEASURE NN 32/2009

3.1. Prolongation of the measure and the related budget extension

- (21) The UK authorities have notified a 5 year extension to the duration of the scheme covered by the Commission decision NN 32/2009. According to the UK, the proposed duration is necessary to ensure the effectiveness of the scheme in meeting its objectives.
- (22) The UK authorities commissioned the independent research institute Ipsos Mori¹¹ to carry out a robust evaluation of the EMI scheme, including a market failure analysis with a literature review, and econometric analysis of EMI firms. The UK authorities argue that the evidence gathered and produced in the submitted evaluation supports the case for the scheme's prolongation, as it demonstrates the existence of a market failure affecting SMEs, the effectiveness of EMI in aiding these difficulties, and that EMI is proportional and well-targeted.
- (23) Based on economic forecasts on the use of the EMI scheme and trends in the share value of EMI beneficiary companies, the revenue losses due to the tax relief provided under the EMI scheme are estimated at approximately GBP 160 million annually for the years the scheme is extended for. Of this amount, approximately GBP 10 million is the annual relief granted to companies, in foregone employer National Insurance contributions. The remaining is foregone income tax and National Insurance contributions of employees.

4. ASSESSMENT OF THE MEASURE

- (24) The Commission must assess whether the notified modification to the scheme approved by the Commission decision NN 32/2009 in the form of a 5 year prolongation affects the compatibility assessment carried out by the Commission in the decision.

⁸ For the purpose of the measure, the term includes UK resident companies established in the UK and foreign companies with a permanent establishment in the UK. The term "permanent establishment" is based on Article 5 of the OECD Model Tax Convention on Income and on Capital, which means a fixed place of business through which the business of an enterprise is wholly or partly carried on, including a place of management, a branch, an office.

⁹ OJ L 124, 20.05.2003, p. 36

¹⁰ As defined in the Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty (OJ C 249, 31.7.2014, p. 1).

¹¹ Evaluation of Enterprise Management Incentive Scheme prepared for HMRC, Ipsos Mori, December 2017

4.1. Existence of State aid

- (25) Article 107(1) TFEU states that *“any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market”*.
- (26) The qualification of a measure as aid within the meaning of this provision therefore requires the following cumulative conditions to be met: (i) the measure must be imputable to the State and financed through State resources; (ii) it must confer an advantage on its recipient; (iii) that advantage must be selective; and (iv) the measure must distort or threaten to distort competition and affect trade between Member States.
- (27) The Commission notes that the measure involves State resources as the tax relief provided under the measure constitutes foregone revenues of the State which, absent the measure, would have to be paid by the employees and the employers. The notified measure is also imputable to the State as it is introduced through a legislative act.
- (28) The tax relief provided under the measure is granted to employees of SMEs i.e. private individuals. However, at their level, the assessed measure does not constitute State aid in the meaning of Article 107(1) TFEU as it is addressed to physical persons.
- (29) The measure also confers an economic advantage to the eligible SME. Through the measure, the eligible SME will not incur remuneration costs, which it would normally have to meet through own financial resources to attain the objective of the measures i.e. to recruit and retain key employees that in the absence of the measure may not have been attracted to the SME. With the tax exemption, the measure enables the eligible companies to grant options for a lower amount of underlying shares in order to provide the same level of post-tax rewards from share options to their employees as would apply under the normal tax treatment. Furthermore, as described above, in a limited number of cases, some eligible companies may also benefit from the NIC relief when their employees exercise EMI options and acquire the underlying shares. The relief from employer NIC obligation confers a direct advantage to those companies, as it mitigates the tax charges which are normally included in the budget of an undertaking when taxing employment related income.
- (30) As the tax relief only applies to employers which are SMEs, the measure is selective.
- (30) Given, that the SMEs are active on markets that are open for competition and trade, the notified measure is liable to distort (or threaten to distort) competition and trade between Member States.
- (31) Taking account of the above, the Commission concludes that the measure constitutes State aid to the eligible companies, i.e. SMEs, within the meaning of Article 107(1) TFEU.

4.2. Legality of the aid

- (32) The measure's prolongation has been notified by the UK authorities on 16 March 2018 following pre-notification contacts. The UK authorities confirmed that the effective prolongation of the measure is conditional upon its approval by the European Commission.

4.3. Compatibility

- (33) According to Article 107(3)(c) TFEU, aid may be compatible with the internal market if it facilitates the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest.
- (34) In order to determine the compatibility of a measure under Article 107(3)(c) TFEU, the Commission performs a balancing test, weighing positive effects in terms of a contribution to the achievement of well-defined objectives of common interest and negative effects on trade and competition in the common market. In this regard, the Commission considers the following principles:
- (a) **contribution to a well-defined objective of common interest:** a State aid measure must aim at an objective of common interest in accordance with Article 107(3) TFEU;
 - (b) **need for State intervention:** a State aid measure must be targeted towards a situation where aid can bring about a material improvement that the market cannot deliver itself, for example by remedying a market failure or addressing an equity or cohesion concern;
 - (c) **appropriateness of the aid measure:** the proposed aid measure must be an appropriate policy instrument to address the objective of common interest;
 - (d) **incentive effect:** the aid must change the behaviour of the undertaking(s) concerned in such a way that it engages in additional activity, which it would not carry out without the aid or would carry out in a restricted or different manner or location;
 - (e) **proportionality of the aid:** the amount and intensity of the aid must be limited to the minimum needed to induce the additional investment or activity by the undertaking(s) concerned;
 - (f) **avoidance of undue negative effects on competition and trade between Member States:** the negative effects of aid must be sufficiently limited, so that the overall balance of the measure is positive;
 - (g) **transparency of aid:** Member States, the Commission, economic operators, and the public, must have easy access to all relevant acts and to pertinent information about the aid awarded thereunder.

4.3.1. Contribution to a well-defined objective of common interest

- (35) The UK authorities have emphasised that the objective of the measure and its prolongation is to continue supporting growth oriented SMEs in competing with larger, well established enterprises by facilitating their employment and retention efforts. To this effect it is envisaged that the scheme will continue leading to productivity and growth benefits for the UK economy as a whole, as small

companies with potential for higher growth find it easier to recruit and retain the kind of employees they need to enable them to realise that potential.

- (36) The importance of supporting the growth of SMEs has been stressed in a recent OECD report drawing attention to the fact that “*SMEs play a key role in national economies around the world, generating employment and value added and contributing to innovation. SMEs are central to the efforts to achieve environmental sustainability and inclusive growth*”¹².
- (37) The Commission on its side has recognised that a shortage of skilled employees adversely impacts the innovation and growth potential of SMEs a.o. by restricting the SMEs abilities to explore the productive potential of innovations and ideas. In this regard, the Commission has already acknowledged the need to promote a more entrepreneurial culture and create supportive environment for SMEs¹³. Employee share option programs or financial participation measures have been identified as an important instrument in helping SMEs overcoming problems in attracting and retaining key employees¹⁴.
- (38) Like in similar Commission decisions adopted in 2017¹⁵, targeting the same objective, the measure subject to this decision also aims at facilitating the efficient matching of labour resources to the economic needs of SMEs increasing their productivity and growth prospects.
- (39) In light of the considerations set out above, the Commission concludes that the measure continues to contribute to a well-defined objective of common interest.

4.3.2. *Need for State intervention*

- (40) In assessing how the measure contributes to efficiency and remedies a market failure, the Commission needs to examine the presence and magnitude of a market failure.
- (41) According to the UK authorities, the market failure affecting SMEs capacity to employ and retain staff stemming both from capital and labour market failures, as identified in recitals (45) - (62) of the Commission decision NN 32/2009 approving the scheme for which a prolongation is sought under the current notification, is still present.
- (42) The independent evaluation submitted by the UK authorities, mentioned above in recital (22), concludes that there is clear evidence that smaller firms continue to face challenges in recruiting and retaining staff.
- (43) These findings are underpinned by the hypotheses that SMEs are disadvantaged in the labour market to the effect that it prevents them from competing for highly

¹² OECD report – *Enhancing the contributions of SMEs in a global and digitalised economy* (2017), <https://www.oecd.org/mcm/documents/C-MIN-2017-8-EN.pdf>

¹³ Communication from the Commission to the European Parliament, the Council, the European economic and social Committee and the Committee of the Regions, *Entrepreneurship 2020 Action Plan, Reigniting the entrepreneurial spirit in Europe*, COM (2012) 795 final of 9.1.2013

¹⁴ *Employee Stock Option: the legal and administrative environment for employee stock options in the EU*, European Commission, DG ENTR, June 2003, p. 20; *The Promotion of Employee Ownership and Participation*, Study prepared by the Inter-University Centre for EU Commission’s DG MARKT, p. 118

¹⁵ SA.47144 (2016/N) - *Tax reduction of employee share option*, OJ C/254/2017 from 4.08.2017; SA.47947 (2017/N) SME-focussed, share-based incentive scheme - Key Employee Engagement Programme, OJ C/121/2018 from 19.12.2017

skilled staff which inhibits their growth. These issues arise in part because the prospective employees have inadequate information for an informed decision on the prospects of the SMEs in comparison to large firms requiring the former to make higher wage offers to attract equivalently skilled staff and ultimately leading to sorting patterns in which highly skilled workers sort into large firm while lower skilled workers sort into SMEs.

- (44) Also imperfections in financial markets constrain the ability of SMEs to meet those wage offers. The capital market information asymmetry causes SMEs to have fewer resources than larger firms to pay and reward staff. This ‘funding gap’ contributes to the recruitment and retention difficulties faced by smaller businesses. These problems are expected to disproportionately affect particularly early-stage or pre-revenue firms, resulting in further social costs when growth constraints inhibit R&D activity resulting in lost knowledge spill-overs.
- (45) The evaluation submitted by the UK authorities also draws attention to the fact that smaller firms are less likely to overcome skills problems internally themselves. Smaller employers suffering from restricted access to capital are not able to allocate additional finance to staffing issues, like training and higher salaries.
- (46) The 2015 UK Employer Skills Survey¹⁶ to which the evaluation submitted by the UK refers also confirms the continuous difficulties faced by SMEs in the UK in terms of attracting and retaining employees. In particular, the survey finds that smaller businesses were less likely to report new recruitments over the previous 12 months. Furthermore, in 2015, the smallest organisations were more likely to report hard to fill vacancies.
- (47) The UK authorities also point out that the Ipsos Mori analysis of the Annual Survey of Hours and Earning from 2013-2015 confirms that SMEs continue to pay lower wages than larger firms for job roles with similar characteristics, regardless of the sector concerned. This reaffirms that SMEs in the UK continue to be unable to offer an economically efficient level of remuneration necessary to attract and retain key employees.
- (48) The UK authorities also point to wider trends in the labour market currently rendering it more difficult for SMEs to recruit and retain staff a.o. due to falling unemployment. The UK Office for National Statistics (ONS) figures show that the trend in falling unemployment is continuing: the unemployment rate in the period from November 2017 to January 2018 was 4.3%, the lowest since 1975. ONS figures also show that the number of vacancies is increasing – in February 2018 there were 10,000 more vacancies than in November 2017, and 56,000 more than a year earlier¹⁷. Low unemployment makes it harder for businesses to recruit and retain workers because workers have more options. This affects SMEs capacity to attract workers who are already employed, as they are less established and less well known than larger firms, as well as less capable of offering competitive remuneration.

¹⁶ UK Employer Skills Survey, UK Commission for Employment and Skills (2015) provides a comprehensive view of the UK labour market, using over 91,000 interviews from employers all over the UK

¹⁷ ONS labour market statistics, www.ons.gov.uk

- (49) The above findings brought forward by the UK authorities point to the continued need for the measure to remain in place in the UK to tackle the identified market failures. The UK authorities have explained on the basis of the submitted evaluation that the proposed prolongation of 5 years is deemed appropriate to further support SMEs affected by market inefficiencies targeted by the EMI measure, before another full and independent review of the scheme is undertaken.
- (50) Considering the above and its recent decision practice applicable to the assessed measure¹⁸, the Commission can conclude that market inefficiencies affecting SMEs capacity to recruit and retain employees continue to persist, which justifies that the public intervention covered by the assessed measure is prolonged by 5 years.

4.3.3. Appropriateness of the aid measure

- (51) Member States can make different choices with regard to policy instruments and State aid control does not impose a single way to intervene in the economy. However, State aid in the meaning of Article 107(1) TFEU can only be justified by the appropriateness of a particular instrument to meet the public policy objective and contribute to one or more of the common interest objectives.
- (52) The Commission normally considers that a measure is an appropriate instrument where the Member State has considered whether alternative policy options exist which are equally suitable to achieve the common interest objective but at the same time less distortive to competition than the selective State aid and where it can demonstrate the appropriateness of the measure in targeting efficiency and/or equity objectives.
- (53) The UK believes that tax advantaged share options continue to be an appropriate policy instrument to address the persisting market imperfections explained above affecting smaller employers and their employees. As demonstrated by the evaluation provided by the UK authorities, the scheme has been effective in helping high growth SMEs in recruiting and retaining staff. Its prolongation is necessary due to the perseverance of the market inefficiencies described above.
- (54) At the same time, the UK authorities acknowledge that the EMI measure is often used by smaller higher risk companies who might also be eligible for the UK's Venture Capital Trusts (VCTs) and Enterprise Investment Scheme (EIS). These schemes are, however, addressing access to finance market failures, thus facilitating access to external finance for investments of a capital intensive nature rather than for labour remuneration purposes. In this regard, the Commission acknowledges that the measure addressing access to finance difficulties is used to address a different objective to that targeted by the assessed measure.
- (55) In addition, as indicated in the Commission decision NN 32/2009, the Commission recognises on the basis of information provided by the UK authorities, that the general tax advantaged share schemes operating in the UK - Company Share Option Plan (CSOP), Share Incentive Plan (SIP) - are not designed to target SMEs (for ex. in terms of caps on the employee maximum share option market value; limited tax benefit period) and, therefore not an

¹⁸ See footnote 15

appropriate instrument to address the recruitment and retention problems faced by SMEs.

- (56) In light of the elements detailed above and taking into account the argumentation presented in the Commission decision NN 32/2009 in recitals (64) to (72), the Commission considers that the tax relief offered under the assessed share option measure continues to be an appropriate instrument to address SMEs problems in recruiting and retaining key employees, the latter being essential to enable their further growth.

4.3.4. *Incentive effect*

- (57) In order to enable the Commission to assess the compatibility of an aid, the Member State must provide evidence demonstrating that the aid has an incentive effect, *i.e.* it is likely to change the behaviour of the beneficiary in such a way that it engages in additional activities.
- (58) The EMI scheme was launched to allow smaller, higher-risk companies to offer tax-advantaged share options, to help recruit and retain employees with the skills to aid their growth. It was also designed as a way of rewarding employees for taking a risk by investing their time and skills to help smaller companies achieve their potential. According to the information submitted by the UK authorities, in its first year in 2000, 790 SMEs used the EMI scheme. Since then the number of firms using EMI has increased to 8,610 for the financial year 2015/16.
- (59) The evaluation submitted by the UK authorities has shown that the scheme was effective in terms of reaching its objectives:
- (60) The primary research among EMI users found that the scheme has been mainly used by smaller, expanding companies, which suggests that the target firms are self-selecting into the scheme.
- (61) The vast majority of firms using the EMI scheme, which took part in the survey, agreed that their company competes in a market for premium quality products or services and more than half said their strategy is based on being the first to introduce new products or services to the market. This is consistent with the scheme's aim of targeting high value added, innovative SMEs.
- (62) The majority of users also perceived EMI to be successful in helping companies retain key and skilled staff (84%) and improve staff morale (85%). Just over half said that EMI had helped with the recruitment of key workers (54%) and attracting higher quality employees (52%).
- (63) Robust econometric analysis (see recital (22)), as part of the evaluation submitted by the UK, concluded that the EMI measure did aid recruitment efforts of companies: EMI users have experienced a reduction in the proportion of hard-to-fill vacancies and the effect of adopting EMI feed through into growth in the number of employees.
- (64) Furthermore, employers using EMI perceived the scheme to be successful in helping companies grow and develop. The survey data which collected baseline characteristics on the number of employees, turnover, equity, profit, R&D and exports of businesses also indicated that EMI adopters are expanding. The

findings also suggest that companies who used the scheme were typically focused on scaling-up and many expected high levels of growth over the next year.

- (65) The Commission considers that the above described results could be achieved in view of the inherent features of the options granted under the EMI scheme, described in recitals (74) – (80) of the Commission decision NN 32/2009 approving the underlying measure subject to prolongation. The tax advantage granted under the EMI measure makes share options economically attractive both for employees and SMEs, a.o. by increasing the amount of post-tax remuneration available to an employee; reducing the amount of underlying shares under the option that an SME would have to provide to offer the same post-tax reward to employees, seeking to encourage SMEs to use equity-based remuneration and encourage employees to accept the potential risk and reward in this form of remuneration.
- (66) Taking into account the above elements, the Commission can conclude that the EMI measure has an incentive effect and, as a result, should contribute to alleviating employment and employee retention problems faced by SMEs.

4.3.5. Proportionality of the aid

- (67) The Commission considers that the aid is proportionate if the same result could not be achieved with less aid.
- (68) The UK authorities have reiterated the features of the measure, described in recitals (83) to (92) of the decision approving the underlying scheme NN 32/2009 subject to prolongation, which ensure that the support granted under the measure is kept to the minimum:
- (a) The minimisation of aid provided by EMI arises directly from its form. The EMI scheme provides tax relief on the rewards from the exercise of employee share options, thus enhancing the post-tax pay-out for them where the share price exceeds the agreed exercise price.
 - (b) The use of EMI options is governed by independent commercially driven economic actors with no direction or further distortion from the state. The incentives of the economic actors in question, the employer and the employee, in the bargaining/negotiating process over the amount of EMI options to be awarded, are such that they act to minimise the aid provided to the minimum necessary.
 - (c) On the employee's side, it is assumed that the employees have a strict preference for greater remuneration over less, and that this holds for contingent share-based remuneration as well. It is under this framework that an individual is assumed to negotiate with an employer over remuneration.
 - (d) The employer's incentives lie in maximising the company's future stream of profits. The employer wants to maximise the value that additional labour resource brings to the company and to minimise the cost of doing so. The employer is thus not willing to pay more than its best estimate of the employee's marginal contribution to the company.
 - (e) As with other forms of remuneration, in order for the overall remuneration package to be sufficiently attractive to secure the employee's services the employer and employee through negotiation will have to reach an agreement on how much share-based remuneration will be included in the

employment contract. Through the course of such bargaining, the employee will look to bid up the amount of remuneration they will receive in return for their services while the employer will aim to minimise the cost of securing those services. This aspect of bargaining by two independent economic actors is a key feature of the EMI scheme and has the effect of producing the least possible distortion.

- (f) From the employer's point of view, EMI options are not cost-free. The granting of any employee share option, including an EMI option, entails the existing shareholders foregoing a proportion of their ownership stake in the company, and the future stream of income associated with that ownership. A company will also have to account for the provision of employee share options in their accounts, which impacts accounting profits. This makes it clear that EMI options are not awarded indiscriminately, rather the amount of EMI options awarded will be the result of a bargaining process.
 - (g) In addition, the EMI scheme also includes limits on the value over which EMI options can be granted per employee on a company basis.
- (69) The Commission therefore considers that the aid granted under the notified measure is proportionate, as it provides for a number of safeguards ensuring that any aid is limited to the minimum necessary to achieve the objectives.

4.3.6. Avoidance of undue negative effects on competition and trade

- (70) A State aid measure must be designed in such a way as to limit distortions of competition within the internal market. The negative effects have to be balanced against the overall positive effects of the measure.
- (71) In the present case, the Commission notes that the measure is targeted at SMEs which typically face difficulties in the recruitment and retention of key employees. Larger companies generally do not suffer from the same magnitude of the market failure due to their ability to compete successfully in the labour market by offering competitive remuneration packages. Therefore, the measure is unlikely to have any measurable negative effects on large enterprises, which are not eligible under the measure.
- (72) The Commission notes that by increasing the ability of SMEs to offer a competitive remuneration package to employees, the measure has a potential to promote competition in the labour market and help improve the efficient matching of labour resources for productive economic activities carried out by SMEs. This should increase product market competition, since it should give smaller companies greater potential to innovate, develop, market and commercialise their products.
- (73) Finally, the Commission notes that the aid characteristics ensure that any potential distortions of competition are limited to the minimum. The incentive advantage will only materialise if there is real productive growth, reflected in the growth of the company's share value, allowing the employee to exercise options and realise gains. Given that the maximum aid amount is limited and that the aid is targeted to a well-defined purpose, it is unlikely to have any measurable negative effects on competition and trade.

- (74) The Commission is therefore able to conclude that the distortions of competition and negative effects on trade due to the measure will be limited.

4.3.7. Conclusion with regard to the compatibility of the measure

- (75) In light of the above, the Commission considers that the measure can be declared compatible with the internal market on the basis of Article 107(3)(c) TFEU.

4.4. Transparency

- (76) The UK authorities confirmed that the measure will be published and accessible on the following website:

<https://www.gov.uk/tax-employee-share-schemes/enterprise-management-incentives-emis>

- (77) In addition, for awarded aid exceeding EUR 500,000, UK committed to publish, on the above website:

- the identity of the granting authority, the form and amount of aid granted to eligible employees per eligible SME, aid granted to the eligible SME, the date of granting, the region in which the eligible SME is located (at NUTS level II) and the principal economic sector in which the eligible SME has its activities (at NACE group level).

- (78) The information covered by the above recital should be published within 1 year from the date the tax declaration is due, which will be kept for at least 10 years and will be available to the general public without restrictions. The UK authorities will implement the necessary legislative changes to give effect to the above requirement at the earliest opportunity.

4.5. Additional observations

- (79) Since the United Kingdom notified on 29 March 2017 its intention to leave the European Union, pursuant to Article 50 of the Treaty on European Union, the Treaties will cease to apply to the United Kingdom from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification, unless the European Council in agreement with the United Kingdom decides to extend this period. As a consequence, and without prejudice to any provisions of the withdrawal agreement, the present decision only applies if (i) the United Kingdom is still a Member State on the first day of the period for which the notified scheme is approved, and (ii) to individual aid granted¹⁹ under the notified scheme until the United Kingdom ceases to be a Member State.

5. CONCLUSION

- (80) The Commission has accordingly decided not to raise objections to the notified aid measure on the grounds that it is compatible with the internal market pursuant to Article 107(3)(c) TFEU.

¹⁹ According to the case-law of the CJEU, aid must be considered to be granted at the time that an unconditional right to receive it is conferred on the beneficiary under the applicable national rules (See Case C-129/12 Magdeburger Mühlenwerke EU:C:2013:200, paragraph 40).

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<http://ec.europa.eu/competition/elojade/isef/index.cfm>.

Your request should be sent electronically to the following address:

European Commission,
Directorate-General Competition
State Aid Greffe
B-1049 Brussels
Stateaidgreffe@ec.europa.eu

Yours faithfully
For the Commission

Margrethe VESTAGER
Member of the Commission

