EMPLOYEE OWNERSHIP TRUSTS

Employee ownership trusts (EOTs) meeting statutory conditions allow the controlling interest in a company to be transferred to a trust to be held for employees. The transferring shareholders may sell their shares to an EOT, and claim exemption from tax on all capital gains, and the company may pay additional rewards to employees by way of tax free bonuses up to £3,600 a year.

Practical points

- There are many success stories with employee owned companies (eg John Lewis, Richer Sounds and Arup) but each employee owned company is different and the chosen structure should reflect the culture and ambitions of the organisation.
- This is a transition event for a company, transferring ownership and control to the EOT and employees.
- When creating an EOT the majority of the company's ordinary shares will be transferred to the EOT. Specific tax and legal advice is needed by the transferring shareholders, the company and the trustees acquiring the shares.
- Communication with employees, trustees and the current shareholders is a vital part of this process and should be built into the planning.
- Original or family shareholders can stay involved through management committees or representation on the board of trustees.

Statutory tax reliefs

The four statutory reliefs and exemptions given are:

- a capital gains tax (CGT) exemption for a disposal of shares to an EOT;
- an exemption from income tax (not national Insurance contributions) on bonus payments of up to £3,600 per year paid to employees by employers owned by EOTs;
- corporation tax relief on those bonus payments; and
- relief from inheritance tax on certain transfers into and from EOTs.

Does the EOT have to own all the company?

The EOT trustees must control the company in terms of ordinary share capital, voting rights and rights to dividends or similar distributions out of profits.

This requirement still allows individuals to hold shares in the company personally, and for employees to acquire shares through an enterprise management incentive (EMI), a share incentive plan (SIP) or any other share plan.

By the way, what Is a trust?

A trust is a legal arrangement where assets, in this case shares in a company, are held by trusted persons (trustees) for the benefit of others (beneficiaries), in this case employees.

Trustees are bound by the trust documentation (trust deed) and trust law to act in the best interests of the beneficiaries. These interests might or might not be the same as the company's or other shareholders' interests.

An EOT must comply with specific statutory requirements (so that the beneficiaries are treated equally) set out in the trust deed.

Statutory requirements

- The company needs to be a sole trading company or the principal company in a trading group.
- Nearly all the company's employees must be potential beneficiaries of the EOT and if benefits are paid out, it must be on the 'same terms' (this phrase having a special statutory meaning).
- The major exception from the all employee principle is for employees and directors who, with 'connected' persons (including close family members), have an interest in 5 per cent or more of the shares. These employees cannot benefit from the EOT and no amendments can change the terms of the trust to cause this test to be failed in future. That usually means shareholders may sell shares to the trust tax free, but if they (with associates) retain 5 per cent or more of the shares, they have limited opportunities to benefit afterwards.
- Employees with less than 12 months' service may be excluded by the trust deed.
- The 'same terms' requirement will often mean that any benefits are distributed in the same proportion to salary and/or length of service and/or hours of work.
- The trustees of the EOT must:
  - own more than 50 per cent of the shares in the company;
  - have a majority of the votes;
  - be entitled to more than 50 per cent of the profits available for distribution (trustees can waive dividends if the trust deed allows); and
  - be entitled to more than 50 per cent of assets available for distribution to shareholders on a winding up.
- There cannot be provision in any document that allows these tests to be failed in future without the consent of the trustees; eg by allowing for loans, sub-trusts or amendments.

Funding

- There are no statutory reliefs specifically for the funding of EOTs buying shares and this needs careful planning when considering the source of funding; eg loans from the company or a third party, outright contributions from the company or vendor financing arrangements.

Other considerations

It is important to check the accounting position of any transactions related to the EOT.

The EOT can be expanded to accommodate international participants (without the UK tax advantages).

Pay careful attention

The tax legislation, rates and reliefs referred to herein are applicable at April 2021.Tax rules change frequently and the value of a relief from taxation depends on the particular circumstances of the taxpayer.

Contact

For further information on share schemes, please contact your usual RSM adviser.

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