Osborne Clarke

Employee Ownership Trusts (EOTs)

EOTs offer generous tax reliefs to encourage indirect employee ownership

What is an EOT?

An EOT is a special type of employee benefit trust that allows a company to become employee-owned.

How does an EOT work?

The shareholders sell shares in their company to an EOT so that the EOT holds a majority stake in the company. The trustee of the EOT holds the shares for the benefit of the employees as a whole.

In many cases, 100% of the shares are transferred to the EOT, but shareholders do not need to sell all of their shares and can continue to hold some shares in the company (as long as the EOT holds a controlling interest and the other conditions are met).

What are the benefits to the selling shareholders?

Shareholders can sell their company to the EOT for the benefit of the employees, enabling them to realise value whilst ensuring that the culture and ethos remains.

The shares will be sold for an agreed market value, and it is possible for the shareholders to retain a minority interest and remain as directors of the company. Not all shareholders need to sell their shares (nor do they need to sell pro-rata).

There are a number of potential tax reliefs available (provided the legislative requirements are met) for the selling shareholders:

- No capital gains tax liability for the selling shareholders
- No inheritance tax liability for the selling shareholders

What are the benefits for the employees?

The sale to the EOT enables the shareholders to realise value but no new third party buyer is being introduced that might disrupt the way the company has been run.

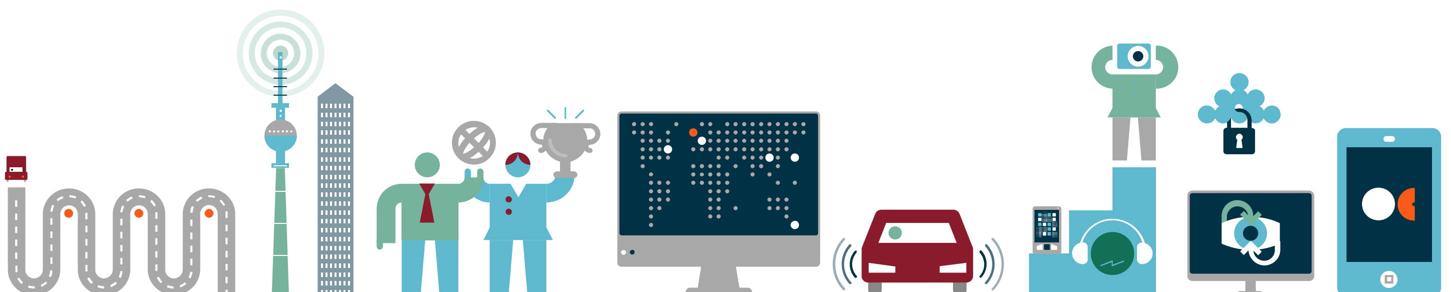
Some EOTs are established with employee representation on the board of the trustee company or an employee council established (see below).

In addition, bonuses of up to £3,600 per employee are exempt from income tax (but not NICs) if certain conditions are satisfied (broadly that they are paid by the company on similar terms).

How is it funded?

Valuation and funding issues are key, and specialist advice should be obtained.

Funding will depend on the cash resources and requirements of the business. The EOT could look to fund the initial acquisition price by the company contributing part of its cash reserves to the EOT, and/or by external bank funding.



The transaction could be structured so that the EOT owes a residual debt (deferred consideration) to the selling shareholders. The company would periodically make capital payments to the EOT out of its future after-tax profits and the EOT would use such payments to pay off part of the deferred consideration to the selling shareholders.

Who is the trustee?

Trustees are appointed to run the EOT. Typically, a corporate trustee would be appointed. Further governance arrangements would normally be put in place, for example an employee may be appointed as director of the trustee company (or an employee council established) to ensure that the employees' interests are properly represented.

The trustee holds the shares for the benefit of the employees, subject to the terms of the governing trust deed and rules and their duties.

Conditions

There are a number of important qualifying conditions which must be satisfied both at the time of the establishment of the EOT and then on an ongoing basis. These include the requirements that:

- The shares in the EOT must be held for the benefit of all employees
- The trustee of the EOT must retain a controlling interest in the company
- The company must remain a trading company
- The trust property must be applied to employees on the same terms (but can be tiered in certain circumstances)
- There must be no on-sale in the tax year of disposal and the following tax year

There are other conditions, and careful due diligence is required to ensure that all the requirements are met. It is important that the company and trustee monitor compliance on an ongoing basis.

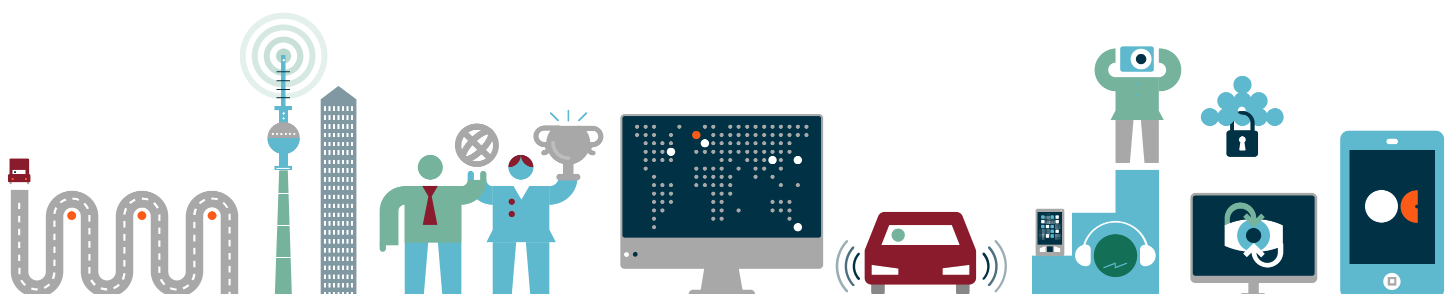
The EOT will need to be registered by the trustee under HMRC's online Trust Registration Service.

Summary

- An EOT can address exit or succession planning issues and is a means of seeking to protect and maintain the culture of the company
- An EOT can provide a tax beneficial way for shareholders to realise value, and the relief must be claimed by the selling shareholders
- The company can fund the realisation through ongoing profits generated

"The team have given us advice on a number of matters including EMI share schemes and employee ownership trusts. They clearly have a lot of experience in these areas, which has always given us a lot of confidence. We appreciate that they've always taken the time to understand our commercial needs, as well as having all the legal detail covered."

Legal 500



How can Osborne Clarke help?

Inevitably there are many technical issues to consider, and at the outset it is important to be comfortable that an EOT is the correct model for your business. Careful structuring is required to ensure that the legislative requirements are met and the reliefs are available. Osborne Clarke can help you through this process.

If you are considering moving to an employee ownership structure and how it might work for you, please speak to your usual Osborne Clarke contact. Alternatively, contact any of the following members of our incentives team.

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