Employee OwnershipWales

Guide to
Employee Ownership Trusts

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Employee Ownership Trusts are used in a large number of employee owned companies. It is a special type of trust into which a company can place shares or other assets, under the distinct and separate ownership of trustees, for the benefit of beneficiaries. The "Trustee" holds shares for employees of a company (known as the "Principal Company"). The employees, and former employees, who stand to benefit are called "Beneficiaries". This is often termed an indirect ownership model as no single employee has a certificate for these shares. The Trustee is usually a corporate one, a limited liability company with directors from the principal company board, elected or appointed employees and one director independent of the principal company. The Trustee is solely there to ensure employees benefit. The Board of the principal company runs the company as before but is accountable to its new owners.

The benefit of the shares held vest in the Beneficiaries as a class but none of them individually has a right to receive a benefit unless the Trustee decides he or she should benefit. It is a form of collective ownership of shares on behalf of employees as opposed to individual ownership of shares by the individual employees.

An Employee Ownership Trust (often referred to as an EOT) has certain tax benefits for owners wanting to sell to employees and also for the employees themselves. It is an all-employee model and with some specific exceptions the Trustee will need to treat everyone the same (called the equality requirement). To achieve these benefits the Trustee must meet a set of criteria. These criteria are not onerous but need to be observed. If they are met then a sale of a company to an EOT will be free of CGT for the owners if it results in the Trustee owning more than 50% of the shares. In addition, employees are able to benefit from an additional £3,600 p.a. tax free amount for payments made under a documented employee profit sharing scheme.

An EOT is usually used to facilitate the sale of all or a significant part of the equity to the employees. The intention is usually that the company will ultimately be owned by the Trust.

The EOT is normally financed directly either as a result of lending money from a third party or by being ‘gifted’ funds by the principal company that created it. It is a separate legal entity controlled by trustees and is not under the control of the principal company even though the principal company may have either ‘gifted’ or secured funds for the EOT to purchase shares.

An EOT can be used in conjunction with direct shareholdings including options schemes for key personnel such as EMI. However, if CGT relief is claimed by the Founders the majority shareholding must be maintained at all times. Also, care must be taken to ensure that dividends agreed by the Board of the principal company and paid to shareholders do not infringe the equality rules and that the EOT and its beneficiaries are treated fairly.

The EOT holds the shares for the benefit of employees. The Trustee will have discretions and powers granted to it under a document known as a “Trust Deed”. The Trustee will be required to act in accordance with the terms of the Trust Deed and this may contain some guidance on how trustees are expected to act in the interests of beneficiaries. The trustees hold the Board of the principal company to account and ensure that they treat employees as owners and run the company in their interests.

The shares held by the EOT will in principle attract a dividend. It is common for the Trustee to waive its right to a dividend as in practice a more tax efficient approach is for an equivalent sum to the dividend to be paid by the Principal Company direct to employees as part of a profit sharing scheme. Such a scheme would provide employees with an additional income tax free amount of £3,600 p.a. providing the qualifying criteria set out in the 2014 Finance Act are met.

One key point to remember is that an EOT is a discretionary trust. Essentially so long as the trustees believe they are acting in the best interests of beneficiaries they can exercise their discretion rather then be instructed by beneficiaries to perform certain acts (such as selling the principal company and splitting the proceeds amongst the employees).

The EOT can act as a ‘market maker’ by buying shares from direct shareholding employees when they leave the business and selling shares to new employees who join. In order to buy shares back the EOT will generally be gifted funds by the principal company.

This provides an advantage when compared to a principal company buying its own shares from employees leaving and being forced to cancel the shares, then having to allot new shares in order to make shares available for new employees to buy shares.

Setting up the EOT

The normal process for setting up an EOT is:

1. **A trust deed is drawn up.** This sets out how trustees are appointed, who the beneficiaries are, what property (shares, money, assets, etc.) has been put into trust, and what the trustees can do with this property they own on behalf of the beneficiaries.

2. **Identify the trustees.** Usually an employee elected trustee, a board appointed trustee and an independent trustee (i.e. someone who doesn't or hasn't worked for the principal company).

3. **The trustees and the principal company sign the trust deed.**

4. **The principal company then gives a small 'gift' of money to the trust** – this might be as little as £100.

It is important to take advice on the suitability of this approach for succession planning. We can provide this and also advise on the selection of law firms who are familiar with Employee Trusts. In particular, the content of the Trust Deed, the agreement between the principle company and the trustee(s), requires careful specialist consideration.

In order for the tax advantages to be realised and maintained, the Qualifying criteria for an EOT as set out in the 2014 Finance Act and Section 236 (H) – (U) of the Taxation of Chargeable Gains Act must be met. We can provide detailed advice on this and train the Directors of both the principal company and the Trustee.