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Hazlewoods

Employee Ownership Trusts

This factsheet summarises the benefits of an EOT structure and the key conditions to qualify for the tax reliefs available.

What is an Employee Ownership Trust?

An Employee Ownership Trust (EOT) is a special form of trust which is set up to enable the employees of the business to become the owners.

The John Lewis model is a well-known example of this type of structure where the employees are also the owners, participating in the company's profits.

Rules introduced in 2014, offer significant tax advantages for establishing similar structures and, as a result, they have become much more popular over the last decade. Even with a reduction in the tax relief available, with effect for disposals taking place on or after 26 November 2025, an EOT can still be a viable and tax efficient exit route .

How it works

Indirect ownership of the company by the employees is typically the most common way to structure an employee-owned company.

This is achieved by establishing an EOT to hold the majority (i.e. greater than 50%) of the shares in the company for the long-term benefit of the company's employees. Effectively, the employees then indirectly own the business in which they are employed.

Where an EOT acquires its shares from a shareholder, the consideration can be left outstanding, and the company typically then makes contributions to the EOT which are used to repay the outstanding amounts over time.

As mentioned above, at least 50% of the shares must be held by the EOT, but this can be as high as 100% if the owner wants a complete exit.

All permanent employees must benefit from the EOT, so it is not possible to just offer the shares in the EOT to the more senior members of the business.

Benefits of employee ownership

The decision to establish an EOT should be driven by commercial reasons. There are a number of advantages of an EOT structure for the original shareholders, the company and its employees, including:

- Shareholders looking for a full or partial exit from a business but with no other obvious route for succession can utilise an EOT to pass the business on. For example, where there are no obvious family members willing or able to take over the business or where a suitable third-party buyer cannot be identified.
- Shareholders can dispose of their shares for full market value (an independent valuation is required).
- Not all existing shareholders have to sell their shares to the EOT and partial exits can be facilitated.
- Employees are typically not required to put up their own cash to purchase the shares.
- Increased productivity and engagement of employees can be achieved by giving them a stake in the business and a say in how it is run.
- Increased profitability is likely to be achieved as employees have a vested interest in the performance of the business.

Key conditions to qualify

In order to be qualify for the tax advantages outlined, a number of conditions must be met. The main conditions to be satisfied are:

1. **All employee benefit requirement** – any settled property (i.e. the shares) on the EOT must be applied for the benefit of all eligible employees on the same terms.
2. **Trading requirement** – the company whose shares are transferred to the EOT must be a trading company or the principal company of a trading group.
3. **Controlling interest requirement** – the EOT must continually hold more than 50% of the ordinary shares and voting rights in the company and must be entitled to more than 50% of the profits available for distribution in the event of a wind up.
4. **Limited participation requirement** – the number of continuing shareholders and 5% participators who are also directors or employees of the company must not exceed 40% of the total number of employees (e.g. only two in five employees can be directors/shareholders or their family).
5. **Trustee independence requirement** – less than 50% of the trustees (or directors of a corporate trustee) can be "excluded participators". Excluded participators are generally the former owners (vendors) of the company or people connected with them, who held a significant share of the company (typically 5% or more).
6. **UK residence requirement**– the trustees must be UK resident
7. **Market value requirement –** the trustees must take all reasonable steps to ensure that the transaction takes place at no more than market value, and any interest paid on deferred consideration is not in excess of market value.

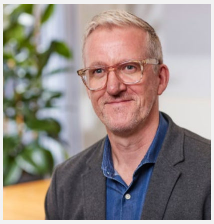
Conditions also need to be met for four tax years following the disposal of shares to the EOT, or the CGT relief could be withdrawn.

Tax advantages

The main tax advantages of an EOT include:

- The original shareholders can dispose of their shares to the EOT with 50% of the gain being exempt from capital gains tax (CGT). This would generally result in an effective CGT rate of 12%. Note that it would not be possible to claim business asset disposal relief where CGT relief under the EOT provisions is claimed.
- Bonus payments of up to £3,600 per year can be made to all qualifying employees exempt from income tax (but not NIC) providing they are made on the same terms, although directors may now be excluded.
- The disposal can provide a steady return in future years, free of income tax and NIC, as the consideration (which is often left outstanding) is repaid.
- No tax liabilities incurred for the employees by holding the shares on trust, providing they are not earmarked for specific employees.

Your key contacts



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