FARRINGFORD LEGAL

Employee Ownership Trusts

- Plan for business succession
- Reward your hard working staff

Where a trade sale is not on the horizon and the management team cannot raise funds for an MBO, business owners can be faced with difficulty when planning for their own exit and the succession of the business. An Employee Ownership Trust ("EOT") can provide a tax efficient solution to this problem.

An EOT can acquire between 51% and 100% of the shares in a trading business. These are then held 'on trust' for the employees: they do not hold shares directly, but indirectly via the trust.

Some of the benefits are as follows:

- A market for shares can be created where this would otherwise not exist.
- There is no CGT to pay for the selling shareholders when they sell their shares to the trust. Now that Business Asset Disposal Relief (previously Entrepreneurs Relief) has been reduced to a lifetime limit of £1m, this can make a significant difference.
- Shareholders and employees can continue to work in the business following the sale.
- Finance can be sought from third party providers, allowing the selling shareholders to extract their value over time.
- Tax free bonuses of up to £3,600 per year can be paid to employees (National Insurance Contributions still apply).
- Research shows that employee-owned companies perform better, retain staff for longer and have lower levels of absenteeism than other companies.

To qualify for the Employee Ownership Trust ("EOT") tax benefits the following criteria must be met:

The company must be a trading company or the main company of a trading group.

The EOT must acquire and maintain a controlling interest in the company (i.e. at least 51%).

All employees must benefit on the same terms.

Continuing shareholders and other 5% participators who are directors or employees (and any persons connected with them) must not make up more than 40% of the employees of the company or group.

Sellers must not have claimed relief in a previous year in respect of shares in the same company or a member of the same group of companies.

Employee Ownership Trust in Action
The Employee Ownership Trust model was based around the John Lewis Partnership's long-running and successful business ownership model, whereby its employees – referred to within the company as partners – hold shares in the business, held collectively in trust by the John Lewis Partnership, so shares cannot be sold by any individual partner, but each partner receives economic benefits based upon their ownership of the shares – most notably by way of a yearly profit share, varying year by year but usually between 10 and 20 percent of the partners' yearly earnings. Find out more.

What to look out for

If any of the following occur in the first year following the tax year in which the EOT structure was created, the CGT relief is withdrawn:

- the company no longer meets the trading requirement.
- the EOT no longer meets the all-employee benefit requirement.
- the EOT no longer holds a controlling interest in the company.
- the participator fraction exceeds 2/5.
- the trustees act in a way which infringes the all-employee benefit requirement.

Where these events occur at a later date, a tax charge may arise on the trustees. For this reason, an overseas trustee is often used.

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