A REAL ASSET

Employee Ownership Trust

Many business owners struggle with the often conflicting aims of exit planning and succession planning.

Perhaps an Employee Ownership Trust might provide the perfect succession solution?

Employee Ownership Trust (EOT)

An Employee Ownership Trust (EOT) could hold between 51% and 100% of a trading company's shares on trust for the benefit of all employees on the same terms. The classic examples being John Lewis Partnership and Waitrose.

Unlike employee share schemes, which facilitate 'direct employee ownership', these schemes provide 'indirect employee ownership' overseen by selected employee Trustees.

They promote better business performance, greater commitment and productivity from employees with increased staff loyalty, lower staff turnover and absenteeism.

How could it work?

- A sale of over 51% of your company's shares into a qualifying EOT would be CGT and IHT free;
- A trading company owned by such a trust is able to pay cash bonuses of up to £3,600 per annum to all employees (on a 'same terms' basis);
- PAYE free (but not NIC's);
- Company gets corporation tax relief on these tax free bonuses;
- This means that, provided finance can be obtained by the EOT trustees, you can dispose of your shares tax free.

Employee Buy-Out v Management Buy-Out

A Management Buy-Out (MBO) might have potential, but why sell to a few when you could sell to all staff? Why not implement an Employee Buy-Out (EBO). An EBO has clear advantages over alternative exit strategies:

1. To a great extent, the terms are within your control. You can plan in advance how and when the EBO happens;
2. It avoids the commercial risk of disclosing confidential information to potential trade buyers (often lifelong competitors);
3. EBO's have a good record of success, which is important where deferred consideration is at stake;
4. You want to see the business survive and prosper with its ethos intact and loyal employees still in work;

Employee Buy-Out v Management Buy-Out (Continued)

5. It recognises the employees' contribution to the success of the business;
6. Continuity can be achieved for customers and suppliers;
7. It can avoid the dismissal of employees or closure of premises that often occurs following a trade sale.

Rules and conditions if you are to get the CGT exemption

- "The controlling interest requirement" - The trust must retain at least 51% controlling interest in the company;
- "The all employee benefit requirement" – The trustees of the EOT must apply benefits to all eligible employees on the same terms;
- "The limited participation requirement" – For one year before the disposal and at all times thereafter the number of director/shareholders and 5% participators must not exceed 40% of the total number of employees. (i.e. if your company has 5 employees in total only 2 of them could be director/shareholders or their family).

Please note:

- The Trustees of the EOT can waive dividends on the shares acquired without the 51% controlling interest requirement being infringed;
- A contribution of cash by a close company to an EOT to enable the trustees to buy the shares is not a 'transfer of value' for IHT purposes;
- To quote Nick Clegg from the Robert Oakeshott Memorial Lecture, March 2015:

  "Too many businesses fail at the point of succession or soon after. Business owners can be faced with the unsettling task of handing their business on to new owners without knowing what those owners will do with the business they have cherished. Many end up selling to the investor who has the largest cheque book, but little regard for the traditions, employees and customers of the firm. Others hand the business on to their children even if that isn't what they or their children really want. What we want to encourage is far more owners to sell the business on to those people who know the business inside out, who will go the extra mile, the wider family who have worked to build it up and contributed to its success – in other words, the employees".

For further information or to discuss Employee Ownership Trusts in more detail please contact our Tax Partner, Steve Crompton, on the details below:

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