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Myerson **Business**

Is ownership via an Employee Ownership Trust suitable for my business?

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Welcome

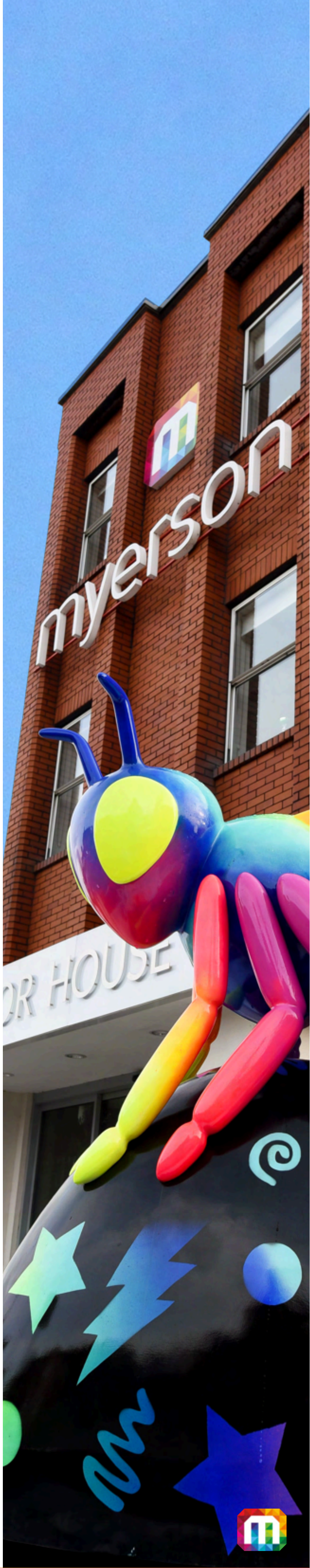
We understand the complexities of modern life and the importance of taking care of your business interests. So it's a deep source of satisfaction that so many businesses choose Myerson as their trusted adviser, from assisting with day to day commercial issues, to advising on growth strategies, investment and business sales.

Why Myerson?

At Myerson, we are employment experts. Putting our clients and their business at the heart of everything we do means we establish long-term relationships and act as trusted advisers.

We are proud to be ranked as **'Top Tier'** in the prestigious international directory **The Legal 500** and commended by The Times **'Best Law Firms 2024'**. Therefore, you can rest assured you will receive a high-quality and truly bespoke service.

Our corporate clients include those with local, national and international business interests across a wide range of sectors including: technology, creative and media, private healthcare, professional services, charities, manufacturing, retail and leisure, fashion and textiles and agriculture



Background

Employee ownership has become increasingly prevalent in recent years and many business owners are keen to explore the extent to which it is right for their businesses. Employee Ownership Trusts (EOTs) offer a structure which gives significant benefits to both the present owners (the selling shareholders) and the employees of the business.

This note summarises some of the key advantages and disadvantages of transitioning to an EOT and the factors that should be considered before pursuing this indirect ownership model.

EOTs were established in 2014 with the aim of promoting employee ownership as a business model in the UK, with the Finance Act 2014 introducing tax reliefs to benefit the selling shareholders on a sale of shares to an EOT and to the company's employees, provided certain conditions are satisfied.

The sale of shares to an EOT essentially entails the current owners of a company ceasing to have control of that company and transferring their shares to a trust (the EOT) to hold for the benefit of the current employees of the company who are the beneficiaries of the trust. Subject to limited exceptions all current employees of the company must be included as beneficiaries.

What are the advantages of an EOT for the selling shareholders of a company?

A key incentive for the selling shareholders is the beneficial tax treatment offered, in particular the exemption from CGT. The Finance Act 2014 offers 100% relief from CGT provided strict requirements are adhered to, which include (amongst others) that:

• the current shareholders cease to have control and the EOT acquires more than 50% of the issued share capital of the company (this is known as the "Controlling Interest Requirement");

• the benefit conferred by the EOT must be to all employees (subject to exceptions) and must be on the same terms (the "Equality" principle). However, employees can receive different amounts dependent on their length of service, hours worked and their remuneration; and

• the company operates some form of trade.

The Subject to satisfying the criteria, the selling shareholders effectively get a CGT rate of 0% on the disposal of their shares.

In addition to relief from CGT, there are also certain inheritance tax (IHT) reliefs available with the transfer of shares in a company by an individual to an EOT being exempt from IHT.

The sale to an EOT can also offer both the opportunity to the selling shareholders to either continue working in the business (which might not necessarily be of appetite to a third-party buyer in a traditional share sale) or allow them to retire and provide a full exit route.

The EOT model allows the business of the company to continue to operate as it has done to date and can therefore prove an attractive option for business owners who wish to preserve a company's independence and values, which might possibly be lost upon a sale to a third-party buyer or in a merger with another business. This is a particular concern for sales to private equity investors or large national companies with different values.

The sale of shares to an EOT can also save time and money as it provides the selling shareholders an exit without the need to find a buyer that will conduct extensive due diligence on the company and its business (following which a buyer may seek to change the terms of the proposed sale or ultimately withdraw their offer to purchase) and require the selling shareholders to give a series of warranties and indemnities relating to various aspects of the company's business. The selling shareholders will generally lead the transaction thus allowing the selling shareholders to set the timescale and control the implementation of the transition to EOT ownership.

Are there any disadvantages of an EOT for the selling shareholdings?

As stated above, there are strict qualifying conditions attached to the available tax reliefs. There is therefore a risk that the tax reliefs could be lost if a disqualifying event occurs following the end of the tax year after the one in which the CGT relief is claimed, for instance the Controlling Interest Requirement ceasing to be met. Usually, the trust or the company will therefore undertake not to take steps that would result in the occurrence of a disqualifying event and possibly even indemnify the selling shareholders against the loss of any CGT relief.

It is also important to consider how many shares the EOT can afford to acquire (noting that this is often funded through future profits) and it may be that it takes a significant number of years to fully fund the consideration. There are, however, debt finance (and future re-finance) opportunities available which can help with this.

The primary disadvantage of the EOT for selling shareholders who are not seeking a full exit is the loss of control over the company. This could lead to conflicts of interest with the selling shareholders who retain a minority stake. The selling shareholders should therefore be comfortable with this transition of power. A shareholders' agreement may help and is permitted under EOT ownership, provided that it does not indirectly preserve control with the selling shareholders.

What are the advantages of an EOT for the employees?

One of the main benefits of the EOT ownership is that it offers indirect employee ownership whereby the shares in the capital of the company are held on trust for the benefit of the company's employees. This is particularly beneficial for senior employees of the business that might be seen as potential successor owners as under the EOT ownership model there is no individual contribution or liability for any employee of the company and therefore one of the inherent risks associated with being a direct owner of a company is removed.

The employees of a company that is owned by an EOT can also benefit in the future success of the company and be eligible to receive an annual bonus of up to £3,600 which will be income tax free (although bonuses will remain subject to national insurance contributions). Although this relief is only available if certain conditions are satisfied some of which mirror those that are applicable for CGT relief.

Whilst the employees will not be able to control the direction of the company, if there is a large employee pool the business could choose to set up an employee council, whose role will be to listen to the concerns of employees and feed those back to the trustee which may influence how the company operates.

The sale of shares in a company to an EOT can also offer continuity to the current employees as they will continue in their current roles on their present contractual terms and there may be less change than what they may otherwise experience if the company was sold to a third-party buyer (as the selling shareholders are likely to stay in place as the company's management team).

Are there any disadvantages of an EOT for the employees?

There are few disadvantages for the employees, although employees (particularly senior employees) who foresee themselves as future business owners may feel that there is less scope for this under the EOT ownership structure. However, it is still possible to award employees with direct share ownership or offer share options should it be desirable.

Are there any advantages for the company itself?

For the company the EOT ownership model can help improve productivity and in turn the financial performance of the company, as employees feel incentivised as they have an indirect stake in the business of the company.

The EOT ownership model can also ensure the long-term security of a company's values and culture which are likely to be disrupted upon a sale to a third party buyer or more traditional succession options.

EOT ownership can also assist with the recruitment and retention of employees as it can act as a key differentiating factor of the company within the market in which it operates.

There are many more points to consider when transitioning to an EOT, from the detailed requirements for relief, how employees may be rewarded within and outside the EOT ownership, to the effective management of the company and EOT going forward. For more information or assistance please contact our corporate team.

You're in safe hands!

If you would like further information about how we can help you with **Employee Ownership Trusts**, or if you have any questions, please don't hesitate to contact a member of our **Corporate Team** today.

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