Employee Ownership Trusts: FAQs

Can you provide examples of Employee Ownership Trusts?

Some well-know examples of Employee Ownership Trusts (EOTs) include:

Richer Sounds

Departing CEO Julian Richer granted his 500 staff a 60% stake in the business. In addition, he gifted £1,000 to every employee, for every year they had worked at the company.

John Lewis

This department store chain (along with Waitrose) has 84,500 employees who collectively own 100% of the company.

Aardman Animations

The Oscar-winning animation studio behind Wallace and Gromit has 130 staff across its two Bristol offices. It remains an independent company, despite approaches from Hollywood studio DreamWorks.

Mott MacDonald

Global engineering consultancy Mott MacDonald has more than 16,000 staff. 3,000 of those are employee shareholders who can vote on company matters. It claims the lack of external shareholder influence gives it “independence” and “freedom” to choose the work it takes on.

Who will receive an employee tax-free bonus and how much will it be?

Companies owned by an EOT are permitted to pay income tax-free bonuses of up to £3,600 per employee, annually. If an employee happens to work for two EOT controlled companies, the employee would be eligible to receive up to £3,600 from each company. The frequency at which this would happen in the real world is very low.

Many share scheme advisers have advocated increasing this amount to take inflation into account. An increase, according to the Finance Act, can be made by the Treasury alone, but a reduction of the amount requires approval of a resolution approved by the House of Commons.

To be considered a qualifying bonus payment, one that is income tax-free to the employee, the payment must meet the following criteria:

1. It is not part of regular salary and wages and doesn’t replace regular salary and wages;
2. The overall scheme must meet the participation requirement and the equality requirement;
3. The company must meet the trading requirement;
4. The company must meet what is called the indirect ownership requirement, i.e., it must be controlled by an Employee Ownership Trust;
5. It must meet the office-holder requirement. This is similar to the participation requirement, in that the number of directors, other office-holders and employees connected to these two classes cannot exceed two fifths of the total employees of the company

6. The company cannot be a service company, which is defined as a company primarily involved in providing employees to other businesses on a leased basis. Under this model, the employee works for company B, but remains employed and paid by Company A; company A would be the service company in this example.
7. The payment cannot be an excluded payment. This is a payment under the Act where the employer and employee agree that the employee will receive the payment, rather than some other form of employment income. This also applies when an employee agrees to give up the right to receive some amount of general earnings in return for the bonus payment. These are very similar points but are listed separately in the Act. In short, the bonus payment cannot replace regular employment income.
8. When payment is made to a former employee, it must be made within the 12 months of the day employment ended.

If these criteria are met, the bonus payment will be income tax-free to the employee but will still be subject to both employee and employer National Insurance contributions.

What happens to the vendor after selling to an EOT?

Given that there is no requirement that vendors step down following the sale to an EOT, most continue to run the company from an operating perspective for a reasonable time post-completion. Not only does this provide for management continuity and increase the chances the company remains successful, it also provides vendors with the ability to monitor and manage performance, which increases the chances that the deferred consideration that will be part of any transaction will be paid as agreed.

Should employees become involved in the EOT transition process?

There is no legal obligation to involve employees in the sale of the company to an EOT, but it is important to involve them in some way. A vendor who doesn’t, is likely more concerned about the Capital Gains Tax (CGT) relief, available in an EOT sale, than in doing what is potentially in the long-term interest of the company and its employees. Experience tells us that the company will not perform as well as it could, nor will it generate the same level of benefit to employees, compared to other EOT-owned businesses where there is greater employee engagement and involvement.

Involvement can occur prior to the transaction completion or as part of the rollout and implementation, but to neglect to involve the employees and solicit input, decreases the chances of maximising the benefits of transitioning to employee ownership. It is also important to differentiate between awareness and involvement. Simply making employees aware of what is transpiring is different from involving employees with what is going on. We are advocates of involving employees in the process.

In all but the smallest businesses, it is not practical to allow all employees to voice their opinions and provide their thoughts and ideas directly to management. In many cases it will be much more effective and efficient to establish some type of representative employee body to present the employees’ interests to management and the trustees. This employee council will be able to serve as a bridge between employees and management and serve to facilitate open communications within the business.

How is the sale of a business to an EOT funded?

Options include:

- Free cash on the balance sheet
- With a loan from the vendor – the EOT trustees borrow money from the vendor with a company guarantee. The loan is repaid to the vendor over time
- With a loan from the bank – a sum of money is borrowed from the bank and the trustees repay this to the bank over time.

How is the business valued?

The EOT's trustees need to agree a fair price with the vendors. An expert share valuation may need to be carried out.

What happens if there is a disqualifying event?

A disqualifying event occurs if:

1. The company ceases to meet the trading requirement
2. The trust settlement ceases to meet the all-employee benefit requirement
3. The EOT no longer owns a controlling interest in the company
4. The participator fraction exceeds two fifths
5. The trustees act in a manner contrary to what the all-employee benefit requirement mandates.

It is difficult to stumble into a disqualifying event, For virtually all of the events listed above, it would generally take a proactive measure to create one of these, so, in most cases, the likelihood of this occurring is small.

The CGT relief afforded the vendors in a sale to an EOT can be "clawed back" from the vendors if there is a disqualifying event in the tax year the transaction occurs, or the succeeding tax year. After the end of the succeeding tax year, any CGT relief claw back is made from the trust, not the vendors.

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