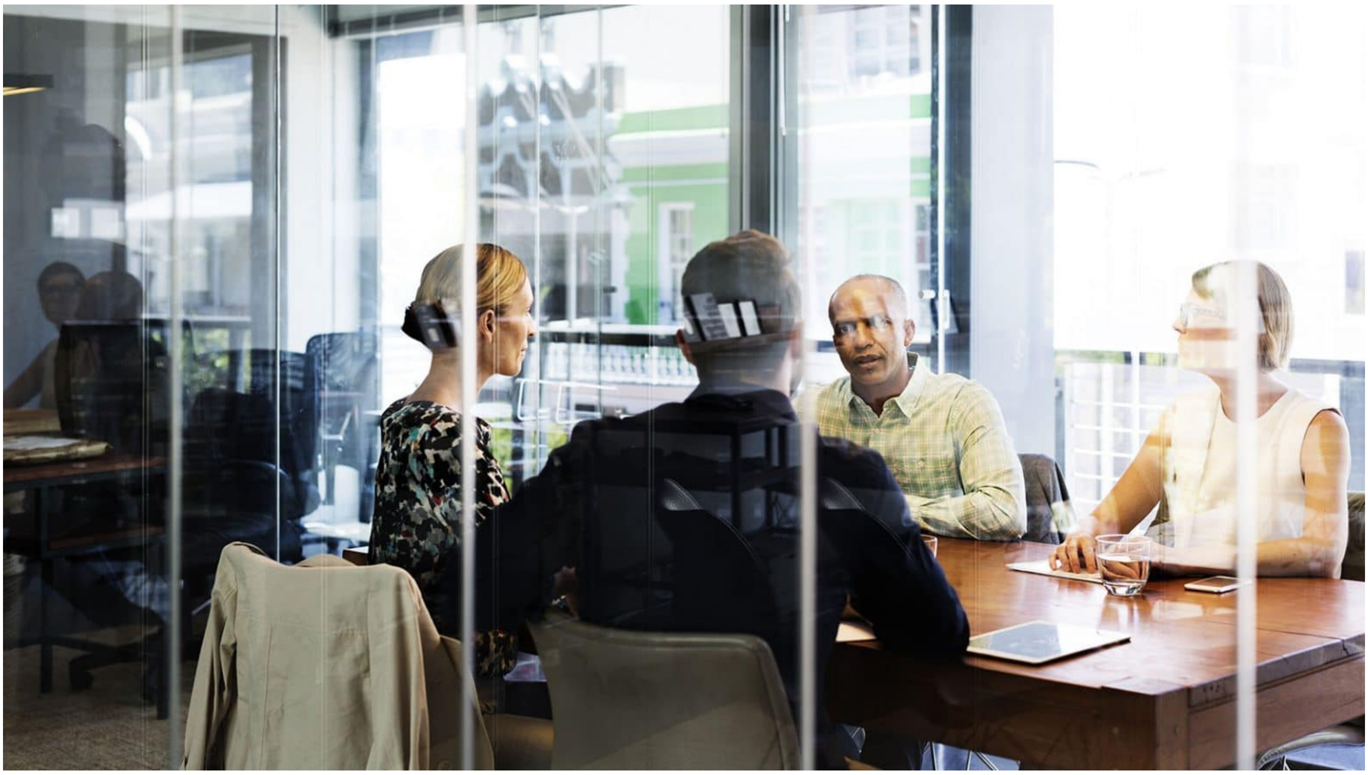
Cripps

Update on employee ownership trusts



Having been with us for almost 10 years the Government has now launched a consultation on the taxation of Employee Ownership Trusts (**EOT**s) and other employee benefit trust arrangements. This is always a worrying sign particularly with an election looming in 2024. Some commentators are already predicting that a change of Government could result in the 0% capital gains tax benefit being restricted or even removed. We think this is unlikely but the outcome of the consultation will inevitably lead to some reform being made to the current tax regimes.

The growth in EOTs

It's perhaps not unsurprising that EOTs have become so popular. Little was heard about them until changes were made to "Entrepreneurs Relief" (now known as Business Asset Disposal Relief) in 2020, when the lifetime limit was reduced from £10million to £1million. Up to that point less than 50 companies had applied to HMRC for approval to convert to an EOT. That number increased to 100 in 2020, 383 in 2021 and a similar number again in 2022. In total, as of June 2023, the total number of companies that had converted to EOT status was just shy of 1,500. Not a huge number it's true but a trend undoubtedly spurred on by the tax advantages.

How does an EOT work?

In short, an EOT is a type of employee benefit trust. Once the trust has been created (onshore or offshore) it can purchase shares which are then held for the benefit of the employees of the company.
There are a number of ways in which the trustees can fund the purchase of shares but essentially the funding comes from the company. Because of this, careful consideration is required to assess the impact of the

transaction on the company and to make sure it is affordable.

How does an EOT benefit employees?

Qualifying employees can receive an annual tax free bonus from the EOT and, of course, if the shares are ever sold, they will be entitled to receive a share of the net proceeds.

How does an EOT benefit shareholders?

For a shareholder who agrees to sell his shares to the EOT, so long as certain conditions are met (principally, the EOT must acquire 51% or more of the shares in the company in the same tax year), the rate of capital gains tax is 0%.

In addition, as an EOT is only required to hold 51% or more to secure the tax benefits, a shareholder can continue to hold shares in the company. Moreover, if an element of the purchase price is deferred, it's common for sellers to become a trustee of the EOT so that they can remain engaged in the day to day business.

Is an EOT the only show in town?

It was Nick Clegg, then Deputy Prime Minister in 2012, who announced the Government's intention to introduce the concept of employee ownership into the mainstream and, in the 2013 Budget speech, George Osborne introduced the 0% CGT charge on sales of companies to their employees via an EOT as a catalyst to create an enterprise culture.

However, there have been favourable tax regimes in the UK for many years by which employees can become shareholders in the companies in which they work. Regimes such as CSOPs, SIPs and EMI schemes exist to provide incentives to employees to participate in the growth in value to which they contribute. For their employers, these schemes provide a means of increasing retention of valuable labour and productivity. For this reason, it's important to review these and other schemes to be sure that EOT is the right path for the company and its employees – it's a fundamental tenet that the driver for converting to an EOT should not be the tax benefits. EOTs are intended as a mechanism by which ownership of company can pass to employees and not merely as a means to secure favourable tax treatment in advance of the company being sold.

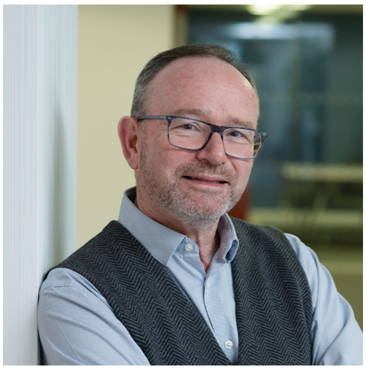
What are the proposals?

he consultation runs until 25th September. Its stated objective is to ensure that the tax reliefs associated with EOTs are meeting the overriding policy objective of encouraging employee engagement. There are likely to be targeted reforms to the tax regimes that apply to EOTs and other employee benefit trust schemes.
The main proposals for reform include:

- prohibiting former owners from being the majority of the trustees of the EOT, thereby preventing them from having continued control of the company;
- requiring the EOT to be resident in the UK rather than offshore;
- reducing the need for HMRC to give clearances for EOT transactions; and
- relaxing the EOT bonus rules so that bonuses can be awarded to employees without necessarily having to be awarded to directors.

Summary

Regardless of the reforms, EOTs are likely to remain attractive for the right company. If you are contemplating a succession plan then the option of becoming employee-owned via an EOT must be carefully assessed and taking professional advice is crucial to getting it right. Please contact the employment team if you would like to learn more about EOTs and how we may be able to help you with your exit options.



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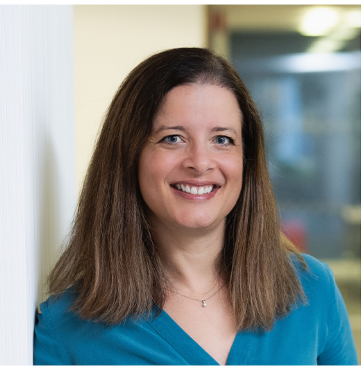

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