SESAME BANKHALL GROUP

What is an employee ownership trust?

ExitPathway

Selling your business is a significant decision, and it's crucial to get it right. That's where Bankhall comes in. Unlike traditional mergers and acquisition (M&A) brokers, we work closely with you to help prepare your business for sale.

We thoroughly examine everything from data quality to regulatory and compliance standards. By identifying and fixing potential issues before a buyer sees them, we help protect and often increase your sale value. Our expertise in risk and regulation also streamlines the due diligence process, reducing the chance of delays or last-minute deal breakers. If there's untapped growth potential in your business, we'll highlight it, giving you the chance to boost your valuation before going to market.

We don't stop there. We use our extensive Sesame Bankhall Group network to help find the right buyer who aligns with your goals, values, and culture. When it's time to negotiate, we're with you every step of the way, from initial discussions to exchange and completion.

With trusted consultancy, practical tools, and end-to-end support, we're your proactive partner for life, whether you're ready to sell now or preparing for the future.

What is an employee ownership trust?

An **employee ownership trust (EOT)** is a business model where a trust holds shares in a company on behalf of its employees. This model is designed to benefit all employees collectively, rather than individual employees owning shares directly.

These structures are typically not beneficial for a company with less than 10 employees.

The benefits of a sale to an EOT include tax benefits, lower risk of disruption to the business and security for staff — although they will need to start thinking differently as they will be responsible for the future success of the business. Whilst this is a tax efficient way to sell your business (as it can be done without incurring capital gains tax) there are other significant costs that will be incurred.

Here are some key points about EOTs:

1. **Indirect ownership:** The trust owns the shares, and employees benefit from the profits and growth of the company.
2. **Long-term stability:** EOTs can provide a stable ownership structure, ensuring the company remains employee-owned over the long term.
3. **Employee engagement:** This model often leads to higher levels of employee engagement and satisfaction, as employees have a collective stake in the company's success.
4. **Tax benefits:** there are tax incentives for companies that transition to an EOT, making it an attractive option for business owners.

When looking at EOTs there are some challenges which need to be considered, including how this will impact the earnings of the advisers in the future and how this will be competitive in the wider market.

Tax benefits of an EOT:

EOTs offer several tax benefits, making them an attractive option for business owners considering transitioning to employee ownership. Here are the key tax implications:

1. **Capital gains tax (CGT) relief:** When a business owner sells their shares to an EOT, they can benefit from a complete exemption from CGT, provided certain conditions are met.
2. **Income tax-free bonuses:** Employees can receive income tax-free bonuses of up to £3,600 per tax year. However, National Insurance contributions are still payable on these bonuses.
3. **Inheritance tax (IHT) relief:** Transfers of shares into an EOT are generally exempt from IHT, provided the trust meets specific criteria.
4. **Corporation tax deductions:** Contributions made by a company to an EOT to repay the former owners for their shares are not charged to income tax as a distribution.

These tax benefits are designed to encourage employee ownership and ensure that the transition is financially viable for both the business owner and the employees.

Bonus rules when it comes to an EOT

In the UK, EOTs can pay tax-free bonuses to employees, but there are specific rules and conditions that must be met:

1. **Participation requirement:** The bonus scheme must be open to all employees on similar terms. However, a minimum qualifying period (up to 12 months) can be set.
2. **Equality requirement:** All eligible employees must receive bonuses on the same terms. This means the bonus amount should be calculated in a consistent manner for everyone.
3. **Tax-free Limit:** Employees can receive up to £3,600 per tax year as a tax-free bonus. Any amount above this will be subject to income tax.
4. **National Insurance contributions (NICs):** While the bonuses are exempt from income tax up to the specified limit, they are still subject to NICs.

These rules are designed to ensure fairness and encourage widespread employee participation in the benefits of the company's success.

Drawbacks of an EOT

While EOTs offer many benefits, they also come with some potential drawbacks:

1. **Complexity and setup costs:** Establishing an EOT can be complex and costly. It involves legal, financial, and administrative processes that require professional advice and can be time-consuming. There are strict conditions that must be met to maintain the tax benefits, such as the trust retaining control of more than 50% of the company.
2. **Governance challenges:** Managing an EOT requires a robust governance structure. Ensuring that the trustees act in the best interests of all employees can be challenging, especially in larger organisations. Decision-making can become more complicated with a larger group of stakeholders.
3. **Limited liquidity:** Unlike direct share ownership, employees do not own shares directly, which means they cannot sell their shares for personal gain. This can limit the financial benefits for employees compared to other ownership models.
4. **Potential for conflicts of interest:** Balancing the interests of the employees, the company, and the former owners can sometimes lead to conflicts. Trustees must navigate these carefully to maintain trust and fairness.
5. **Cultural shift:** Transitioning to an EOT can require a significant cultural shift within the company. Employees and management need to adapt to a new way of thinking about ownership and decision-making.