Employee Ownership Trust (EOT)

Summary: a 'John Lewis' style all employee trust, with zero CGT for sellers

What is an Employee Ownership Trust?

The Employee Ownership Trust (or EOT) was created by the Finance Act in 2014 to facilitate and encourage business owners to sell their companies to their employees. The objective of the Government was to create a larger number of businesses in the UK where employees can directly benefit from the performance of the business. As a result, employees would become more engaged in their company, leading to higher productivity, which would benefit the country as a whole.

The number of EOT owned businesses in the UK passed 1,000 in 2022, with the volume increasing exponentially as the model, and benefits associated with it, become better known.

Tax Benefits

There are two tax benefits associated with EOTs.

1. Owners who sell their shares to an EOT receive 100% relief against Capital Gains Tax. The transaction to sell a business becomes entirely Capital Gains tax-free regardless of the size of the business. Stamp Duty must still be paid.
2. Employees of businesses owned by EOTs are entitled to received tax-free bonuses up to £3,600 annually.

To qualify for the tax benefits the EOT must own the majority of the shares in the company.

Why do owners decide to sell their companies to their employees?

The headline benefit quoted by many is that a business can be sold free of tax, however for the vast majority of owners the tax relief is rarely at the top of their reasons for selling to an EOT. The main benefit can be summarized in that the business does not need to be sold to a third party. In particular:

- An external buyer does not need to be found;
- The sale process is seller controlled, as there is no third party to negotiate with or making other demands;
- The transaction is gentle on the business. The business has not changed, only the owner, whereas a new external owner will often make significant changes to a newly acquired business;
- Owners can sell their shares for a fair value, tax free and exit in a timescale of their choosing, that suits them and the business;
- Compared to third party sales, EOT transaction are quick and relatively low cost, and there is no risk that a buyer will walk away from a deal;
- The employee ownership structure allows employees to be rewarded well beyond what they might expect. **Note:** The selling owners will need to be paid for their shares prior to colleagues seeing the main financial benefits of employee ownership.

So, what is the catch?

There are none, at least none relating to the transaction. However, it is important for owners using the EOT model to understand the following:

- Owners that sell to an EOT must be more patient for their funds. A fairly valued business can take five to six years for an owner to be fully paid;
- In traditional company sales it is the buyer who takes most of the risk, however the seller takes all the risk in an EOT transaction, for example, if a business makes no profit following an EOT sale the amount of deferred consideration that an owner can be paid is limited to the cash reserves in the business prior to the sale.

Rm2
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How does it work?

How does a trust buy a business?

The transaction process is as follows:

1) The price at which the business will be sold will be agreed by the owners with the assistance of their advisors. There is likely to be a valuation and affordability analysis carried out;
2) Legal documents will be drafted including
   a. Share Purchase Deed
   b. Loan documents
   c. Guarantee from the business (the trust will owe the sellers not the business)
   d. Debenture (optional)
3) The trust is created and trustees appointed;
4) The shares are sold to the trust, with the trust writing a large IOU to the sellers. Note: Third-party funding can be used, although not in the majority of transactions;
5) The previous owners are paid via a combination of surplus cash/assets available on completion and deferred consideration via contributions made by the business from post-tax profits until the debt is paid.

Who runs the business after the transaction?

The EOT will be the majority shareholder of the business but delegates the responsibility of running the business to the Board. As a result, there is usually no change to the management structure of the business after an EOT transaction.

Most EOT transactions take place because some, or all, of the previous owners wish to exit the business, as a result a succession planning process is likely to be put in place, if it has not already been initiated.

The role of trustee varies greatly between different businesses, but always the ideal relationship between the trustees and the company's management is to be friendly and cooperative. Where trustees are required to make decisions, as the representatives of the EOT owner and employee beneficiaries, they are likely to make those decisions in cooperation with the Board.

What we can do for you

RM2 has been in business for over 25 years and we have only ever done one thing. Employee ownership. We are true specialists in our field. Whereas many of our competitors work on EOT transactions on a part-time basis, our EOT team only do EOT transactions. We believe we are unique amongst EOT specialists in that none of our EOT team are career advisors, with most of our careers spent working in various industries. As we have worked in similar companies to those we now advise, we believe we are uniquely well placed to give practical expert advice that delivers our clients objectives, whether it is the required return for the selling owners or giving the employee-owned business the best possible chance for a successful future.

RM2 is EOT owned and our previous owner has been fully paid and exited the business. As an employee-owned business we have never been more successful and we consider ourselves as a great example of what can be achieved under the EOT model.

We have helped over 100 businesses become employee owned.

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