

# Employee Ownership Trusts

An employee ownership trust (“EOT”) is a special type of employee benefit trust established to hold a controlling interest in a trading company for the benefit of its employees and to preserve the long-term independence of the company.

EOTs, which were introduced in 2014 as a tax-efficient form of achieving indirect employee ownership, are growing in popularity. Increasingly, shareholders and businesses are recognising that EOTs not only act as a way to incentivise employees but also offer a potential solution to a key concern for a number of business owners, being the preservation of legacy and succession planning.

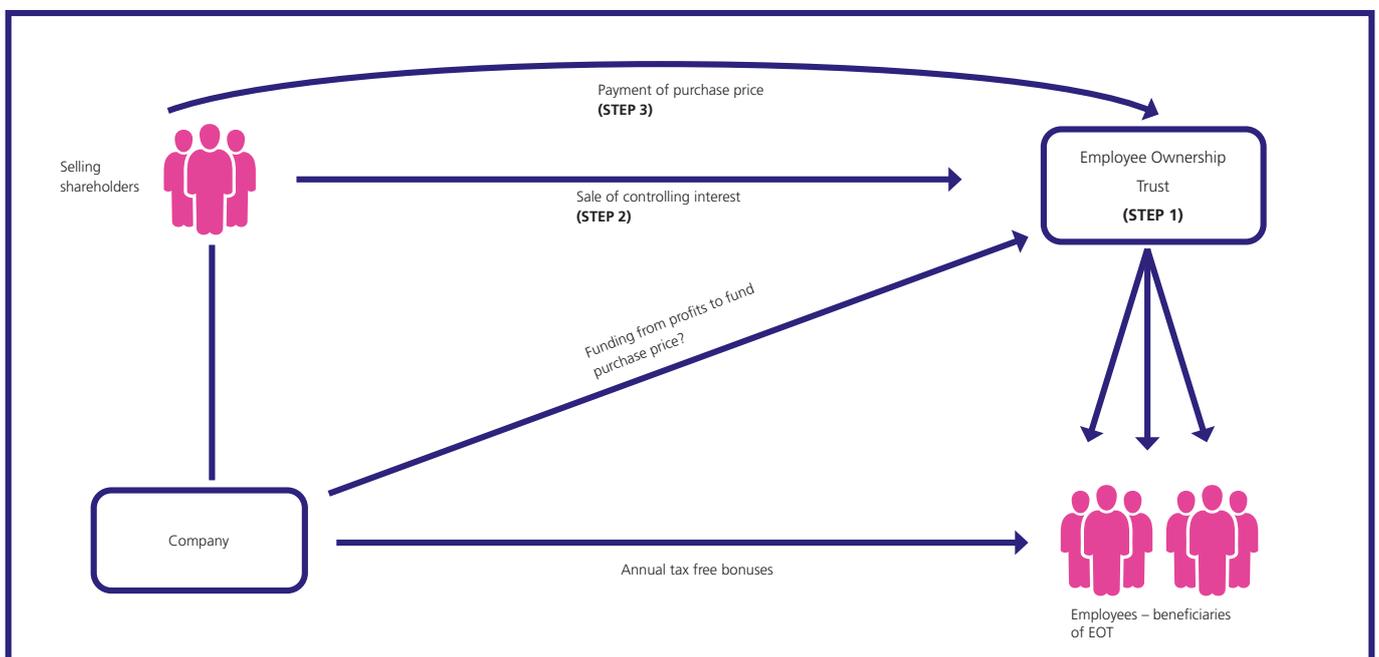
The transfer of control from the selling shareholders to the EOT will require careful planning. Legal and tax advice will be needed in particular to ensure that the EOT tax reliefs are available. There are essentially three key steps to the process, illustrated in the diagram below.

## Establishing the EOT

The first step is that an EOT is established by the company by entering into a trust deed with the trustee of the EOT. As part of the set-up process, the company will appoint a trustee of the EOT. Whilst day-to-day control of the company will lie with the board of directors, the ultimate control of the company lies with the trustee. Accordingly, the shareholders and the company will need to give careful consideration to the identity of the trustee, for example, will the trustee be UK resident or offshore and will the trustee be individuals, a subsidiary of the employer company or a professional corporate trustee?

## Selling the controlling interest

Once the EOT is established, the selling shareholders will sell a controlling interest (i.e. more than 50% of the ordinary share capital) in the company to the EOT. The selling shareholders and the EOT must agree a purchase



price for the controlling interest – this may be a significant amount if the selling shareholders wish to achieve full market value for their shareholding - and so typically an independent share valuation expert will be engaged to value the company.

## Financing the sale

Thought will need to be given to how the EOT will fund the purchase of the controlling interest. Alternatives include a contribution by way of gift from the company using existing cash reserves, third party borrowing by the EOT or, commonly, vendor financing, whereby the selling shareholders agree to the payment of the purchase price in instalments, often over a number of years. The instalments are funded by contributions made to the EOT by the company out of trading profits generated by the company.

## Tax advantages

The selling shareholders can sell their shares to the EOT without paying any capital gains tax provided that certain conditions are satisfied including that:

- the company is, and remains, a trading company or the principal of a trading group;
- the EOT is for the benefit of all eligible employees on the same terms; and
- the EOT acquires, and maintains, a controlling interest in the company.

In addition, a transfer of shares in a company to an EOT by an individual is an exempt transfer for inheritance tax purposes.

Employees of the company can also benefit from tax efficiencies - an income tax free bonus of up to £3,600 per employee per year can be paid to each employee by the company provided that certain conditions are satisfied.

## Why choose an EOT ownership model?

EOTs enable shareholders wishing to sell a controlling interest in a company to realise value in a way which maintains the culture, legacy and future of the company. The flexibility of the model allows the selling shareholders to retain a minority shareholding if they wish whilst continuing to be involved in succession planning and the day-to-day running of the Company. For controlling shareholders wishing to both exit their business and preserve their legacy over the longer-term, an EOT may be an attractive proposition.

## Employee incentivisation

In addition to the payment of income tax free bonuses, a further benefit of the EOT model is that the company can continue to grant share options to employees as an additional form of incentivisation. Although the EOT holds a controlling interest in the company, the EOT's ownership does not preclude the company from granting tax-favoured share options including enterprise management incentive and company share option plan options to employees (subject to the company meeting the relevant statutory conditions).

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