Employee Ownership Trusts

A Comprehensive Guide

Forrester Boyd
CHARTERED ACCOUNTANTS

Introduction

> An Employee Ownership Trusts (EOTs) is a unique and increasingly popular business model that allows companies to transition to employee ownership, ensuring long-term stability and fostering a motivated, engaged workforce.

Established through the Finance Act 2014, EOTs offer significant tax advantages for both business owners and employees, creating a mutually beneficial structure that supports sustainable growth.

This brochure provides an overview of how EOTs work, their benefits, and key considerations to help you determine if this innovative ownership model is right for your business.

Explore the potential of EOTs to transform your company and secure its future success.

What exactly is an Employee Ownership Trust (EOT)?

An Employee Ownership Trust (EOT) is a trust established to hold a controlling stake in a company on behalf of its employees.

The EOT holds a controlling interest in the company, typically more than 50% of the shares. This gives the employees, through the trust, a significant say in the direction and management of the business.

Employees do not normally own shares under an EOT and the operating company continues to trade as it did before the transfer of ownership.

The EOT is governed by a board of trustees, which can include a mix of employees, external trustees, and sometimes former owners. This board is responsible for ensuring that the trust operates in the best interests of the employees.

EOTs are often used as a succession planning tool for business owners who wish to retire or exit their business while ensuring its continuity and preserving its culture and values. By giving employees a stake in the ownership, EOTs can increase motivation and engagement, as employees are directly invested in the success of the business.

About EOT's

Employee Ownership Trusts (EOTs) are rapidly emerging as one of the most popular SME business ownership models and succession planning tools. Over 1,650 businesses in the UK are now employee-owned. For many, it is not only a viable form of ownership succession but also potentially superior to alternatives such as third-party sales, management buy-outs, or liquidation.

In the last 12 months alone 330 businesses turned to the EOT model, as more business owners recognised the numerous benefits this transition can offer to themselves, their businesses, their employees, and the wider economy.

EOTs have a long-standing history of success, with the John Lewis Partnership taking its first steps in 1929. This demonstrates the widespread suitability of EOTs across various sectors.

In recent years, EOTs gained mainstream acceptance as more people become aware of its advantages. For private company owners looking to retire and seeking an alternative to a trade sale, employee ownership through an EOT is certainly worth considering. It places the business in the hands of those who understand it best, have a strong personal commitment to its long-term success, and are motivated by their ownership to help it thrive.

SOURCE: www.employeeownership.co.uk

1650

Employee Owned

Trusts

To Date

In the last 12 months

330

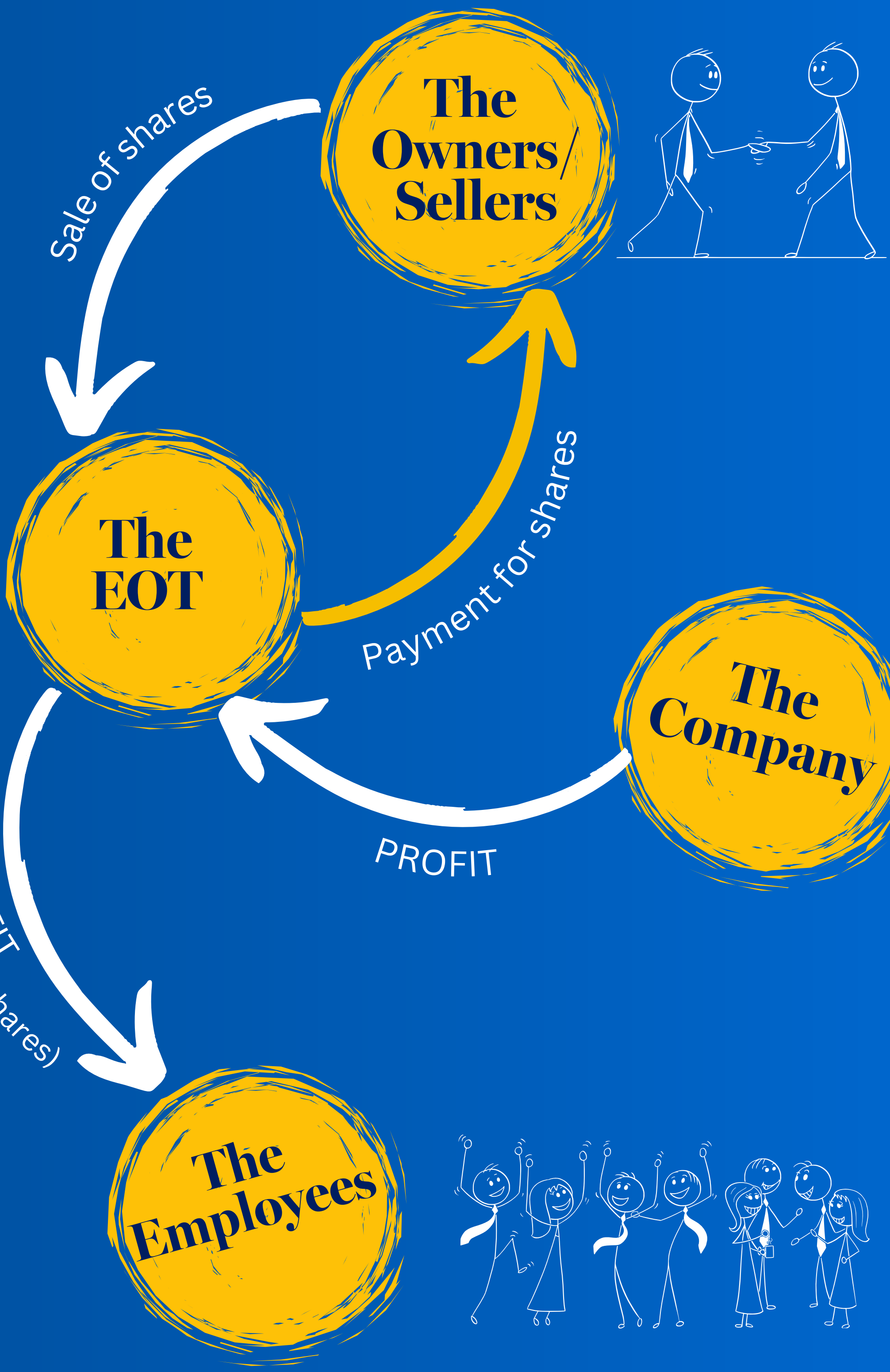
New EO Businesses

Average Annual Rise

16.2%

In the last decade

How an EOT works...



Why your business should convert to an EOT?

> Other than the attractive tax advantages of selling to an EOT, there are various other benefits of adopting an employee-ownership model.

Other than the attractive tax advantages of selling to an EOT, there are various other benefits of adopting an employee-ownership model. Studies indicate that a workforce with a vested interest in the company are more productive, less likely to move elsewhere and are more innovative.

EOTs can also provide a succession solution where there are doubts over who will take over a business when an owner retires or dies. They also represent a way for a business to pass to the next generation without taking on new outside partners.

A Closer Look

Tax-Free Sale Proceeds
All proceeds from selling shares into an EOT are tax-free, thanks to legislation introduced in the Finance Act 2014. In contrast, selling shares through other means typically incurs Capital Gains Tax.

Tax-Free Profit Share for Employees
Employees can receive up to £3,600 per annum in profit share completely free of Income Tax, although National Insurance still applies.

Business Continuity
The company can continue to operate exactly as it did before the sale, maintaining the same Board and management structure.

Merit-Based Promotions
Promotions to the Board can be based entirely on merit rather than the ability to purchase shares in the business.

Long-Term Business Continuity
Ownership is secured for the life of the Trust (historically 99 years), removing it as a barrier to the continuation of the business.

Flexible Exit Strategy
Former shareholders have the flexibility to remain involved in the business as much or as little as they wish after the sale.

Flexible Payment Terms
Since the company is essentially buying itself on behalf of the employees, payments to shareholders can be spread out over time, easing cash flow concerns for the trading company.

Increased Employee Influence
Employees generally have more input in the operation of the business for feel much more engaged and have a sense of ownership, which can lead to increased profitability.

Fair Profit Sharing
Employees have the right to share in the profits fairly if a profit share is declared, as outlined in legislation.

Cultural Continuity
The culture of the business tends to remain consistent, as the same managers continue to run the business as they did before the sale.

Is an EOT right for me?

An EOT is not right for every business. This is why it is critically important to talk to professionals such as ourselves who can discuss the options with you and help you make informed decisions about your succession planning ideas.

For any business considering EOTs or looking at succession planning there are some fundamental things that must be done. You should conduct a feasibility study to evaluate the financial and operational feasibility of transitioning to an EOT.

You should discuss your plans with employees and key stakeholders to gauge interest and readiness. You need to consult with advisors who have experience in setting up and managing EOTs.

Finally, you need to evaluate the alternatives, compare the EOT model with other succession options to determine the best fit for your business.

Determining if an Employee Ownership Trust (EOT) is right for your business involves evaluating several factors related to your company's structure, culture, and long-term goals such as:

Business Values & Culture

- Does your company value collaboration, employee engagement, and long-term sustainability?
- Are your employees committed to the business and interested in taking on the responsibility of ownership?

Succession Planning

- Are you looking for a succession plan that preserves the company's legacy and culture?
- Do you have a management team capable of leading the business post-transition? Financial Considerations

Financial Considerations

- Is your business financially stable and valued accurately for a transition to an EOT?
- Do you have or can you secure the necessary financing to fund the buyout?
- Employee Readiness and Engagement
- Are your employees interested in owning a stake in the business?
- Do your employees have the skills and willingness to take on new roles and responsibilities associated with ownership?

Legal and Tax Implications

- Is your business legally structured in a way that supports the transition to an EOT?
- Are you aware of the tax advantages and implications of setting up an EOT?

Long-Term Vision

- Does transitioning to an EOT align with your long-term vision for the company's growth and sustainability?
- Are employees likely to be motivated and engaged by the prospect of ownership, leading to improved performance and business outcomes?

What are the benefits of an EOT?

Tax reliefs are not the only driving force behind the increasing use of EOTs. Increased employee engagement from direct or indirect ownership also supports:

- Higher productivity and innovation leading to greater job security
- Better financial performance
- Lower absenteeism
- Higher employee commitment
- Higher resistance to market volatility
- Lower staff turnover

> Independent research, for example the employee ownership index, shows that a combination of shared ownership and employee participation can deliver strong business performance.

Business Impacts

- 20% increase in performance, driving revenue increases of up to 43% after becoming EOT
- 25% more likely to have seen profits grow in the past 5 years post transition
- 50% more likely to invest in R&D

Economy & Social Impacts

- 8-12% more productive per employee
- 50% more likely to expand their workforces than other businesses

Employee Impact

- 73% more likely to have increased employee satisfaction, motivation, and work-life balance
- 12% higher investment in training, skills, and on the job development
- £2,700 average higher basic wages and share profits

The Pitfalls

While EOTs can be an appealing option for business owners looking to exit, they are not suitable for everyone. As with any decision, there are disadvantages to consider.

One significant drawback is that the company is essentially buying itself, which means shareholders do not receive their payment immediately. It can take many years for the final sums to be paid, during which time shareholders are somewhat at risk, as payments depend on the underlying profitability of the operating company.

Additionally, the funds used to pay the shareholders come from profits that could otherwise have been distributed as (taxable) dividends. Therefore, EOTs may not be ideal for younger business owners who would be forgoing many years of dividends. This trade-off should be weighed against the motivational benefits the EOT structure can offer to staff. Studies have shown that profitability can increase by up to 15% following a conversion to an EOT.

How can we assist you?

Selling your business to an Employee Ownership Trust (EOT) involves various complex financial, legal, and operational steps. We play a crucial role in ensuring a smooth transition and supporting your throughout the whole process and beyond.

As accountants, we don’t’ just undertake the accountancy and tax compliance services, we perform financial due diligence, valuation of the business, structuring the sale including the agreement of payment terms, help with financing arrangements, tax planning and advice, tax clearance with HMRC through to post-sale forecasting and accountancy services, ensuring the business continues to perform and grow, paying off the debts from the sale.

We do so much more than that though. We help to communicate what is happening with your employees, an EOT is a complex structure so we work with you to explain to your teams what is happening and why, answer any questions and alleviate any potential fears they may have.

We also act as the conduit between yourselves, financers and legal teams to ensure everything runs to plan. We become your key liaison, helping to streamline the process and let you continue to keep ‘business as usual’.

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