employee ownership trust (eot)

An EOT is a special form of employee benefit trust introduced by the Government in September 2014 in an attempt to encourage more shareholders to set up a corporate structure similar to the John Lewis model. The aim is to facilitate wider employee-ownership, albeit via an indirect holding.

The incentive for owners is that the Government introduced very generous tax breaks to encourage shareholders to move to an employee-ownership model. However, in order to qualify for the tax incentives, the employee ownership needs to be structured in a particular way.

How Does A Sale To An EOT Work?

There are three key steps:

1. A qualifying EOT will be established with a corporate as the trustee of the EOT (the Trustee Company).
2. The shareholders sell their shares to the Trustee Company under a share purchase agreement. The shareholders and the Trustee Company will jointly engage a share valuation expert to value the company: the Trustee Company will use this value as the basis for determining the purchase price. On the sale of the shares, the purchase price will create a debt owed by the Trustee Company to the shareholders which will be left outstanding.
3. The company will continue to generate trading profits each year and it will use these profits to make contributions to the EOT. The EOT will use these contributions to repay the outstanding purchase price that it owes to the shareholders.

What Are The Advantages Of Selling To An EOT?

There are many advantages for shareholders, some of which we've highlighted below.

- It allows employees to indirectly buy the company from its shareholders without them having to use their own funds - thereby creating an immediate purchaser and addressing succession issues
- Shareholders can sell their shares for full market value (an independent valuation will be required)
- No capital gains, income or inheritance tax liabilities should arise on the disposal of a controlling interest in a company to an EOT (or on the subsequent receipt of the purchase price by the former shareholders)
- Not all shareholders are required to sell their shares to the EOT
- The directors can remain in situ post-disposal and can continue to receive market-competitive remuneration packages
- The EOT is generally seen as a "friendlier purchaser" which means the sale process may be quicker, with potentially lower fees.

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What Are The Advantages For The Company And Employees?

As all employees get an indirect stake in the company there are substantial practical benefits associated with being owned by an EOT, such as:

- Greater employee engagement and commitment
- Greater drive for innovation
- Reduced absenteeism
- Improved business performance.

Companies controlled by EOTs are also able to pay tax-free cash bonuses to their employees of up to £3,600 per employee per year.

Key Qualifying Conditions

To carry out a qualifying sale to an EOT there are five key conditions to meet:

1. The company whose shares are transferred must be a trading company or the principal company of a trading group
2. The trustees of the EOT must restrict the application of any settled property (the shares) for the benefit of all eligible employees on the "same terms"
3. The trustees must retain, on an ongoing basis, at least a 51% controlling interest in the company
4. The number of continuing shareholders (and any other 5% participators) who are directors or employees (and any persons connected with such employees or directors) must not exceed 40% of the total number of employees of the company or group
5. Trust property must generally be applied for the benefit of all eligible employees on the same terms but the trustees may distinguish between employees on the basis of remuneration, length of service and hours worked.

Diagrammatically, it would look like this: