November 2020

Tax incentives for business owners and employees

Employee Ownership Trusts ('EOTs')

EOTs are a Government initiative to promote employee ownership, what many people term the 'John Lewis model', through added tax incentives for both the owners who relinquish control and the employees.

EOTs do not involve direct share ownership by employees, rather a controlling interest in the shares of the company is held by an all-employee trust.

Why use an EOT?

Commercial benefits

- Employee ownership encourages employee engagement
- Allows an exit where there is no obvious third party purchaser
- Owner can retain some involvement (up to 49%)
- Share capital still available to incentivise management and key employees
- Mechanism for extracting future profits in a tax efficient manner
- Avoids a 'hostile' take-over

Employee benefits

- Aligning the goals of stakeholders and employees
- Improved employee retention and workplace attendance
- Encourages innovation at all levels
- Improved business performance by driving growth of stakeholder values

Tax benefits

- **Owner:** Disposals into the trust can be made free of capital gains tax, saving up to 20%. A gift of shares to an EOT is an exempt transfer for inheritance tax purposes
- **Employee:** The EOT can pay annual bonuses of up to £3,600 to employees free of income tax
- **Company:** A corporation tax deduction for the value of the bonuses will be available to the company

Qualifying conditions

Control	Trustees must hold more than 50% of the company (or holding company of a group). As a result the trustees must be entitled to more than 50% of: ordinary share capital and voting rights; profits available for distribution; and, assets on a winding up.
All employee	The trust assets must be available for the benefit of all eligible employees on the same terms (broadly this excludes current and previous shareholders who own more than 5% of the business). Those employees with less than 12 months service can be excluded.
Equality	The assets of the trust can be applied based on remuneration, length of service and hours worked, with each of those factors to be applied separately. The assets of the trust cannot be applied such that only some employees benefit.
Trading	The group or company must be trading.

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Disqualifying events

A disqualifying event occurs on any of the following:

- EOT no longer holds more than 50% of the share capital
- EOT no longer meets the 'all employee' requirement or the trustees do not act in the favour of 'all employees'
- Continuing vendors and other 5% (or more) shareholders who are directors or employees, make up more than 40% of the total number of employees
- Company ceases to meet the trading requirements

Where such an event occurs before the end of the tax year following the disposal, any claim for CGT relief by the vendor is revoked, otherwise CGT arises on the part of the trustees of the EOT, who are treated as disposing and reacquiring the shares held by the EOT for a consideration equal to their market value at the time of the disqualifying event.

Who will run the company?

The EOT will control the company and the EOT will be governed by the trustees. The trustees will often be a company (to insulate trustees from onerous financial risk). The directors of the trustees company will typically comprise of both management and employees' representatives (or representatives of an employee committee), together with at least one 'independent director'.

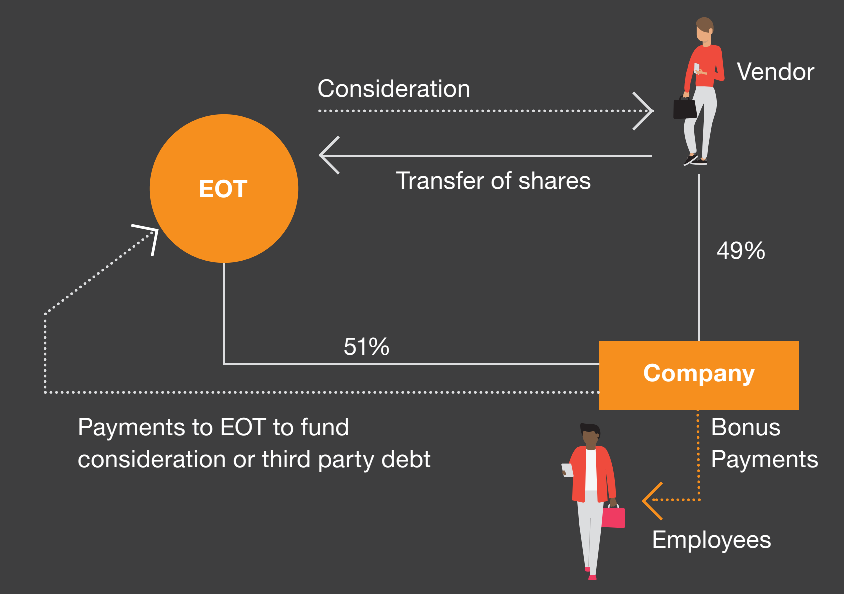
Ultimately, the EOT must act in the best financial interests of the beneficiaries. Nonetheless, the person selling their shares to the trust will want the right structure in place to ensure the company will continue to operate effectively and that funds of the company will first be used to pay off debts of the trust, e.g. any outstanding debt on the share sale.

EOT structure and funding

On setting up an EOT, funding will be required in order to allow the EOT to purchase shares from the existing owners. The nature and structure of this funding must be considered carefully in order to ensure that any loans are not caught by the provisions of the 'loans to participators' rules or the 'disguised remuneration' rules.

The vendor will often be paid for their shares out of future income generated by the Company, rather than the trustees being funded by third party lenders.

The following shows a typical EOT structure



How can PwC help

PwC can assist with all aspects of implementing an Employee Ownership Trust, including:

- Strategic review, We will advise on ensuring that an EOT is the best option for the company and outline the key considerations taking into account potential alternative structures
- Plan design, working with the company and owner(s) to ensure that the structure is as efficient and effective as possible
- Share valuations
- Employee communications
- Plan administration and ongoing support
- Legal assistance with adopting articles and establishing the trust via PwC Legal

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