



# Succession using an employee ownership trust

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# Employee ownership trust (EOT)



HaworthTompkins



PORTLAND GALLERY

# Employee ownership trust (EOT)



hodge jones & allen  
solicitors



# Employee ownership trust (EOT)

- / A new(ish) form of employee trust
- / Created in 2014
- / Now over 300 in UK
- / Two new tax reliefs

*Has an entirely different purpose and structure compared with EBTs for remuneration planning*

# Government's intention

- / Encourage the growth of employee-owned companies
- / Enjoy greater productivity, resilience, performance
- / Employees to share in rewards

# So what did they do?

- / Tax reliefs introduced in 2014 to encourage employee ownership
- / Full CGT relief on sale to employee ownership trust (EOT)
- / Income tax free bonuses for employees of a company controlled by an EOT

# When could employee ownership be a succession solution?

We can't find a third party purchaser who would be compatible with our business

New potential partners don't wish to invest and/or can't source funds with which to do so

Employee ownership creates the strongest platform for continued success and growth

It's the employees who know the business best – shouldn't they be the next owners?

We're not big enough for an IPO

# Approaches to succession



Trade sale



Consolidator (for professional practices)



Management buyout or buy-in



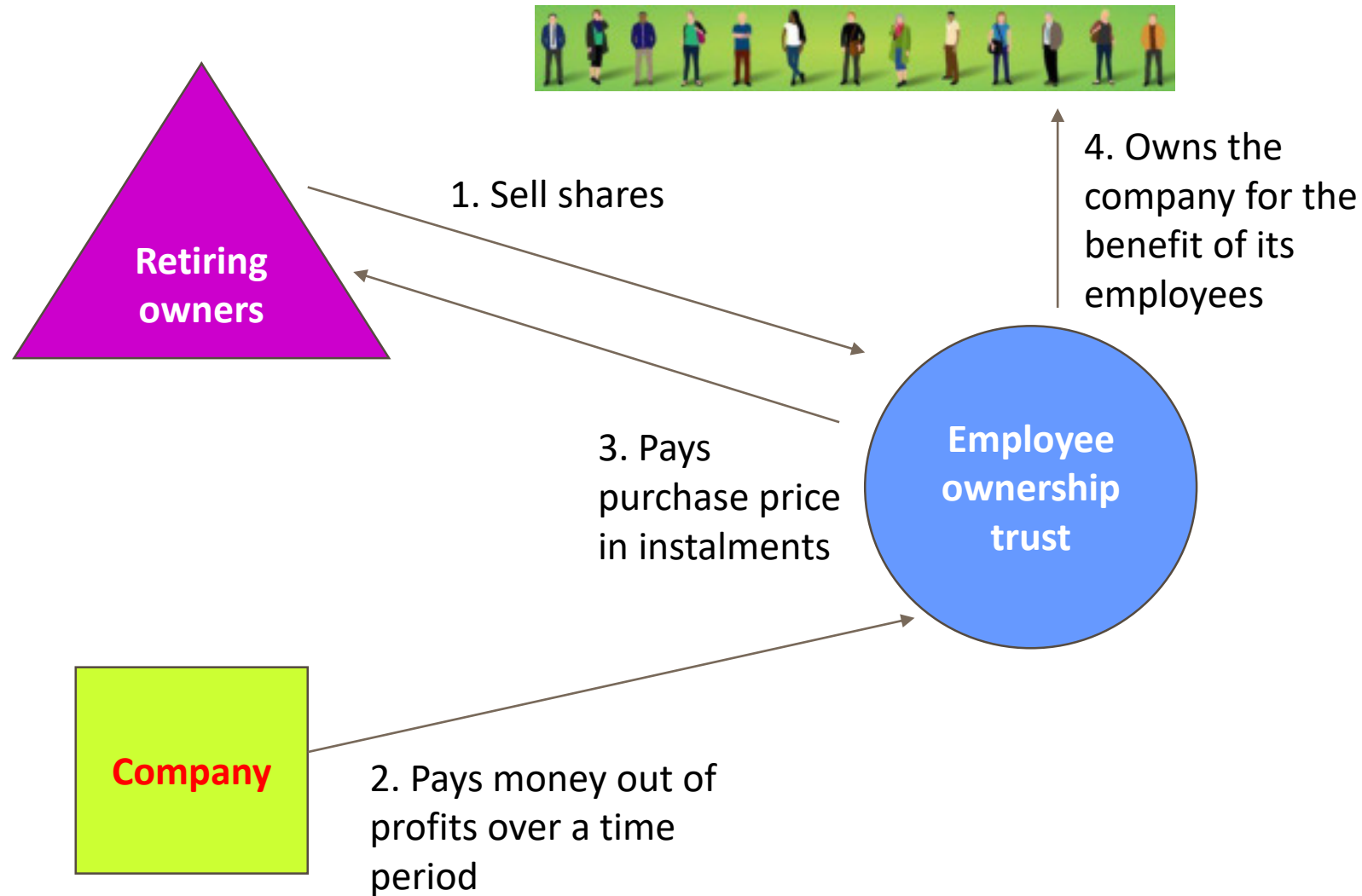
IPO



Employee ownership



# A typical EOT transaction



# CGT relief

## Finance Act 2014: sale of controlling interest to an “employee ownership trust”

- / 0% CGT for sellers
- / Must be a trading company (or the holding company of a trading group)
- / Limited participation requirement must be met
- / If EOT benefits employees financially (e.g. transfers shares to them) must be on “*same terms*”

# Same terms

- / “*Same terms*” means that benefits cannot be allocated by the trust in favour of particular employees, but can be varied by reference to salary, length of service or hours worked.
- / Any income tax free bonuses must be paid on the “*same terms*”
- / Can pay additional sums on different terms

# Rewarding employees

The company paying bonuses or profit share	Employees acquiring shares	Eventual sale of the company?
<p>Any part which goes to all (qualifying) employees on same terms can be income tax free.</p> <p>Max of £3600 per employee per year</p> <p>Same terms can reflect each employee's remuneration, hours worked or/and length of service</p>	<p>Should there be individual employee share ownership?</p> <p>Pros and cons</p> <p>If the EOT transfers shares to employees, it must be on the same terms</p>	<p>All (qualifying) employees would share in net sale proceeds, under terms of trust deed</p> <p>Unless it provided for proceeds to go to charity</p>
<p>The company can also pay bonus or profit share other than on same terms, but taxable in the normal way</p>	<p>More senior/key employees can be allocated larger numbers of shares than others, but not by the EOT</p>	

# What are the benefits for retiring owners?

- / Legacy – enables the business to continue
- / Retiring owners can realise the value built up
- / Employees are often the most natural next owners
- / Business well positioned to enjoy further growth
- / Allows time for leadership succession
- / Allows for key people to be appropriately rewarded
- / No CGT (but don't make this your prime reason)



# What are the benefits for employees?



Sustainable ownership structure



Greater engagement



Profit share (partly income tax free)



Participation without investment



*And if the EOT transfers shares to individual employees:*



Dividends



Capital growth

# When is it most suitable?



Confidence that employee ownership will work well



The best succession solution compared with alternatives (if there are any)



Management support



Employee engagement

# When less suitable?

- / Doing it mainly or purely for tax reasons – don't believe employee ownership will be good for the company
- / Insufficient cash (present and future) to fund purchase price
- / Management need to support it and won't



# What proportion of company should be sold?

- / Must be 51% for EOT to qualify
- / Clearance easier where >75% is sold
- / Must show fundamental change of ownership
- / Sale of 100% can be cleaner and avoid discounts
- / Keeping a shareholding can show employees that sellers have skin in the game, and also gives sellers some protection if company sold on
- / Consider anti-embarrassment clause if selling 100%

# Valuation issues

- / What proportion of company is to be sold? Must be >51%, typically 75% or 100%
- / Should a minority/majority discount apply?
- / How far can future performance be factored into valuation?
- / Could there be an earnout where future results uncertain?

# Further valuation issues

- / Value must be “right”
- / Trustees would probably want to instruct an independent valuation
- / Valuation doesn't need to be a fixed number but can factor in conditional and deferred consideration
- / Majority stake in trading company so EBITDA based valuation probably most suitable?

# Structure going forward

- / Typically, one or more of the sellers will become a trustee of the EOT
- / New directors appointed to board of trading company
- / EOT must have right to control board of directors, though does not need to exercise it
- / EOT will generally act as passive shareholder, unless things start going wrong.....

# Risks

- / Decline in profits
- / Failure to engage employees
- / Over promise/under deliver
- / Leadership/key people don't get it
- / Retiring owners don't let go

# Getting from A to Z

## Key steps

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## 1. Design

- / Valuation
- / What price can the company fund and over what time period?
- / External funding towards purchase price?
- / How much of the company is to be sold?
- / Who will run the EOT?
- / Will the EOT retain its shares or pass some of them through to employees?

# Key steps

## 2. Implementation

- / Shareholder agreement between EOT and sellers if sale is less than 100%
- / HMRC clearances
- / Main documents, e.g. trust deed and share purchase agreement, any finance documents
- / Obtain support of leadership team
- / Employee communication



# Thank you

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