



Employee Ownership Trusts

Practical strategies for
Business Continuity
and Tax Efficiency

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DWF Panel



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Key Questions...

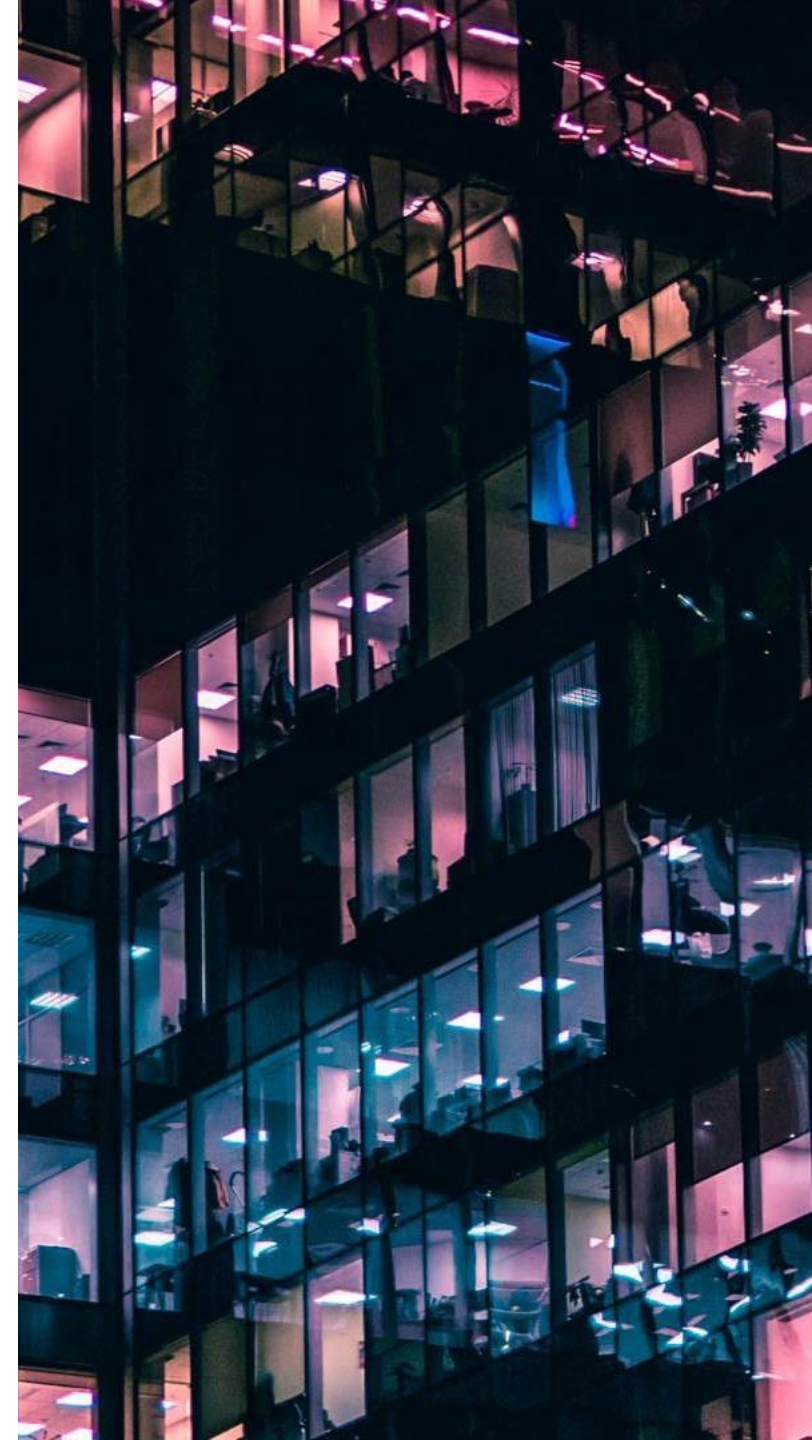
- What are they?
- Why should you use it?
- How do you do it?
- What's changed?

What is an EOT?



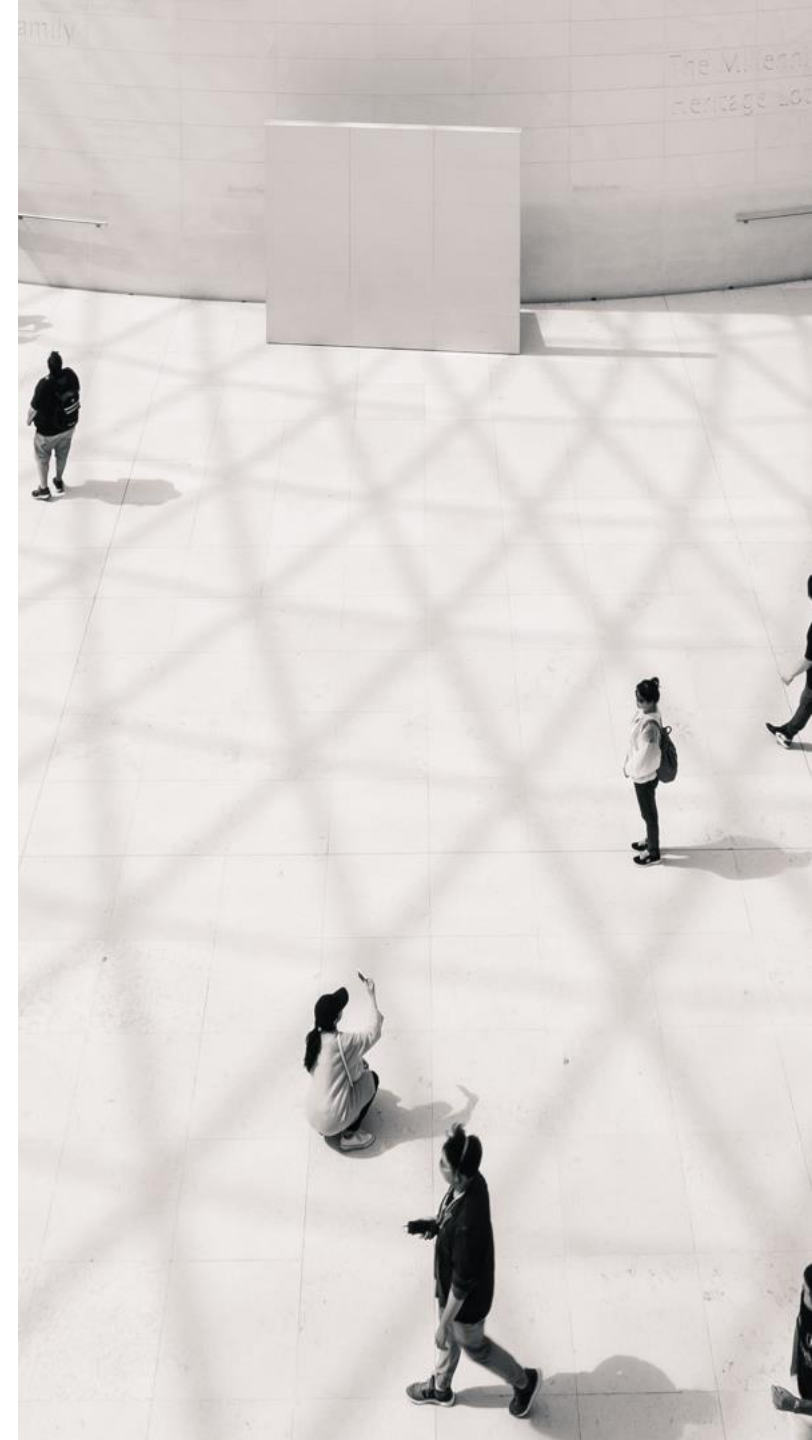
The Employee Ownership Trust

- The EOT model was introduced in 2014 with the intention of encouraging more employee ownership models.
- Importantly for the business owners, any sale of the business to an EOT is potentially tax free.
- This means that the owners can extract the proceeds of sale over time without facing a dry tax liability whilst consideration is unpaid.
- Additionally, it allows the owners to remain involved with the business to ease the transition for the continuing employees and management.
- Recent statistics indicate nearly 2000 EOTs have been established in the UK to date, with recent notable examples in Northern Ireland such as Relinea and Savage & Whitten.



Key points to consider?

- The Company, the Trust and the transaction documents must meet the key statutory requirements to avail of the tax exemptions.
- Choice of advisors is critical – this is a very technical process which requires careful review to ensure compliance.
- How will the transaction be funded, e.g. bank debt and how will debt payments interact with Trustee payments to sellers.
- How much control to pass to the EOT (must be a controlling interest) and how long the deferred payment process is to last.
- Employee representation and messaging to employees critical to obtain the benefits that come with employee engagement. Role of the Trustee board critical here.
- How to incentivise key management who are not sellers but are critical to long term financial success of the Company.

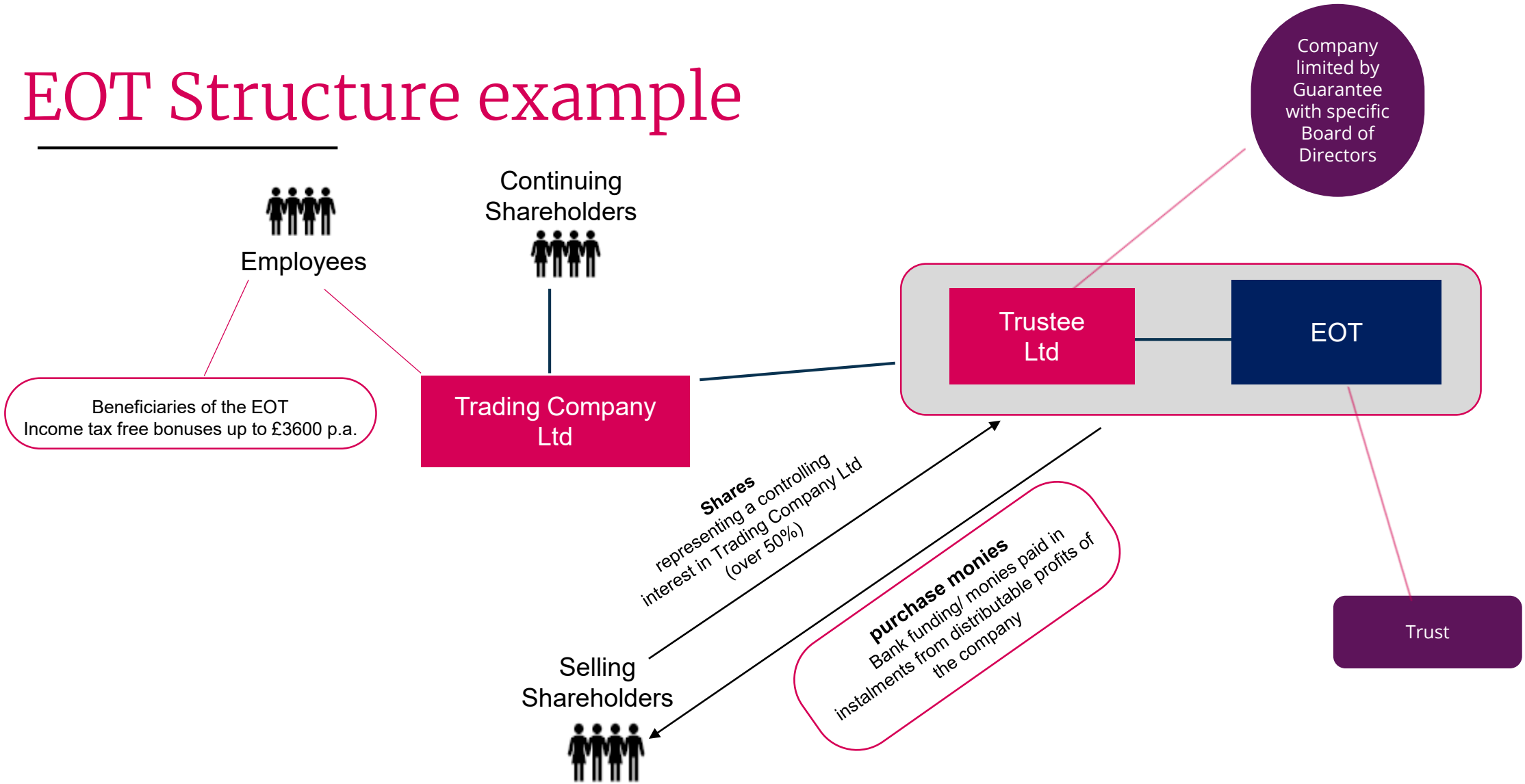


The Process

- An EOT is a vehicle which purchases a controlling shareholding in a trading company (or its holding company) and holds it on trust on behalf of the employees as a whole.
- The trading company must be a limited company (consider this with professional services businesses usually held in LLP structures)
- The sellers of the shares will often be paid for their shares out of future income generated by the Company via deferred consideration. This period of time for these payments is negotiable and can be covered off in the legal documents.
- Going forward the Company will either be wholly owned by the Trust or the Trust will have a controlling interest with a Board of Directors which will usually include the Seller representatives, Independent Trustees and Employee representatives.



EOT Structure example



What are the pros
and cons of an
EOT?



Key considerations

1. The advantages for succession planning

Preservation of Company Culture - Research into this has found employee ownership improves employee retention and employee owned businesses are 8-12% more productive than their counterparts

Continuity - in theory should be a seamless transition and removes stress and complications of intense diligence process and general deal uncertainty.

Improved Corporate Governance - workforce representation at all levels of the Company decision making process.

Tax benefits - both for Seller and Employees .

2. Is it the best option?

- Risk of overvaluing the business and **possibility of better return** from a third party trade buyer or private equity. Need for independent expert valuer and can lead to sellers erring on side of caution when valuing their business.
- Ultimately this is a self financing option. Are the Sellers prepared to accept **deferred payments**?
- **Constraints** as to what the Trustee Co as controlling shareholder can or can't do
- **Employee Messaging**. Also may be some time before employees see the distributions of the Company's profits
- **Technical process** with many inadvertent pitfalls which could preclude tax benefits

Tax advantages



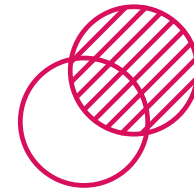
For the owner

Capital gains tax – exemption for individual shareholders who make a qualifying sale to an EOT (base cost acquired by the trustees)



For the employee

Income tax (not NICs) exemption on bonuses of up to £3,600 per year per employee



For the company

Corporation tax relief on those bonuses

Key conditions for tax relief

For an individual owner to benefit from the CGT relief, there are a number of detailed conditions.

There are additional conditions for income tax relief.



Trading requirement

Company must be a trading company or the principal company of a trading group (group's activities must not include to a substantial extent non-trading activities).



All-employee benefit requirement

The terms of the trust must be carefully drafted to ensure equality of treatment to eligible employees and prohibit certain actions.



Controlling interest requirement

Five-limbed test to determine that the trustee will hold a controlling interest in the company (e.g. more than 50% ordinary share capital, profits).



Limited participation requirement

Restricts availability of CGT relief in companies where a significant proportion of employees are owners of the business or connected with the owners.



No related disposal

The individual owner nor connected person claimed EOT relief in an earlier year on any disposal of shares in the same company/group.



Trustee resident in the UK

Trustee is resident in the UK at the time of the disposal.



Trustee independence requirement

The EOT is not controlled by excluded participators (in general terms, shareholders owning more than 5% of the ordinary share capital, entitled to 5% or more of the assets on its winding up).



Consideration

The consideration paid to the shareholders must be no more than the market value of the shares.



More on trustee residency

- Trustees must be UK resident, as a single body of persons.
- *"This will still allow flexibility for EOTs to be established with a mix of UK and non-UK resident trustees, provided that the settlor of the EOT was UK resident at the time the EOT was set up"*
Government consultation response 30 October 2024
- UK residence [s. 69 TCGA 1992]:
 - All trustees UK resident.
 - If not all trustees are UK resident, at least one trustee and the settlor must be UK resident.
 - Corporate trustees – Company residency – central management and control. UK incorporated company can have ROI directors.

Clawback

- If a **disqualifying event** takes place, the sellers are not eligible for relief or there is a tax charge on the trustees.
- First four tax years following the tax year in which the sale took place – CGT relief clawed back from the exiting shareholders.
- EOT trustee(s) should ensure these conditions continue to be satisfied.
- Shareholders to ensure contractual protection.

Disqualifying events are ceasing to meet the trading requirement, the all-employee benefit requirement, controlling interest requirement and trustee requirements regarding UK residency and independence.



How do I set up
an EOT?



Key Legal Documents



A **valuation report**, which typically includes an independent valuation of the Company and determines the fair market value of the shares being transferred to the EOT



A **trust deed** between the Company and Trustee Company to set up the Employee Ownership Trust.



A **share purchase agreement** detailing the terms of the Trustee Company (acting as trustee of EOT) acquiring the Company shares from the Sellers

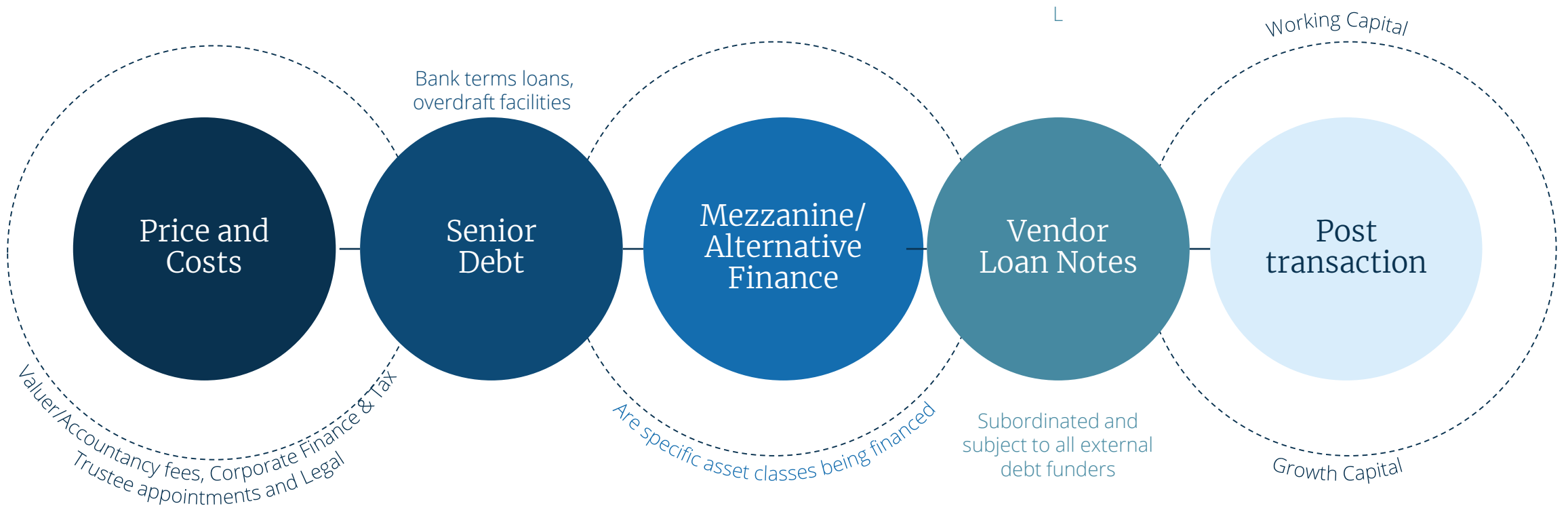


Corporate governance docs
A new shareholders agreement and Articles for Company and Articles for Trustee Company setting out decision making process of the Trustees and who Directors will be



HMRC Clearance (statutory and non – statutory)

Funding?

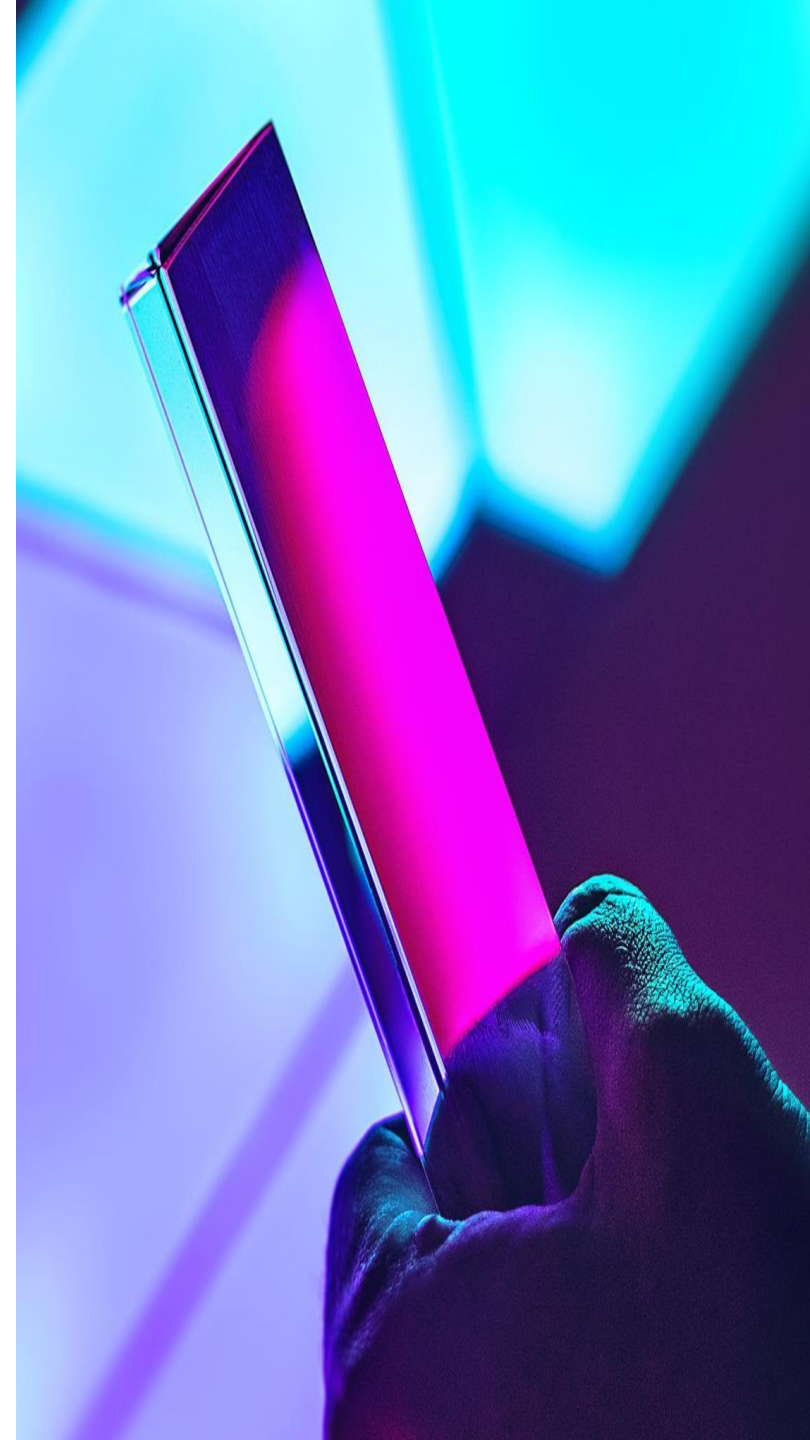


A look ahead

All change to the tax regime?

The changing tax landscape

- Increased CGT and BADR (formerly entrepreneurs' relief) rates
- Budget 30 October 2024 – increased general CGT rates Higher rate: 24%
- From 6 April 2025, the CGT BADR rate rises from 10% to 14%
- From 6 April 2026, the CGT BADR rate increases further to 18%
- The Finance Act 2025 received Royal Assent on 20 March 2025, making changes to the EOT regime.



The Finance Act 2025

Key changes (some of which we have touched on) include:

- EOT trustees must be UK tax resident.
- The majority of the EOT trustees must be independent of the selling shareholders.
- The consideration paid to the shareholders must be no more than the market value of the shares being sold.
- Contributions to the EOT from the company – treated as distributions but tax-free if the contribution is to repay the sellers for shares in the company and meet the costs of acquiring the shares (including stamp duty, reasonable interest on deferred consideration and “such other reasonable expenses as are directly connected with the acquisition” (but not relating to ongoing management costs))

Most changes apply with effect from 30 October 2024



The Finance Act 2025

Additional changes:

- Income tax-free bonus of £3,600 must be paid to all employees on the same terms, with some limited exclusions. The change allows bonuses to be paid to employees but not directors.
- Length of time the CGT relief can be clawed back from one tax year following disposal to **four** years.
- Additional information to be provided in claims for relief by selling shareholders and trustees.
- From the Government's consultation response published on 30 October 2024 - HMRC will cease to provide clearances in relation to the application of the targeted anti-avoidance rule in section 464A Corporation Tax Act 2010 to a loan to an EOT.



Changes: Areas to watch out for

Following the changes in the Finance Act 2025, there are some areas where selling shareholders and trustees need to pay particular attention:



Valuation

The burden is on the trustees to show no more than market value is paid to the selling shareholders and all reasonable steps are taken by the trustees to ensure this. Manual guidance is awaited.

Valuation reports should be addressed to trustees as well as sellers



Increased administration

Trustees are required to claim statutory relief. Also, for the 2024/25 onwards, sellers of shares to EOTs must include details of the consideration and the number of employees of the company at the date of disposal when making a claim for EOT CGT relief in their self-assessment tax return.



Trustee costs

HMRC guidance is awaited. Legislation refers to “such other reasonable expenses as are directly connected with the acquisition” but excludes ongoing trustee costs.



Clawback

How does the seller ensure that the company continues to meet the necessary conditions and does not trigger a clawback?

This is already a problem for the sellers but the period for clawback has been extended significantly.



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