UHY

UHY Ross Brooke
Chartered Accountants

# A Guide to Employee Owned Trusts (EOTs)

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Helping you prosper

# Contents

# Welcome to our EOT Guide

Over recent years, we have seen an increasing number of SMEs looking at EOTs as an alternative route to exit.

In 2022, 332 businesses transitioned to employee ownership, and by June 2023, the total had grown to 1,418, a 37% increase over the previous year. Momentum continued, with 542 more businesses adopting EOTs by the end of 2023, marking a further 27% rise. By mid-2025, the sector has surpassed 2,400 employee-owned businesses nationwide, highlighting the growing popularity of employee ownership as a succession and resilience strategy.

Whilst many business owners may associate employee ownership with larger corporations, due to high-profile examples such as John Lewis, this can also be an appealing option to SMEs. In fact, in a 2017 report on The Employee Ownership Effect, evidence showed a stronger positive influence from employee ownership in smaller firms.

In this guide, we will aim to explain the rationale behind the increasing popularity of EOTs and answer some of the key questions that a business owner may have about EOTs, such as:

- Why choose employee ownership?
- How does an EOT work?
- What are the tax benefits (and implications)?
- How are EOTs implemented?
- What is the role of the Trust and Board?
- How do EOTs compare to alternative exits?
- What's an EMI scheme and why are they often used in conjunction with an EOT?

Of course, there's only so much we can answer in a generic guide, so professional advice should be sought that is tailored to your situation. At the end of the guide, you'll find the contact details of our expert team should you have any questions.

# Why transition to Employee Ownership?

In its most simplistic terms, employee ownership refers to a business that is majority-owned by its employees. Transitioning to employee ownership offers an alternative exit route for shareholders to the more traditional third-party sale route, but there are other important stakeholders involved as well as the sellers. We'll cover the main stakeholders and the benefits of transitioning to employee ownership below:

### The Shareholder(s)/Seller(s)

One of the main beneficiaries of transitioning to employee ownership will be the current shareholder(s)/seller(s). From their perspective, an EOT transaction can help them:

- Realise a fair price for their business
- Benefit from tax relief (more on this later)
- Maintain their company legacy, culture, and values
- Maintain their company's independence and provide employees control over the future
- Ensure a controlled succession
- Retain, reward, motivate and protect the staff that have helped them and their business achieve their success and also attract new staff that will support future success.

### Employees:

Of course, as the name suggests, this transaction and model is one that benefits employees, as:

- They can receive up to £3,600 income tax free bonuses per year
- They share the profits, so their financial reward isn't dependent on a third-party sale
- There's no financial commitment required
- This can provide greater opportunity and a louder voice and control in the future of the company
- The future ownership and succession are clear, offering the team certainty
- They have better leadership opportunities

### The Company:

There are case studies and evidence, that indicate that transitioning to employee ownership can also improve company performance too, in areas such as:

- Larger employer ownership stakes can lead to stronger financial performance in the long-run
- Increased productivity & innovation from a more motivated workforce and a better company culture - see here.
- Better employee engagement, retention and an enhanced ability to attract new staff - see here.
- Better governance by way of the trust, leading to reputational, employee and customer experience benefits - see here.

There are also other beneficiaries of employee ownership, such as a business's customers and its community so the impact can be wider than just the three stakeholder groups covered above.

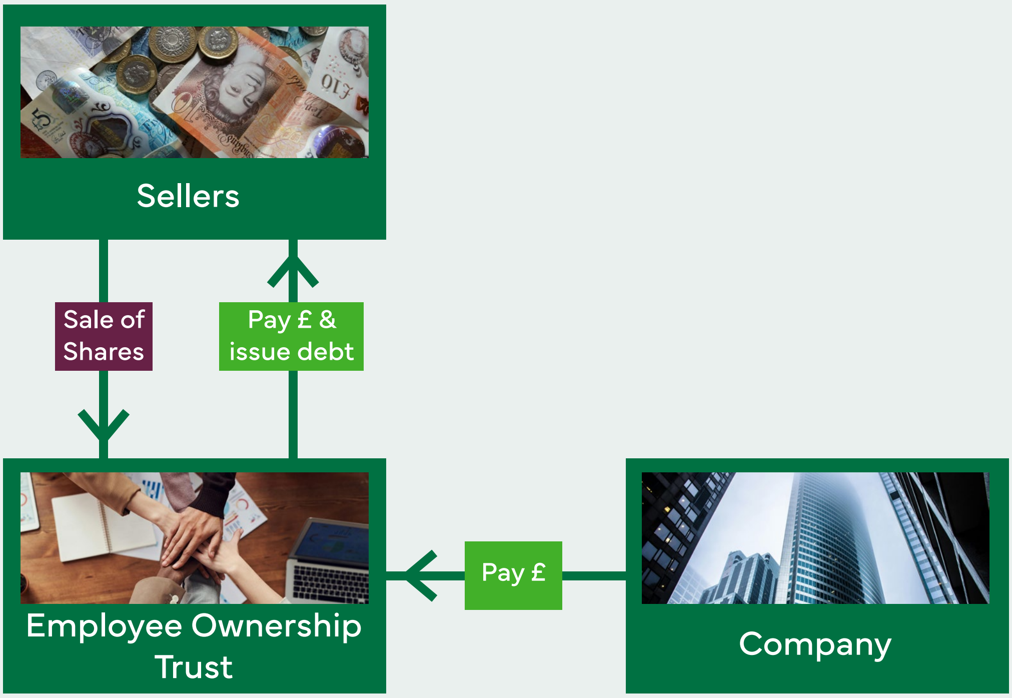
# How does an EOT work?

## What is an Employee Ownership Trust?

A trust is a special entity where trustees hold assets on behalf of one or more beneficiaries. Therefore an Employee Ownership Trust (EOT) is a special trust where assets are held for the benefit of one or more employees (and can consider future employees too).

As a simplified explanation of the deal structure of transitioning to an EOT: first the EOT is set-up, the seller(s) will then sell the majority of their shares to the EOT. The purchase price for the shares is likely to be via an initial upfront payment from the trading company's reserves (possibly also supported by external funding) with the rest funded by debt. This debt will then be gradually repaid from the trading company's profits into the EOT and back to the sellers over an agreed time period.

This setup is illustrated in the below diagram:



# What are the tax implications?

Whilst there are many benefits to implementing an EOT that we have already covered, undoubtedly one of the biggest advantages is the tax breaks that it can provide:

### On the transaction:

One of the main benefits for the sellers is that unlike with alternative exit routes such as third-party sales or Management Buyouts, they'll pay no capital gains tax (CGT) on the consideration paid for their shares. It should be noted that the majority of the company shares must be sold to the EOT to qualify for this tax relief and the EOT must remain as an EOT for, as an absolute minimum, the remainder of that tax year and the entirety of the following four tax years following the tax year in which control passes to the EOT.

### Employee Tax:

For the employees, they can be paid annual bonuses of up to £3,600 income tax free. These bonuses will be paid via payroll and national insurance will still be deducted. As this is processed via payroll and there's no income tax to pay, these bonuses won't trigger the requirement for employees to do a tax return if they haven't needed to do so previously. Like with CGT, the majority of shares need to be owned by the EOT in order for these income tax-free bonuses to be paid and there are also 'all employee' participation requirements to ensure that these amounts are fair and proportionate.

### Purchaser Tax:

On the side of the purchaser (i.e. the newly formed EOT), the acquisition of the shares in the company would be subject to Stamp Duty in the same manner as any normal share transaction. This is currently 0.5% of the purchase consideration.

# How are EOTs implemented?

At UHY, we would assign a team of experts to work alongside specialist EOT legal experts to design, plan and perform the sale of the business to an EOT in accordance with the owners' wishes. To provide a high level overview, the headline phases delivered would include:

### Valuation

To prepare a formal and substantive business valuation for the purposes of the proposed transaction, to be seen as justifiable and fair from the perspectives of the vendors and the trustees of the EOT. This valuation would encompass provision of a report to the shareholders which will also be submitted to HMRC as part of the clearance application process (detailed below).

### Design

To build a bespoke financial model to prove the viability of the proposed sale of the business by the existing owners to an EOT, using a number of criteria regarding headline variables such as valuation, earning levels pre/post transaction, pay out duration and expectations for trading trends over the years ahead.

### Tax Clearance

To prepare an application to HMRC outlining the proposed transaction, current and future structure in pursuit of obtaining their clearance to the deal and confirmation that the transaction will be subject to the anticipated tax legislation and reliefs. This clearance process includes sharing with HMRC the valuation report and a schedule of detailed special consents to provide transparency on decision making policies post implementation in order to ensure that HMRC are fully appraised of the overall plan.

### Transactional Support

We provide support throughout the entire process, from initial valuation through to completion, to ensure the implementation of the legal documentation is in accordance with the transaction discussed and agreed at the outset.

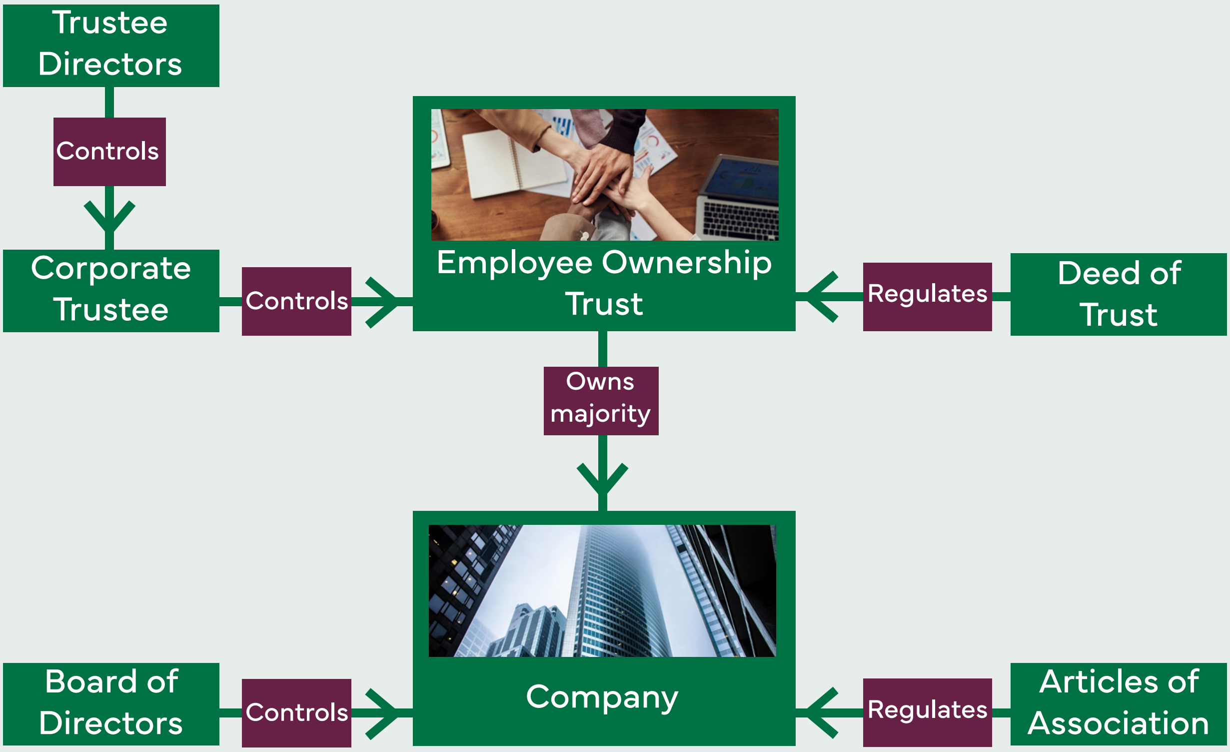
### Legal Support from EOT Specialists

Our legal experts would also be engaged directly to support, including with:

- Participation in the initial fact find stage to ensure that the EOT transaction is structured in accordance with the wishes of the selling shareholders
- Liaising and consultation with the employee group
- Preparation of all legal paperwork required to perform the sale
- Engagement and training with key stakeholders, including employees and, in particular, prospective EOT trustees

# The Role of the Trust and the Board

Once an EOT transaction is implemented, the set-up in terms of control and regulation will be as illustrated in the diagram below:




As shown in the bottom row of the above illustration, the trading company is still regulated by its Articles of Association and it is still controlled by the Board of Directors. Whilst the transition to an EOT may be an opportunity to consider changes in the day-to-day running of the business, this is by no means a requirement and, by default, there is no impact in this respect.

However, the key change to the structure is that a majority of the shares have been sold by the shareholders to the EOT. As well as creation of the trust itself, a Corporate Trustee is incorporated and is controlled by the appointed Trustee Directors to act collectively as the trustee of the EOT. Whilst the Trustee Directors are appointed to exercise control over the EOT, a trust deed is also established to regulate the EOT, ensure good governance and provide clarity on decision making powers.

In terms of the roles of the Board and the EOT & trust:

### The Role of the Board

The Board of Directors for the trading company still sets the strategy and oversees the running of the company. The board will still also be subject to statutory requirements, responsibilities and hold the personal liability.

## The Role of the EOT & trust

However, the EOT will have ultimate power as the majority shareholder and it is required to hold the company's board accountable and monitor the performance of the business in the interests of its employees.

Trustee Directors are appointed to perform this role and they will usually include each of:

- At least one employee representative, being an individual not previously connected with the ownership or directorship of the business
- A seller representative, being one of the selling shareholders
- An independent trustee, which could be one of the experts at UHY or a legal specialist, the purpose being to provide an external and independent viewpoint

All Trustee Directors must act in the best interests of the employee group in their role as Trustee Directors, without personal or self-interested bias.

The ultimate role of the Trust is:

- To make decisions that are in the best interests of the beneficiaries – i.e. the employees, both current and future
- To monitor how the business is performing and how it is benefitting employees
- To provide consent for certain major decisions that the company makes

# Business exit route comparison matrix

For many business owners looking to exit, the main options they're likely to consider are third-party sales, a Management Buy Out (MBO) or selling to an Employee Ownership Trust (EOT). Each of these should be considered based on the business and the business owner's circumstances and objectives of the sale and discussed with a professional. However, below is a high-level comparison of the main components for each exit route:

| | Third-Party Sale | Management Buy Out (MBO) | Employee Ownership Trust (EOT) |
|---|---|---|---|
| Headline definition | Sale to a third-party or private equity/investor group | A sale to either an existing management team or a newly identified one | A sale to a special entity trust that's set-up for the benefit of the existing and future employees of the trading business |
| Valuation | A premium valuation can be achieved through a third-party | The valuation would need to provide management with a reasonable ROI to proceed | The valuation must provide the EOT with a reasonable ROI, but a discount may be provided due to the tax saving (see next row) |
| Capital Gains Tax applicable on sale | ✓ | ✓ | X (Providing conditions are met) |
| Transaction costs | High | Low | Middle |
| Is the seller likely to have a role post-sale? | Unlikely | Potentially, but it will be different | Can continue in the role (usually until the consideration is paid) |
| Consideration / funding | Consideration paid by the third-party | Likely to be investment from the MBO and borrowing | Borrowing is possible, but consideration is likely to be mainly paid by the trading company's profits |
| Deal terms | There are several methods for attracting possible third-party buyers, but once a preferred bidder is sourced, a negotiation will be required.<br>Whilst sellers will be looking for the highest possible consideration, they can expect downward pressure from the potential buyers. This can make negotiations very tough and stressful. | Negotiations will be easier than third-party sales due to management's existing knowledge of the business. Providing the valuation provides reasonable value and the deal is structured so future profits can help fund the deal, the negotiation should be more straightforward to conclude. | Likely the easiest of the three to arrive at deal terms, as these terms are primarily arrived at by the seller. However, the valuation must be set to provide a reasonable ROI to the EOT. |

| | Third-Party Sale | Management Buy Out (MBO) | Employee Ownership Trust (EOT) |
|---|---|---|---|
| Deal structure | There's no one-size-fits-all, as the structure depends on the negotiations between both parties. However, typically 75% - 100% of the valuation is paid as an initial consideration on completion, with the remainder paid over the next 1 – 3 years. | The initial consideration will depend on the level of upfront funding that can be raised against the company's assets. The remainder will typically be paid over the next 3 – 5 years. | The initial consideration will depend on the trading company's reserves and any additional funding that can be raised, but typically the remainder will be paid over the next 5 – 8 years. |
| Transaction Due Diligence (DD) process | This option requires the most detailed and rigid due diligence including financial, commercial and legal DD.<br>This route will also attract more questions throughout the process, partly due to the lack of knowledge from third parties of the business. | This option will require more simplified due diligence as the management team will know the business well. | This route will require simplified (if any) due diligence. |
| Culture / legacy | At risk – it's not uncommon that the culture within a newly acquired business will gradually erode to be more aligned with the culture of the buyers, which can impact the legacy of the original business. | Continuity of legacy and culture is possible due to the retention of the key management team. | EOTs offer a high chance of continuity of culture and legacy as it puts employees at the heart of the business, this can be especially true when management are retained via an EMI scheme. |
| Legal protection for sellers on unpaid deferred payments | The buyer(s) will provide a personal guarantee or a charge over shares of the company (or both) | The management team will be required to provide personal guarantees or a charge over shares of the company (or both) | There are no personal guarantees here, so no legal action can be taken against the EOT for non-payments of the deferred payments. This often leads to sellers continuing in an active role until the remaining consideration is paid (and possibly exploring an EMI scheme for key staff) |

<table>
<tr><th></th><th>Third-Party Sale</th><th>Management Buy Out (MBO)</th><th>Employee Ownership Trust (EOT)</th></tr>
<tr><td>Benefits for employees</td><td>The benefits will be subjective based on the individual, but the acquisition offers the chance to be part of a larger group and to have more progression opportunities.</td><td>For management, they'll take on ownership responsibilities and rewards. For the rest of the employees, this offers continuity of leadership and more protection of their jobs and roles vs a third-party sale.</td><td>This option benefits the employees greatly with job security, retention of culture, leadership succession and financially they can receive a share of the profits up to £3,600 a year which would be income tax-free.</td></tr>
<tr><td>Summary of benefits for sellers</td><td><ul><li>For the right businesses, this option has the potential to achieve the best valuation and structure, especially if there are a pool of potential buyers and the preferred buyer has a strategic interest.</li><li>The buyer will likely have the resources to help unlock potential and grow the business.</li></ul></td><td><ul><li>There's no need to find an external buyer and negotiations will be easier vs a third-party sale.</li><li>This route allows the management team to take responsibility (and the rewards) for running the company.</li><li>It is possible for legacy and culture to be retained.</li></ul></td><td><ul><li>There's no need to find an external buyer and negotiations will be easier vs a third-party sale.</li><li>Subject to conditions being met, the sellers won't have to pay capital gains tax on the consideration received for the shares.</li><li>This option helps to reward the employees that helped build the business with a profit share.</li><li>Legacy and culture can be retained.</li></ul></td></tr>
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# How are EOTs implemented?

Another project that is often considered alongside EOT transactions is the implementation of an Enterprise Management Incentive (EMI) scheme directly after the implementation of the EOT. The EMI scheme is a long-term incentive plan that many companies utilise to offer share options to their key employees. These share options effectively provide the right to acquire shares in a company at a future date at a pre-determined price.

So why are these often considered alongside an EOT? We see there being two main reasons for this:

### Removing Risk & Retaining Key Staff:

EMI share option schemes are designed to retain and motivate the key employees which will be crucial to the future success of the business. As the seller is likely to be owed a sizeable proportion of the consideration on a deferred basis the future performance of the business is key to receipt of that money and therefore so is motivation of the team.

It's important to remember that with an EOT transaction, employees will only have indirect ownership in the business, meaning that they will eventually benefit through the profit share of the EOT, rather than owning shares. Therefore, EMI schemes can help to enhance that position for certain key individuals by providing them with the opportunity to have a direct share of ownership in the future, in addition to their status as a beneficiary of the EOT trust.

## Contact our experts to find out more about how we can help your business


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