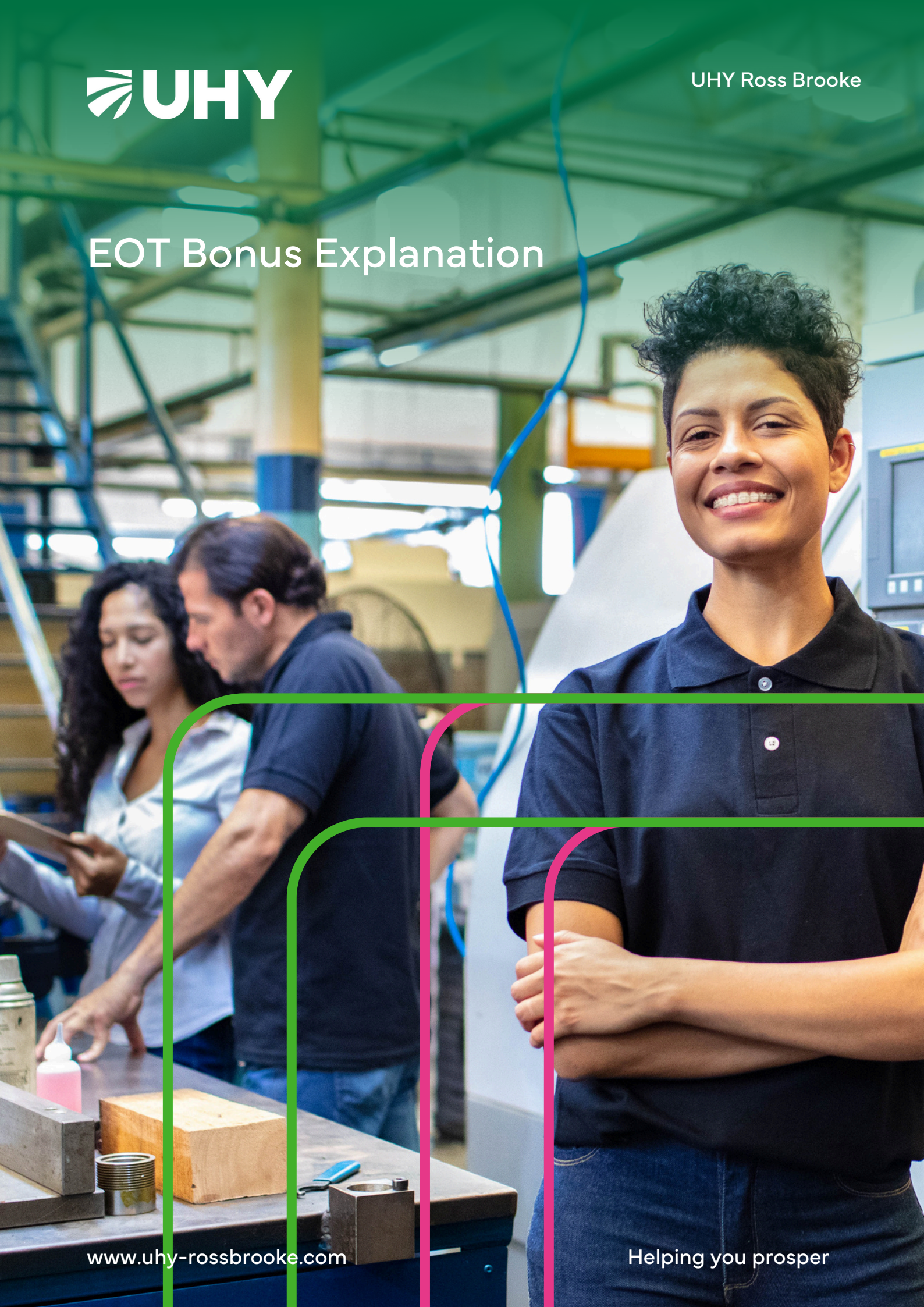




UHY Ross Brooke

# EOT Bonus Explanation





## Context:

Under UK law, companies controlled by an EOT can pay income tax-free bonuses to employees (up to £3,600 per employee per year), provided certain equality conditions are met under Section 312C of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA).

## Equality Conditions (Simplified):

The bonus scheme must:

1. Be open to all eligible employees.
2. Distribute the same amount or use objective criteria (e.g., length of service, hours worked, salary) for varying amounts.
3. Not exclude employees other than for specific reasons (e.g. recent starters or certain situations involving gross misconduct and summary dismissal).

### Example: EOT Tax-Free Bonus Scheme Operation

**Company:** GreenTech Ltd

**Total employees:** 10

**EOT status:** Fully EOT-owned

**Available bonus pool:** £36,000

**Bonus to be tax-free:** £3,600 per employee

**Eligibility criteria:**

- Employed for more than 6 months.
- Still employed on the bonus date.

**Eligible Employees (8 employees):**

- 3 full-time staff with >2 years of service
- 3 part-time staff with >2 years of service
- 2 full-time staff with 6–12 months of service

## Equality Condition Application:\*

### Option 1: Equal Bonuses

- Every eligible employee gets **£3,600** (the tax-free maximum).
- **Meets equality condition** – everyone receives the same.

### Option 2: Pro-rata by Hours Worked

- Full-time (FTE = 1.0): £3,600
- Part-time (FTE = 0.5): £1,800
- Still **meets equality condition**, as it's based on an objective factor (hours worked).

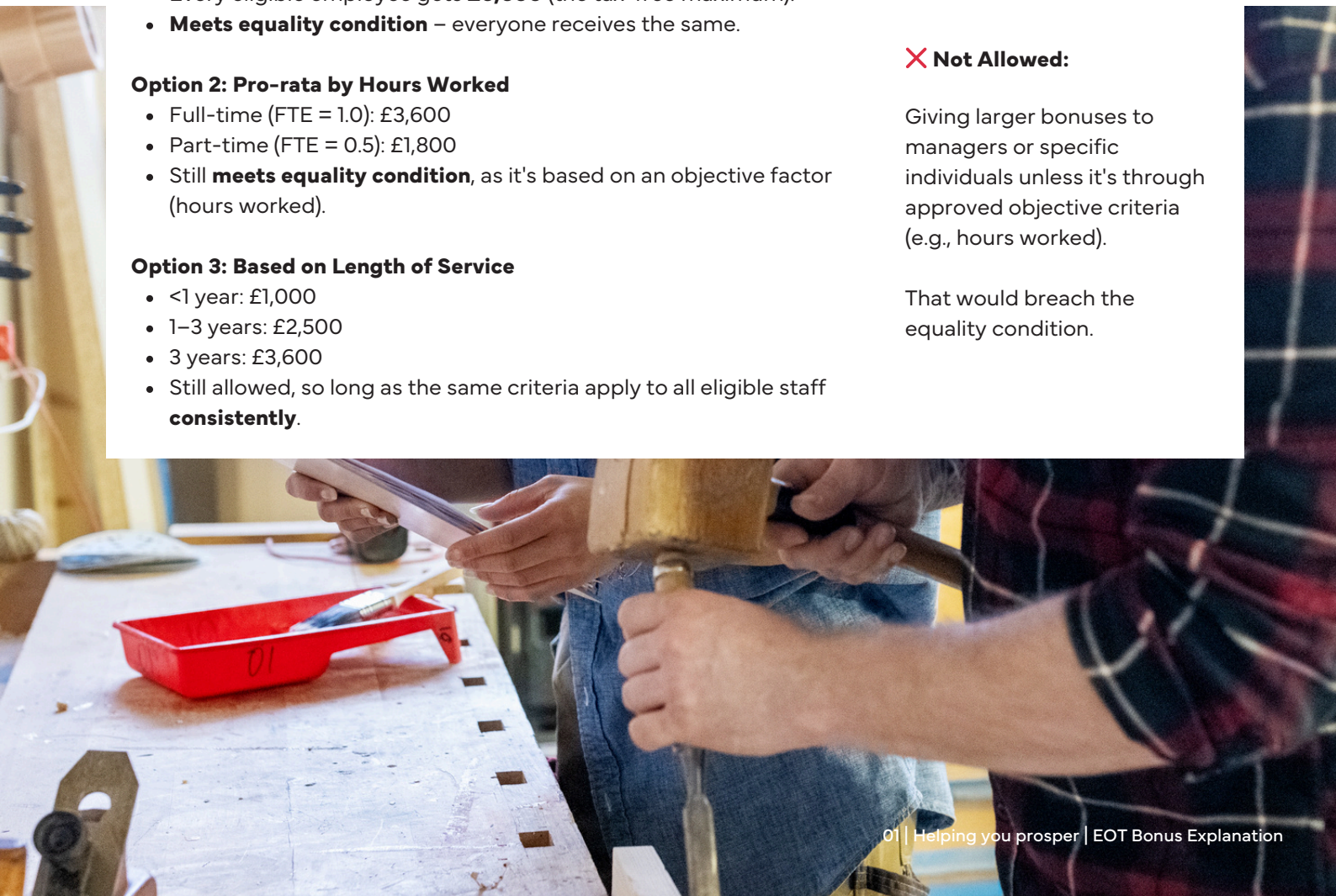
### Option 3: Based on Length of Service

- <1 year: £1,000
- 1–3 years: £2,500
- 3 years: £3,600
- Still allowed, so long as the same criteria apply to all eligible staff **consistently**.

### ✗ Not Allowed:

Giving larger bonuses to managers or specific individuals unless it's through approved objective criteria (e.g., hours worked).

That would breach the equality condition.



## Penalty for Non-Compliance:

If the conditions aren't met:

- The entire bonus loses tax-free status, and
- Employees must pay income tax

According to HMRC guidance (EIM11290) on Equality Requirements (Section 312C ITEPA 2003):

"Different amounts may be awarded based on **just one** of the following permitted criteria:

- remuneration,
- length of service, or
- hours worked.

But they cannot be combined."

## What This Means:

In the bonus scheme:

- You can vary bonuses **by hours worked, or by length of service, or by salary** (remuneration).
- But you must pick **only one** of these objective criteria to vary bonus amounts.
- If you apply two or more together (e.g. hours and service), it fails the equality requirement, and the bonus becomes taxable.

In practical reality therefore this means if you want to apply more than one criteria to the bonus then you need to split the allocation into components e.g.:

- **Bonus entitlement A** - £1,200 based on length of service
- **Bonus entitlement B** - £1,200 based on salary
- **Bonus entitlement C** - £1,200 based on hours worked

In short, HMRC does allow multiple factors to be used if:

1. Each factor gives rise to a separate entitlement, and
2. The total bonus is the **sum** of those entitlements (not a product or interaction of them).

This is subtly different from combining factors into one composite formula e.g.

✓ Allowed:

- £1,500 for length of service
- £1,500 for hours worked
- £600 for salary level
- → Total bonus = £3,600 (additive)  
(or a variation of these numbers)

✗ Not allowed:

- Formula like bonus = hours × service years × salary factor (multiplicative or compounded criteria)

This aligns with EIM11290, which says:

"A distribution may be made by reference to one or more of these factors, **but they must give rise to separate bonus entitlements.**"

As these are three separate entitlements within the bonus, they can each have one criteria applied to them.



## The next step

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