Employee Ownership Trusts (EOTs)

A guide for Accountants

Postlethwaite

> The Employee Ownership sector now has 2,500 businesses in the UK – a growth of over 1,600% since 2014 – EO continues to anchor jobs in the UK economy for the longer term, offering a resilient and inclusive model for succession and growth."
>
> eoa 2025

Succession planning with a tried and tested approach

All business owners will eventually need to plan for succession, and their first port of call for advice will often be you, their accountant.

For most businesses, succession has traditionally involved seeking a third party buyer or, if there is no-one interested in the business, arranging either an MBO or, in the absence of any viable alternative, winding it up. But there is now a tried and tested alternative: **the employee ownership trust (EOT)**.

This guide aims to equip you, as the accountant and trusted adviser of any company whose owners are considering succession, with the key information to help evaluate the feasibility of a sale to an EOT and support your client through the process.

Helping you and your clients

We are solicitors specialising in employee ownership with broad experience of providing support to accountants and tax specialists. We can help you, or your client directly, on any areas where EOT expertise is needed. Companies (and advisers) commission us to help design an employee ownership arrangement that suits their needs, and then to implement it by drafting the legal documents and, as required, provide legal and tax advice, project management and other assistance.

To date we have helped over 200 companies move to ownership by an EOT, across a range of sectors.

We are 100% owned by an EOT ourselves.

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What is an Employee Ownership Trust (EOT)?

An EOT is an arrangement under which a majority of shares in a company are held on trust for the benefit of the company's employees.

In most cases, the shares are acquired from the company's shareholders as the cornerstone of an ownership succession plan.

The EOT was created under the Finance Act 2014 under a government initiative to encourage companies to improve productivity by engaging their employees in their company's performance and sharing with them any resulting financial benefit.

POSSIBLE BENEFITS OF EMPLOYEE OWNERSHIP FOR:

1 The Business Owners/ Shareholders

- Realise the value built up in the business
- Leadership succession can be implemented over time
- Peace of mind that the business is in good hands
- Legacy
- Tax reliefs

2 The Business

- A solid foundation for future growth
- Helps create a more resilient and adaptable business
- Preservation of the business' values and culture
- Increased productivity

3 The Employees

- More engaged, committed and motivated – clear shared purpose
- No personal investment or changes to their employment required
- Full share in the rewards of success – a tax free bonus (limits apply)
- Targeted rewards available for key people if required

The EO Sector

2650+

Employee Owned businesses

1640%

growth of Employee Owned businesses since 2014

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When might an EOT be suitable?

An EOT should be evaluated, alongside other succession choices, by most private companies whose owners are considering succession. For many it may be a good choice, but it won't necessarily be right for all.

Here are some positive indicators – the more of these are present, the more suited a company may be to an EOT:

- a positive and collaborative culture (or the potential to develop one)
- a 'healthy' business with good prospects for further growth
- a belief that continued independence will be good for the company
- an effective leadership team that will see employee ownership as a benefit
- a wish to create a legacy
- a conviction that the employees are the natural next owners and that employee ownership will be good for the business
- the current owners' having a realistic idea of the company's value.

The EOT tax reliefs will often be an attraction, although we suggest they be seen as the icing on the cake rather than the main reason for selling to an EOT.

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How does a sale to an EOT work?

These are generally the key steps (after some careful initial planning):

1. A valuation of the company is obtained, sometimes accompanied by modelling future profit and cashflows. This is often done by the company's accountants, but it could be any independent valuer.
2. The company might also explore whether third party funding is desirable and, if so, available, to help fund an initial payment to the selling shareholders.
3. The company establishes an EOT by signing a trust deed, and appoints the EOT's first trustees (often the trustees will be directors of a specially formed trustee company).
4. The trustees enter into a share purchase agreement (SPA) with the company's owners, under which the owners agree to sell at a fixed price (not more than the valuation), to be paid in future instalments (based on the above modelling) although often with an initial down payment. An earn-out can also be built in if appropriate.
5. The change of ownership is immediate upon signing the share purchase agreement.
6. The purchase price is funded by the company making gifts (out of available cash and distributable profits) to the EOT trustees.
7. EOT trustees use these funds to make the initial payment and then subsequent instalments of the purchase price to the sellers.
8. Selling shareholders pay CGT at a reduced rate
9. The company's directors continue to be responsible for managing the business, but they now report to the EOT trustees.

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The EOT tax reliefs

- Where an EOT acquires control of the company, the sellers are not liable to capital gains tax (CGT), although the relief can be clawed back in certain circumstances[1]
- The company may pay its employees an annual income tax free bonus (National Insurance will be due), to a maximum of £3,600 per employee each tax year[2]

Inevitably each tax relief comes with conditions. **These will always need to be worked through carefully. What follows is a brief summary.**

Conditions for CGT relief

Several conditions apply, the primary purpose of which ensures the EOT works for the benefit of all employees, the company actually has a minimum number of employees, and prevents the EOT being used for tax avoidance:

- The company must be a trading company (or holding company of a trading group).
- The EOT must acquire control of the company (broadly: holding more than 50% of ordinary shares; entitled to more than 50% of shareholder votes, profits, and assets on a return of capital).
- Any benefit from the EOT must go to all company (or group[3]) employees (although a qualifying period of up to 12 months is allowed) on the same terms (e.g. can take into account length of service, remuneration or hours worked)
- The EOT trustees must not be allowed to make loans to beneficiaries.
- The EOT trustees must not be allowed to create a new trust or transfer property to another trust (except to another EOT).
- The company (or group) must have a minimum number of employees compared with the number of selling shareholders and their associates (the limited participation requirement).
- The selling shareholders (and persons connected with them) must make up less than 50% of the trustees and must not control the EOT.
- The trustees must be UK residents.
- The trustees must take all reasonable steps to ensure they are not paying more than market value (so must obtain a professional valuation).

[1] Taxation of Chargeable Gains Act, sections 236H-U
[2] Income Tax (Earnings & Pensions) Act 2003, sections
[3] As defined in section 170 TCGA ie holding company and 75% subsidiaries

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The limited participation requirement

This is determined by considering the **participator fraction**. This must not be greater than 2/5, over the whole of the twelve month period prior to the sale, on the date of the sale and then until the end of the following tax year. In certain circumstances the twelve month period may be reduced to six.

The participator fraction means NP/NE, where:

NP is the sum of the following:

- The number of people who are both participators in the company and employees or officeholders of the company; and
- The number of people who are employees or directors of the company or a member of the company's group, and connected with another employee or officeholder who is a 5% participator.

NE means the total number of the company's or group's employees.

Participator means a participator who is entitled to or has rights to acquire 5% or more of any class of the company's share capital or would be entitled to 5% of more of the assets on a winding up of the company (section 454 Corporation Tax Act 2010).

Conditions for the Income Tax relief

- The maximum amount of income tax free bonus per employee per tax year is £3,600.
- The payment must not be normal wages or salary.
- The payment must be made under a scheme (preferably in writing).
- All employees of the company (or group) including those outside the UK who may not qualify for income tax relief, must participate on the same terms (as with the CGT relief requirement, this can take into account length of service, remuneration or hours worked and a qualifying period of up to 12 months is permitted).
- The company (or group) must be trading.
- The company (or holding company) must be under the control of an EOT.
- The ratio of directors and other officeholders to employees must not be greater than 2/5.

An excluded participator (even one who is a seller) remains eligible to receive an income tax free bonus. Directors can waive their entitlement.

There is nothing to prevent a company paying bonuses above the £3,600 limit and/or to selected employees in any amount approved by the company, but these will be subject to normal income tax and National Insurance.

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The EOT tax reliefs CONTINUED

What happens if the conditions cease to apply?

Where a seller to an EOT has claimed the 50% CGT relief, their liability for that CGT does not disappear but is assumed by the EOT trustees.

If a **disqualifying event** occurs before the end of the fourth tax year following the one in which the EOT acquired control, the CGT relief will be clawed back from the seller(s).

A disqualifying event is:

- The company ceases to be a trading company (or holding company of a trading group).
- The EOT ceases to meet the requirement to benefit all employees on the same terms.
- The EOT ceases to have control of the company e.g. because it sells the company on.
- The participator fraction exceeds 2/5.
- The EOT trustees act in a way which infringes the all employee or same terms requirement.
- The trustees cease to be UK residents.
- 50% or more of trustees are the original owners (or persons connected with them).

If a disqualifying event occurs after the end of the fourth tax year, the EOT trustees will be liable for CGT on 50% of the difference between the seller's original base cost and the value of the EOT shares at the time of that disqualifying event.

Note that if the trustees sell the company on, their base cost in relation to the shares for which the relief has been claimed will be the same as the original sellers'. So even a sale at the same price as the EOT transition may give rise to a significant CGT liability. For this reason, an EOT sale should not be considered as a first step towards a third party sale.

When does the CGT have to be paid?

The basic rule is that it must be paid by 31 January following the end of the tax year in which the sale to an EOT is completed.

Where a seller may not receive sufficient funds from their sale price to do this, HMRC should normally agree to the payment of CGT in installments over up to eight years

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What does an EOT ownership structure look like?

Owners

Employees

1 Sell shares

4 Pays purchase price in instalments

Employee Ownership Trust

2 Own the company, for the benefit of its employees

3 Pays money out of profits over a time period

Company

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When and how you can help your client

1 Your client is considering an EOT

A company considering an EOT will find it helpful to involve their accountant in the process. Here are some ways you can add value:

- A long standing and deep understanding of the company's business, financial and tax affairs.
- The ability as a trusted adviser to act as a sounding board and help the company and its owners make informed decisions.
- Providing advice on the value of the company (or the shares to be sold if the EOT is not to acquire 100%).
- An initial review of eligibility.
- Financial modelling of future cashflows and profits to help plan a payment timetable.
- Where the company wishes to take out a third party loan to help fund a down payment on the purchase price, assistance in sourcing funders and negotiating terms.
- Advice on existing CGT is only payable from sale price amounts received.

For any company wishing to explore whether an EOT is feasible in principle, we would recommend first considering **suitability**, **eligibility**, **valuation** and **modelling**. If the outcome is that the company is eligible and a good candidate for ownership by an EOT, the valuation is acceptable to the shareholders and can be paid over an acceptable period, then it is generally safe to move on to plan for how it would be structured by considering some further key planning tasks and questions.

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2 Planning an EOT

Your client has decided to go ahead with this approach. Here are some key things to consider when helping your client plan for an EOT:

- Eligibility to claim the EOT tax reliefs (now in more detail)
- Does the company plan to take out a third-party loan to help fund an initial payment?
- Confirm how many shares are to be sold to the EOT.
- What the sale price should be, how much is to be paid on completion, how much will be deferred and then paid over what period (informed by a valuation and modelling)?
- Will the EOT be the only form of employee ownership or will it be part of a hybrid structure in which the EOT retains control but some shares are also held by individual employees directly?
- What governance arrangements will work best? Should there be a formal agreement between the company, EOT (and any other shareholders) about governance?
- Who should be the EOT trustees?
- What are the key terms of the EOT trust deed?
- What are the best ways to engage the employees as owners?
- What should be the terms of the purchase contract between the EOT and the selling shareholders (for example, will it include warranties and non-compete provisions?)
- Plan arrangements to pay CGT.

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3 Implementing an EOT: key tasks we can help and assist with

Once a company has completed its EOT planning and decided to go ahead, the next stage is **implementation**.

- Apply for statutory clearance under section 701 Income Tax Act 2007 transactions in securities – to ensure sale proceeds are not taxed as a distribution.
- Prepare the key documents (including EOT trust deed, share purchase agreement, new articles of association, new shareholder or governance agreement) and agree these with the company.
- Ensure the company's senior leadership are aware of and support the EOT.
- Employee communications to ensure they understand the ownership change and what it means.
- Finalise arrangements for any external funding.
- Form corporate trustee company (unless the EOT is simply to have individual trustees).
- Ensure that there is a valuation of the shares being sold.
- Appoint the first trustees (i.e. directors of the trustee company).
- If a hybrid employee ownership model with employee incentives, establish a separate share ownership or option plan: for example, EMI options (key employees) or a Share Incentive Plan (all employees).
- Organise completion and prepare all required ancillary documents (e.g. board minutes, shareholder resolutions, forms).
- Arrange post-completion filings and stamp duty compliance; update the company shareholder records. Register the EOT with HMRC.

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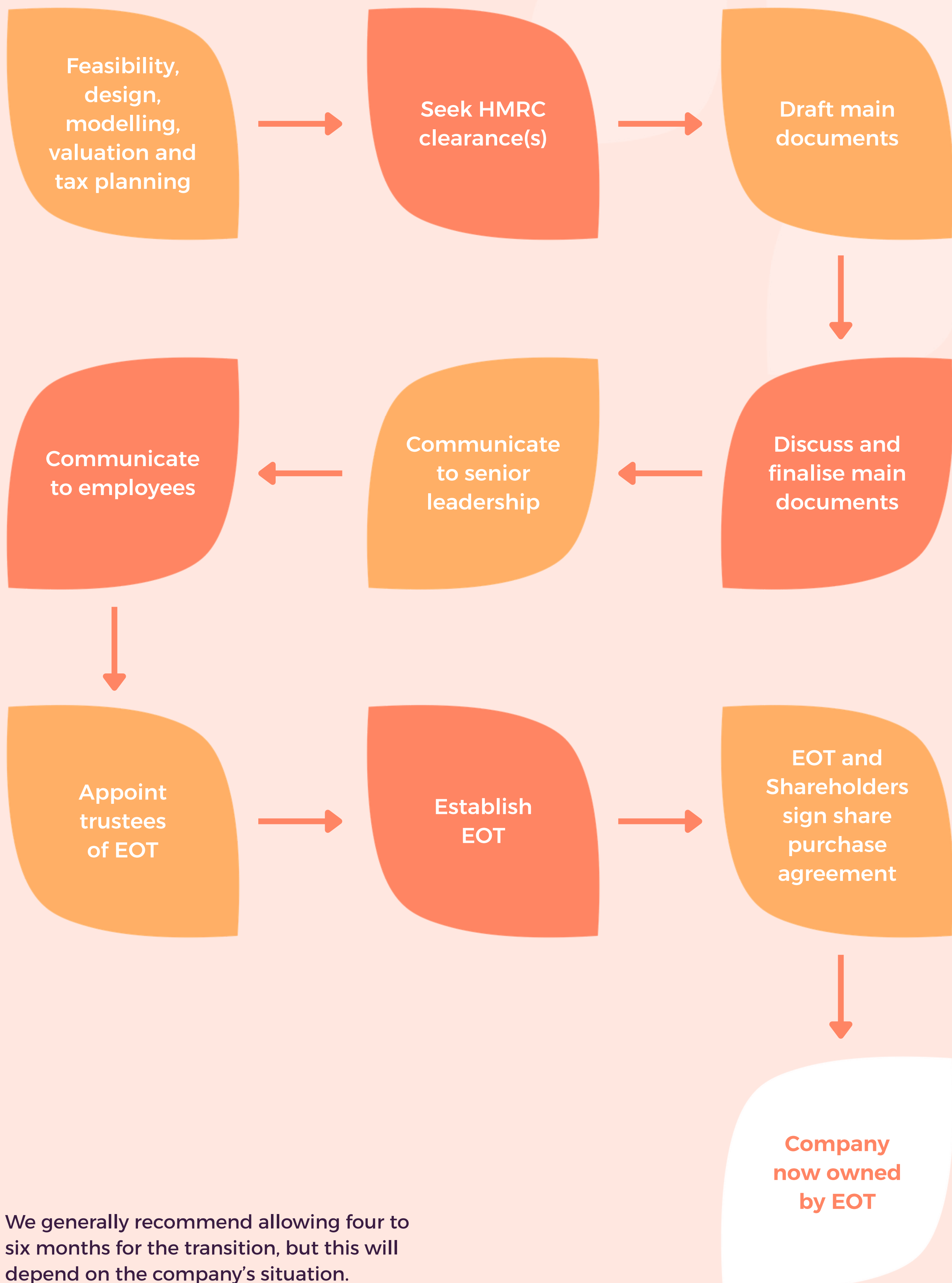
Process overview



We generally recommend allowing four to six months for the transition, but this will depend on the company's situation.

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Post-completion tasks

Tax compliance

As the accountant, it is likely you will assist with:

- Registering the EOT with HMRC for tax and anti-money laundering purposes.
- Preparing annual EOT accounts and separate accounts for the trustee company.
- Preparing and submitting tax returns for the EOT and the trustee company (unless or until in either case HMRC confirm this is not needed on the basis that neither the EOT nor the trustee company has taxable income).
- Submitting annual Companies House filings for the trustee company.
- Applying for the CGT relief for the sellers to the EOT.

Payments by the company to the EOT

Each payment of an instalment of the purchase price will be funded by a gift from the company to the EOT. Any such gift must be paid out of the company's distributable profits and it is important not to call this a dividend.

Where there is a group of companies:

- Any subsidiary can make a gift directly to the EOT (out of distributable profits) or
- Instead, any subsidiary can pay a dividend to the holding company which then enables the holding company to make a gift to the EOT (in each case, payment must be out of distributable profits).

Contributions made by a company to an EOT will not generally be corporation tax deductible.

Accounting for EOTs

It is important that you form your own view of the accounting treatment of an EOT and payments to it. Our understanding is:

- Where an EOT has control (which will nearly always be the case) of the company, there is no requirement to consolidate it with the company (unlike an employee benefit trust holding a minority shareholding where those shares will generally be considered to be held at the direction of the company).
- Contributions to the EOT by the company are not profit and loss account items and should be shown in Statement of Changes in Equity and Statement of Cash Flows.

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Post-completion tasks CONTINUED

Ownership of the trustee company

If there is a trustee company, the easiest and most common way to structure this is for the trustee company to be limited by guarantee, this avoids circularity of ownership and potential questions being raised from the company's bank.

In other circumstances, sometimes the trustee company will be a share capital company whose single share is held by the trading company. This creates an apparently circular ownership and can lead to questions from the company's bank.

This is addressed by section 138 Companies Act 2006 which states the circularity is broken because the trustee company acts as a trustee (i.e. does not hold its shares in the company for its own benefit) but it is better to instead have the one share in the trustee company held by one of its directors

Persons with significant control (PSCs) and relevant legal entities (RLEs)

On a change of control of the company, it will be necessary for it to update its register of persons with significant control and to notify Companies House of any changes. An individual controlling more than 25% of voting rights of a company (or the right to appoint directors) is called a PSC in relation to that company, and in the case of a company with that degree of control it is called an RLE.

The trustee company will require to be shown as an RLE of the company. For any shareholders who cease to be PSCs or RLEs on completion of the sale, this will also need to be recorded. Both changes must also be notified to Companies House.

Turning to the trustee company, if it has four or more directors then generally no single individual will have control of it. If had has fewer than four directors, they must be recorded as PSCs in relation to that company and this must be notified to Companies House.

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Working with you

In our experience, a successful EOT transition requires strong collaboration between the company's accountants and lawyer.

We often work collaboratively, helping with any aspects where specific EOT expertise would be useful. **We are happy to take on as much or as little as is required of us.** For example:

- You might provide your client with an initial outline view of how and whether an EOT might work, but you would want this to be subject to confirmation by an EOT specialist.
- We can formally advise on eligibility and help design an EOT for the company. We would start by gathering a full set of information about the company, its ownership and any subsidiaries.
- Our primary focus as lawyers would be on EOT design, eligibility, tax advice (as required), documents and helping with employee communications (also as required).

Testimonials

I recently had the pleasure of working with Robert Postlethwaite and his team at Postlethwaite's Solicitors in connection with the establishment of an Employee Ownership Trust for a client of my firm. We chose to work with Postlethwaite's as they came highly recommended from other firms that had worked with them.

From the outset, I was extremely impressed with their level of professionalism, expertise, and commitment to getting things done quickly and efficiently. They took the time to listen our client's needs and concerns and provided clear and concise guidance on the best course of action to take.

One of the service highlights that stood out to me was that Robert had an excellent knowledge on the technical aspects required as well as a sound practical experience of how to set up and manage an Employee Ownership Trust in practice.

Overall, I would highly recommend Postlethwaite's to any business owner looking to set up an Employee Ownership Trust or to any other Employee Incentive arrangements."

Stuart Hinnigan, Director, Scott & Wilkinson Accountants

We have worked closely with Postlethwaite Solicitors for many years and more recently on several EOT transactions. They are always responsive and timely in dealing with both us and our clients, and their advice is always clear, particularly when discussing some of the more technical tax issues. David Reuben is a pleasure to work with. He always goes above and beyond, and overall we consider the team at Postlethwaite Solicitors to be experts in the Employee Ownership field"

Anthony Rose, Partner, Private Clients & Dispute Resolution at Simmons Gainsford

The firm has great technical knowledge and can provide really useful and helpful advice. They were always very prompt to reply to any questions that were being raised."

Chambers & Partners research 2024

Wonderful support, professional service and on time delivery – exactly where you need to go for an EOT transaction."

Atal Malviya, Director, Concepto Diagnostics

Many thanks to David, Toby and the team at Postlethwaite for their impressive work on completing our EOT. Highly efficient and very easy to work with, they made the whole thing painless!"

Simon Mellinger, Managing Director, Hattons of London

Notes

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Meet the Postlethwaite team

We are 100% employee owned ourselves, regulated by the Solicitors Regulation Authority (SRA), and have top firm and lawyer rankings for several consecutive years with Law Guides, Chambers & Partners and Legal 500.

You can therefore be sure you're making the right decision when choosing to work with us.

THE SOLICITORS

Robert Postlethwaite
Partner and Managing Director

Robert set up Postlethwaite in 2003. He's the author of 'The Employee Ownership Manual' written and independently published and top tier ranked for 16 years by Chambers & Partners.

David Reuben
Partner

David has worked at Postlethwaite since 2010. He is an expert in share schemes and employee ownership transitions. He has been top tier ranked for 14 years by Chambers & Partners.

Toby Locke
Share Plans Director

Judith Harris
Senior Solicitor

Jo Cunningham
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