

## Creating an Employee Ownership Trust

**When our client, Mark, wanted to sell his company while protecting the future of the business and his employees, an Employee Ownership Trust was the perfect solution. He approached our Corporate Commercial & Finance team to guide him every step of the way.**

### Our Challenge

An Employee Ownership Trust (EOT) is an increasingly popular structure for SMEs owned by entrepreneurs looking to sell their business without it losing its identity to private equity or a larger trade buyer. Introduced by the government in 2014, an EOT is created specifically to hold shares in a company on trust for its employees, so that they become the (indirect) majority owners of the company.

The benefit for the company's employees of an EOT is that, once Mark has been paid his cash, the future profits of the business will ultimately belong to them, giving them a strong incentive to make it a success. The most famous employee-owned company is John Lewis, and it is a shining example of how employee ownership can drive the success of a business. A sale to an EOT means no third-party buyer needs to be found, and an EOT also has material tax advantages: the owner pays no tax on the sale to the EOT, and the employees are able to receive (income) tax free bonuses in the future (capped at £3,600 per year. While there is no income tax, national insurance is still payable).

However, creating an EOT is not straightforward. Such generous tax reliefs come with a significant amount of legislative conditions, and the sale requires considerable specialist expertise to make sure it satisfies all the requirements while still being commercially viable. In particular, as there (usually) is no third-party injecting funds, the proceeds typically have to be extracted out of the company itself. This requires careful structuring, as the payments will be over many years.

### Our Work

The process was led by our corporate and tax experts who worked in parallel on two key elements of the transaction. Firstly, the company sale and secondly, creating the EOT, providing the necessary tax advice and making the required amends to the corporate documents such as the Articles of Association of the target company.

For the company sale, the key requirement was to draft a share purchase agreement with bespoke seller protection provisions (because EOT legislation does not let the seller take security for deferred payments of consideration over all of the shares sold).

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At all time sit was crucial that our experts worked closely together to ensure their work and advice complemented the others working on the transaction. We also needed to work through with the client all of the commercial ramifications and help them to decide how to best to address them.

For example, we have already alluded to the fact there is a significant risk for sellers in establishing an EOT, because consideration is typically paid out of a company's future profits (occasionally accelerated with bank lending), meaning a seller can't walk away immediately following the sale with their full consideration - they need to trust the business to succeed for several years and generate enough profit to eventually pay them out.

In this case, Mark would no longer be the controlling shareholder during this period. The EOT must always act in the best interests of the employees (not Mark), and Mark could not take security over all his sale shares.

There is therefore a risk Mark may not receive future payments, and it is vital that his interests are protected. So our advice and experience was crucial, during what was a highly stressful but exciting time.

## Our Impact

We were able to establish the trust and sell the company to it within 5 weeks of instruction, on the day we had originally earmarked. Achieving this deadline helped align the sale with the target company's year end.

Ultimately, we were able to ensure the entire process was as smooth as possible, during what must be a highly stressful but exciting time for Mark. As he says,

*"I found the team at KN to be enormously efficient, professional and knowledgeable. Their combined assistance ensured what proved to be a successful and event-free transaction."*

## Get in touch

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