Employee Ownership Trusts: A Summary

The HMRC Open Consultation on the Taxation of Employee Ownership Trusts and Employee Benefit Trusts has just closed as at 25 September 2023 and includes a portion dedicated to the examination of Trustee Tax Residency – particularly the use of Non-Resident Trustees for Employee Ownership Trusts (EOTs).

By **Paul Harvey**, 18th October 2023

This Article briefly summarises the potential advantages of an Employee Ownership Trust ("EOT"), and why the use of an Isle of Man Trustee could be beneficial.

We have a far more detailed Article on this topic, if you require additional information: Employee Ownership Trusts: An Introduction.

HMRC Open Consultation

Any discussion regarding EOTs with Non-Resident Trustees must start with reference to the HMRC Open Consultation on this subject, which closed on 25 September 2023. The current rules leave the potential for a Non-Resident EOT to escape UK Tax liability regarding onward sale to third party purchasers. Whilst there is no evidence of widespread offshore EOT abuse, HMRC feel that some refinement of these rules is required.

Although we eagerly await the outcome of the Open Consultation, we thought it would be a good opportunity to revisit the basics of EOTs, their advantages and underline the value that a properly licensed and regulated Isle of Man Trustee can add to bona fide EOT planning.

1. What is an Employee Ownership Trust and Why Use One?

An EOT is a method of facilitating the employee ownership model and involves transferring ownership of a business into a Trust for the long-term benefit of all Eligible

Employees.

The UK Government has incentivised transferring a business to its employees via an EOT with notable tax exemptions for the exiting owner. Under an EOT, majority shareholders can sell greater than 50% of the share capital to the Trust, receiving tax-exempt proceeds.

The circumstances and objectives of both the exiting owner and the business will typically determine whether an EOT is an appropriate solution. Common drivers for EOT planning include; where private owners are considering succession planning, to support growth plans and/or upon initiating a new venture.

EOTs should not be viewed merely as tax-planning tools. Their establishment should genuinely benefit the ongoing success of the business and its employees. The holistic benefits are explored in the next section.

2. What are the Advantages of an Employee Ownership Trust?

The most prominent benefits are divided into three main categories, as detailed below;

i) Benefits for the Business

Studies and real-world case studies have shown that employee ownership leads to enhanced trading performance.

Key outcomes for the business include:

- Lower Absenteeism
- A Happier Workforce & Increased Staff Wellbeing
- Lower Staff Turnover and therefore reduced expenses in areas like recruitment
- Faster Employment Growth

- Increased Productivity

- Better equipped to handle challenging market conditions as the workforce has an ‘owner’s mindset’

- No third party acquisition, therefore the existing culture, values, and operations are preserved

- Acts as a natural catalyst for succession planning

ii) Benefits for Owners

Exiting owners have compelling incentives to sell to an EOT, chiefly the potential for a Capital Gains Tax exemption on the disposal of their shares (a saving of up to 20%).

An internal sale process, through an EOT, also offers numerous practical advantages:

- No need to find an external buyer

- The sale price aligns with an independent market valuation, avoiding lengthy third-party negotiations

- Pre-determined Sale and Purchase Agreement offers opportunity to tailor terms

- Involving employees in the transition process, especially incoming Board Members, ensures a seamless handover

- Transitioning to an EOT acknowledges the workforce’s contributions and preserves the owner’s legacy

iii) Benefits for Employees

All Eligible Employees benefit from the company shares, held in their name, through the EOT. As such, EOT-owned businesses offer both financial and non-financial advantages to their employees.

Employees can access a tax-free bonus of up to £3,600 annually.

Beyond the bonus, Eligible Employees have a voice in the business and can benefit from future profit-sharing once the EOT's funding commitments are met. This longer-term financial incentive means employees can benefit from the business' growth, driven by improvements in their increased engagement and commitment, in turn leading to greater trading performance.

3. Why Use an Isle of Man Trustee for your Employee Ownership Trust?

Professional Trustee Option for Employee Ownership Trusts:

Selecting a Professional Trustee for your EOT fundamentally addresses various concerns related to trust management and risk mitigation; we consider the pros and cons of Lay and Professional Trustees in this separate article.

The general issues regarding the appointment of Lay Trustees include lack of Trust expertise, conflicts of interest, the administrative burden of meeting obligations, the requirement to be objective and independent in the exercise of their duties and a need to maintain a legal and regulatory awareness.

Choosing a Professional Trustee removes all of these pitfalls and safeguards the EOT from potential mismanagement and legal non-compliance.

Isle of Man Professional Trustees for Employee Ownership Trusts

As at time of writing, no Inheritance Tax (IHT) charges arise, on the transfer of the exiting owner's shares to an EOT, and the EOT is also exempt from the IHT Relevant Property Regime. Even where the exiting owner, company and employees are UK Tax Resident Domiciliaries, there is currently nothing to prevent the use of Non-Resident Trustees. In fact, there can be very compelling non-tax reasons for choosing Non-Resident Professional Trustees, such as those located in the Isle of Man. However, it is important to acknowledge that each case needs to be considered on its own merits – as with all

things Trust related, one size does not fit all.

Isle of Man Trustees, such as Dixcart, are required to be licensed under the Financial Services Act 2008 and the Regulated Activities Order 2011, ensuring consistent regulatory oversight by the Isle of Man Financial Services Authority. This oversight assures clients that these trustees adhere strictly to best practices in their EOT obligations. Comparatively, UK Professional Trustees require no Licence, and their Trustee services are not regulated.

The Isle of Man is globally recognised as an exemplary international financial hub, boasting a stable political, economic, and regulatory landscape. With deep roots in intricate Trust and Corporate planning, the Island's financial services sector is populated by seasoned professionals.

The Isle of Man and UK are separated by the Irish Sea, meaning Isle of Man Professional Trustees are truly independent from the EOT-owned UK business. However, The Isle of Man's proximity and transport links mean that Trustees can promptly attend crucial UK meetings, offering an ideal blend of autonomy and accessibility.

4. How Can Dixcart Help with Employee Ownership Trust Planning?

Dixcart Isle of Man have been assisting with owner-managed businesses, complex Trust arrangements and intricate employee share ownership structures, for over 30 years – therefore, we are exceptionally well placed to assist with Employee Ownership Trusts.

By leveraging Dixcart's expertise and quality focused services, we can; deliver an effective bulwark between the business and its ownership, providing checks and balances on the business, assurance against conflicts of interest and ensure that the rights and interests of the beneficiaries are always the first priority.

Get in Touch

If you would like to discuss how our Professional Trustee services can augment your Employee Ownership Trust planning, please feel free to get in touch with Paul Harvey at Dixcart: advice.iom@dixcart.com

If you'd like to read more on this topic, in greater detail, it's available here: Employee Ownership Trusts: An Introduction.

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