

BRIEFING: EOA POLICY CONSULTATION

2023

Introduction

In the EOA's policy and advocacy work, it is vital to ensure that we are accurately representing the true interests of our members and the employee owned (EO) sector. So that this work is relevant, we have consulted extensively with our member and advisor network to better understand their priorities for employee owned businesses (EOBs).

These priorities fall into three key areas:

- > Employee Ownership Trusts
- > Supporting transitions and best practice
- > Unlocking the Potential of EO

The following summary outlines the insight, experience, and expertise emerging in discussions with members and other key stakeholders, particularly across three roundtables held in June/ July 2023 corresponding to the above themes.



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1. Employee Ownership Trusts



A [government consultation on Employee Ownership Trusts](#) (EOTs) was announced at the end of April 2023. EOTs have been instrumental in the exponential [growth of the employee ownership sector in recent years](#), and the majority of transitions to EO are now through EOTs.

For this reason, members and advisors have prioritised a strong response to this consultation, and further engaging with government on EOTs to ensure that the model's integrity and value is sustained in the future.

Consultation outcomes – EOTs:

It is a priority for members for the EOA to coordinate a strong response to the 2023 government consultation on Employee Trusts. The EOA has been called on to publish guidance to members in responding, submit our own response on behalf of the sector, and engage further with HMRC as far as possible.

Our response to the consultation, and any future advocacy work around EOTs, must prioritise the following points:

- Ensuring the CGT exemption, a powerful incentive for transitions and essential for the sustained growth rate of the EO sector, is maintained.
- As well as maintaining the CGT exemption, proactively advocating measures that can ensure it is only used for its intended purpose of supporting transitions to EO.
 - To support this, a consensus has emerged that the option for offshore EOTs presents an unacceptable risk to the integrity of the EOT model.
 - There has been a strong preference for the EOA to support the inclusion of employee representatives on the trustee board, although others have been concerned that rigid trustee requirements may disincentivise some transitions.
- The EOA must consider sustaining the value of the employee benefit as a long-term priority in policy and advocacy work.
- The EOA must continue to work with advisors to identify any barriers arising from technical elements of the EOT and its rules that may present barriers to transitions (or unintentionally put existing EOBs into accidental non-compliance) and engage with HMRC to address these.

1.1. Tax advantages

a. The relief on Capital Gains Tax (CGT) for an owner selling a controlling interest of shares to an EOT

EOA members and advisors have emphasised the importance of this relief in the EO sector's growth. It is considered vital for the continued growth of the sector.

Some concern was expressed by advisors that, in difficult economic circumstances, the revenue impact of the CGT exemption may be scrutinised by HMRC, which may lead to potential reductions or onerous additional protections being applied. Related to this, concerns were also raised that small number of businesses may use the EOT model in order to take advantage of this relief, but not meaningfully embed EO into a business, thereby damaging the integrity of the EO model overall.

It has become increasingly clear to members and advisors, particularly following the announcement and publication of the consultation of EOTs, that protecting the model from unintended use is a priority for government.

It is clear, from the above, that the EOA community prioritises preserving the reputation and integrity of the EOT model. A consensus has emerged that the EOA must have a role here by proactively proposing measures to protect the model from unintended use; these are outlined below.

b. Payment of income tax free bonuses to employees of a company owned by an EOT, up to £3,600.

The bonus is regarded as key to the spirit and success of the EO model, as a means of employee owners sharing in a business's success, and a way of incentivising staff engagement.

The government had originally expressed intention to review this incentive within five years of the introduction of the EOT in legislation in 2014. Now, almost a decade on from the introduction of the EOT, the value of the maximum bonus would sit at over £4,700 (as of July 2023) had it been adjusted in line with inflation. For many employee owners, particularly in the context of an ongoing cost of living crisis, this is a substantial difference with significant financial implications.

During our consultation, the EOA asked whether an uplift to the bonus would be a priority for employee owned businesses and their employee owners. There has been some contention as to whether this is would immediately be feasible, but there has been general agreement that the value of the bonus must be maintained.

This is therefore a long-term priority for the EOA, and will be reflected in our response to the government EOT consultation, and our advice to members.

1.2. Integrity

Preserving the integrity of the EOT as a model is a key concern, particularly considering HMRC's intention to prevent its use "for unintended tax planning". The following measures were discussed with the EOA community and have been identified in the government consultation:

a. Employee Ownership Trust tax residency

Some EO advisors have raised concerns that the option to establish EOTs offshore may make the model vulnerable to use by vendors seeking to access the CGT exemption without authentically embedding EO in the business. More specifically, advisors are concerned that CGT does not apply to the onward sale of a business from an offshore EOT (compared to an UK-resident EOT, where the full CGT exemption would be clawed back from the trust if sold out of employee ownership.) This may, in worst cases, enable the EOT to be used in a predetermined arrangement to dispose of the company to a third party without suffering the Capital Gains Tax that would otherwise be due.

This concern has also been raised in the government's consultation, resulting in a proposal to make it no longer possible to "establish a qualifying EOT that is non-UK resident for tax purposes, whilst still allowing scope within the EOT rules to appoint non-UK resident trustees."

However, some EOA members and advisors raised various examples of best practice EO being embedded into businesses owned by offshore EOTs. Reasons that a company committed to 'good EO' may opt for the offshore model include the flexibility it offers businesses in the event of an onward sale, to avoid the clawback of the original vendor's CGT relief. It has also been suggested that access to professional trustee markets available outside of the UK may make offshore EOTs an advantageous option.

Based on the consensus of advisors and members we welcome the above government proposal as a way of protecting the EOT from potential misuse, by preventing it from being used for the CGT-free disposal of shares in a pre-arranged disposal of shares.

b. Trustee board composition

A great deal of feedback during our consultation raised the importance of trustees in meaningful employee ownership, and this has again been reflected in the government proposal to "prohibit former owners [from] appointing themselves in control of the EOT trustee board." The input of advisors has demonstrated that this aligns with current best practice, as allowing former owners and connected person to control an EOT board may present a conflict of interest and be contrary to meaningful employee ownership.

Respondents also discussed whether it would be appropriate to require employee and/or independent trustees to be included on EOT boards. It was agreed that both these trustee types should be included as best practice, but there was debate as to whether this should be made an explicit requirement, although the idea of an employee trustee being required was more widely favoured. Related to this question, government's current EOT consultation also seeks views on whether "government [should] go further and require that the EOT trustee board includes persons drawn from specific groups, such as employees or independent persons," the EOA will also be considering input from members and advisors on whether and how this will be appropriate in submitting our response.

2. Transitions and embedding best practice



A strong support ecosystem has been built over many years in the EO sector, enabling transitions to EO and supporting existing EOBs to embed best practice. This includes, but is not limited to, public bodies providing support for transitions in Scotland and Wales, advisors and specialists, peer-to-peer learning through the EOA network, and the EOA's learning resources.

Research so far suggests that best practice is generally strong across the EO sector. The following two points came out of the White Rose Centre for Employee Ownership's EOT survey in 2022

- > Governance – 97% of EOBs have at least one form of employee governance, 74% have at least two.
- > Involved and informed – 90% of EOBs report that employees have some or a lot of say in decisions on working conditions, 85% have some or a lot of say in new working methods. 75% of businesses share financial information at least several times a year and a further 21% share it at least annually.

Engaging with members has suggested that continuing to develop the support ecosystem and ensuring best practice should be a key priority for the sector and for the EOA.

Consultation outcomes – Transitions and embedding best practice:

While the existing support eco-system is strong, the above demonstrates that further development is an existing priority, a few actions arise out of this:

- > Government and local authorities should better signpost to existing guidance around transitions to employee ownership.
- > Combined and local authorities should review the Ownership Hub as a template programme for delivering transitions to employee and worker ownership.
- > Government should review the evidence of success from organisations like Cwmpas and CDS in supporting transitions, and consider how this might be built on and replicated in England and Northern Island. In connection to the above, supporting regional and local Ownership Hubs to provide similar services as part of the Levelling Up agenda is one approach that might be taken.

To support this, the EOA can take forward several actions, including:

- > Advocating for the above actions from government and others on behalf of the sector, and where necessary collaborating on stakeholders around delivery.
- > Continue to develop learning resources and materials.
- > Work with the sector towards a clearer definition of "Good EO"
- > Bringing the previous two actions together, coordinate existing and new materials and resources to establish a clear framework around "Good EO" – this framework should be based around putting the principles of Good EO into practice, with meaningful examples of practice and clear parameters for how practice can and should be adapted. We look forward to the launch of the Knowledge Programme in October 2023, which should support this with a repository of best practice identified by researchers, and a toolkit for EOBs to assess their own practice.

2.1. Supporting transitions

Members have been positive about the support available when transitioning to EO. Particularly at the roundtable on this topic, attendees emphasised the importance of advisors in transitioning, although members offered mixed accounts of when advisors were brought into this process. In some cases, a great deal of initial research was done before contacting an advisor to reduce expected costs – in these situations, initial conversations and the informational content released by the EOA and others were welcome.

The EOA's membership network has also been put forward consistently as key asset for transitioning businesses and new EOBs. It reportedly offers peer-to-peer learning from those "further ahead" in their EO journey. This is especially useful when businesses can engage with others of similar size and sector. Feedback suggests that the EOA may be better able to leverage this network, by creating sub-groups, communities, and further spaces for focused discussion within the EO community. This is something that the EOA is now exploring, as we are developing our approach to engaging with members.

Capacity is one of the key challenges with transitioning and new EOBs consistently raised. This includes capacity to carry out the transition itself, which can be a time-intensive process, and include a "tidal wave of legal documents", as one participant put. The second challenge arises around embedding EO from the transition onwards. Learning was considered key to address this, and members expressed interest in receiving greater assurance that the approaches they are using to embed EO reflect best practice.

2.2. A "Good EO" Framework

A shared understanding of the definition of "Good EO" and best practice have been put forward as key for the sector; for unlocking its economic benefits, and for advocating on its behalf. Defining "Good EO" is considered now more important than ever before, with the growth of the sector over the last decade.

While the need for best practice has been emphasised consistently, members and advisors have also expressed strong aversion to rigid standards being enforced on the sector, praising the EO model's flexibility as one of its greatest strengths. This has been apparent in consistent opposition to ideas of government intervention, and in reference to accreditation. Instead of a set of arbitrary standards, respondents welcomed the idea of a general framework around "Good EO." Members expressed interest in having established boundaries, parameters, principles and goals representing best practice. Emphasis was placed on the importance of "concrete examples," demonstrations of how the principles of EO could be practically adopted, and clarity on how practice can be adapted to an EOB's individual circumstances.

Feedback suggests the need for a strong focus on principles, and how each stakeholder is responsible for or can contribute to these. The format for delivering this "framework" should be flexible depending on the stakeholder in question. This may encompass learning activities and opportunities, such as our EO Learn courses. It may also include case studies, and other fixed resources that demonstrate examples of best practice.

Existing resources and activities have been praised, particularly in the context of limited government guidance (compared, for example, to a CIC, where government has guidance on how to set up). But it has been suggested that there could be further development to bring these together into a coherent framework. Various members and advisors have expressed the sentiment that there is content, advice, and learning that remains "hidden." Additionally, several policy areas were identified where the EOA might support the healthy development of the sector by coordinating notes of best practice (or similar), such as on valuations, and employee governance.

Overall members suggested that the EOA must be more proactive in defining "Good EO" and coordinate the sector in explicitly demonstrating how this can be achieved by individual businesses and the sector overall. The EOA must also continue to work with other stakeholders to signpost to relevant content and information and ensure that it is accessible.

3. Unlocking the Potential of EO



One of our aims in consulting with members has been to establish the key areas of economic policy that impact existing EOBs. While legislation and programmes exist to support transitions to EO, there is currently little to support existing EOBs.

Given the potential that the EO model has for businesses, employees and the wider economy, the EOA has considered it a priority to identify any barriers to unlocking this potential, and policy solutions to those barriers.

Consultation outcomes – Unlocking the potential of EO:

The EOA must amplify the sector’s voice and form meaningful relationships with key stakeholders to support anchoring EO in the economy. This can be understood as encompassing three areas:

- › Raise general awareness.
- › Demonstrate evidence for the sector’s value. The emerging Knowledge Programme, to be published in October 2023 will form an essential part of this narrative by providing hard econometrics.
- › Engage with government, decision makers, institutions and other key stakeholders on the [practicalities](#) of working with the EO sector. This may include specific initiatives that might target the sector, or necessary changes to an institution’s policy or public policy that can further include the EO sector.

Members have welcomed being engaged on these issues, and the EOA should continue and build on this practice. Organising the membership network around specific industries and issues will be key to developing this.

Finally, a number of specific policy asks have emerged that can be put to government. Some of these have been identified above, when they relate to EOTs or Supporting Transitions. Others include:

- › A return to previous practice of identifying a Cabinet Minister with responsibility for EO.
- › Set UK-wide targets for growth of the EO sector, building on existing targets set for Scotland.
- › HMRC, other relevant government departments, and combined and local authorities should work with the EOA to signpost to existing learning resources on transitioning to and embedding EO.
- › Government should explore options to enable EOBs, and other forms of mutual business, to raise capital without risking dilution of the ownership model. Recent international examples of this include the use of Mutual Capital Instruments in Australia.
- › The British Business Bank should be leveraged as a patient lender for EOBs.
- › Review whether UK legislation might be reformed to permit Mutual Guarantee Societies, to support EOBs, and other SMEs, in accessing capital.
- › Introduce specific statutory and non-statutory guidance for public procurement processes to integrate proper weighting for EOBs, aligning with evidence of social value impact. Similar weighting should apply to the awarding of grants.

It has also become clear that many of the policy issues facing EOBs are not specific to the EO model and may relate to scale (i.e. that most EOBs are SMEs), industry, or may apply to “alternative” business models more widely. Therefore, in developing the above asks, the EOA will be working with partners to identify shared platforms and priorities.

3.1. Anchoring EO in the economy

Through engaging with members, partners, advisors and other key stakeholders, the EOA identified a number of policy areas where EOBs may be facing problems and barriers. These included finance, procurement, equity, taxation, public procurement, as well as other issues.

A consensus emerged that issues relating to these areas are generally linked to wider awareness and understanding of EO and its impacts in government, in institutions, amongst other stakeholders, and the wider public. One respondent reflected on this sentiment in the roundtable, stating that “everything else follows out of awareness.”

Extensive discussion was had on this. Firstly, it was generally felt that EO is still not a well-understood business model or segment of the economy, although there has been improvement here as the sector has grown over the past decade. “Spreading the noise wider and further” of how EO works, and its impacts should be regarded as a baseline priority.

It was also noted that this must go further; government, institutions, and key stakeholders must be aware of how EO works in practice, and how they can practically work with the EO sector. Stakeholders identified include – but are not limited to – banks, anchor institutions and public bodies, accountants, and business advisors. Various members have noted anecdotal evidence of difficulties with these organisations, due to a lack of understanding of EO. For example, several cases have been noted of banks threatening the closure of accounts due to a lack of organisational understanding of the EOT structure, which has raised red flags within their checks and processes.

Overall, members and advisors have identified amplifying the EO sector’s overall voice amongst government, decision-makers and other stakeholders as the headline priority here. The EOA has a key role in emphasising this voice, not only demonstrating the value of the sector, but also forming meaningful working relationships around how the sector can be worked with practically.

3.2. Advocating as an association

Through the policy roundtables, and in wider engagement, we have sought the reflections of respondents on how we have gone about consulting with them. This has been to understand how the entire EOA network can work together around policy priorities as an association, and ensure that our policy and advocacy work continues to be relevant and well-targeted.

Overall, the roundtables were welcomed, and seen as an opportunity to ensure the EOA’s voice reflects member priorities. Briefing notes on content, sent out to attendees in advance, were particularly welcomed to inform a productive discussion and contributions.

Several reflections were offered on how roundtables and similar activities might be built on. It was also generally welcomed that a number of perspectives were represented at the roundtables, from EOBs, to advisors and supporter members, and technical experts.

Roundtable participants also suggested generally preferring discussion-based methods of engagement, such as roundtables, focus groups and one-to-one discussions, compared to surveys. If surveys are to be used, it would be preferred for these to be short and with very specific focuses.

Emphasis was placed on the importance of continuing to develop the membership network and incorporate it into policy and advocacy work. With the formal creation of the EOA’s policy function and its growing work in this area, the EOA continuing to take a more active role in facilitating discussion between members on key issues was welcomed. It has been suggested that future engagement with members might be coordinated with greater specificity; sub-groups or “vertical communities” based on industries/sectors, roles, or areas of interest have been suggested for this.