



Assets and Residence Team
HM Revenue and Customs
100 Parliament Street
London
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21st September 2023

To whom it may concern,

I am writing on behalf of the Employee Ownership Association (EOA) in response to the **HMRC consultation on the Taxation of Employee Trusts**, closing on 25 September 2023.

The EOA has strongly welcomed this consultation and the relevance of the associated proposals. We also note the recognition in the consultation document of the success of employee ownership as a business model over the past decade, and the importance that the EOT has had in unlocking this success.

The powerful positive impact that employee ownership has on businesses, employees, and the wider economy (and by extension, the strong economic value of the EOT) will be evidenced in the EO Knowledge Programme – a groundbreaking piece of research into the employee owned sector commissioned by the EOA and delivered by independent think tank Ownership at Work – when the findings are released on the 18th October 2023. We note and appreciate the engagement that the consultation leads and other members of HMRC have had with this research in the run up to its release.

About the EOA

The EOA is a not for profit, politically independent organisation that represents and supports the development of the employee ownership sector. We work to support UK employee ownership to become more successful and to demonstrate its strong impact both for people and the economy. The EOA connects its 750+ members with learning and support and works closely with them to champion the sector by sharing their insights, expertise and best practice.

Since the announcement that there would be a consultation on EOTs on Tax Administration and Maintenance Day in April, we have been working with our member and advisor network to co-produce a meaningful set of shared priorities for the employee owned sector.

The following response reflects these shared priorities.

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Our responses:

1 Do you have any comments on the proposal to prohibit former owners and connected persons from retaining control of an EOT-owned company post-sale by appointing themselves in control of the EOT trustee board?

Although in some cases it may be advantageous for former owners to be involved in an EOT Trust board, it is correct that they should not have majority control. If a former owner is permitted to maintain majority control of the EOT Trust, then this may lead to conflicts of interest and present a barrier to meaningfully embedding employee ownership into the business.

Therefore, we agree with the proposal that former owners and connected persons should be prevented from being the majority of a Trust Board. We note that this change would formally bring legislation in line with existing best-practice.

2 Should the government go further and require that the EOT trustee board includes persons drawn from specific groups, such as employees or independent persons? If so, how should these groups be defined?

Regarding composition of the EOT trust board, best practice tends to include a mix of trustees, typically comprising of at least one independent and at least one employee trustee.

It is thought that both these types of trustee can provide a great deal of value in meaningfully embedding EO into a business. However, concerns have been raised that placing specific requirements on these trustee types may present practical challenges, at least if not approached with care. These concerns are:

- ***Independent trustees*** – although independent trustees offer a great deal of experience and expertise in running a trust board, there is a cost attached to including these trustees. Making a rigid requirement of this type of trustee will place a disproportionate burden on SMEs that are EOT-owned.
- ***Employee trustees*** – Again, employee trustees offer a great deal of value when it comes to meaningfully embedding employee ownership. However, it is important to note that the statutory duties involved here are significant and it has been reported that employees can be reluctant to volunteer for this role, particularly recently after a transition to employee ownership. Furthermore, where an employee trustee leaves the business, it may not be possible to replace them immediately, particularly if it is necessary to provide training to ensure that employees are able to effectively fulfill the role of trustee.

Based on the above, it is appropriate to require that at least one employee representative will be included on the trustee board, and that this trustee should not be a company director. However, such a requirement should aim to avoid well-meaning employee owned businesses finding themselves accidentally non-compliant. If employee trustees were to be required, it may be necessary to stipulate, for example, that the requirement will only apply one year after the transition to EOT. It would also be appropriate to provide a grace period for companies who need to replace existing employee trustees, to afford appropriate time to identify a suitable replacement, and provide any training necessary.

Conversely, we suggest that it would not be appropriate to require independent trustees in the composition of the EOT trust board. Instead, independent trustees should be promoted through best

practice guidance.

3 Do you have any comments on the proposal to require that the trustees of an EOT are UK resident as a single body of persons?

We accept HMRC's proposal to require EOT trustees to be UK resident as a single body of persons. We also welcome the scope this proposal allows for non-UK resident trustees to be appointed alongside UK resident trustees.

It should be noted that there are various examples where meaningful (and in some cases best practice) employee ownership has been embedded into businesses owned by offshore EOTs. Such businesses may have had a number of legitimate reasons to transition to employee ownership through an offshore EOT.

However, despite the examples of good employee ownership in businesses owned by offshore EOTs, we accept HMRC's concern that the availability of offshore EOTs does open the CGT relief to misuse by actors seeking to dispose of shares without meaningfully transitioning to employee ownership. We note that we are not aware of any evidence that this misuse occurs beyond a few anecdotal examples, compared to the 1000+ EOT controlled businesses that currently exists, but in the interest of preserving the model's integrity as a lever to encourage meaningful transitions to employee ownership, HMRC's proposal is fair and reasonable.

4 Do you have any comments on the proposal to confirm in legislation the distributions treatment for contributions made by a company to an EOT to repay the former owners for their shares?

The current arrangements around contributions made by a company to an EOT to repay former owners for shares, where tax clearances are sought from HMRC to avoid income tax from being applied, has often been discussed. Previously [the 2021 CIOT submission on EOTs to the Autumn budget](#), which was supported by the EOA, has reflected that this arrangement creates unnecessary costs for both HMRC and the companies in question.

We therefore agree with the proposal that legislation should confirm that such contributions would not be treated as distributions, provided that the consideration does not exceed the open market value for the shares.

5 Do you have any comments on the proposal that HMRC stops giving clearances on the application of section 464AA of the Corporation Tax Act 2010 to the establishment of EOTs?

We have no objections to this proposal.

6 Should the EOT bonus rules be eased so that tax-free bonuses can be awarded to employees without directors necessarily also having to be included, and would this undermine protections which ensure that bonus payments are not abused or weighted towards some employees?

Some concern has been expressed that awarding employees the tax-free bonus, without awarding directors, may undermine the "all-employee" principle around employee ownership. However, we acknowledge the difficulties that HMRC have pointed out in the consultation – particularly in cases where a group has a subsidiary with one employee who is a director, or a small enough number of employees that the office holder requirement is not met.

We note a lack of clarity in the wording of this proposal.

If the proposal intends that a company not including directors in the tax-free bonus requirement will prevent this director from being counted in the office holder requirement, then we accept that this may be a solution to making the tax-free bonus payment easier to administer in cases such as the above example. However, this requires clarification.

Furthermore, to protect the spirit of the “all-employee” principle around the EOT model, further options should be considered for how the officeholder requirement might be altered to make the EOT bonus payments easier to administer.

7 Do the EOT bonus rules create any other unintended consequences or challenges in administering the tax-free bonus payments?

We are not aware of any other unintended consequences or challenges.

8 In addition to the reforms proposed at Chapters 4 to 6, do you have any views on ways the EOT tax regimes could be reformed to better support employee ownership?

We have two recommendations:

8.1. Excluded participators; share classes

“Participators” (individuals owning or entitled to more than 5% of a company’s share capital) are excluded from any benefit on a future sale of an EOT owned company. Additionally, if Participators make up more than 40% of a workforce a company will not meet the “limited participation” test.

The EOA has been advised that this can be problematic because the test for Participators is based not on 5% of a company’s total share capital, but the right to acquire more than 5% of any share class. Problems may arise where companies, particularly small companies, have different share classes to grant employees share options; for example, where a company runs an EMI scheme it may be likely that individual option holders will have rights to more than 5% of this specific share class, but this may still be significantly less than a company’s total share capital. It has been noted that in some cases, this has created a complete block on companies with EMI options from transitioning to employee ownership via EOT.

8.2. Future-proofing the tax free employee bonus payments available through an EOT

We note that the £3,600 limit on the annual income tax free bonus was introduced in June 2014 and that, since this point, the value of the bonus has declined in real terms; for the bonus to have matched inflation it would now be set at over £4,600. We also note that it was intended for a review of this tax relief to take place within five years of the 2014 legislation, but this review does not appear to have taken place.

We propose that that employee bonus should be uplifted to this value, and that it should be written into legislation that the value of the bonus will be subject to regular review. This will allow the bonus to continue to function as an effective incentive, both for businesses to transition to employee ownership, and for employees to be engaged in that business’s commercial success – unlocking some of the key benefits of employee ownership for businesses.

We also note evidence from the White Rose Centre for Employee Ownership that the average

bonus paid by EOTs is £2,818 per employee per year. This would suggest that an uplift to the upper limit should not place additional strain on tax revenues, but can still act as a powerful incentive for high performing employee owned businesses and employee owners.

Please note that for the section of the consultation concerning EBTs, the EOA has not so far heard concerns from members, advisors, or experts that HMRC's proposals are likely imply negative repercussions for employee owned businesses.

We hope that our response has been helpful in providing context on the experience of the employee owned sector in operating employee trusts. We look forward to reading the outcomes from this consultation in the future.

Yours Faithfully,

A handwritten signature in black ink, appearing to read 'James de le Vingne', with a horizontal line extending to the right.

James de le Vingne
Chief Executive of the EOA