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Employee Share Ownership Trust

Since the demise of Employee Benefit Trusts (EBTs), a new variation of trust has come about, called an Employee Share Ownership Trust (ESOT). They are a tool used to benefit the employees who have helped create the value in the company which is enjoyed by its shareholders. An ESOT provides the employee with indirect ownership of the company through a trust, and can be a great motivational tool as increased productivity means increased profitability.

The advantages are as follows:

- Each employee can receive a bonus of up to £3,600 free of income tax. This must be in addition to their normal compensation. You can differ the amount awarded to each employee, but only for certain reasons. This bonus is still subject to NIC.
- Unlike other trust schemes, an ESOT can be used alongside other employee share option schemes, such as SIPs, EMIs and CSOPs. This further incentivisation could not be done alongside an EBT, and is a real advantage to participating companies. The details of the schemes do differ, for example, any shares granted under an EMI must be made more than 12 months before the sale of the company.
- When you are selling the company, using an ESOT will give a long-term, stable ownership plan. This can be a real benefit if the company has been in a family for a long time and you do not wish to sell to private equity companies or competitors.
- In the tax year in which you sell a controlling interest in the company, you will gain full capital gains tax relief. This is extremely useful as it means the gains on the sale of the company will not contribute towards your lifetime entrepreneur's relief limit (currently £10m). The condition with this is that a controlling interest must be sold in one year, which represents a significant reduction in shares.

There are a few conditions that an ESOT must meet, which are outlined below:

- You must make the ESOT available for all employees. The benefits to certain employees can be differentiated, but there must be a benefit for each employee should they want to join. There are a few exceptions to this rule, including employees who are currently facing disciplinary action or those who have been employed for less than 12 months.
- The ESOT must always retain a controlling interest (+50%) in the company. If interest drops below this then the capital gains tax relief, as described above, will lapse. At this point, the trust is liable to pay that capital gains tax and not the individual who originally got the relief.

There is an argument between having the trust onshore, or offshore. An advantage of an offshore trust is that the Capital Gains Tax exemption cannot be clawed back should interest drop below the threshold. There are, however, higher initial costs of setting up the trust and any directors need to be domiciled offshore.

If you are considering an ESOT, please do call us and we would be happy to discuss the benefits and drawbacks in more detail, as well as some alternatives.

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