PLANNING FOR EMPLOYEE OWNERSHIP TRUSTS 5 TOP TIPS

Corporate and M&A

Planning for EOT

An Employee Ownership Trust ("EOT") is a legal arrangement through which a trustee holds a controlling stake in a company for and on behalf of the employees of a company. Under an EOT, the shares are sold to the trustee in order for them to be permanently held for the benefit of the employees of a company or group of companies. Crucially, the EOT must benefit all employees on equal terms based on certain criteria. The criteria include hours worked, length of service and level of remuneration.

Below are some top tips for shareholders looking to sell to an EOT.

01. PRELIMINARY STEPS

Unlike more conventional transactions, an independent valuation of the company is mandatory when shareholders are selling to an EOT. HMRC Clearance should also be sought. If the transaction is going to be third party funded, discussions around this and the requirements of any lender should be commenced very early on so as not to delay the transaction if the intention is that completion will dovetail with completion of any third party funding.

02. DUE DILIGENCE

Unlike a traditional share sale, the legal due diligence process for an EOT is a lot smaller in scope. The reason for this is that it is acknowledged that the majority of information is already known to the potential purchaser – the Corporate Trustee for an on behalf of the employees of the company.

Although due diligence is not a legal obligation, lawyers acting for an on behalf of the corporate trustee are likely to insist on some due diligence being conducted and will expect to receive enough information for them to be able to advise the corporate trustee and negotiate the transaction documents.

Shareholders looking to sell their company to an EOT can greatly reduce the time, costs and resources needed to complete a due diligence exercise by getting a head start on the process.

As a starting point:

1. All companies house filings have been made and are correctly filed;
2. The company registers and books are up-to-date;
3. The company is aware of its obligations under any share-option or incentive schemes and whether this will affect the transaction.
4. The company is aware of any obligations or notifications arising from change of control provisions in contracts or agreements; and
5. All insurance policies are renewed and valid.

03. TYPICAL STRUCTURE

The most common form of an EOT sale structure is selling to a corporate trustee. A corporate trustee is established by incorporating a separate legal entity (usually a company limited by guarantee). The board of this entity will ultimately govern the trust in accordance with the trust deed and instructions of an employee council.

It is common, particularly in owner-managed businesses, for the selling shareholders to retain a percentage of their shareholding and also a directorship in the target. This can greatly assist the transition to employee-ownership, give confidence to the employees, and often protects existing relationships with clients and supply-chains wary of a change in ownership. Planning the shareholder structure and understanding its impact on internal and external relationships will be key.

04. NAVIGATING EMPLOYEE ENGAGEMENT

Understandably, employee engagement will play a particularly key role in EOT transactions as it is the employees who stand to benefit from the future success of the company. However, the concept of an EOT can be misleading to employees and early interactions and discussions can help alleviate initial fears and rectify common misconceptions. Regular and open discussion and engagement can also help the company understand appetite amongst the employees to be nominated as trustees and/or form an employee council.

05. TAX ADVICE

EOT transactions have a number of significant tax benefits for sellers and employees. However, the rules around the tax treatment of EOT's are complex and it is important to understand the requirements pre and post completion. Specialist tax advice ought to be sought.

Our corporate and M&A solicitors have experience in transitioning business into employee ownership, both with and without third party funding. Please contact Corporate Partner Stuart Mullins (Stuart.Mullins@clarkslegal.com) for further information.

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