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Employee Ownership Trusts

A growing route for selling your business

The Government brought in legislation in 2014 allowing a business owner to give or sell their business to an employee trust completely free of inheritance tax and at a reduced rate of capital gains tax. Many business owners are considering taking advantage of this tax relief.

What are Employee Ownership Trusts?

Employee trusts have been used by employers for a number of purposes to benefit their employees. Such trusts (employee benefit trusts being one example) have been around for a number of years. The UK tax legislation has always given employee trusts tax advantages where they are implemented to genuinely benefit a company's wider employee base.

In 2014, in pursuit of a Government initiative, legislation was introduced to incentivise "indirect" employee ownership of companies through new qualifying trusts – Employee Ownership Trusts or EOTs (indirect employee ownership, by the way, is the ownership of the company via a trust benefiting employees as opposed to the company's shares being owned directly by employees). Initially there was scepticism about the likelihood that these new reliefs would be taken up. It all seemed a little too altruistic – "am I going to give my company away to my employees? Probably not". But business owners have started to realise the advantages of EOTs when it comes to selling their businesses.

It started to become clear that the tax reliefs that were given by the new legislation were available not just for gifts of businesses to an EOT, but for sales of businesses to EOTs at full value.

So not only does an EOT allow a business owner to pass on their business to their employees as a legacy of future employment, it also (and this is what is attracting people) allows the business owner to sell their business to a newly set-up EOT for full value at a reduce rate of Capital Gains Tax (CGT) at 12% and no Inheritance Tax (IHT).

Sale of shares to an EOT – what are the tax reliefs?

Capital Gains Tax relief

From 6 April 2014 an individual (or trust but not a company, note) who gives or sells their shares to an EOT, leading to the EOT having a controlling interest in that company by the end of the tax year which it did not have at the start of the tax year, will have a complete exemption from CGT on the sale/gift of their shares to the EOT. From 26 November 2025, only50% of the gain is now exemption from CGT, meaning an effective tax rate of 12% is applied.

The shares benefiting from this CGT exemption have to be sold to the EOT in the tax year in which the EOT first acquires a controlling interest. A controlling interest for these purposes means the EOT holds more than 50% of the ordinary share capital and the voting rights and must be entitled to more than 50% of the company's profits and assets if it is wound up.

Other conditions that need to be satisfied to qualify are:
The controlling interest requirement: The shares must be in a trading company or holding company of a trading group.

The all-employee benefit requirement: The EOT must be established for the benefit of all employees of the company (excluding, broadly, individuals who hold or have previously held 5% of the shares).

The participating and equality requirements: All eligible employees must be able to benefit from the EOT (the "participation requirement") and they should do so on the same terms if there is ever a distribution from the EOT (the "equality requirement"). In this latter requirement, the company can, to an extent, differentiate on the grounds of salary, length of service or hours worked.

The limited participating requirement: The number of continuing shareholders who are directors and employees must not exceed 40% of the total number of employees of the company or group.

Employee annual bonus exemption

A company owned by an EOT can pay bonuses of up to £3,600 per employee per tax year completely free of income tax (but not NIC strangely) if these bonuses are paid to all qualifying employees on a "same terms" basis.

Potential structure and benefits

There are several ways of taking advantage of the reliefs:

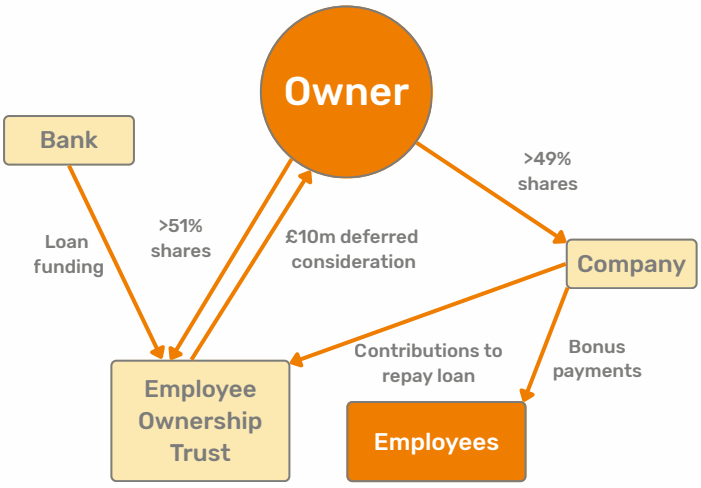
The trustee of the EOT can borrow money from a bank to finance the purchase of the shares;

The company can borrow the money and lend it to the EOT;

The company can borrow the money and contribute this to the EOT;

The seller can sell their shares to the EOT on a deferred payment basis with the sale proceeds due in instalments.

The structure could look like the one in the diagram below:



Tax analysis of the structure	
1. Loan from Bank to EOT	No tax event
2. Purchase price of £10m (on deferred payment terms)	12% tax payable on purchase price of £10m
3. More than 50% of shares transferred to EOT	No tax other than 0.5% stamp duty
4. Contributions to the EOT from profit to cover interest and repayment of capital	Tax relief where related to interest payments but not for repayment
5. Additional payments from profits	Tax deductible if distributed to employees by way of bonus payments
6. Bonus payments to employees	No tax payable on bonuses to employees of up to £3,600 pa (saving income tax but not NICs)
7. Repayment of loan	No tax event

Summary

The CGT benefits for the seller plus the IHT exemption mean that EOTs must be considered by anyone planning on selling their business. Most businesses when sold will currently be able to benefit from the 10% entrepreneurs relief tax rate on the first £1m of gain. But that's still £1.9m tax on a £10m gain on sale. Using an EOT would mean the seller would have no tax on a gain of £10m on selling their shares to an EOT.

To add to the CGT benefit is the benefit to the employees of tax-free bonuses and the chance for a business owner to bequeath the gift of longterm employment to his or her employees.

Who might be interested in an EOT?

Any owner managed business whose owners are thinking of selling their business. This will also be of interest to owners who want to realise some of their capital value from a sale into their EOT.

Because of the nature of their businesses, we think this might be of most interest to knowledge-based companies where the pyramid structure between employees, management and owners is fairly flat. Such businesses as architects, those in advertising, design, publishing, fashion or music, quantity surveyors, management consultancies, healthcare companies, we think will be particularly interested.

But no company should rule it out. We know of printing companies, manufacturing and retail companies that have used it.

Information correct as of December 2025.

Find out more

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