Scottish Enterprise

Co-operative Development Scotland

Taxation and the EOT

13 September 2023

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Who we are, what we do

Co-operative Development Scotland is a specialist unit within Scottish Enterprise, covering Highlands and Islands and South of Scotland.

Provides expert advice on:

- Co-operatives
- Employee Ownership

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What is employee ownership?

Significant ownership by employees

- Trust ownership
- Individual share ownership

Enhanced employee influence

- Employee Council
- Elected employee directors
- Employee Trustees

Employee ownership sector in UK and Scotland

UK

- 1,418 EOBs operating across the UK (as of June 2023)
  - 37% increase on previous year
- Growth due to success of the EOT
  - 90% of all EOBs became employee-owned after 2014 EOT Legislation

Scotland

- 195 EOBs operating in Scotland
  - 146 Scottish-registered EOBs and worker co-operatives have a combined turnover of £691m and employ 5,350 people (as of 31 March 2021)
- Current estimate is around 230 EOBs operating in Scotland
- Scottish Government aspiration: 500 EOBs by 2030

Examples of Scottish and UK EOBs

CLANSMAN DYNAMICS

WH ENGINEERING SERVICES

accord (esi) delivering energy solutions

GORE Creative Technologies Worldwide

Jerba CAMPERVANS

PERTEMPS

GRIPPLE

Scott & Fyfe

INTERNATIONAL chemco PROTECTIVE COATINGS

Aquascot

Aardman

ARUP

richer sounds Experience Better

John Lewis

GUARD archaeology

Go APE

voice TECHNOLOGIES

Aspire Housing & Personal Development Services

MEDIAscape Integrated Audio-Visual Solutions

Golder Associates

hhc

Succession Planning and Employee Ownership Support

Up to 3 days funded support:

- Ownership succession review
- Employee ownership feasibility study
  - Report outlining ownership structures, governance systems, engagement mechanisms and funding options.
- Our specialist advisors can also advise around implementation

Employee Ownership Resources

- CDS web pages: https://www.scottish-enterprise.com/eo
- Social media videos
  - Intro
  - Support
- CDS Blog: https://cdsblog.co.uk/
- Podcast series: The EO Podcast
- Video guide: Could employee ownership be good for your business?
- Video guide: How to sell your business to an EOT)

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Taxation and the EOT

Nick Wright, Jerroms Miller
Richard Jones, ICAEW

13 September 2023

Jerroms Miller
SPECIALIST TAX

Employee Ownership Explained

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Background and Basics

A Brief History

Nuttall Review, 2012, by Graeme Nuttall; https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31706/12-933-sharing-success-nuttall-review-employee-ownership.pdf

Recommendations included:

- Increased awareness
- More guidance
- Simplification of structures

Tax changes implemented in FA 2014

Policy is to promote long-term employee share ownership

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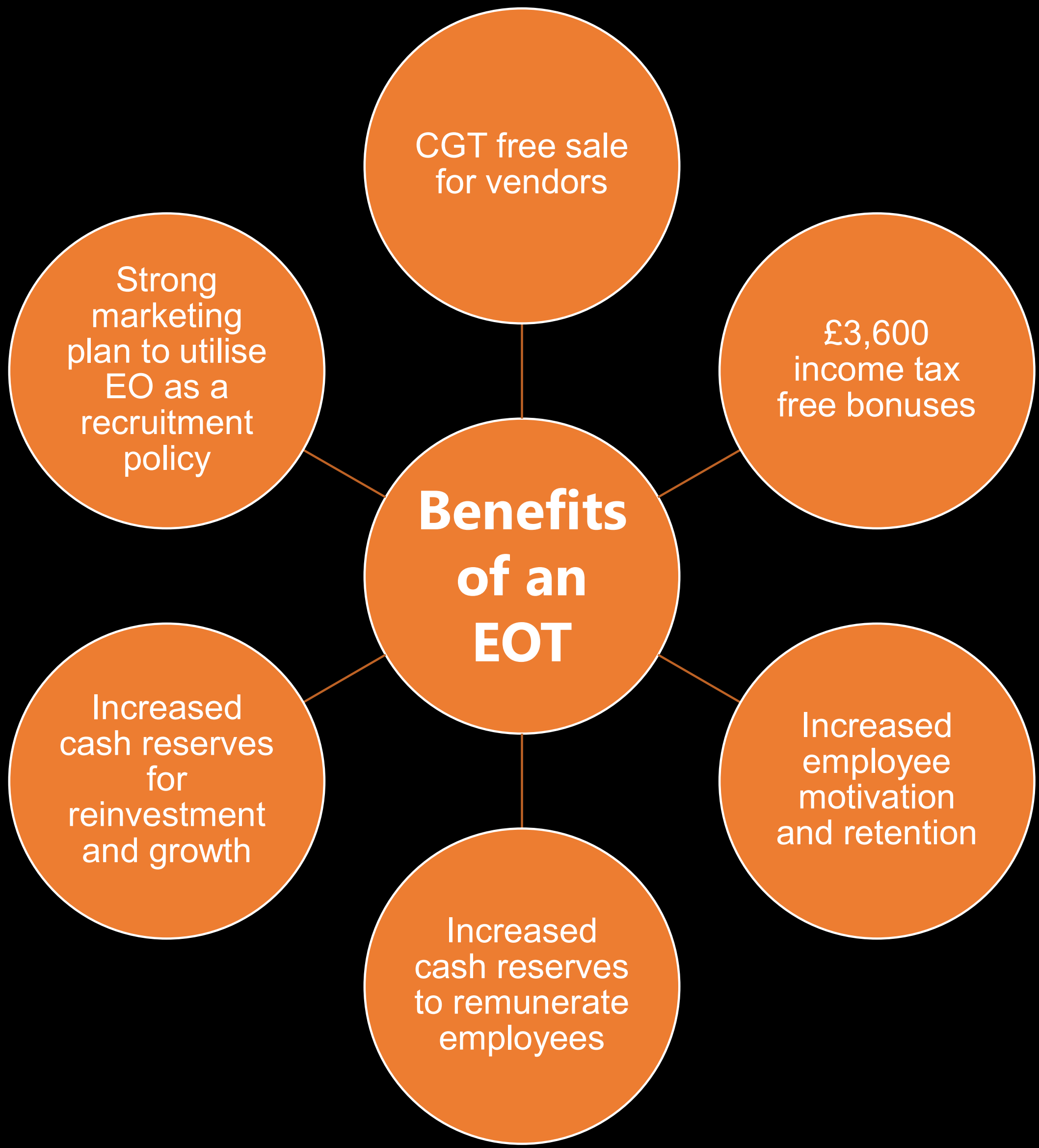
CGT free sale for vendors
Strong marketing plan to utilise EO as a recruitment policy
£3,600 income tax free bonuses
Benefits of an EOT
Increased cash reserves for reinvestment and growth
Increased employee motivation and retention
Increased cash reserves to remunerate employees

Compare and contrast

MBO	EOT
• Vendor can be any legal person • Company can have any business • Must be at market value • CGT at normal rates (inc. BADR) • Relief conditions for CGT straight-forward • Relief is a rollover • Relief is permanent • Clearances available	• Vendor cannot be a company • Company must trading • Can be below market value (TCGA s.17 doesn't apply) • No CGT • Relief conditions complex • Relief is a holdover • Relief can be withdrawn • Clearances available

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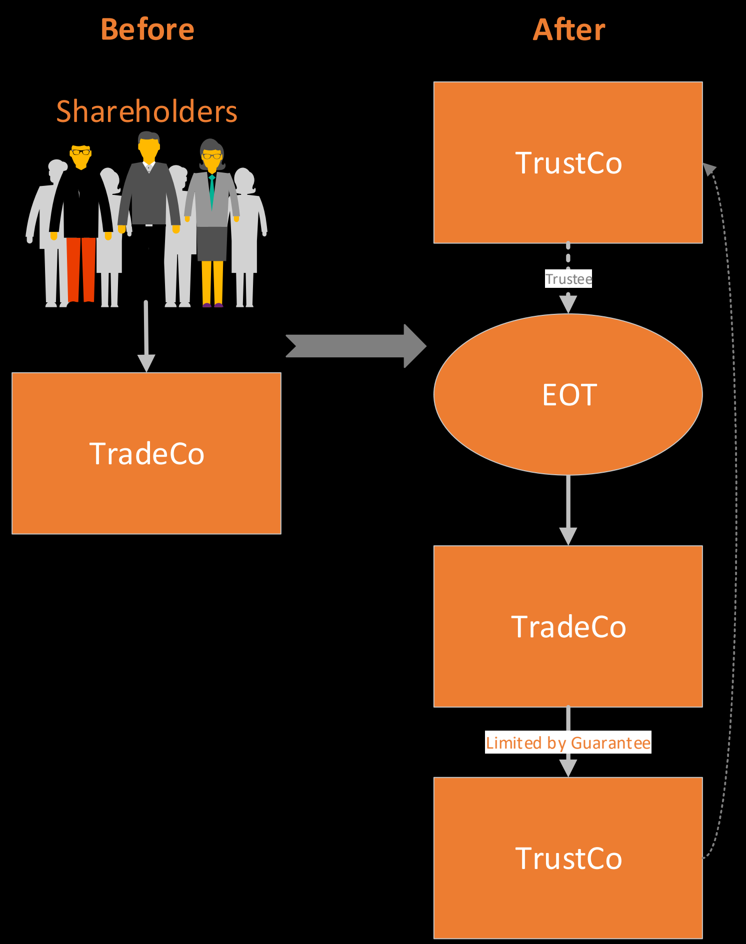
A Typical Structure



Relief Requirements

Relief conditions

Trading requirement

All-employee benefit requirement

Controlling interest requirement

Limited participation requirement

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Trading requirement

Company must be a trading company or principal member of a trading group

i.e. carrying on trading activities whose activities do not include to a substantial extent activities other than trading activities

Trading activities – Income/Expenses/Assets/Management Time

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All-employee benefit requirement

Trust property can only be applied for the benefit of eligible employees and on the same terms (the 'equality requirement')

Settled property must generally be applied for the benefit of all eligible employees equally.

Can be varied by reference to some or all of:

- Remuneration
- Length of service
- Hours worked

Each of these must be applied separately

It is permissible to exclude

- Employees with less than 1 year service
- Anyone who asks in writing to be excluded
- Office holders who are not otherwise employees

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Excluded participators

Excluded participators are not eligible to benefit.

Excluded participators

- Any participator of the company or of any group company
- Any participator in another close company that has made a disposition into the same trust that would have been a transfer of value for IHT purposes
- Any person who has been such a participator since the trust was first settled
- Any person connected with any of the above

Connected persons also excluded participators

- Spouse or civil partner
- Brother, sister, ancestor or lineal descendant
- Uncles, aunts nephews and nieces

Not excluded participator if:

- Does not have 5% of share capital (NOT OSC), or of any class of shares, ***and***
- Does not have rights to 5% in a winding-up

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Controlling interest requirements

The trustees must:

- Hold more than half the ordinary share capital
- Have the majority of voting power
- Be entitled to more than 50% of the profits available for distribution to equity holders
- Be entitled to more than 50% of the assets available for distribution to equity holders on a winding up

Equity holders defined as per Chapter 6, Part 5, CTA 2010

Conditions cannot cease to be satisfied without consent of the trustees

- Prevents claw-back arrangements

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Limited participation requirement

Condition A is that, in the year up to the disposal, the participator fraction must not exceed 2/5, while vendor is a participator

Condition B is that, from the date of the disposal to the end of the tax year, the participator fraction must not exceed 2/5

NP = Number of participators that are employees or office holders

NE = Number of employees

NP also includes employees or office holders who are not participators but are connected with participator employees / office holders

Does not apply to participators with <5% interests in the company, including shares of any class

Disregard periods of up to 6 months where fraction exceeds 2/5 "by reason of events outside the reasonable control of the trustees"

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When is relief available?

Relief is available for any disposals to the EOT in the tax year in which the trust's interest first exceeds 50%

Can be several qualifying disposals in the same tax year

No relief for disposals in earlier or later tax years

- BADR may still be available for those other disposals

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Disqualifying Events

Disqualifying events

The company ceases to satisfy the trading requirement

The trust ceases to satisfy the all-employee benefit requirement

The trust ceases to satisfy the controlling interest requirement

The participator fraction exceeds 2/5

The trustees act in a way which the trusts, as required by the all-employee benefit requirement, do not permit

Disqualifying events

Disqualifying event within 12 months of the following tax year in which the trust acquires control:

- The vendor loses relief
- No claim may be made after the disqualifying event
- Any claim already made is revoked

Disqualifying event in a later tax year:

- The trustees incur a tax charge
- Trustees are treated as disposing of the shares and immediately reacquiring it at market value immediately before the disqualifying event
- Only applies to shares that were subject to relief originally

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Employee Bonuses

Employee bonuses

No income tax on qualifying bonus payments

- But NICs still apply

Must be a bonus, not regular salary or wages

Must meet requirements

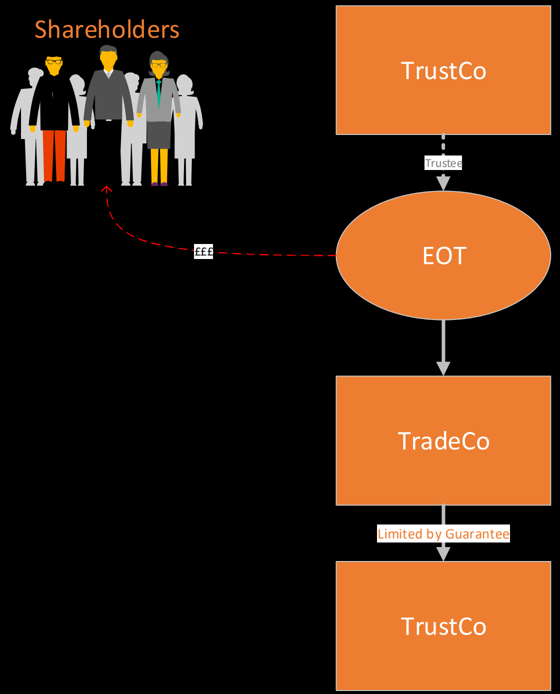
- Participation and equality
- Trading
- Indirect employee-ownership
- Office-holder
- Not service company

Must not be an excluded payment

- Prevents salary sacrifice

Other issues

Funding of an EOT acquisition



- Vendors arrange to set up trust for the benefit of the employees
- There may be bank funding or debt can be left outstanding
- Trusts can issue loan notes
- Trustees can only pay out of cash from the company
- The company can only pay the trustees out of distributable reserves (as a matter of company law)
- Why is this not a taxable distribution?
- Current practice is a complete fudge

Governance

No tax rules on governance

Company directors and trustees can be the same people, which can lead to conflict

- Especially if they are the vendor shareholders and they retain some shares!

Why would we use offshore trustees?

- Does it resolve disqualifying event risk?
- Is that tax avoidance or prudent planning?

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HMRC consultation

HMRC proposals – Trustee issues

- Prohibit former owners and connected parties from controlling the EOT trustee board
- Require specific groups (eg employees) to be represented on the trust board
- Require trust to be UK resident

HMRC proposals – Funding issues

- No distribution treatment confirmed in legislation for contributions to EOT to buy company's shares
- No future clearances for s464A CTA 2010 treatment

HMRC proposals – Income tax bonus issues

- Awarding of tax-free bonuses to group companies where directors excluded
- Corrects a problem where there are non-executive directors

Questions?

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SPECIALIST TAX

Associate director Nick joined Jerroms as a Corporate Tax Manager in 2019 to undertake technical tax research, planning and advisory projects for business and corporate clients.

With Pete and the team, he provides specialist corporate tax advice in areas such as transactions tax, company reconstructions and Employee Ownership Trusts, Employment Related Securities and employee share schemes both to individuals and to accountants and solicitors requiring support for their own clients.

Nick particularly enjoys finding solutions to planning projects in often very technical/complex taxation areas, as well as supporting clients to achieve the optimum solution to their business tax issue, whether that relates to selling their business, demerging, or rewarding employees.

Nick Wright, Associate Director

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Jerroms Miller
SPECIALIST TAX

Richard Jones is a Senior Policy Manager within the Tax Faculty at ICAEW. He focuses primarily on the issues affecting businesses along with tax compliance and investigations matters. He regularly represents the Faculty in discussions with HMRC, other government bodies and tax industry stakeholders.

Prior to joining the Faculty in 2020, Richard worked in the National Tax teams in BDO, RSM and Mazars, having responsibility for internal technical, training and risk management matters. He also managed a varied portfolio of clients at PwC, from international banks to tech start ups.

Richard Jones, Senior Tax Policy Manager

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