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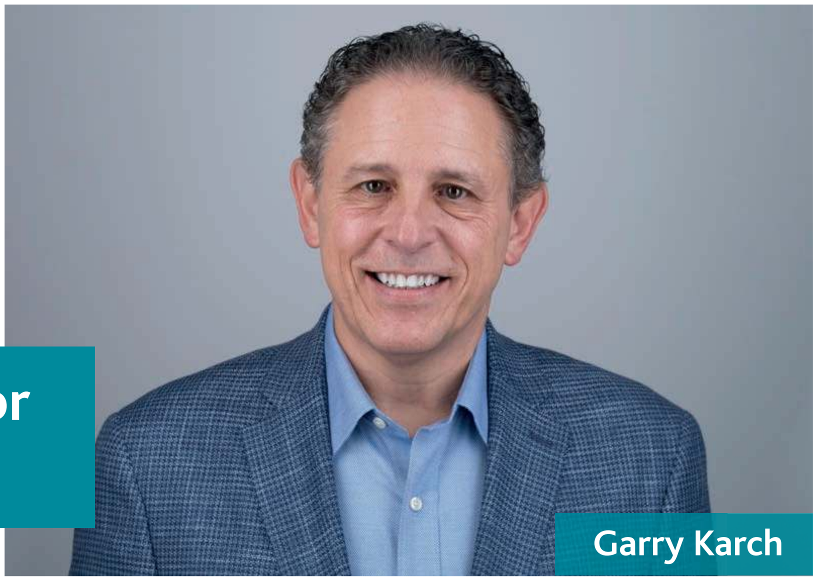
The Compelling Case for Employee Ownership



Garry Karch

There are many reasons employee ownership makes sense for businesses, vendors and employees, but the Capital Gains Tax ("CGT") relief available to vendors selling to an EOT is an important incentive. The lack of a significant incentive for vendors has made it less likely that vendors would sell to their employees. This tax benefit should not be the only consideration with an EOT sale, but it is important.

Employee ownership often leads to superior customer service and a better client or customer experience and, as a result, superior company performance. Numerous studies in both the UK and the United States have demonstrated the benefits of employee ownership:

- A positive, statistically significant relationship between employee ownership and business performance.
- Productivity increases in companies adopting employee ownership.
- Higher sales and employment growth.
- Greater employment stability in tough economic times.

The consistency of the findings with respect to employee ownership shows that its benefits aren't limited to a particular employee ownership model or country. The benefits are universal in nature. Employee ownership works best when done for the right reasons, not just for the tax benefits to vendors that may be in place at any particular time.

Qualifying for CGT Relief

CGT relief is available when a person sells ordinary share capital to an EOT. The five "relief requirements" that must be met are:

- **The Trading Requirement** -
  The trading requirement means that the company must be actively involved in trading activities.
- **The All-Employee Benefit Requirement** -
  All qualifying employees must be included as beneficiaries and benefits must be allocated on a non-discriminatory basis.
- **The Controlling Interest Requirement** -
  The primary requirement is that the EOT must acquire more than 50% of the ordinary share capital of the business.
- **The Limited Participation Requirement** -
  Vendors with 5%+ of the shares do not participate as EOT beneficiaries.
- **Provisions of the Legislation do not Apply to Previous Tax Year Sales** -
  CGT relief is unavailable with respect to shares sold in a previous tax year.

Companies owned by an EOT are also permitted to pay income tax-free bonuses on a non-discriminatory basis of up to £3,600 per employee annually using a fair and equitable allocation mechanism. EOT-owned business can also use tax-advantaged share schemes to further incentivise employees.

Is an EOT Right for You?

The EOT will not be the right option for everyone. For vendors looking to maximise cash at completion and step quickly away from the business, a third party sale is probably the best approach. If the vendor is looking at stepping away over time and doesn't need to maximise cash at completion, the EOT can fit the bill.

Business owners thinking about selling their company should at least consider the EOT as an alternative to a third-party sale. The tax benefits make it competitive from a financial perspective and it provides the opportunity for business owners to leave a legacy and help preserve and create jobs, which benefits us all.

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