Legal Clarity.

A guide to employee ownership

AN ALTERNATIVE EXIT

FIND OUT HOW YOU COULD UNLOCK THE POTENTIAL OF EMPLOYEE OWNERSHIP.

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April 2025

A new era for business ownership

Employee ownership is one of the UK's fastest growing business models and this growth shows no signs of slowing with more and more businesses following in the footsteps of the likes of Riverford Organic Farmers, Go Ape, Richer Sounds and Aardman Animations.

Higher productivity, better employee engagement, the opportunity to cement the founder's legacy into the fabric of the future business – the value of employee ownership has been growing for decades. But what's prompted the sharp rise in the size of this sector in recent years? Here are what we believe are the four top reasons behind the growing popularity of this business model.

1. Awareness of the financial benefits of employee ownership trusts is growing

Employee ownership trusts were launched in 2014, allowing owners to pass majority control of their business to a trust without capital gains tax. This gives owners of companies of all sizes a compelling financial incentive to sell a controlling stake of their business to their people. Yet awareness of the new tax-efficient exit strategy was initially low and EOTs were relatively slow to take off. However, a flurry of employee ownership activity in recent years is changing this.

2. A new perspective on succession

Heartened by the commitment, loyalty and support of their employees, many owners feel moved to reward their employees for their contribution. And let's not underestimate the impact of the uncertainty and turmoil of the last few years both domestically and internationally on how entrepreneurs and company founders view succession planning. Seeing how everything can change quickly has encouraged owners to put more thought into their exit strategy.

3. Proven performance benefits

The success stories are stacking up for employee ownership. It's definitely a common trend in our client base at Legal Clarity and research by the Employee Ownership Association shows that employee-owned businesses are recording a 20% increase in performance and a 43% increase in revenue. The positive effects on employee morale are also shown as

73% of employee-owned businesses are more likely to have increased employee satisfaction, motivation, and work-life balance with a £2,700 higher than average basic wages and share profits.

4. It's no longer seen as a niche option for large companies

Previously, there was an assumption you must be a business of the size or scale of John Lewis to benefit from employee ownership. This isn’t the case. The flurry of activity in recent years, spurred on by the rising popularity of EOTs, has shown employee ownership is not about emulating John Lewis and it’s not limited by headcount, turnover or sector.

We’ve completed employee ownership deals for companies valued at everything from a few hundred thousand pounds to more than a hundred million.

2000+

Total number of employee-owned businesses in the UK as at December 2024

200,000

Employees of EO businesses

43%

Increase in revenue

£42bn

Delivered per year towards the UK economy

**Statistics from the Employee Ownership Association*

Key takeaways

- More than 2,000 companies across the UK are now employee-owned – it’s the fastest growing ownership structure for private businesses in the UK.
- Employee ownership isn’t anything new, but it’s become significantly more popular in recent years thanks to Employee Ownership Trusts.
- With Employee Ownership Trusts, you can sell your shareholding without incurring capital gains tax.

- Making employee ownership part of your exit strategy is a way to reward the employees who have helped you to grow your business. You can also feel reassured your legacy is in loyal hands.
- The positive cultural effects of employee ownership are now shown to have a favourable impact on productivity and business performance in general.

Are you curious about employee ownership?

If you're considering adding your company to the 2,000 plus employee-owned businesses in the UK, you'll first need to evaluate which form of employee ownership works for you. In this document, we outline the three main models. And when you're ready to talk, our employee ownership experts can guide you (and, if you want to involve them, your management team) through your options.

Introducing the 3 models of employee ownership

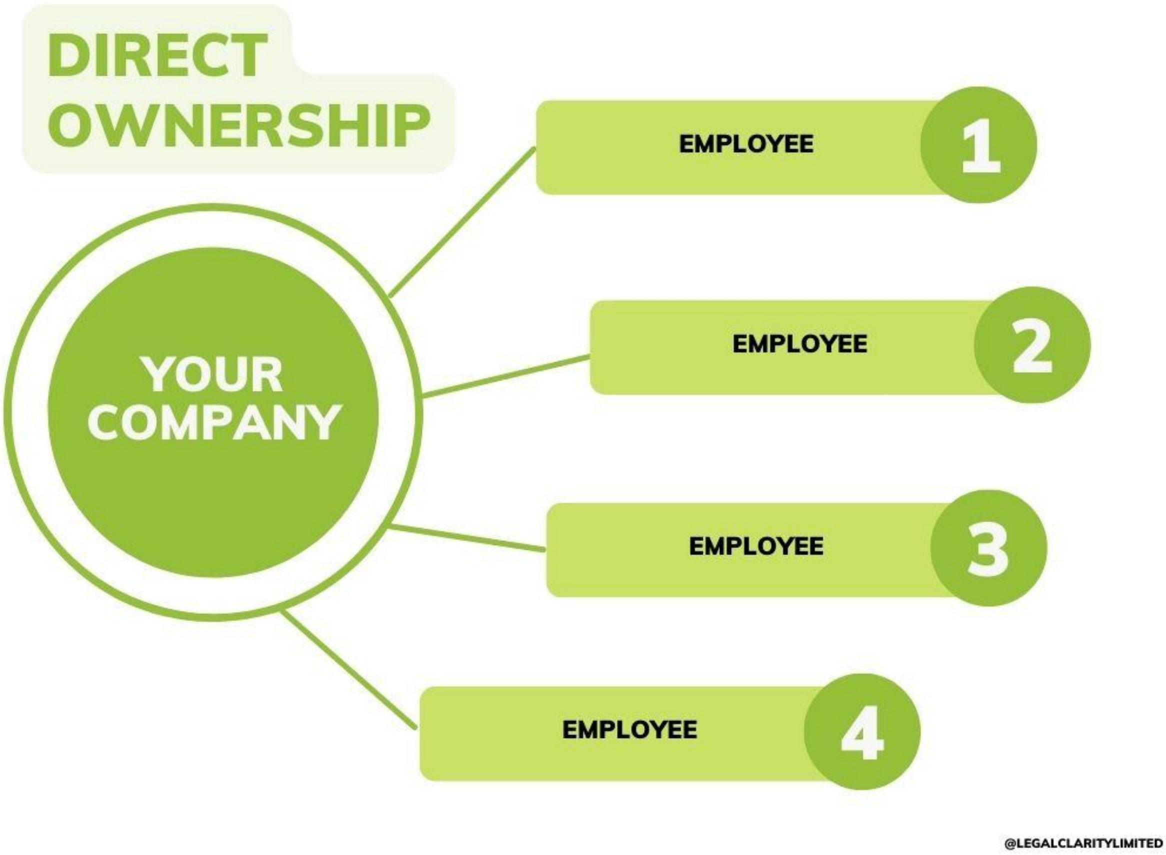
An employee-owned company is wholly or majority owned by the people that work for it. There are three ways you can transition to this structure.

1. Direct (or individual) ownership	Employees hold the shares in their own names (e.g., a traditional management buy-out).
2. Indirect (or trust) ownership	A trust is formed to hold shares on behalf of the employees (e.g., Employee Ownership Trusts).
3. Hybrid ownership	A minority stake is reserved for owners and/or employees to retain some direct ownership. But an employee ownership trust is also formed and holds a majority of the total share capital.

Direct ownership

Employees own shares directly in the company in their own name. This is offered through tax advantaged share incentive arrangements – such as a Share Incentive Plan (**SIP**) or Enterprise Management Incentive (**EMI**) options.

How it works



You can offer employees shares in your business in one of **three** main ways:

Direct purchase	**Gift**	**Share options**
Employees buy shares in the business they work for. This gives them immediate ownership of shares in the business.	Shares are awarded to employees for free. This can be part of a bonus or attached to hitting a performance milestone.	Share options offer an opportunity for employees to buy shares at a favourable fixed price at a point in the future.

Important considerations.

Buying back shares when employees leave

Anyone leaving the company must sell their shares back to the company, or another shareholder. One way to manage this process is to create a trust to act as a 'warehouse'. Shares that are sold by leavers are held in trust until the time comes to transfer them to another employee. When structuring direct employee ownership, you need to consider how you decide the value or price paid to a leaver for their shares. Crucially, this may be skewed to be more favourable for good leavers (e.g. death or incapacity) than bad leavers (e.g. serious misconduct or leaving to join a competitor).

Valuing shares for purchase by employees

The price employees pay for shares will depend on how you value the company or group, and how this is reflected in the share price. You may choose to seek an external valuation, or alternatively, you can use an agreed valuation formula. A common example is an EBITDA multiple.

Rules around disposal of shares

Encouraging longer term ownership is prudent for many reasons (not all financial). We advise adding provisions that guard against an over-active internal market and help you to control and ideally minimise the cost of ad hoc share trading. In short, you'll need to agree when employee shares can be bought or sold, and by whom. For example, you could schedule periodic 'trading days' when employees can buy or sell. In circumstances where employees are allowed to exit outside of the permitted windows, you'll need to outline how they can sell shares and at what value. Again, it's possible that a trust may be used for holding offloaded shares before they are re-sold.

Corporate governance

Inviting more shareholders into your business means you need to offer complete clarity around how the business is governed. This should be reflected in a shareholders' agreement or the company's articles of association. The types of things this can include are how shares may be transferred, the respective powers of the trading board and shareholders (and requisite majorities), the ability to 'drag' or force a sale by other shareholders, and so on. We can guide you through all these issues.

The ongoing costs of direct ownership

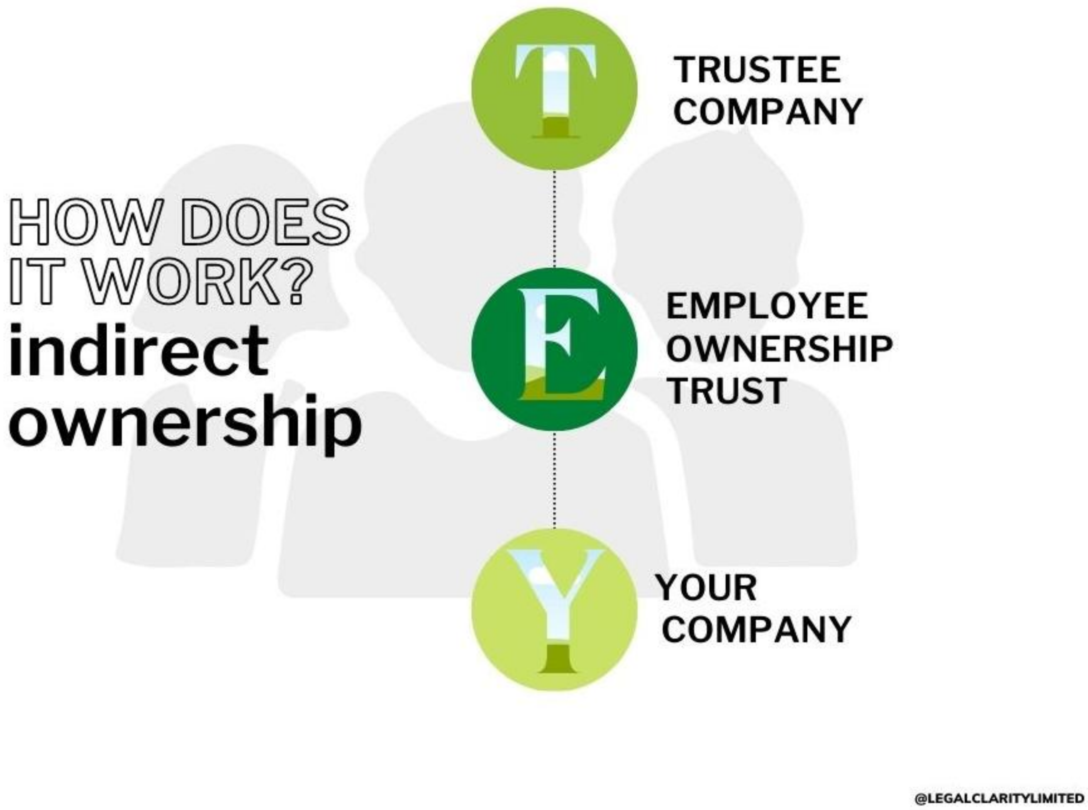
A direct employee ownership model is likely to be more costly to adopt and subsequently to run. This is partly due to the ongoing need to deal with share transfers or issues for joiners and leavers. The cost implications depend on the level of flexibility you adopt, and the volume and frequency of share dealings.

Key features

- Shares are registered in each employee's name.
- Employees can buy shares, be offered share options, or be gifted shares as part of a reward scheme.
- Organising share purchase through specific incentive arrangements offers tax advantages.

Indirect ownership

Employee shares are held collectively and permanently in an employee trust, giving employees an indirect stake in the business. This avoids some of the downsides of direct share ownership, such as buying back shares when people leave the business.



Important considerations

Creating a tax-efficient trust

Theoretically, you can use any type of trust to facilitate indirect employee ownership. But using an employee ownership trust (EOT) will allow you to qualify for two government-backed tax breaks. Firstly, owners can sell their shares to an EOT entirely free from capital gains and inheritance tax. Secondly, when a company is owned by an EOT, it can pay annual bonuses of up to £3,600 to each employee free of income tax.

Appointing trustees

Once the shares are held in trust, a trustee is appointed to hold and manage the employee share assets on their behalf. Trustees can be individuals, but it's more common to use a company because it offers more legal protection. The directors of that company are referred to as trustee directors. Essentially, the primary purpose of the role is to make sure decisions are being taken in accordance with the best long-term interests of the business and all employees collectively. This includes asking questions of leadership when necessary.

Choosing a trustee director

The decision on who holds office as a trustee director is an important one. The options include founders or selling shareholders, directors from the trading company or group, independent trustee directors and employee trustee directors. Following changes in the legislation introduced in October 2024 whilst a selling shareholder can still be a trustee director, the trust board cannot be under the control of the selling shareholders. Furthermore the trust, and therefore the trust company, must be UK resident. Other than that there are no hard and fast rules or legal requirements (at least at present), but there are some guiding principles in terms of good governance which you should keep in mind. We can help you here.

Setting boundaries to avoid conflict

It's not for the trust company or the trustee directors to manage or run the business – that remains the job of the directors of the trading group or company. The scope of the trustee director role can feel vague, so it's important to be clear about and formalise the boundaries of power and responsibility between the trading company and the trustee directors. This can avoid future conflict, uncertainty or generally time being wasted.

Changes in accountability

There's a common misconception that employee-owned companies must act as a co-operative with every decision hanging on the outcome of an employee vote. This isn't the case. While sale documentation should contain protections for the selling shareholders, it's crucial that the directors are free to make the necessary day-to-day decisions to run the business to best effect. However, what does change is they're now accountable to the employee trust. Consequently, the articles of association (or shareholders' agreement) will spell out any special protections required by the Trust Co.

The employee council

Firstly, an employee council isn't obligatory. You may decide having an employee as a trustee director or appointing a single employees' representative is sufficient to fulfil this function. But in some cases, an employee council – set up to represent employees, acting as a two-way channel of communication between the employees and leadership – can be beneficial.

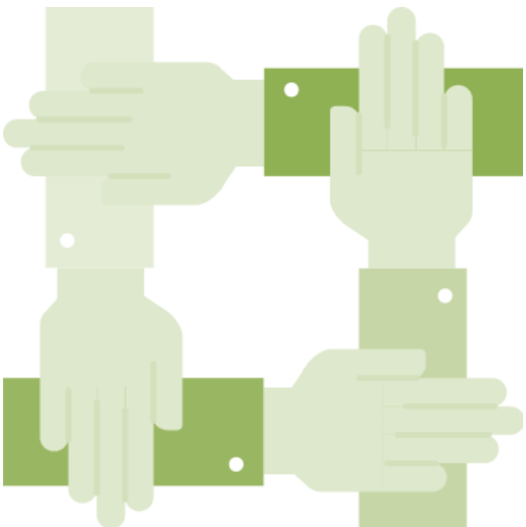
The exact remit, powers and responsibilities of this body are for each business to decide. How members are elected, terms of service and other governance issues will also need to be clearly agreed.

Key features

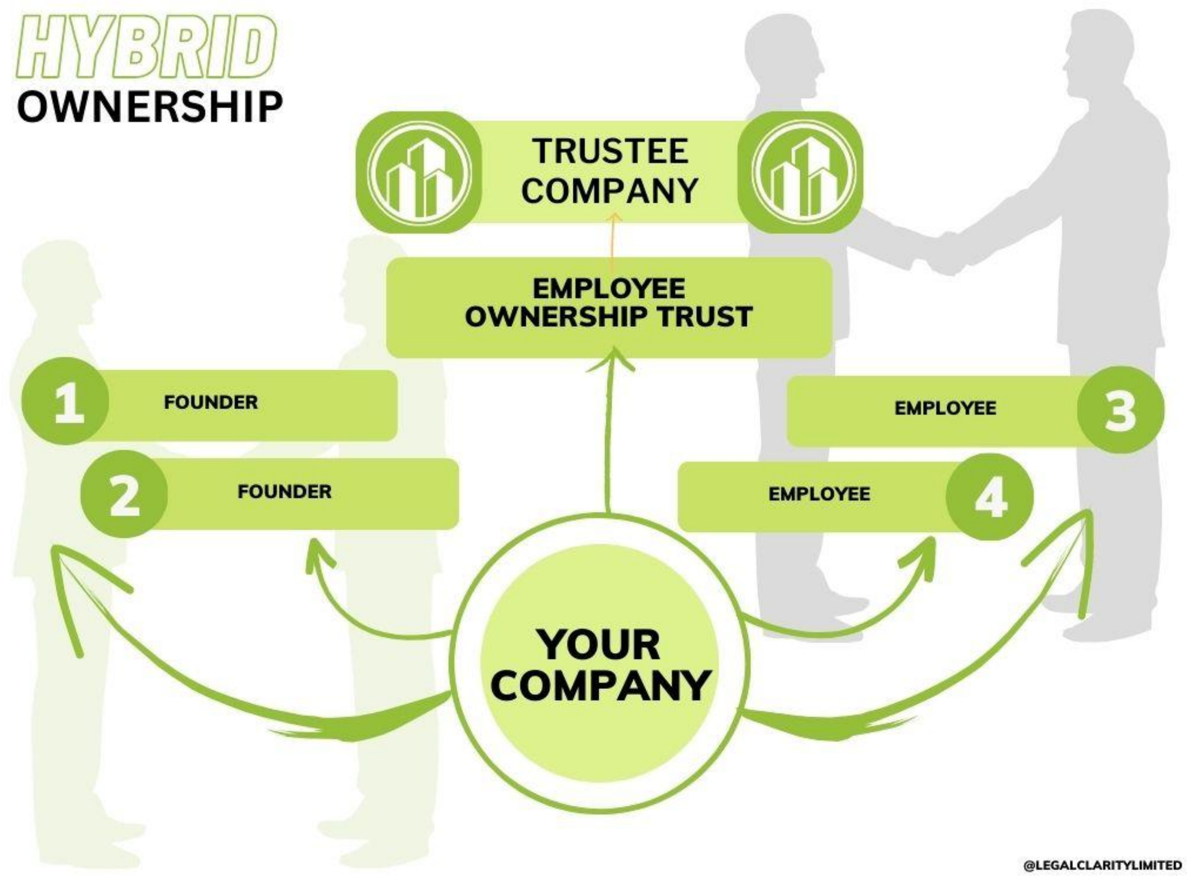
- Employee shares are held collectively in a trust, which is administered by individual trustees, more usually, by a trust company.
- Utilising the employee ownership trust as a vehicle for indirect ownership unlocks attractive tax breaks.
- There's no obligation for owners to stand down as directors of the trading company whose directors remain responsible for day-to-day decision making, though the owners can't be a majority controlling the trust company board.

Hybrid ownership

An increasingly popular model that offers the tax benefits of the employee ownership trust (EOT) model, while giving individuals the option to purchase shares directly too.



How it works



Key considerations

Employee ownership doesn’t have to be 100%

A hybrid structure starts with a trust acquiring and holding a majority stake on behalf of employees. This leaves a minority shareholding that can be retained or acquired by individual shareholders directly. This can be the original selling shareholders or new shareholders from the management team or wider employee group. The challenge comes in finding the right balance and making sure the governance is clear and watertight.

Finding the right balance

A sale to a 100% direct or indirect model is obviously more straightforward. But this doesn’t mean it’s the best choice for your company. By navigating the complexities of a hybrid approach, you can achieve significant long-term value for founders, unlocking EOT tax advantages, and compelling employee incentive options. You’ll need to make sure you hit HMRC’s criteria to access the benefits of the EOT model and also add in provisions to make any direct elements operate smoothly.

When a sale isn't an immediate exit

Not all owners are looking for a fast exit. A hybrid model can be attractive when the founder(s) or selling shareholders wish to retain an equity stake and maintain some involvement in the future prosperity of the company. For example, when their ongoing involvement and influence is integral to driving forward the business and achieving the full growth potential. Or it may be for businesses on a steep growth curve selling all shares at the current value isn't in the founders' best financial interests.

Offering shares as an incentive

Providing share rewards is a compelling incentive for your senior management team. A direct share purchase or option scheme can be an attractive part of an employee benefits package. However, you'll need to consider how you structure this. For example, you can offer tax advantaged EMI options, growth shares which offer equity value above the current market value only, or schemes where value is linked in some way to the outstanding debt due to selling shareholders.

Key features

- An employee ownership trust acquires and retains a majority stake to unlock tax breaks.
- Owners and employees also have the option to retain or acquire shares individually, which could be through EMI options or a growth share scheme.
- Provides flexibility to create a bespoke structure to meet the aims of the business and selling shareholders.

Could employee ownership be the future for your company?

Are you a retiring business owner? Maybe you have shareholders looking to release capital quickly? Or perhaps you're a start-up struggling to attract and retain the best talent?

The next step is to book a consultation with our employee ownership experts. They will make sure it's the right approach to employee ownership for you and you'll learn:

- the criteria you'll need to meet to be tax-efficient
- what's involved in the process
- the implications for you and your employees
- how we can help you through the transaction.

MEET THE EOT TEAM:

Gary Davie | Partner & EOT Lead

Gary acts as lead adviser on our EOT transactions, and as a trustee director including chairing the trust board of The 1:1 Diet Business (winner of *Employee Ownership Business of the Year*). Drawing upon his experience in a whole range of approaches to employee ownership – MBOs, trusts and hybrid models – he will guide you to the right employee ownership structure for your business.

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Legal 500: The 'outstanding' Gary Davie, reputed for his capabilities in employee buyouts.

Jane Jevon | Legal Director & Tax Specialist

Jane acts as our lead tax specialist with over 25 years advising on share schemes related matters as well as general trust matters. She is experienced in tax, commercial and wider employment related securities issues relating to share schemes.

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Richard Underwood | Managing Partner & Corporate Specialist

Richard is our corporate finance expert. Specialising in advising owner managers on all types of disposals, together with acquisitions, investments, shareholder arrangements, employee incentives and re-organisations.

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Legal 500: Richard Underwood, lauded by multiple owner-managed businesses for his 'broad range of technical specialisms'...... 'is commercially astute'......'is always accessible.'

Christina Conlon | Associate Solicitor

Christina is an Associate Solicitor who specialises in Corporate Law. She assists on many EOT transactions alongside Gary and Jane. Christina will be able to assist in guiding you to the right employee ownership structure for your business and make the transition a smooth and easy process.

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Contact us on 0121 314 9102 or drop us an email at eot@legalclarity.co.uk **to discuss further.**