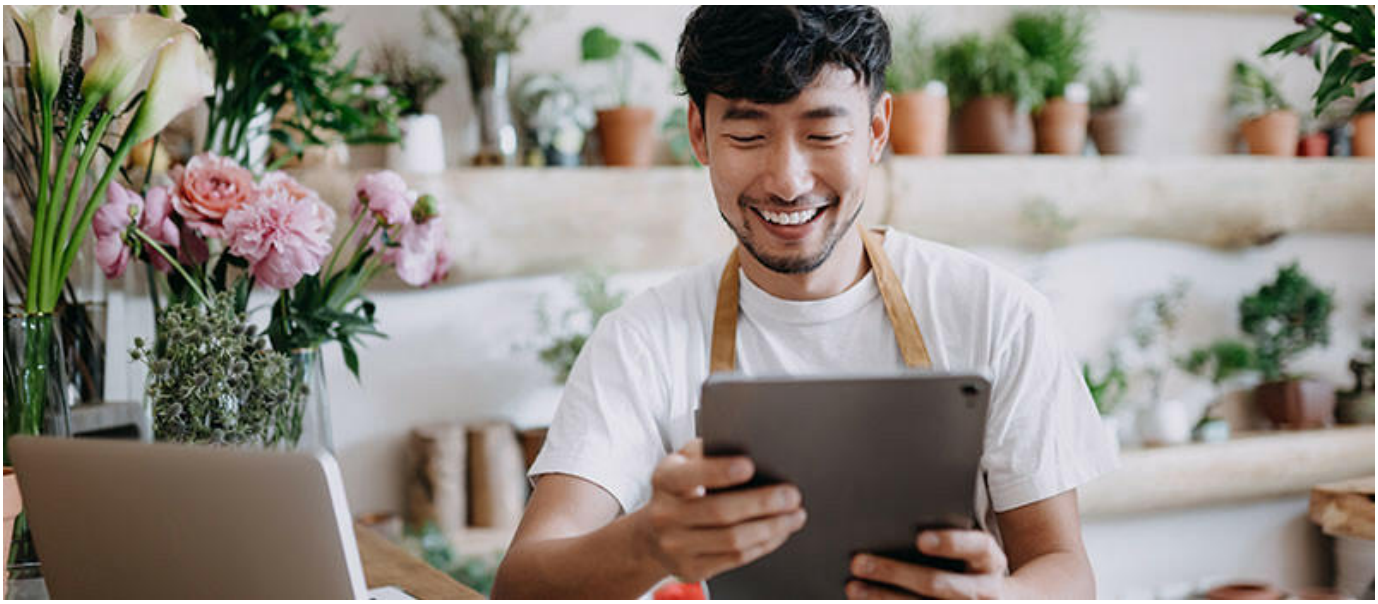
Employee Ownership Trust and Employee Benefit Trust consultation

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The CIOT has responded to a consultation on proposed reforms to Employee Ownership Trusts and Employee Benefit Trusts, which was launched as part of the 'L-Day' proposals.

On 18 July 2023, several consultations were launched as part of 'Legislation Day' (or 'L-Day'); one of these concerned the tax treatment of Employee Ownership Trusts (EOTs) and Employee Benefit Trusts (EBTs). The aims behind the proposals are to ensure that the regimes remain focused on the targeted objectives of rewarding employees and encouraging employee engagement, whilst preventing tax advantages being obtained through the use of these trusts outside of these intended purposes. Several of the proposals were in line with recommendations that the CIOT made in a Budget representation in 2021 (tinyurl.com/3wyaz79s).

The current consultation addresses several issues.

The first is that of companies' former owners (and connected parties) becoming trustees of the EOT and, therefore, effectively retaining control of the company. The consultation considered restrictions on them being the sole trustees. Issues around the residency of trustees were also considered by the consultation, noting the implications from a capital gains tax perspective of the EOT being UK or non-UK resident. The response from the CIOT was that whilst restrictions on the control of former owners and connected parties were welcome, new rules should not be over-prescriptive as to who should control the trust. Furthermore, whilst acknowledging that offshore EOTs still serve a valuable purpose, the CGT restriction was in line with the aim to tackle potential abuses.

The next issue discussed in the consultation document is around funding of the EOT. As per the consultation document, newly established EOTs do not typically have any funds of their own to pay upfront for shares from the departing owners. It is therefore common for all or part of the consideration due to the departing owners to remain outstanding at the point of sale. Any such balance owed is typically paid to the departing owners over a period of time, and is commonly funded through distributions of profits paid to the trustees. Clearances are usually advisable to confirm that such payments are not treated as distributions under Corporation Tax Act (CTA) 2010 s 1000. The proposals are for this treatment to be enshrined in statute, thus avoiding the need to request a clearance. This would also apply to clearances under CTA 2010 s 464A (the targeted anti-avoidance rule). The CIOT welcomed these proposals.

The £3,600 income tax-free bonus payable to employees was also raised. There are strict rules governing the payment of the bonus, as set out at Income Tax (Earnings and Pensions) Act 2003 s 321B. The consultation suggested that the participation condition is amended so that directors do not necessarily have to be included. We did not raise any objection to this suggested change. However, we said that the £3,600 figure should be raised (to take into account inflation since 2014 at the very least). Another point made was that the bonus would ideally also be exempt from National Insurance contributions, for the sake of both consistency with the income tax treatment and as a further benefit to employees.

With respect to EBTs, the inability for participators and their connected parties to benefit for the lifetime of the EBT was proposed, and this was broadly welcomed in our response. However, we were less keen on the proposal to restrict inheritance tax relief for those participators who have owned shares for at least two years prior to

settlement into an EBT; instead, we suggested that a ‘motive defence’ test might be fairer than a blanket restriction.

The full CIOT response can be found here: www.tax.org.uk/ref1179.

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