Employee ownership trusts: unexpected reduction in capital gains tax relief

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05 January 2026

Budget 2025 included an unexpected and immediate reduction in the capital gains tax relief available for the sale of a business to an employee ownership trust.

In a Budget where most announcements were widely speculated on beforehand, one surprise in Budget 2025 came in the form of a change to the capital gains tax relief (CGT) for sales to employee ownership trusts (EOTs). Previously, qualifying sales have benefited from a complete exemption from CGT; however, Budget 2025 announced that the full CGT exemption will be replaced with a 50% relief for sales taking place on or after 26 November 2025. Practically, this means that 50% of the gain that arises to the sellers on the sale of their company will now be treated as a capital gain that is subject to CGT.

Draft legislation within the Finance Bill confirms that the remaining gain will be held over and deducted from the trustee's base cost, effectively coming into charge on a future sale of the company by the EOT. Furthermore, business asset disposal relief and investor relief will no longer be available where the EOT CGT relief applies.

EOTs have grown in popularity in recent years, and the latest change comes hot on the heels of significant changes to the regime that were included in FA 2025, largely designed to tighten the regime, prevent abuse and discourage a practise of EOTs being used as a short-term conduit for a third-party sale. Those changes, which were welcomed by CIOT, included restrictions on the former owners controlling the EOT, UK residency requirements for the EOT trustees and steps to ensure the shares are not sold at an overvalue. They also included the introduction of a statutory relief from income tax for contributions made by the company to the trust to fund the share purchase price and certain associated costs of the acquisition.

Whilst this latest measure might have been unexpected, it is perhaps not entirely surprising that the government is making further moves to ensure the relief promotes fairness and discourages misuse of the EOT regime, by requiring some tax to be paid by the business owner. The effective rate of tax on sale remains much lower than a sale via another route (12% as compared to 24% of the chargeable gain for higher rate taxpayers). For those business owners that are genuinely motivated by the benefits of employee ownership as a succession route, such as greater employee engagement and long-term stability for the business, the revised tax relief should still be acceptable.

We await detailed guidance on precisely how this latest change will operate in practice. Given that many EOT sales are structured so that a significant element of the sale consideration is deferred and payable in instalments post completion, one immediate question is whether HMRC will permit the payment of the CGT in instalments.

The CIOT has previously highlighted a need for greater focus on ensuring that EOTs remain attractive to the company's employees; for example, an increase in the level of tax-free bonuses that can be paid annually to employees (the current figure of £3,600 has not changed since the regime was introduced in 2014) and/or extending the exemption to NIC. No announcements were made in this area in Budget 2025 – as such it remains a watching brief.

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