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Via email: *[redacted]*

Dear James

Employee Ownership Trusts

As you know, the CIOT raised several issues regarding the employee ownership trust (EOT) legislation at a meeting of HMRC's Capital Taxes Liaison Group[1] in May. At that meeting, HMRC noted its view of the legislation as being clear in its effect, agreeing with our analysis such that certain fact patterns would give rise to disqualifying events, effectively removing the tax benefits of an EOT. HMRC suggested that the outcome in those cases, i.e. that tax relief would be limited, would have been the original policy intention. This seems to be at odds with government policy to encourage long-term ownership by EOTs, given that restrictions on commercial transactions are not conducive to long-term ownership.

We are writing to set out the commercial circumstances in which the issues arise to demonstrate why clarification and simplification through legislative amendments (or other means) would be welcome reform and deliver more effective policy.

As is our normal practice, we will publish this letter to raise awareness among our members and the public of the situations in which otherwise routine transactions can create unexpected complexity, and show that the issues have been raised with you.

As a starting point, we recognise that the growing use of EOTs as a business model can be seen as a success story. They can offer business owners a flexible exit with enhanced employee engagement and greater business continuity and stability compared to alternative succession strategies.

However, an EOT-owned business, like any other business, may need to grow into new markets, separate activities with different risk profiles, reorganise its financing or undertake a demerger to protect viable parts of the group. The EOT rules do not necessarily accommodate these ordinary developments as intended, as early adopters are now finding. The main issue relates to the widely drawn 'disqualifying events' section of the EOT rules. These rules withdraw the capital gains tax (CGT) relief on a later restructuring because the EOT no longer *directly* holds the share capital of

[1] Capital_Tax_Liaison_Group_21_May_2026_Minutes.odt

the original company (the controlling interest requirement) where a new holding company is inserted or where part of the group is demerged. This applies even where the transaction is commercially driven, does not undermine employee ownership and would be a familiar tax-neutral reorganisation where an EOT is not involved. The consequence is a clawback of the tax relief for the original shareholder - despite that person no longer controlling the company or the commercial decision which gives rise to the disqualifying even - or a dry tax charge for the EOT trustees. The examples that follow are not contrived avoidance arrangements. They are commercial transactions of the kinds for which the share reorganisation legislation was designed. Companies should be able to rely on that legislation, and to adapt their structures as the needs of the business change, without triggering a tax charge under the EOT rules where employee ownership and the substantive conditions for relief continue to be met.

Example 1

Adam transfers his company to an EOT, qualifying for tax relief on the capital gain. Later, the company's board of directors decides to set up a holding company to allow the business to expand into new ventures. Ordinarily, inserting a holding company is a CGT free transaction, with the shareholders effectively swapping their shares in the trading company for shares in the holding company. However, the EOT rules require the EOT to continue to directly hold the shares in the company that was acquired from Adam rather than indirectly holding them through their ownership of the shares in the new holding company[2]. Therefore, where an EOT is involved, this type of share-for-share transaction results in a disqualifying event.

Example 2

Bethan owns a holding company that controls two separate trading companies, involved in manufacture and distribution. She sells the group to an EOT, claiming CGT relief. Later, she realises the distribution arm is under threat from increased regulatory pressure and would be better moved out of the group in order to ringfence the commercial risk posed to the manufacturing business. The board of directors want to undertake a capital reduction demerger. However, the first step is a share exchange to insert a new holding company, which again leads to a disqualifying event under the EOT rules (as per Example 1).

Similarly, if a liquidation demerger were used, the original holding company would cease to exist, and the EOT would hold two new holding companies, instead. This would also be a disqualifying event for EOT purposes.

A demerger by exempt distribution might not lead to a disqualifying event, as the EOT would continue to hold the shares in the original holding company, as well as holding the shares in the demerged trading company or its new holding company (depending on the mechanism used).

This, however, leads to a secondary question, which is what happens if the demerged company were to be sold some years later. The EOT would continue to hold the company it originally acquired, and that company would still be a holding company of a trading group, so this would not, prima facie, be a disqualifying event. Please could HMRC confirm its position on this point, which is currently giving rise to uncertainty.

In our view, these examples demonstrate a mismatch between the EOT rules and the commercial reality, creating both practical uncertainties and undermining the policy behind the rules. They show that the transactions are undertaken for identifiable business purposes, using mechanisms that the tax legislation is intended to facilitate, with no attempt to extract value contrary to the policy of the relief.

The anomaly in the operation of these common corporate transactions where EOTs are involved creates additional complexity to the tax system and risks stifling the continued adoption of EOTs as a business model. The risk of a disqualifying event may deter boards from making decisions in the best interests of the business, deter trustees from making decisions in the best interests of the beneficiaries, and increase professional fees as alternative solutions are sought.

[2] Under s236O(2)(c) TCGA 1992, or s236P(2)(c) where the relevant time has passed.

We therefore suggest that the legislation is amended, or otherwise clarified, so that bona fide reconstructions do not trigger disproportionate consequences and companies can adapt and plan with a greater degree of certainty, supporting the government objectives of both supporting business growth and simplification of the tax system.

We would be happy to discuss this with HMRC in further detail.

The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 20,000 members, and extensive volunteer network, in providing our response.

Yours sincerely

James Geary and Jitendra Patel
Joint Chairs, Owner-Managed Business Technical Committee

The Chartered Institute of Taxation

The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

Our stated objectives for the tax system include:

- A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
- Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
- Greater certainty, so businesses and individuals can plan ahead with confidence.
- A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
- Responsive and competent tax administration, with a minimum of bureaucracy.

The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.

Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.