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Changes to Employee Ownership Trusts within Finance Bill 2024 (clause 31 and Schedule 6)

Response by the Chartered Institute of Taxation

1. Executive Summary

1.1. 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.

1.2. The purpose of this paper is to give some feedback to the legislative changes to the Employee Ownership Trusts (EOTs) which took effect from 30 October 2024. Whilst many of the changes are in line with our recommendations in last year's consultation, we still have some concerns about this draft legislation. There is one specific technical concern surrounding the new statutory relief for contributions to the EOT from the company, which we feel is too narrow when considering the other necessary costs involved in establishing and running an EOT. Related to that are questions about practicalities over company contributions and this new relief, as well as the status of past non-statutory clearances. We also feel that even with these progressive changes there is insufficient focus on the benefits to employees, concerning the tax-free bonus in particular.

2. EOTs

2.1. The CIOT is pleased to note that a number of the changes that have been made (such as the trustees' residence and independence requirements) reflect suggestions made in our representations to HMRC on improving the EOTs regime. We do, however, have some concerns with these changes in the Finance Bill.

2.2. The general issue is that whilst the spirit behind these changes is to prevent abuses of these trusts beyond their original intention (which is largely addressed), they do very little ultimately to reward employees and encourage employee engagement. All the employees can really benefit from is a £3,600 bonus which, whilst income tax free, is still subject to Class 1 National Insurance (NI) and has been the same figure since 2014. We appreciate the financial constraints which the government are currently operating under, but when finances permit, we would welcome a review on the level and status of this bonus, given its importance.

There remains too an element of disconnect between the business and the employees – they do not benefit from the normal advantages of business ownership and have no control in the day to day running of the business, both of which are elements we would expect to see in genuine ownership by the employees. The opaque nature of EOTs is reflected in the tax position too. For example, were the underlying company in the EOT to be sold the trust would be subject to capital gains tax and the distributed proceeds would then be subject to income tax and NI in the hands of the employees. This could be resolved by either making capital distributions to the employees tax-free or giving employees the benefit of a tax credit against distributions they ultimately receive. There should only be one layer of taxation when a company is sold and if the spirit of an 'employee-owned' business were followed, it is the employees who should ultimately reap the proceeds of a sale. The potential to receive a tax-free lump sum upon sale of a business would likely lead to a more motivated and incentivised workforce. Given the relatively few companies actually being sold by EOTs, it is unlikely that having a more transparent structure with respect to capital payments would have a detrimental effect on HM Treasury's revenue.

We do acknowledge, however, that the current imposition of double taxation acts as a form of disincentive to use EOTs purely as a means for business owners to sell off their companies to third parties via EOTs; having anything in place to encourage the continued long-term use of EOTs is no bad thing.

Nonetheless, our concern remains that these changes are aimed primarily at the status and validity of the business owner's tax relief. Whilst they address potential abuses and continued influence of that owner, none of these changes ultimately benefit the employees or further their interests.

2.3. Our specific concern lies with the statutory relief against (or deduction against) income tax on distributions from the company to the trust for purchase of the company's shares (including interest and stamp duty). Whilst this is a welcome move, we still have reservations.

The most serious is that the relief does not apply to other costs incurred by the trustees and reimbursed by the company. This sits rather oddly with the new statutory requirement that the trustees must make sure that they do not overpay for the shares or for the deferral of payment. In effect, the new rules introduce a mandatory expense for the trustees but no tax relief for dividends paid by the company to cover this new mandatory cost, which seems rather counter-intuitive.

We understand from James Shuttleworth that the limited scope of the proposed relief is based on the costs that were historically the subject of non-statutory clearance applications. But one of the reasons for pushing for a statutory relief was to ensure that all the legitimate costs incurred by trustees could be funded by tax free payments from the company. As the use of EOTs to increase employee ownership becomes more common, it seems likely that more and more bodies of trustees will incur costs of one sort or another, which will need funding. These costs are necessarily incurred by the trustees to ensure that they can properly carry out their legal duties as trustees for the benefit of the beneficiaries of the trusts.

Until the recent budget, it was always assumed that if such costs were to become apparent, the trustees or their advisers would be able to apply to HMRC, using the non-statutory clearance facility, for a further clearance that those necessarily incurred costs could also be reimbursed by tax-free contributions from the company. This is no longer an option, as HMRC has recognised that '*the better reading of the legislation is that the payments are distributions*' (see page 10 of the responses to the consultation document). In effect, this means that, if the trustees need to incur any costs in carrying out their duties to look after the trust for the benefit of the beneficiaries, the company will have to pay them a dividend of such an amount that, following the payment of 39.35% income tax, will leave the trustees sufficient money to pay the relevant costs.

As you know, we have given a great deal of thought as to what these fees might be throughout the period that a company is owned by an EOT. In particular, we are concerned about the following:

- In theory, the trustees ought to pay a significant proportion of the professional costs of acquisition of the shares, as one would expect from the purchasers in any transaction. Historically, these costs have been assumed by the sellers or by the company, but this does not reflect the commercial reality of the situation.

- As pointed out above, the trustees now have a statutory duty to consider the terms of the transaction (price of shares and interest on debt), and they are likely to incur professional fees on satisfying this new tax legislation.

- While external finance for an EOT is rare, we are aware of lenders in this market, and their prominence may increase as the use of EOTs increases. As well as charging a commercial rate of interest, there is often a significant up-front arrangement fee, which would not be covered by the proposed relief.

- Given the new independence requirement, we can already see a greater willingness to use professional trustees. But the proposed relief does not cover fees to professional trustees. So the independence requirement effectively encourages the use of professional trustees and the dividend relief discourages it!

- We can also envisage scenarios where the trustees are approached with an offer to buy the company. The trustees will need to evaluate whether they should sell, bearing in mind that their overriding concern should be whether a sale would give the best result for the employees of the company, as beneficiaries of the EOT. In many cases, this will be a complex decision to make and the trustees will need to take legal and other professional advice in order to make a properly-informed decision.

- If the trustees ever make distributions to beneficiaries, they will certainly need professional advice as to the operation of payroll taxes. Alternatively, they might need to pay a third party for payroll services, to deduct and administer the income tax and NI.

We do not suggest that this is an exhaustive list, as every trust and trading company will be unique, so we are not asking for a discrete set of expenses to be added to the relief. We believe it would make more sense to allow the relief to apply to legitimate costs arising to the trustees, so long as those costs are for commercial / fiduciary purposes and so long as they are not at more than a reasonable commercial rate.

We would therefore ask that HMRC withdraw their comment in the consultation document that payments are to be treated as distributions – or at least restrict it to scenarios where the EOTs owns 100% of the company shares. For one thing, this interpretation might be taken as a broader interpretation and have an impact upon other employee trusts, payments into which are not treated as distributions. Payments into Employee Benefit Trusts (EBTs), for example, are allowable corporation tax deductions for the companies under s.1291 CTA 2009. As an alternative to increasing the scope of the statutory relief, our reservations would be overcome if payments to the EOTs from the company were treated in the same way as those to EBTs rather than as distributions, ie as deductible under s.1291.

Whilst they are ultimately different types of entity and for different purposes, the sentiment behind EBTs and EOTs are the same. To make this change and treat relevant payments to EOTs the same as those to EBTs would be another big step toward simplification, removing the question of whether a payment is a distribution and thus avoiding the need for statutory claims or further clearances concerning company distributions.

2.4. Another reservation with the statutory relief relates to the administrative burden. The trustees have to claim the relief, rather than it being automatic. This is a missed opportunity and another easy win as it would have been a simple yet highly effective move toward simplification to afford trustees the ability to utilise the relief automatically. Having to make the claim actively is a layer of administration which could be easily avoided and would assist in the wider goal of simplification.

Having to claim will also, presumably, necessitate the completion of a self-assessment tax return by the trustees. Many EOTs are self-administered so this compliance requirement is not something that many trustees will appreciate or realise they are required to carry out.

2.5. The response to consultation document (also on page 10) states that clearances already given for distributions from the company will be honoured. We have assumed that this means that existing clearances that cover payments outside the list of items in the new statutory relief will be honoured for payments made on or after 30 October 2024; but none of the published documents explain how this might work.

There are a number of practical questions here, some of which we have been asked by our members and their clients:

- A company has been making regular contributions to its EOT shareholder on the last day of every calendar month and continues to do so after 30 October 2024. In line with HMRC's, comments about honouring clearances, please confirm that HMRC will simply treat such post-30 October 2024 contributions as not being distributions, as has hitherto been the case?
- Now that the draft legislation has been published, does HMRC expect companies to fund future payments to the trustees by way of dividend, and claim relief, or do companies have a free choice in the matter?
- Exactly how is the relief to be claimed? We are aware of a number of companies that are ready to start paying dividends to trustees, instead of making contributions, and we are already getting questions about the claim process.

2.7 We are also concerned that some of the drafting in the EOT amendments contained in the Finance Bill are vague and imprecise, descriptions such as: '*consideration requirement*', '*all reasonable step*s' '*reasonable commercial rate*'. Taxpayers will require clear guidance from HMRC that they can rely on in order to interpret these terms; we would therefore recommend that this be issued as soon as possible given the immediate effect of these changes.

2.8 It would also be useful for a further review into the EOT regime at some point in the near future, once these changes have had time to take full effect. As the popularity of EOTs increase and their companies develop (including through mergers and acquisition), on-going reviews of their effectiveness, and how greater focus on employee benefits might be achieved, would be welcome.

2.9 **Acknowledgement of submission**

We would be grateful if you could acknowledge safe receipt of this submission.

The Chartered Institute of Taxation

25 November 2024

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.

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.