**Consultation response**

**Taxation of Employee Ownership Trusts and Employee Benefit Trusts**

**September 2023**

1. ***Question 8: In addition to the reforms proposed at Chapters 4 to 6, do you have any views on ways the Employee Ownership Trust tax regimes could be reformed to better support employee ownership?***
   1. Yes, **we propose that government amends eligibility for the reliefs attached to the employee ownership trust (EOT), so that they also apply when the sale of the majority stake in a company is to a ‘Common Ownership Workers Co-operative' (COWC)** formed by the employees of that company.
   2. The EOT regime has been a great success, incentivising a huge increase in transitions to employee ownership year on year. But the current rate of such transitions is tiny fraction of the businesses and jobs that are lost each year because of failed or unfavourable succession, divestment or closure. This is in part a consequence of how the Finance Act 2014 preferences one model of employee ownership over others, in a way that distorts and limits options for business owners and employees.
   3. The EOT model is not the only arrangement suitable for transitions to employee ownership in the UK. There are more than 400 ‘common ownership worker co-operatives’ (COWCs) in the UK and in the past this model has been used successfully for transitions. Of the over 900 COWCs created in the decade from 1976 to 1986, 210 (23%) were created through the conversion of existing businesses.[[1]](#endnote-2)
   4. The COWC model has several characteristics that make it suitable for employee ownership transitions. The COWC is a **simple, straightforward and low-cost legal arrangement for employee ownership**. We estimate **cumulative cost savings for transitioning businesses of many millions of pounds each year** from using a COWC for transition instead of an EOT.
   5. A COWC could be a more optimal and attractive option in some cases, especially for micro businesses, lower value businesses and worker-initiated transitions. Our proposal would provide businesses, business owners and employees with more choice in arrangements. This would **unlock opportunities to secure thousands more viable jobs and businesses each year through additional employee ownership transitions**.
   6. Yet the EOT it is the only arrangement that is advantaged by tax relief under Schedule 37 the Finance Act 2014. As is often the case when policy preferences one model over others, this creates distortion by limiting the options available to businesses and workers.
   7. There would be great value in offering businesses and workers the COWC as an additional tax advantaged option for transitioning to employee ownership.
   8. At a time when hundreds of thousands of potentially viable jobs are at risk because of business closure, transitions to employee ownership via a workers co-operative offers a proven way to sustain some of these jobs through resilient, productive and socially just enterprises. To maximise the potential for this, we need to ensure employees and businesses have more good options open to them. This requires government to end damaging distortions in tax law that currently limit these options.

*Our proposal*

* 1. We propose that government **amends eligibility for the reliefs attached to the EOT, so that they also apply when the sale of the majority stake in a company is to a ‘Common Ownership Workers Co-operative' COWC formed by the employees of that company.**
  2. We propose that to be eligible, a COWC should be a co-operative society registered under Co-operative and Community Benefit Societies Act 2014[[2]](#endnote-3) with the following provisions in its constituting rules:
     + **Purpose:** To meet the common needs and aspirations of its members, including specifically to create and sustain decent, rewarding and empowering livelihoods for employee-members
     + **Employee control:** The membership of the co-operative must include employees of the business being sold, with these employee-members holding the majority of voting rights, and with membership open to all employees of the business
     + **Democratic governance:** Members must exercise democratic control of the co-operative on a ‘one member one vote’ basis
     + **Surplus and assets:** Surpluses and assets must be applied for the purposes of the co-operative, which can include a profit share distributed among employees, but the residual assets of the co-operative must not be distributable among members and must instead be used to further the purposes for which the co-operative existed (e.g. to support the development of other COWCs, wider social action, acts of solidarity)[[3]](#endnote-4)
     + **Investor members:** Investor members, if any, must either have no voting rights, or voting rights that strictly limit their ability to influence the governance of the co-operative, with no vote on matters relating to the use of surpluses and residual assets, or co-operative status
  3. On order to comply with the FCA Mutuals Team’s conditions for registration, the transitioning company would need to be made a partially or wholly owned subsidiary of the COWC co-operative society.[[4]](#endnote-5)
  4. All of the above could be easily and reliably verified by HMRC in a COWC’s Mutuals Register entry.[[5]](#endnote-6) Just as the law requires EOTs to continue to meet certain conditions in order for the tax relief to be applied and not clawed back, the law could easily require the same for COWCs.

1. ***Question 1: Do you have any comments on the proposal to prohibit former owners and connected persons from retaining control of an EOT-owned company post-sale by appointing themselves in control of the EOT trustee board?***
   1. We agree with government’s proposal to prohibit former owners and connected persons from retaining control of an EOT.
   2. Related to this, we believe that empowering employees in the EOT helps mitigate the risks of inappropriate influence of former owners. Therefore, it should also be government policy to encourage effective employee representation and influence in EOTs.
2. ***Question 2: Should the government go further and require that the EOT trustee board includes persons drawn from specific groups, such as employees or independent persons? If so, how should these groups be defined?***
   1. Yes. It should be **mandatory for *at least* one seat of the trustee board, or one third of the seats if there are more than three, to be reserved for employees** who are appointed by their fellow employees through a democratic process. In the interests of flexibility, there should be no prescriptions about the nature of the democratic process.
   2. From a co-operative perspective, we would advocate for employees to have democratic control in any employee-owned businesses. Many of the benefits usually ascribed to employee ownership, such as engagement, culture, discretionary effort, performance, purpose and wellbeing are actually linked to employee empowerment. However, in the interests of retaining flexibility, we acknowledge that while full democratic employee control is our preference, it is impractical to suggest this as a mandatory requirement for all EOTs at this time.
   3. Also in the interests of flexibility, we **do not** believe it should be mandatory to appoint independent EOT trustees. This would be overly prescriptive, costly and burdensome, especially for smaller businesses.
   4. However, where independent persons are appointed to the trustee board, it **should be mandatory for their appointment to be approved by employees** through a process that enables employees to hold these persons to account. This is standard good practice for independent directorships in the mutual sector.
   5. Stronger minimum requirements for employee representation and control in EOTs will increase transparency and accountability. It will ensure EOT operate as legislation intends, in the interests of all employees. It will help reduce inappropriate use of the model and strengthen integrity.
3. ***Question 3: Do you have any comments on the proposal to require that the trustees of an EOT are UK resident as a single body of persons?***
   1. We support the proposed changes that would prevent the creation of a qualifying EOT that is non-UK resident for tax purposes.
   2. We are concerned by the *potential* for a small number of wealthy individuals misuse a vehicle intended for democratic business ownership for tax avoidance and private gain. In addition to ethical issues, it undermines the credibility and reputation of democratic business, which is something our member co-operatives have a direct stake in.
4. ***Question 7: Do the EOT bonus rules create any other unintended consequences or challenges in administering the tax-free bonus payments?***
   1. There are unintended consequences and perverse incentives that arise from only applying the tax-free bonus in EOT-owned businesses, and not applying it in the other established employee ownership arrangement: worker co-operatives.
   2. Worker co-operatives are employee owned and controlled enterprises, of the sort that the creators of the EOT regime sought to encourage. Yet the employees in this structure do not benefit from the tax-free bonus. Not only does this unfairly penalise employees of worker co-operatives, but it also creates a perverse incentive for businesses that are already employee owned to adopt the EOT model.
   3. While the EOT is the more common model for transitions, the worker co-operative model is more popular for creating businesses that are employee-owned form the outset. Thus, extending the tax-free bonus to worker co-operatives would have the added benefit of encouraging the creation businesses that are employee owned from the outset. Given the greater propensity to create jobs and higher survival rates in worker co-operative start-ups, there are good economic reasons for having the tax-free bonus to act as an incentive in this way.
   4. For these, and other for more substantial reasons outlined in our answer to question 8 below, we assert the reliefs attached to the EOT should be extended to ‘common ownership worker co-operatives’.

**Notes and references**

1. According to Industrial and Common Ownership Movement (‘ICOM’) newsletter from 1986. 15% were ‘recuperations’ and 8% were buyouts, making 23% in total. [↑](#endnote-ref-2)
2. See FCA handbook on co-operative societies here: <https://www.handbook.fca.org.uk/handbook/RFCCBS/4/?view=chapter> [↑](#endnote-ref-3)
3. Government has just legislated to give itself the powers to give co-operative societies the option of making some or all of their capital surplus non-distributable to members – [see here](https://bills.parliament.uk/bills/3193) [↑](#endnote-ref-4)
4. See FCA handbook here: <https://www.handbook.fca.org.uk/handbook/RFCCBS/3/?view=chapter> [↑](#endnote-ref-5)
5. The rules of incorporation for all co-operative societies are freely and easily available on the Financial Conduct Authority’s [Mutuals Register](https://mutuals.fca.org.uk/), which has statutory equivalence with the Companies Register [↑](#endnote-ref-6)