The John Lewis model of employee ownership can offer business security and tax benefits

Employee Ownership Trusts are a sensible way to keep a business in good hands, says Robert Postlethwaite

As much as a change in ownership can make a business, it can also be its nemesis. Get succession wrong and, well, the business sections of publications are littered with tales of share values plummeting and soul-searching at board level about vision and leadership.

And the size of the business doesn't matter - the effect is the same. If anything, when founding entrepreneurs decide it's time to retire or exit it is even more acutely the case that the essence which has underpinned growth and success should not be lost.

The dilemma, then, is how entrepreneurs realise material value from the business they've created without destroying the business in the process. Oddly, because it's not automatic to think of the Treasury as offering a solution in such cases, recent tax changes present a choice which is at once tax efficient and ticks many practical and emotional boxes.

Take the example of Jon Harvey and Barry Hayes, co-founders and majority owners of Mavenwire (Europe) Limited, a transportation management consultancy and systems design business that they founded in 2007 and which, by 2014, had around 100 employees and operations throughout Europe and other parts of the world - a healthy business with growing profits.

Jon and Barry were ready to retire. They saw the real value in their business lying with the expertise and motivation of their employees. Any legacy in terms of sustained future performance needed to keep those employees on side, happy and engaged. 'We looked at selling the business to a third party but we had major concerns that the company would become a less rewarding and enjoyable place to work. That would not be in the interests of our employees and they are critical to success and longer-term performance.'

So what next? What about selling the business to the employees? Jon and Barry's thoughts crystallised when changes to capital gains tax (CGT) affecting the sale of a business to an employee ownership trust (EOT) came into play. This offered the best of all worlds.

The EOT model (as John Lewis so often demonstrates) gives all employees a stake in the business and a share in the fruits of strong performance. By allowing shares to be retained in trust for employees in the long term, it can also avoid the need for employees to make a personal financial investment, often a major advantage where employees have little or no money with which to do so or are concerned about taking that kind of risk.

For Jon and Barry, HMRC confirmed that, thanks to the Treasury's recent tax changes, any tax payable by UK taxpayers on the proceeds of selling a majority of shares in their company to an EOT would be treated as CGT rather than dividend income tax, following which full relief against CGT could be claimed. This was great news for them and those senior employees who also personally owned shares in the company.
The EOT is funded by the company out of its profits. Once established, it made an initial payment to the selling shareholders financed by the company's retained profits. The intention is to pay the balance of the purchase price within a defined number of future years out of future profits. Rewards to employees for future performance will be based on a new company-wide bonus plan.

A second tax relief, intended like the first to encourage employee ownership in more companies, will allow the company - now that it is controlled by an EOT - to pay annual bonuses (if paid to all employees) free of income tax, with a separate (income taxable) bonus plan for its more senior employees.

The EOT is the company's controlling shareholder but it doesn't run the company. This remains the responsibility of its directors and, initially, Jon and Barry are continuing to perform this role.

The EOT is run by its trustees, which comprise one employee, one director and one independent person from outside the company. As the beneficiaries of the EOT are the company's employees as a whole, the trustees have a duty to act in the employees' best interests.

Mainly this means ensuring that the company's directors manage the company effectively and generate strong profits which can be shared with employees and invested in the future. It also means fostering a company culture which is positive and rewarding for its employees and which encourages them to contribute wherever possible.

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