Social Business Wales

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A guide to employee benefit trusts

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Also available in Welsh. Also available in large print format.

What are Employee Benefit Trusts?

Employee Benefit Trusts (EBT) are used in a large number of employee owned companies.

An EBT is a special type of discretionary trust into which a company can place shares or other assets, under the distinct and separate ownership of trustees, for the benefit of beneficiaries. The "Trustee" holds shares for employees of a company (known as the "Principal Company"). The employees, and former employees, who stand to benefit from the EBT are called "Beneficiaries". The Trustees are generally chosen by the principal company and employees and contain one trustee independent of the principal company.

The benefit of the shares held in the EBT vest in the Beneficiaries as a class but none of them individually has a right to receive a benefit unless the Trustee decides he or she should benefit. Being a beneficiary doesn't guarantee a dividend or allow for a situation where 'ownership' can be sold on leaving the business as is the case with shares.

It is a form of collective ownership of shares on behalf of employees as opposed to individual ownership of shares by the individual employees.

Why would we need an EBT?

EBTs are used for many purposes, but in employee ownership the role of an EBT is normally to act like a warehouse and hold shares on behalf of employees for the long term, to act as a 'market maker' for employees wanting to buy or sell shares, or fulfil both roles at the same or different times.

EBT as a warehouse

The EBT is often used as a "warehouse" for the acquisition and holding of shares often as a result of a business succession. An EBT is often created so that it can be used as a legal vehicle to purchase shares from the original outgoing owner when they wish to exit the business.

The EBT is normally financed directly either as a result of lending money from a third party (though security may be provided by the principal company), or by being 'gifted' funds by the principal company that created it.

The EBT is a separate legal entity controlled by trustees and is not under the control of the principal company even though the principal company may have either 'gifted' or secured funds for the EBT to purchase shares.

How does an EBT holding shares benefit employees?

The EBT holds the shares for the benefit of employees. The Trustee will have discretions and powers granted to it under a document known as a "Trust Deed". The Trustee will be required to act in accordance with the terms of the Trust Deed and this may contain some guidance on how trustees are expected to act in the interests of beneficiaries.

Holding shares and acting in the interests of employees might mean the trustees holding the shares for a long time and not distributing them. During this period the trustees hold the Board of the principal company to account and ensure that they treat employees as owners and run the company in their interests.

The trustees may decide to hold shares for a short time only before passing them out to some employees, or granting options to certain employees.

The shares held by the EBT will attract a dividend and the trustees might decide to benefit the employees by distributing this dividend to them. However, this rarely happens, as there are a number of far more tax efficient methods of rewarding beneficiaries.

As part of the Finance Act 2014 it is possible for Companies who are owned at least 51% by a qualifying Employee Benefit Trust to make bonus payments of up to £3600 annually free of income tax to employees.

One key point to remember is that an EBT is a discretionary trust. Essentially so long as the trustees believe they are acting in the best interests of beneficiaries they can exercise their discretion rather then be instructed by beneficiaries to perform certain acts (such as selling the principal company and splitting the proceeds amongst the employees).

John Lewis Partnership is an example of an employee owned Company wholly owned by an EBT.

EBT as a 'market maker'

The EBT can act as a 'market maker' by buying shares from employees when they leave the business and selling shares to new employees who join. In order to buy shares the EBT will generally be gifted funds by the principal company.

This provides an advantage when compared to a principal company buying its own shares from employees leaving and being forced to cancel the shares, then having to allot new shares in order to make shares available for new employees to buy shares.

How can we set up an EBT?

Setting up an EBT is quite straight forward, but you should take professional advice in doing so in order to ensure that the EBT will deliver the outcome you want.

The normal process for setting up an EBT is:

1. A trust deed is drawn up. This sets out how trustees are appointed, who the beneficiaries are, what property (shares, money, assets, etc) has been put into trust, and what the trustees can do with this property they own on behalf of the beneficiaries.

2. Identify the trustees. Usually an employee elected trustee, a board appointed trustee and an independent trustee (ie someone who doesn't or hasn't worked for the principal company).

3. The trustees and the principal company sign the trust deed.

4. The principal company then gives a small 'gift' of money to the trust – this might be as little as £100.

Further Information

The guide has been produced for the Social Business Wales project. Social Business Wales is funded by the European Regional Development Fund and Welsh Government. It is delivered by the Wales Co-operative Centre and is part of the Business Wales service.

Social Business Wales aims to support social businesses with aspirations to grow. For further assistance, please contact:

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