EQUITY
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LIMITED

Employee Benefit Trusts

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What is an EBT?

An Employee Benefit Trust (EBT) is, in broad terms, a discretionary trust for the benefit of employees. A trust is a legal arrangement by which one person owns assets on behalf of somebody else. The most common examples are pension funds, charities or family trusts. An EBT is a trust which owns shares in a company for the benefit of employees (and sometimes former employees) of a company.

There are different types of EBT and, confusingly, different names for an EBT. An EBT can also be referred to as:

- an ESOP (employee share ownership plan)
- an employee share trust
- case law employee trust

A basic, discretionary EBT has a set of trustees and a set of beneficiaries. The beneficiaries will be the former employees and employees of a company or a group of companies. The trustees will generally be chosen by the company and will tend to be either a professional trustee company or directors of the company appointed as trustees. The trustees decide who should be given shares (or cash), how many shares a person should be given and when they should be given them. They may decide that it is in the best interests of the employees that the shares are held in the trust for the long term and not distributed. They may hold shares only for a short time before passing them out to some or all employees.

The different types of EBT include some types of trust which are set up under specific pieces of legislation and which bring specific tax reliefs. These include:

- QUEST (qualifying employee share trust)
- PST (profit sharing trust), and
- SIP (share incentive plan).

Why do I need an EBT?

An EBT can be used for a variety of purposes.

Market maker in an internal market

One of the commonest uses for an EBT is where an unquoted company wishes to create some liquidity to make share ownership more meaningful for its employees.

Employees wishing to sell can offer their shares to the trust which can be funded either by other employees wishing to buy shares, or by the company. The company can fund the EBT either by way of loan or by a gift and this enables shares to be recycled for employees.

Warehouse for shares

Alternatively, a company may choose to park a number of shares in the safe and stable hands of an employee trust. This can act well as a communication tool to employees and has been successfully used to capture value for employees which will be distributed on an exit but avoids widespread individual employee shareholdings.

Providing an exit

EBT's have been used to provide an exit route for founder or family shareholders. This can be particularly useful where the company wishes to maintain its independence, or its independence is crucial to its market positioning. In such cases, a trade sale is not attractive and a flotation may not be achievable in the short to medium term.

An EBT can be financed directly by the company or by a third party loan (though the liability may well fall on the company to repay this loan) and can then purchase shares from the shareholders. The shareholders may well benefit from attractive rates of capital gains tax if they benefit fully from taper relief. Alternatively, the structure can be modified to involve a SIP which offers complete capital gains tax deferral.

Mechanism for employee share plans

The simplest use for an EBT is as a mechanism for employee share plans. A quoted company may choose to set up an EBT to buy shares on the market for use in its employee share schemes. This is particularly useful where the company is approaching the dilution limits which govern the amount of new issue shares that can be used for employee share schemes.

In a private company, an EBT may be used to buy shares from shareholders who want an exit or from employees who leave the company in order to create a pool of shares for use in a share plan.

In either type of company, they can be used to grant options and will be needed if the company wants to give away free shares.

How do I set up an EBT?

An EBT can be easily established. The basic steps are:

- draw up a trust deed which sets out how trustees are appointed, who the beneficiaries are and what the trustees can do with the shares they own on behalf of those beneficiaries
- decide who the trustees will be, usually either a professional company or individuals appointed by the board
- trusts can have a "corporate trustee", a company of which the individual trustees are directors to give them some limited liability
- the trustees and the company sign the trust deed
- the company then gives a small initial gift to the trust (say £100)

What is the tax treatment of an EBT?

An EBT is highly flexible but does not benefit from any particular tax advantages.

The EBT itself will pay income tax on any income it receives (such as dividends) and may pay capital gains tax if it makes a profit on any shares it holds. This can be avoided if structured properly.

The company may get a corporation tax deduction on the costs of funding the trust, but only if the company can show that the cost was incurred for the benefit of its trade and is of a "revenue nature" (small regular payments rather than large capital payments). This will not be available however until any resulting shares leave the EBT and leave at a loss to the EBT. This is because for accounting purposes the assets and liabilities of the EBT are shown on the company's balance sheet and there will be no cost to the company until there is a cost to the EBT.

Who are we?

Equity Incentives has substantial experience in all aspects of employee benefits, including equity incentives. The Managing Director, Graeme Nuttall, is a member of the HM Treasury advisory group which helps the Inland Revenue introduce new share schemes including EMI and SIP. Through membership of the **Global reward plan group** we implement international share schemes.

For further information, please contact:

Graeme Nuttall:

E-mail: graeme.nuttall@equityincentives.co.uk

Sarah Anderson:

E-mail: sarah.anderson@equityincentives.co.uk

This document is intended as a general guide on complex subjects. It is not intended as a comprehensive review. It should not be relied upon as a substitute for advice in a particular circumstance.

Equity Incentives Limited 35 Vine Street London EC3N 2AA
Tel: +44 (0)20 7861 4717 Fax: +44 (0)20 7488 0084
E-mail: info@equityincentives.co.uk Website: www.equityincentives.co.uk CDE: 823