EQUITY INCENTIVES LIMITED

ESOPs as an exit

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When an ESOP sources its shares from an existing shareholder, then from that shareholder's perspective, the ESOP provides an exit route.

This can often be an attractive solution in the following circumstances :

Retiring Owners

An owner-manager may turn to an ESOP trust as a mechanism for staging a gradual withdrawal from the business. Alternative exit routes - such as trade sale or flotation - may be infeasible or unattractive. They are certainly irreversible. A sale to an ESOP can be arranged gradually at a pace which suits the vendor, the company's finances and the remaining shareholders. This is a common application of ESOPs in the USA.

Family-Owned Companies

Some family-owned companies extend the definition of "family" to encompass loyal and long-serving employees. For these companies, an ESOP is a natural buyer of family shares, especially in situations where the family shareholding is dispersed or where family members no longer work in the business.

Closely Controlled Private Companies

An ESOP can avoid the sensitivity of *individual* employee share ownership in companies where it is important to retain boardroom control or maintain an existing balance of power. By holding onto shares acquired from a selling shareholder, the ESOP can hold shares for the benefit of employees but be otherwise controlled by directors or major shareholders acting as trustees.

Companies difficult to sell

A company that is heavily dependent on one person, one product or one customer may be difficult to sell to a third party at an attractive enough value. Nevertheless, cashflow may be strong enough to support a company-financed ESOP exit which can be structured to be tax-efficient for the vendors, for the company and for employee beneficiaries.

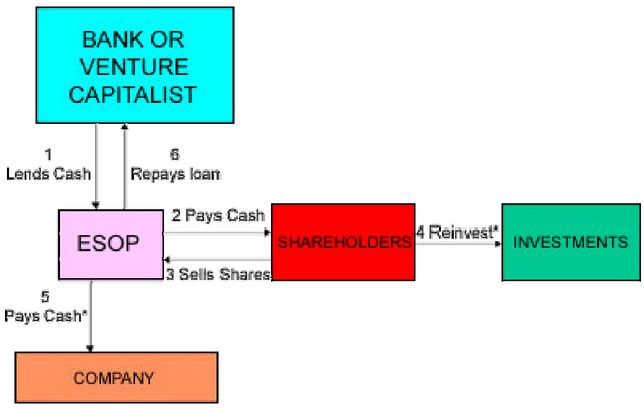
There are four main tax reliefs under UK legislation which can be relevant in an ESOP exit. The first two of these relate specifically to ESOPs.

CGT rollover relief on a sale to a Qualifying ESOP ("QUEST"). The QUEST must own 10% of the company within 12 months of the disposal, and the vendor must reinvest in "chargeable assets" (any asset which itself is subject to CGT on a subsequent disposal) within 6 months of the disposal. This is one of the most flexible and attractive CGT reliefs in the UK.

Relief from inheritance tax on transfers at below market value of a controlling interest in a company to an ESOP trust. This is useful in situations where the vendors are prepared to accept less than full market value.

Retirement relief. This exempts the first £200,000 of gain from CGT and reduces the tax charge on the next £600,000 of gain to half the normal rate. The individual must be aged over 50, must have worked for more than 10 years in the company to claim full relief and must have 5% or more of the voting rights. Retirement relief is gradually being phased out and is being replaced by taper relief.

Taper relief. This reduces the gain on a sale of shares (e.g. to an ESOP) by a percentage figure which increases the longer the shares have been held. The eventual effect for certain vendors will be to reduce the effective rate of capital gains tax to 10%.



*Where ESOP is a QUEST, company gifts are deductible against corporation tax and any capital gains realised can be deferred.

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. Through membership of the **Global reward plan group** we implement international share schemes.

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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.

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