Written evidence submitted by the Chartered Institute of Taxation (FB10)

Finance Bill 2024-25

Clause 31 and Schedule 6

Employee Ownership Trusts

Executive Summary

Clause 31 provides for amendments to the capital gains tax (CGT) treatment of transfers of trading company shares into Employee Ownership Trusts (EOTs) and the income tax treatment of employee bonuses, details of which are contained in schedule 6. This follows from a 2023 consultation which tightens up the CGT reliefs on such a transfer. Whilst these are positive changes, the CIOT remains concerned that the emphasis within them still lies with the tax benefits afforded to the business owner rather than attempting to make EOTs more favourable to employees.

Overview

1.1. An EOT is a type of trust, the rules for which were introduced in 2014, to facilitate greater employee-ownership (albeit indirectly). The EOT trustees (often consisting of professional trustees) must hold a controlling stake in the limited company employer for the benefit of all employees on equal terms, who can receive an income tax-free bonus of up to £3,600 from the company. By putting at least 51% of their shareholding into the trust, no liability to CGT arises for the business owner as the disposals are treated as being for no-gain or no loss. EOTs can be a very useful way of retaining a workforce and encouraging longevity for the business by facilitating employee-ownership; however there has also been some concern that the CGT benefits available might be exploited to allow the business owner to sell the business to a third-party via an EOT.

1.2. For EOTs, when a business owner transfers a controlling shareholding of a trading limited company into such a trust, the transfer is treated as ‘no-gain/no-loss’ for the individual owner, i.e. it is a tax neutral transfer with no CGT payable. Clause 31 and Schedule 6 change the requirements for obtaining this relief, confirm the treatment of contributions made to the trustees to fund acquisition costs, and make an administrative change to the conditions for obtaining income tax relief on qualifying bonus payments to employees of EOT-owned companies. These changes have effect from 30 October 2024.

1.3. In particular, the changes:

- Require all new EOTs settled on or after 30 October 2024 to be UK-resident
- Ensure that at least 50% of the trustees are not shareholders (or connected persons) in the company (the ‘trustee independence requirement’)
- Require consideration paid to the business owner not to exceed the market value of those shares
- Extend the period during which the relief paid to the business owner can be clawed back in the event of a breach of conditions to four years

- Increase the amount of information that needs to be included when a business owner makes a relief claim

These changes, contained in Part 1 of the schedule, are in place to ensure that the CGT relief conferred on the business owner is not abused and the EOT is not being used simply as a short-term conduit for a third-party sale.

1.4. Part 2 of the schedule contains two measures relating to income tax. First, it eases rules around income tax-free bonuses to allow these to be awarded to employees without directors necessarily being included. Second, when companies provide funding to the EOT to purchase the shares from the owner, those funds constitute distributions (i.e. dividends) which are subject to income tax. In practice, before the budget announcements, a non-statutory clearance request was made to HMRC to ensure there are no tax consequences to this funding. However, the legislation now provides for a statutory relief from income tax on those dividends granted from the company to the EOT for the purchase of the shares and payment of loan interest and stamp duty.

CIOT comments

1.5. Whilst we welcome the general direction of these changes and tightening up the rules which have been in place since 2014, we have several concerns, largely that the changes don't go far enough.

1.6. The rules being tightened up largely revolve around the business owner's eligibility for CGT relief when placing shares into trust. We would have preferred greater focus upon changes which might benefit employees – for example there is no increase in the level of the employee's income tax-free bonus (which is not free from national insurance contributions - NIC); increasing that tax-free amount and/or extending the exemption to NIC would have been a simple and effective opportunity to reward employees and make working for an EOT-owned company more attractive. The current £3,600 figure has not changed since 2014 and would be just under £5,000 now had it kept up with inflation.

1.7. Also, the employees' ownership of the business is indirect which leads to an element of double taxation. For example, any sale of the EOT-owned company would be taxable first on the trustees for CGT then again on the employees under income tax and NIC if they receive any of the proceeds. We recognise that these tax rules may be intended to act as a disincentive for company owners to use EOTs as a short-term conduit for a third-party sale. Nevertheless, our view is that, ideally, there should be only one layer of taxation within the EOT.

1.8. However, our biggest concern revolves around the statutory relief for contributions from the company to the trustees. Payments made by the company to the EOT to fund the share purchase, interest on outstanding consideration and stamp duty would ordinarily be classified as a distribution and the trustees would have to pay income tax. This new rule allows a claim to be made for those specific costs to be deducted from this taxable distribution, avoiding the need for a clearance application.

1.9. Our concern is that trustees of a trust that holds the shares of a trading company will have many other expenses to cover, such as professional transaction fees and finance arrangement fees as well as ongoing compliance costs such as professional trustees' fees, costs of operating PAYE on any payments to beneficiaries and general professional advice. We do not necessarily consider this an exhaustive list.

1.10. None of these other costs are covered by the new income tax relief, thus any payments by the company to the EOT to fund those costs will still be treated as distributions. What this means is that, to fund a cost to the trustees of, say, £600, the company will have to pay the trustees a dividend of £1,000, so that after paying income tax of £3,935, the trustees are left with sufficient funds to pay the expense. With the boundaries of relief being enshrined in statute, it would appear unlikely that HMRC would be able to extend it under their own discretion.

1.11. As well as some uncertainty about the practicalities as to treating future payments to EOTs, the same is true of pre-existing clearances and whether they will cover future payments in the light of the new relief. It would be helpful if the government could clarify whether this will be the case.

1.12. Additionally, this new statutory relief must be claimed, presumably via a self-assessment tax return. This is likely to be something many trustees will be unaware they have to carry out. It would be much easier, and a great step toward simplification, if an automatic relief were to be in place for all payments received by trustees in respect of all relevant capital and ongoing costs. Ideally this should apply to all EOTs (which meet the all-employee benefit requirement), even those which do not attract or require CGT relief for the business owner. These trusts are not defined by CGT relief alone, yet all still require financing and administrative simplicity is key to making employee ownership an attractive option.

1.13. We are aware that the Employee Ownership Association have drafted amendments to the legislation to clarify some of the measures and deal with apparent unintended consequences of, or gaps in, the legislation. These overlap heavily with the concerns we express above. We endorse the objectives of these amendments and encourage ministers and the wider committee to consider accepting them.

The Chartered Institute of Taxation

1.14. The CIOT is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

1.15. The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

1.16. The CIOT's 20,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA' and 'CTA(Fellow)', to represent the leading tax qualification.

The Chartered Institute of Taxation
Thursday 16 January 2025