MNCEO

MINNESOTA CENTER FOR EMPLOYEE OWNERSHIP

Employee Ownership Trusts

What is an Employee Ownership Trust (EOT)?

- In the UK, an EOT operates as a profit-sharing plan for employees that holds some or all of the shares of a company on behalf of the employees of the company. In the US, the EOT is sole owner of the Company and the profit-sharing plan is not part of the Trust
- Traditionally, EOTs are perpetual trusts that expect to preserve employee ownership for current and future employees
- Like an ESOP, typically the profits/financial gains, and the corporate governance of an EOT-owned company are directed to the benefit of the company's employee-owners
- Unlike an ESOP, an EOT does NOT have individual employee accounts
- Rather, the trustee holds the shares for and on behalf of all employees and the company can design profit-sharing to allocate profits, or a portion of profits to the employees.

History of EOTs

- Form of employee ownership popularized in the UK
- Most well-known UK example is the John Lewis Partnership:
  - A UK retail chain currently with over 80,000 employees
  - Held in trust for the benefit of employees since 1929
  - Employees earn a percentage of profits while working at the firm
  - But employees leave/retire without any stake in growth in the firm’s value
  - Also provides voting rights to employees to elect the governing body
- UK provides tax incentives for perpetual trusts established for employees’ benefit

Advantages and Disadvantages of EOTs

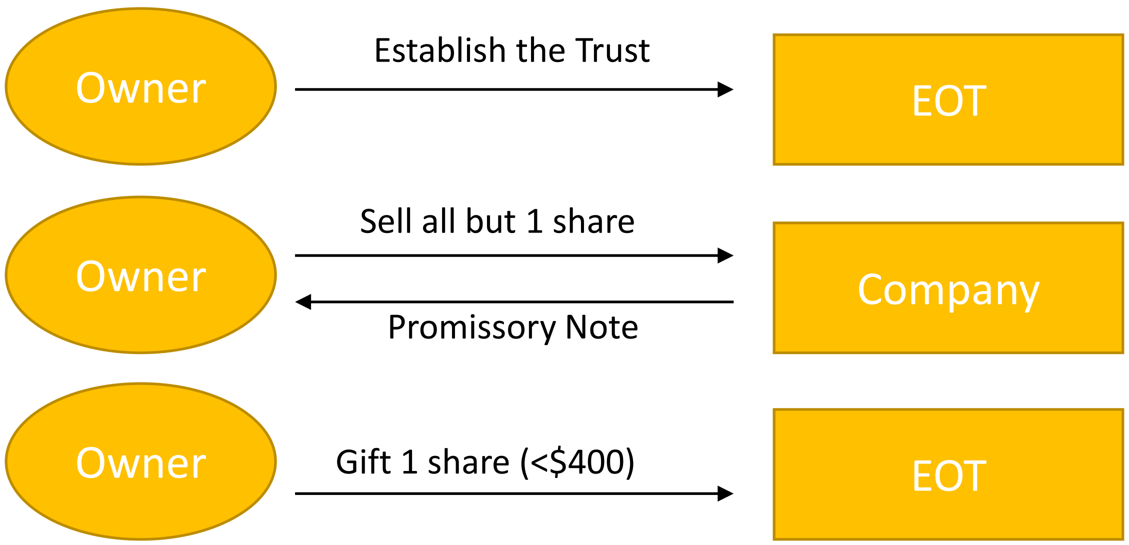
EOT Advantages

- Not regulated by ERISA
- Perpetual
- No repurchase obligations when employees leave/retire
  - Removes a cash flow issue common to ESOPs
- No annual valuations
- Simplicity
- Lower costs to create and administer

EOT Disadvantages

- No tax benefits in the U.S.
- Less U.S. precedent than ESOPs
- May not create retirement benefits for employees (can have an EOT allocate a portion of profits to a standard 401(k) plan)

Creating an EOT



1. The company/owners create a perpetual trust with the exclusive purpose of operating the company for the employees' benefit
    - Where: In a jurisdiction that allows perpetual trusts

2. Owner(s) sell interests in the company to the company either all at once or in installments

3. Company can allocate profits, or a portion, to employees and/or set up a qualified profit sharing plan
    - In profitable years, experienced as a bonus for participating employees

ESOPs vs. EOTs

- **Both**
  - Can address succession issues for family-owned businesses
  - Give employees an interest in the company
- **Differences**
  - ESOPs are subject to ERISA regulations, EOTs are not
  - In the U.S., EOTs lack the tax benefits of ESOPs
  - ESOPs – employees receive beneficial shares in individual accounts
    - When employees leave or retire, they receive payment for the value of those shares
  - EOTs – employees do not receive actual shares
    - Rather, the trustee holds the shares for and on behalf of all employees
  - ESOP trustees, as fiduciaries, must consider offers to buy the company, whereas EOT trustees need not because the beneficiaries are current employees
  - Costs:
    - ESOPs: $150K to $250K to create; approximately $30K in annual fees
    - EOTs: $20-30K to create; approximately $5K in annual fees

For more information on EOTs

Fredrikson & BYRON, P.A.

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