

FAQs for Employee Ownership Trusts (EOTs)



Frequently Asked EOT Questions

1 IS THIS FORM OF EMPLOYEE OWNERSHIP KNOWN BY ANOTHER NAME?

- Employee Ownership Trust (EOT)
- Perpetual Trust
- Perpetual Purpose Trust (PPT)

2 HOW DOES THE TRANSACTION WORK?

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

3 ARE THERE ANY TAX BENEFITS FOR EOTS?

Sorry, none yet! But there are bills in Maryland and Wisconsin. These bills would provide a state capital gains exemption on sales to EOTs and ESOPs.

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4 DOES IT HAVE TO BE PERPETUAL? WHAT IF I EXPECT A FUTURE SALE?

An EOT does not need to be perpetual. As the trustor, you can (and should) specify the precise conditions under which a sale would be permitted. Sale proceeds will be distributed as provided in the trust document, e.g., to charity.

5 WHAT ABOUT GOVERNANCE?

In most cases, governance will be the same as an ESOP, i.e., a “circular” structure where the board appoints the trustee and the trustee appoints the board. However, if so motivated, the founder can also provide for limited or full voting rights, like a cooperative.

6 SO WHAT'S THE FINANCIAL BENEFIT TO EMPLOYEES? AND WHAT ABOUT RETIREMENT?

An EOT-owned company shares a portion of its profits with employees. These profits are paid out at the corporate level as compensation and are therefore tax-deductible. Profits can be paid out as cash or as a contribution to a 401(k) plan.

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7 DO I NEED SPECIAL TRUST LAW IN MY STATE?

No! Your state may or may not offer adequate trust law. If not, an “administrative trustee” can be hired from another state for less than the cost of an ESOP trustee (due to lower litigation risk). Note: Your corporate domicile is the same.

8 CAN I INCLUDE OTHER BENEFICIARIES IN MY EOT?

Yes, that’s a great place to start a discussion about installing an EOT.

9 WAIT, NO REGULATION UNDER ERISA?

That’s right. An EOT is not a retirement plan and is therefore not regulated under ERISA. The EOT is regulated under state trust law, which generally respects the wishes of the trustor. However, the IRS charges income tax on any portion of the sale price that exceeds FMV.

10 HOW MUCH DOES THIS COST?

Well, an ESOP might cost between \$150K and \$250K to install and roughly \$30K annually. An EOT should cost between \$20K and \$30K to install and roughly \$5K annually.

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