Case Study: Award winning architects firm

A case study of how a collegiate professional firm both cemented its long-term future and gave an exit to the owners by using an Employee Ownership Trust

The Company is an award-winning architects firm with a score or so of employees. It has always been run and managed in an open and inclusive manner with all being encouraged to take a full part in the Company. The founder still owned the majority of the business with one other director owning a substantial majority of the shares.

So why an Employee Ownership Trust (EOT)?

The Company's founder wished to remain involved in the business but also to spend time on other projects. He had begun to consider long term succession and the sharing of ownership, inviting another director to become a substantial majority shareholder.

The Company was a small and close-knit team of professionals and skilled support staff who all worked together and shared knowledge and responsibility. The founder wished to encourage and reward this collegiate atmosphere and was concerned about the long-term future of the firm. He began to consider employee ownership as a means of (1) giving an exit for existing shareholders and (2) to protect the long-term future of the Company. In particular, although the Company tended to retain its employees due to the culture of the firm, an employee ownership structure would help to cement the culture with the ownership structure reflecting the way the Company was run.

RM2 spent time with the founder to understand his aims and to understand the corporate financial situation of the Company. RM2 recommended transferring all of the shares to an EOT.

(1) An EOT is a long-term ownership solution as it is designed to hold shares for all employees without the need to distribute them to individuals. Indirect ownership prevented the need for the Company to finance or support the buying and selling of shares by individuals each time an employee left or there was a management succession.

(2) An EOT allowed different shareholders to sell on different terms and at different values (always ensuring of course that the EOT did not overpay).

(3) An EOT is an "all-employee" trust. The Company's culture had always been inclusive and the all employee nature of an EOT reflected this in its ownership structure.

(4) Because the EOT was to hold the shares in the Company for the long term, this allowed the Company to distribute its income amongst its employees, rather like a quasipartnership where partners enjoy the income during their term but the capital remains in the partnership. In addition, the EOT allows a company to give bonuses to all staff on certain terms tax free up to £3,600 a year.

(5) A standard ownership structure with founders or directors holding the shares and other employees having no ownership did not reflect the way the Company was run. An EOT allowed the directors to continue their management role but also gave employees an ownership role; encouraging a flatter ownership structure more in keeping with the collegiate aspects of the company. In particular, some employees were able to take on the role of trustees.

So how was the transfer to the EOT managed?

RM2 advised the Company on all the legal and financial issues surrounding the EOT. We managed the necessary tax clearances from HMRC to ensure that selling shareholders were within the Capital Gains Tax regime, enabling them to claim full tax relief i.e. they paid 0% on their sale to the EOT.

The Company established the EOT and chose two employees to be trustees along with the founder. In this instance, the Founder was happy to sell his shares for below market value but the EOT enabled him to do this while still allowing the other shareholder to receive full value for his shares.

The EOT was funded by the Company out of its profits. If the founder had wished to take full value from his majority shareholding the sale could have been structured to enable this to happen. RM2 has advised on structures allowing staged payments the shareholders and has the capacity to find external funding where this is appropriate.

So how does the EOT affect the management of the Company?

The EOT controls the Company. The trustees therefore have all the rights and responsibilities of any other controlling shareholder. But it is important to remember that shareholders do not run a company. A company is run by its directors for the benefit of its shareholders. Where an EOT is the shareholder this means that directors are running the Company for the benefit of the shareholders who are also the employees.