

# Factsheet

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### A guide to Employees' Trusts

#### General Features

'Employees' trust' is a term commonly used to describe a discretionary settlement or trust for the benefit of employees, under which property - usually shares or cash - is held on behalf of a company's employees. The settlement is created by the transfer of trust property to the trustees and the execution of a trust deed (which will usually set out in some detail the powers and duties of the trustees).

The trustees are under a duty to deal with the trust property in accordance with the terms of the trust deed in the best interests of the beneficiaries (i.e. the employees).

#### 'ESOP' or Employees' Share Ownership Plan

An ESOP, or Employees' Share Ownership Plan, is the term which has been applied in this country to arrangements involving the use of an employees' trust in conjunction with one or more of the familiar types of 'free share', restricted share, share purchase, profit sharing or share option schemes.

A typical ESOP arrangement might involve the following:

- The company, or its shareholders, creates an employees' trust.
- The trustees might be individuals or a wholly owned subsidiary of the company formed for the purpose as an independent trustee company.

The trustees either borrow or receive funds from the company or a bank or other institutional lender, which are used to acquire shares in the company. In the case of a listed company such shares could be purchased in the market as well as direct from an existing shareholder. In certain circumstances the trustees might instead subscribe for new shares in the company.

The trustees make those shares available to employees through the operation of a share scheme.

In some cases, particularly those of unlisted companies, the trustees may also act as market makers to repurchase shares from employees who leave, die or simply wish to sell their shares.

#### Case Law ESOP

The case law ESOP is very flexible and can be used for whatever purpose the company may choose but it does not bring with it any express tax relief's, though the company may obtain tax relief for its payments to the trust in intrinsic circumstances established through contract, to the extent that employees receive benefits out of the trust which are subject to income tax (and National Insurance). It can be used to benefit all or any selected directors or employees, but the ESOP is not obliged by law to actually distribute its shares to individual directors or employees.

#### Limits

The ESOP is unlimited in the proportion of the company's equity capital which it is capable of acquiring. The trust has power to borrow in order to finance its share purchases.

Any director or employee with an interest in the company exceeding 5% may not be a beneficiary of an ESOP.

#### Factors for Non listed companies

ESOP trusts can be used to assist in ownership succession problems and, to establish management/employee buyouts. In non-listed companies they may create a market in shares for departing employees. A specialised use sometimes made of ESOPs is connected with employee buyouts, where the trust may serve as the buyout vehicle.

#### Benefits to employer

Flexible in giving the company choices such as its financing and methods of distributing to employees. The employee trust can also reduce the dilution of earnings per share because it makes existing shares available to employees, rather than newly issued shares.