It?s good to share

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Stephen Chater asks: is it time toconsider employee ownership to ensure succession at your firm?

The ownership of surveyors? businessestypically tends to follow a traditional model in which control is restricted toa relatively small number of partners or shareholders. To a large extent, thismodel has stood the test of time, but increasingly it is under pressure fromchanging expectations among younger practitioners who are less prepared tocommit the same amount of time and money.

Practice owners wishing to retire andbe paid for their stake may find that younger employees who are seen as primecandidates to replace them will often be unwilling or unable to make a capitalcontribution, removing the traditional source of funds used to buy outretirees. Furthermore, there are generally few external buyers, making a tradesale a pipe dream for all but a handful of businesses.

These issues are shared by many other professionalpractices. Some are addressing the problem by moving to a new model, in whichall or most of their workers can acquire a stake: this model is employeeownership.

Why employee ownership?

Surveyors? firms are no different fromother professional organisations in some ways. They rely heavily on the skillsof their people, a strong team culture is critical to long-term success andthey take pride in providing a quality service. These reasons alone may besufficient to consider the potential merits of employee ownership, but thereare others.

Businesses are finding that giving everyone a stake in the organisation is both compatible with their strategic objectives and could help staff in their careers

1. Employee-owned companies tend tooutperform their peers against a number of measures. Evidence shows greaterproductivity and employee satisfaction, stronger growth and more resilience.
2. The 2nd benefit stems from the1st and takes the form of 2 new tax incentives, which are intended to encouragemore businesses to extend their ownership to all employees. They have beenintroduced as a result of the government?s belief that a growth in the numberof employee-owned businesses makes sound economic sense.

More businesses are finding thatgiving everyone a stake in the organisation through employee ownership is bothcompatible with their strategic objectives and could help staff in theircareers.

Current employee-owned businesses

Employee ownership is being adopted asa new model by property-related businesses, such as the architecture practiceNorman Foster, engineering consultancy Arup and construction bodies, togetherwith other professions such as accountancy, law and patent agents. Each hastheir own reasons for the shift to employee ownership, but their commonconviction is that their business will thrive as a result, benefiting fromlonger-term staff commitment and a stronger team ethos.

What are the tax incentives?

In 2014, the UK government introduced2 statutory tax reliefs to encourage employee ownership among companies.

- The 1st is aimed at existing tradingcompany owners and provides them with the opportunity to sell a majority staketo an employee-ownership trust entirely free of capital gains tax.
- The 2nd enables any tradingcompany, a majority of which is owned by an employee trust, to pay annualbonuses to staff free of income tax (with a maximum of ?3,600 per worker peryear).

In both cases, strict rules govern howworkers can gain from the trust and how tax-free bonuses can be paid, to ensurethat benefit is spread fairly among employees. This does not prevent theorganisation rewarding selected workers more generously than others, but anybonuses not within the ?all-employee? requirement will be taxable. It is alsopossible for chosen employees to acquire more shares than others, so long asthese do not come from the trust and the trust retains control of the company.

How does it work?

Where employee ownership isintroduced, the transition will often proceed like this:

- the company, partnership or LLPcommissions a valuation
- once the valuation is produced, thebusiness looks at its anticipated future cash flow to determine how long it maytake to fund the purchase of shares from existing owners
- if the valuation and anticipated timeperiod for payment are acceptable, the company sets up an employee ownershiptrust (if the business is a partnership or an LLP, the 1st step will be toincorporate it)
- the trust agrees to purchase a majoritystake, up to 100% of the company, paying a fixed price but over a period ofyears, funded out of the company?s future surplus profits.

The sellers will be exempt fromcapital gains tax on their sale proceeds, and as soon as the company is able topay bonuses it will be able to do so free of income tax.

Do employees acquire sharespersonally?

This will depend on what the companythinks would work best. Employees can acquire personal shareholdings from thetrust, so long as they are each entitled to the same amount of shares ordiffering numbers according to their salary, length of service or hours worked.There are additional statutory tax reliefs, such as the share incentive plan(SIP), which can significantly reduce both the cost to employees of acquiringshares and the impact of any tax incurred on subsequent growth in their value.

Tax incentives are encouraging more business owners to consider a new succession route as an alternative to a sale to a 3rd party

Individual share ownership is favouredby some employee-owned firms, because it is often considered to be more easilyunderstood and offers staff the prospect of capital gains on their shares.However, a firm might not anticipate significant growth in its value, reducingor eliminating any opportunity for employees to make a profit from theirinvestment. It can also be time-consuming to administer, since arrangementswill normally have to be made to award shares to new employees and buy backshares from leavers.

The alternative approach is for theshares to continue to be held in trust on behalf of the employees. Thisstructure has been adopted by the architectural practice Make, engineeringconsultancy Arup and retailer John Lewis, with the trust managing 100% ofshares in each case. The financial benefit to employees will probably take theform of an annual profit share that creates a performance incentive andorganisational benefits, such as building a participative and transparentculture. This helps to create fulfilling roles and, indirectly, a financiallysuccessful practice.

What if not all the current ownerswant to retire?

The tax incentives attached toemployee ownership can be enjoyed so long as the trust acquires more than 50%of the company, so this will often be possible if some existing owners wish tocontinue.

If none or not all of the existingowners intend to retire, an employee ownership trust may not be the rightsolution. Alternative approaches are likely to exist, including:

- allowing all employees the opportunityto acquire shares personally, for example, benefiting from the tax incentive ofan SIP
- allowing a more limited range ofemployees to acquire shares (or to be granted options to acquire shares in thefuture)
- setting aside a specified percentagein an employee trust, representing a claim by employees as a whole to the samepercentage of annual profits.

Conclusion

These tax incentives are encouragingmore business owners to consider a new succession route as an alternative toselling to a 3rd party, and they create an opportunity for employees toreceive a higher net share of any future profits. Employee ownership is notalways appropriate and will not necessarily work successfully in everypractice. For example, there are no doubt some firms that genuinely believethat only a limited number of partners or employees are sufficientlyexperienced or committed to take on the responsibilities of ownership.

It is not a matter of 1 size fittingall. A business might understand the possible benefits of employee ownership,but may want to retain stronger financial incentives for its management team.In such a case, the firm could combine employee ownership with higher-levelrewards, including more significant shareholding or share options formanagement team members.

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Further information

Thisfeature is taken from the RICS*Property journal* (May/June 2016)