

Saving more jobs by improving the employee buyout tax reliefs

January 2024

What are we proposing?

Extend eligibility for reliefs under Schedule 37 of the Finance Act 2014, awarded when a controlling stake of a business is sold to an employee ownership trust (EOT), so that these also apply when a controlling stake of a business is sold to a 'common ownership worker co-operative' (COWC) formed by the employees.

Why are we proposing it?

Jobs and businesses sustained: At a time when livelihoods are at greater risk because of a wave of business closures with 2022 for the first time since 2010 seeing business deaths outstripping births, our proposals would enable additional transitions to employee ownership that would not happen otherwise, with higher levels of transition in the foundational economy and among micro businesses, and more jobs saved through employee-initiated transitions.

Choice: These measures would provide businesses and employees more good options in arrangements. In some circumstances a COWC could be a more optimal and attractive option, especially for lower value businesses, micro businesses and employee-initiated transitions.

Reduced complexity and cost: COWCs offer a simple, straightforward and low-cost alternative legal arrangement. Transitioning businesses using this model could save between £7m and £46m, cumulatively, over three years, in legal and other associated costs.

Reduced tax-risk for HMRC: Full democratic employee-led governance in a COWC would significantly reduce the risk of tax avoidance.

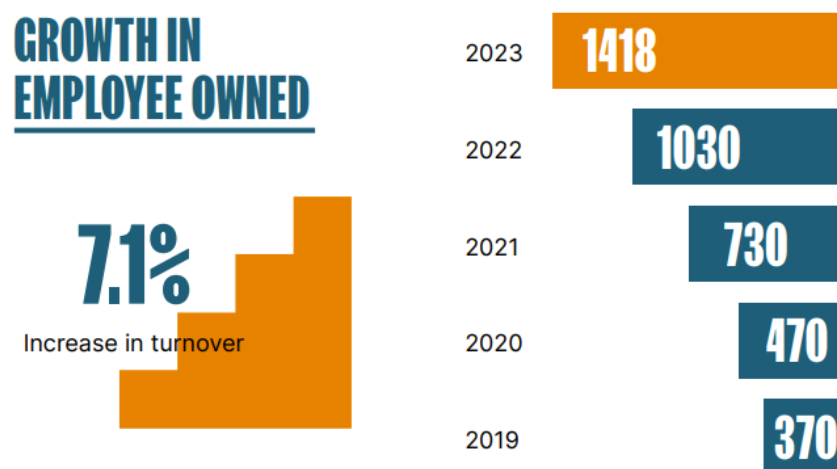
Increased transparency: COWCs are very transparent in terms of beneficial ownership and governance.

Cost neutral: The impact to the Exchequer would be broadly cost neutral and over time the economic, social and fiscal benefits that accrue will far outweigh a marginal increase in forgone tax receipts.

1 Introduction

- 1.1 At a time when hundreds of thousands of potentially viable jobs are at risk because of business closure, transitions to worker ownership offer a proven way to sustain some of these jobs through resilient, productive and socially responsible enterprises. To maximise the potential for this, we need to ensure employees and businesses have more good options open to them. This requires government to end damaging distortions in tax law that currently limit these options.

- 1.2 2022 was the first time the business death rate has exceeded the business birth rate since 2010, with the overall number of businesses shrinking by 1.7% while overall number of co-operatives grew by 1.1%.
- 1.3 In recent years the transition of UK businesses to employee ownership via planned owner exit ('employer buyouts') has become more common, with an incredible 37% leap in the number of employee-owned businesses the last year alone.¹ This is in large part due to the success of measures introduced by the Coalition Government in the Finance Act 2014, which provide Capital Gains Tax (CGT) relief (and other reliefs) when a controlling stake of a business is sold to an employee ownership trust (EOT).²



- 1.4 The EOT regime has been a great success, incentivising a huge increase in transitions to employee ownership year on year. But the current rate of such transitions is tiny fraction of the businesses and jobs that are lost each year because of failed or unfavourable succession, divestment, or closure. This is in part due to limited awareness of options and gaps in information, support, and finance. But it is also in part a consequence of how the Finance Act 2014 preferences one model of employee ownership over others, in a way that distorts and limits options for business owners and employees.
- 1.5 The EOT model is not the only arrangement suitable for transitions to employee ownership in the UK. There are more than 400 'common ownership worker co-operatives' (COWCs) in the UK and in the past this model has been used successfully for transitions. Of the over 900 COWCs created in the decade from 1976 to 1986, 210 (23%) were created through the conversion of existing businesses.³
- 1.6 The COWC model has several characteristics that make it suitable for employee ownership transitions. The COWC is a **simple, straightforward, and low-cost legal arrangement for employee ownership**. We estimate **cumulative cost savings for**

transitioning businesses of many millions of pounds each year from using a COWC for transition instead of an EOT.

- 1.7 A COWC could be a more optimal and attractive option in some cases, especially for micro businesses, lower value businesses and worker-initiated transitions. Our proposal would provide businesses, business owners and employees with more choice in arrangements. This would unlock opportunities to secure thousands more viable jobs and businesses each year through additional employee ownership transitions.
- 1.8 Yet the EOT it is the only arrangement that is advantaged by tax relief under Schedule 37 the Finance Act 2014. As is often the case when policy preferences one model over others, this creates distortion by limiting the options available to businesses and employees.

2 Our proposal

- 2.1 We propose that government **amends eligibility for the reliefs attached to the Employee Ownership Trusts (EOT), so that they also apply when the sale of the majority stake in a company is to a 'Common Ownership Workers Co-operative' (COWC), formed by the employees of that company.**
- 2.2 We propose that to be eligible, a COWC should be a co-operative society registered under Co-operative and Community Benefit Societies Act 2014⁴ with the following provisions in its constituting rules:
- **Purpose:** To meet the common needs and aspirations of its members, including specifically to create and sustain decent, rewarding and empowering livelihoods for employee-members
 - **Employee control:** The membership of the co-operative must include employees of the business being sold, with these employee-members holding the majority of voting rights, and with membership open to all employees of the business
 - **Democratic governance:** Members must exercise democratic control of the co-operative on a 'one member one vote' basis
 - **Surplus and assets:** Surpluses and assets must be applied for the purposes of the co-operative, which can include a profit share distributed among employees, but the residual assets of the co-operative must not be distributable among members and must instead be used to further the purposes for which the co-operative existed (e.g. to support the development of other COWCs, wider social action, acts of solidarity)⁵

- **Investor members:** Investor members, if any, must either have no voting rights, or voting rights that strictly limit their ability to influence the governance of the co-operative, with no vote on matters relating to the use of surpluses and residual assets, or co-operative status

2.3 Co-operative societies are limited liability corporations that by law are registered and regulated by the Financial Conduct Authority (FCA) Mutuals Team to ensure their bona fide co-operative status. This includes checks relating to:

- who comprises the members of a co-operative society and how this relates to its stated purpose (for example, whether members are indeed employees of the target business)
- ensuring democratic governance
- ensuring assets and surpluses are used and distributed in accordance with co-operative principles (for example, ensuring value is not being diverted out of the co-operative in ways that are not in keeping with the interests of employee-members)

2.4 In order to comply with the FCA Mutuals Team's conditions for registration, the transitioning company would need to become a partially or wholly owned subsidiary of the COWC.⁶

2.5 All of the above could be easily and reliably verified by HMRC in the COWC's Mutuals Register entry.⁷ Just as the law requires EOTs to continue to meet certain conditions in order for the tax relief to be applied and not clawed back, the law could easily require the same for COWCs.

3 About common ownership worker co-operatives (COWCs)

3.1 There are currently over 400 COWCs trading in the UK, which already demonstrate the efficacy of the model terms of:

- **Performance** - Mutual purpose and democratic empowerment in worker co-operatives are regularly found to enrich culture, aid innovation, increase discretionary effort and boost business performance.^{8 9 10 11} New research has found that people in worker co-operatives and employee-owned firms in the UK are **8-12% more productive** than in comparable 'control groups' of non-employee-owned firms.¹²
- **Resilience** - Official data from the UK shows that co-operative start-ups are almost twice as likely to survive the first five years of trading than start-ups generally, with similar findings in other countries¹³ In 2022 we saw business death rate exceeded the business birth rate for first time since 2010¹⁴, while Co-operatives bucked the trend and continued to show a net growth

- **Job creation** – Recent research also found that worker co-operatives in the UK have a greater propensity to create jobs than UK businesses generally. Proportionally they are much more likely to have 5-9, 10-19 and 20-49 employees than their peers.¹⁵ UK data shows that after five years of trading new worker co-operatives employ 6 times more people than start-ups generally¹⁶
- **Employee wellbeing** – A growing body of research shows that empowering workplaces are good for employee satisfaction and wellbeing.^{17 18 19} And research into the performance of various co-operative models through the economic shock of COVID, showed that worker co-operatives were especially good at protecting worker wellbeing.²⁰

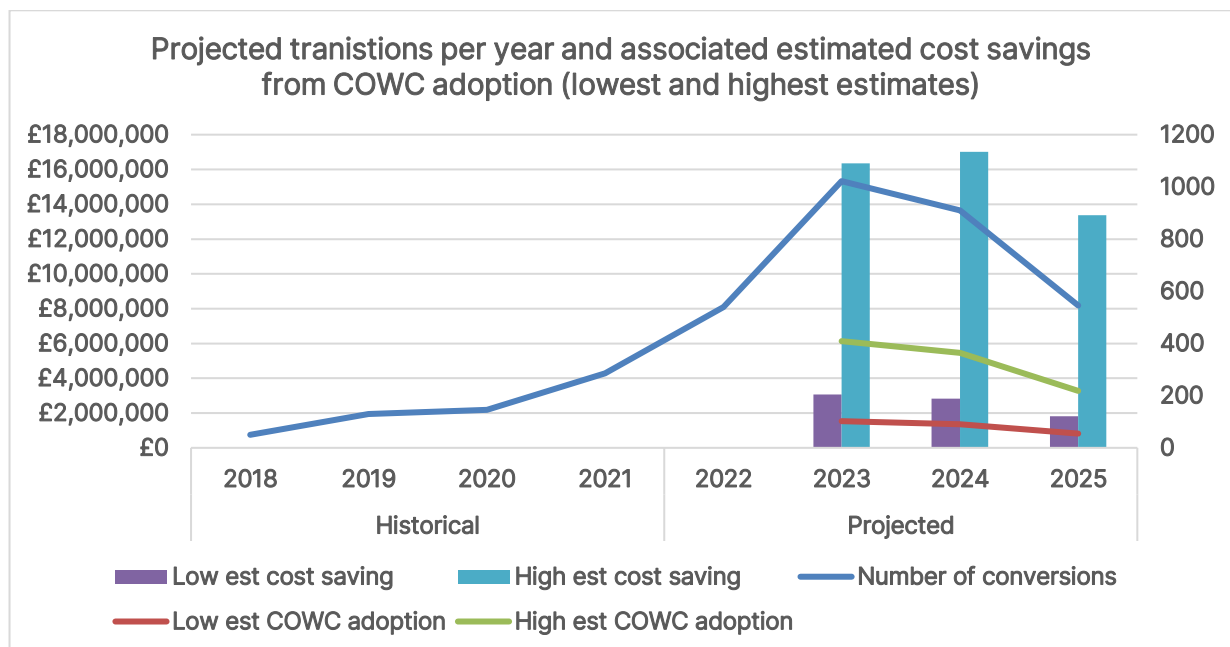
3.2 The COWC model would be very suited to tax-advantaged employee buyouts, for the following reasons:

- **Commercial confidence** – COWCs are viable, successful, resilient business (see 3.1 above) and business owners, employees and government can have confidence that the COWC model would add value to a viable business
- **Collective ownership** – COWCs establish stable, long-term collective ownership, just as EOTs do (government explicitly recognised the value in this collective ownership through its 2012 Nuttall Review of Employee Ownership²¹ and its consultation on the employee ownership tax reliefs²²)
- The COWC model has several characteristics that make it suitable for employee ownership transitions. The COWC is a **simple, straightforward and low-cost legal arrangement for employee ownership**. We estimate **cumulative cost savings for transitioning businesses of many millions of pounds each year** from using a COWC for transition instead of an EOT.
- **Very low 'tax risk'** – COWCs represent a very low 'tax risk' for the Exchequer, because of democratic collective control by employees and a high degree of transparency in ownership and governance.

4 Choice, complexity and cost

4.1 Our proposed measures would provide businesses and their employees with more good choices in arrangements and processes. COWCs offer a simple, straightforward, and low-cost legal arrangement. A COWC establishes collective, democratic employee ownership through a single corporate entity. The use of the co-operative society legal form further increases transparency and reduces complexity. Experts estimate that transitioning a small business using a COWC could cost between £20,000 and £30,000.

- 4.2 The EOT model can be comparatively more complicated and costly to adopt and maintain. It requires two or three corporate entities and layers of governance to be created and administered. It tends to cost £50,000 and £70,000 to transition a small business using the EOT model, with between £35,000 and £50,000 of these costs arising specifically because of the use of a trust.²³
- 4.3 Businesses using a COWC to transition could therefore **save £30,000 to £40,000 on the transaction.**
- 4.4 We have been told that the ongoing cost of administration and compliance with the EOT is between £1,500 and £10,000 a year. **We believe the ongoing costs for maintaining a COWC structure would be *at least* 60% lower.**
- 4.5 Under our proposals some transitions that would have used the EOT will use the COWC instead. On the assumption that COWCs will be a more optimal option for many smaller businesses, we might see between 10 percent and 40 percent of transitions in a year using the COWC model.²⁴ This would not in itself be a net increase in transitions, but rather represents a significant proportion of transitions using a model more optimal to their size. Based on projections for potential transitions overall, and of those using the COWC model, we **estimate cumulative cost savings for transitioning businesses could be between £7.6m and £46.7m over three years,** if between 10% and 40% of transitioning businesses adopted the COWC in 2023-25.²⁵



- 4.6 Thus, COWCs would be a simpler and more economical option for some employee ownership transitions, especially in circumstances where lower complexity and cost are important. This includes:

- Micro businesses, where it would not be economical to use an EOT sell the business and keep it trading – indeed the Federation of Small Business tells us that the cost and complexity of the EOT puts off microbusiness owners from exploring employee ownership as an exit route.²⁶
- Lower value businesses in the ‘foundational economy’, which may still support many livelihoods, but where it would not be economical to use an EOT sell the business and keep it trading.
- Employee-initiated transitions (see **part 5** below)

4.7 It is dysfunctional that these benefits of the COWC are undermined by the current distortive tax treatment, which exclusively promotes the EOT.

5 Employee-initiated transitions

5.1 While not currently common in the UK, it is possible for transitions to employee ownership to be initiated and led by the employees themselves, acting together. Employee-led transitions tend to occur when:

- The owner decides to close a viable business without considering a transition to employee ownership and the workforce initiates this discussion and process.
- The owner lacks attractive options for sale to anyone except their employees and the workforce takes the initiative in the process.
- The transition is financed by the employees rather than ‘vendor financing’.²⁷
- The owner chooses, or is forced, to dissolve or liquidate the business, and employees form a ‘newco’ co-operative to buy some or all the assets and keep trading (such transactions would not currently benefit from an employee ownership tax relief).

5.2 In circumstances where the employees have the initiative, reduced cost and complexity in the COWC model would make it an attractive choice. And just as important, given the choice, some groups of employees will prefer governance arrangements that enable them to govern the business effectively in their own rational, collective, self-interest. The comparative simplicity and much lower cost in establishing such governance via a COWC would therefore be attractive for employees.

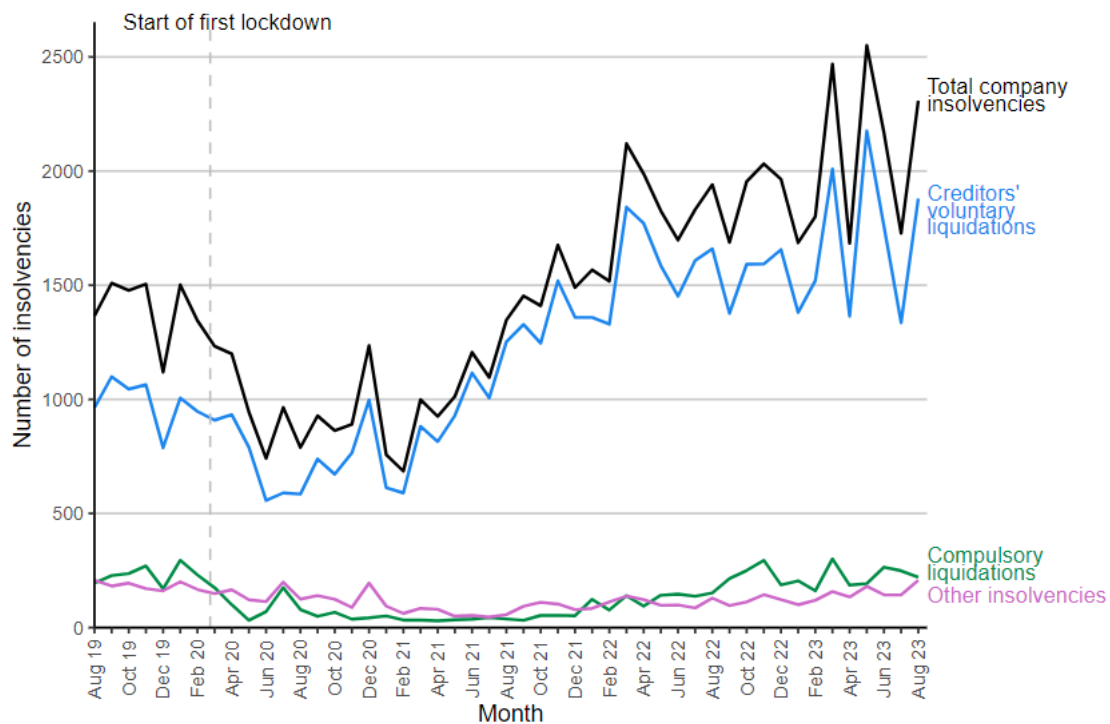
6 Impact on transitions to employee ownership and on jobs

6.1 In the coming months and years hundreds of thousands of potentially viable livelihoods are at risk because of a wave of business closures. Not only has the

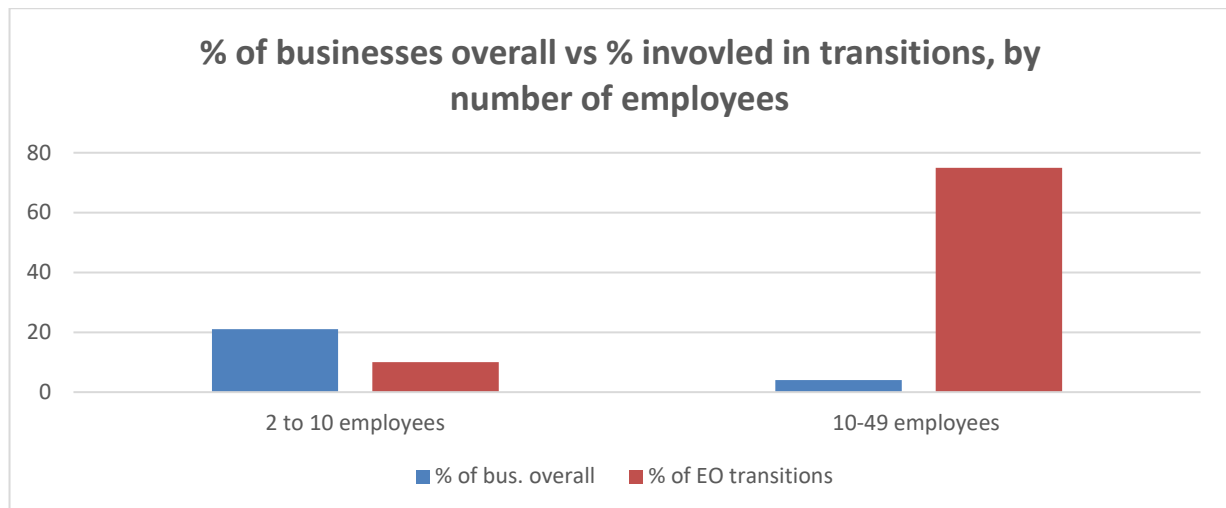
UK's SME owner retirement 'timebomb'²⁸ not been adequately prepared for, but for over a year the ONS has reported high numbers of business closures in the UK, and a trend of more businesses closing than being created.²⁹ What is more, monthly insolvency data shows voluntary liquidations in August 2023 running at almost double the levels seen in August 2019.³⁰

Figure 1: The number of registered company insolvencies in August 2023 was higher than in the same month last year, driven mostly by a higher number of CVLs.

Company insolvencies, England and Wales, August 2019 to August 2023, not seasonally adjusted



- 6.2 Our proposal will help address this by enabling many transitions that would not have happened otherwise. The availability of the COWC would make transitions more economical in the foundational economy and for smaller businesses generally, and more attractive for employees in circumstances where they have the initiative. It is notable that at present businesses with under 10 employees are significantly under-represented in transitions to employee ownership, accounting for 21% of businesses overall, but just 10% of transitions. Meanwhile, businesses with 10-49 employees account for just 4% of businesses overall, but around 75% of transitions.



- 6.3 Under our proposals some transitions that would have used the EOT will use the COWC instead. On the assumption that COWCs will be a more optimal option for many smaller businesses, we might see between 10 percent and 40 percent of transitions in a year using the COWC model.
- 6.4 There is clearly untapped potential for more transitions of micro-small businesses, which tax-advantaging the COWC model would help to unlock. This has the potential to save thousands of additional jobs each year that would otherwise be at risk because of business sale and closure.

7 Impact on Exchequer

- 7.1 We believe the impact of our proposals on the Exchequer would be broadly cost neutral. And over time the economic, social, and fiscal benefits that accrue will outweigh a marginal increase in forgone tax receipts.
- 7.2 Some transitions that would have used the EOT will use the COWC instead at no additional cost to the Exchequer.
- 7.3 Some additional transitions that would not have happened otherwise will occur and receive relief, at a cost the Exchequer. These additional transitions will overwhelmingly be of smaller businesses and so the costs will be small. Furthermore, some will involve saving jobs that would otherwise be lost as businesses close, and this will save the Exchequer money in unspent Universal Credit and other public spending resulting from unemployment.
- 7.4 Alongside benefits from improving the EOT rules, the Exchequer would also benefit from the low tax risk and high transparency in COWCs.
- 7.5 The economic benefits from improved employee wellbeing, enriched culture, innovation, increased engagement, and boosted business performance in COWCs, will also offset and over time outweigh costs to the Exchequer.

8 Environmental Implications

- 8.1 Supporting new conversions to employee ownership through a COWC will help the Government meet its net zero target. New data shows that worker co-operatives and employee-owned businesses are 75% more likely to be taking action to decarbonise their business than comparable non-employee owned businesses.³¹

9 Employee Bonus Rules

- 9.1 There are unintended consequences and perverse incentives that arise from only applying the tax-free bonus in EOT-owned businesses, and not applying it in the other established employee ownership arrangement: COWC.
- 9.2 Worker co-operatives are employee owned and controlled enterprises, of the sort that the creators of the EOT regime sought to encourage. Yet the employees in this structure do not benefit from the tax-free bonus. Not only does this unfairly penalise employees of worker co-operatives, but it also creates a perverse incentive for businesses that are already employee owned to adopt the EOT model.
- 9.3 While the EOT is the more common model for transitions, the COWC model is more popular for creating businesses that are employee-owned from the outset. Thus, extending the tax-free bonus to worker co-operatives would have the added benefit of encouraging the creation businesses that are employee owned from the outset. Given the greater propensity to create jobs and higher survival rates in worker co-operative start-ups (see 3.1 above) there are good economic reasons for having the tax-free bonus to act as an incentive in this way.

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¹ <https://www.uk.coop/resources/co-operative-and-mutual-economy-2023>

² <https://www.legislation.gov.uk/ukpga/2014/26/schedule/37/enacted>

³ According to Industrial and Common Ownership Movement ('ICOM') newsletter from 1986. 15% were 'recuperations' and 8% were buyouts, making 23% in total.

⁴ See FCA handbook on co-operative societies here: <https://www.handbook.fca.org.uk/handbook/RFCCBS/4/?view=chapter>

⁵ Government has just legislated to give itself the powers to give co-operative societies the option of making some or all of their capital surplus non-distributable to members – [see here](#)

⁶ See FCA handbook here: <https://www.handbook.fca.org.uk/handbook/RFCCBS/3/?view=chapter>

⁷ The rules of incorporation for all co-operative societies are freely and easily available on the Financial Conduct Authority's [Mutuals Register](#), which has statutory equivalence with the Companies Register

⁸ [Pérotin 2012](#)

⁹ [Kruse 2016](#)

¹⁰ See the evidence presented in the 2012 [Nuttall Review of Employee Ownership](#)

¹¹ Fathi Fakhfakh, Virginie Pérotin, Monica Gago (2011) '[Productivity, Capital and Labor in Labor-Managed and Conventional Firms](#)'

¹² <https://ownershipatwork.org/wp-content/uploads/2023/10/Exploring-the-potential-of-the-Employee-Ownership-business-model.pdf>

¹³ https://www.uk.coop/sites/default/files/2020-10/co-operative_survival_1.pdf

¹⁴ <https://www.ons.gov.uk/businessindustryandtrade/business/activitysizeandlocation/bulletins/businessdemography/2022>

¹⁵ <https://www.uk.coop/sites/default/files/2022-11/Labour%20Conference.pdf>

¹⁶ Based available data, after 5 years the average worker co-operative has 6 employees, whereas the average start-up a one-person enterprise

¹⁷ [National Centre for Employee Ownership 2017](#)

¹⁸ Cultural Workers Organise (2020) [Sharing Like We Mean It: Working Co-operatively in the Cultural and Tech Sectors](#)

¹⁹ Employee Ownership Association (2017) '[The Ownership Dividend](#)'

²⁰ Co-operatives UK (2021) '[Ready for what's next](#)'

²¹ BIS (2012) '[Nuttall review of employee ownership](#)'

²² HM (2013) '[Supporting the employee ownership sector](#)'

²³ Based on interviews with leaders in businesses that have transitioned using the EOT

²⁴ Based on new research for Scottish Government, 11% of employee-owned businesses in Scotland have under 10 employees and 38% have between 10 and 19 employees. Our assumption is that approximately 10% of transitions in the UK involve a business with fewer than 10 employees and approximately 40% involve businesses with 10 to 19 employees.

²⁵ Based on between 10% and 40% of transitions using a COWC, with a cost saving per transition of between £30,000 and £40,000, and an ongoing cost saving of between £900 and £6,000 per business per year. With projections for transitions per year to continue growing at a rapid rate in 2022 and 2023, before falling back again and settling at a higher-than-now level in 2024 and 2025. With COWC adoption beginning in 2023.

²⁶ Discussion with Federation of Small Business's Northeast regional manager

²⁷ Vendor financed buyouts are the most common solution in the UK and involve the selling owner loaning the money to the EOT to purchase the business and then being paid out over a number of years

²⁸ <https://gov.wales/sites/default/files/publications/2019-05/sme-succession-planning-support-in-wales.pdf>

²⁹

<https://www.ons.gov.uk/businessindustryandtrade/business/activitysizeandlocation/bulletins/businessdemographyquarterlyexperimentalstatisticsuk/apriltojune2023>

³⁰ [Commentary - Monthly Insolvency Statistics August 2023 - GOV.UK \(www.gov.uk\)](#)

³¹ <https://ownershipatwork.org/wp-content/uploads/2023/10/Exploring-the-potential-of-the-Employee-Ownership-business-model.pdf>