3. The trustees

3.1 The role of the trustees

As a consequence of the sale and transfers of shares, the company (C) will become majority owned and controlled by the trustees of the EOT.

The primary duty of the trustees – or of the trustee company and, in effect, the directors of the trustee company (trustee directors) – is then to exercise:

- the rights attaching to the shares of C held by the trust; and
- the rights of beneficial ownership of those shares,

in a manner that is in the best interests of the beneficiaries of the trust, namely the employees. That may include – if, in the reasonable opinion of the trustees, it is in the best interests of the employee beneficiaries – accepting an offer for the sale of C, although this will give rise to a disqualifying event for tax purposes (see **Chapter 13**). For the reasons given at **14.5**, a restriction on the sale of shares in C in the trust deed may not be sufficient to prevent such a sale.

3.2 Who are the trustees?

3.2.1 Who may act as a trustee?

There is no restriction in TCGA 1992 as to who may act as a trustee of an EOT. There are, however, many practical and commercial considerations, not least of which is the (theoretical) risk of a trustee being subject to potentially unlimited liability.

For tax purposes, the trustees are treated as a single person distinct from the persons who are the trustees from time to time.

Law: TCGA 1992, s. 69(1), 236H(1)

3.2.2 Individuals as trustees, or a corporate trustee?

An advantage of having only individuals as trustees is that it allows C, or an employer subsidiary, to claim relief from corporation tax in respect of employee share acquisitions (see **11.5**).

There are, though, significant practical disadvantages, including:

- the risk of personal liability;
- the risk associated with the death or incapacity of an individual trustee; and
- the conflicts of interest arising if such an individual trustee is also a director or employee of C or a subsidiary of C (although these are little different from those conflicts arising in the case of a director of a corporate trustee who is also a director or employee of C).

Typically, the first such risk – notwithstanding that it might be mitigated by C indemnifying the trustee against any loss – is regarded as reason enough to appoint a corporate trustee.

One other clear advantage of a corporate trustee – over the use of individual trustees – lies in the fact that, if properly established, the death**,** incapacity or retirement of an individual trustee director should not give rise to immediate practical difficulties; the mechanism for selecting and appointing a new trustee director will be prescribed in the articles of association of the trustee company**.** The corporate trustee itself remains in office.

It should be noted that, if there are two individual trustees of a trust, one cannot resign, leaving a single individual trustee as, unless the EOT was first established with only a single trustee**,** the retiring trustee will not be discharged from his or her obligations as trustee unless there is either a trust corporation or at least two persons to act as trustees.

Law: *Trustee Act* 1925, s. 37(1)(c)

3.2.3 An in-house, or independent corporate trustee?

It is therefore almost invariably the case that an EOT will have a single corporate trustee that is either:

- an independent trustee services company (or a specially formed private trust company established by the trustee services organisation); or
- a specially formed company of which the members are either:
    - C itself; or

- in the case of a guarantee company, individuals who might include:
  - directors and/or employees of C;
  - one or more of the vendors; and
  - at least one individual who is otherwise independent of C.

The majority of EOTs have as trustee a single company, specially formed for the purpose. In many cases this is simply down to cost as it will usually be cheaper to administer than would be the fees of an independent trustee services company.

3.2.4 A company with a share capital or a guarantee company?

One alternative is to use a company with a share capital that is specially formed as a directly wholly owned subsidiary of C. This provides a circularity of ownership, as C owns the trustee that acquires ownership of C.

The checks and balances inherent in a circular ownership structure, combined with the fact that the trustee directors will typically have a detailed knowledge of the business, mean that C can be managed efficiently and cost-effectively without the need for outside interference by an independent fiduciary owner.

The use of a guarantee company was proposed in the *Nuttall review* (see **1.8**), and the *Model documentation* mentioned at **1.9** includes a form of articles for such a company to act as sole corporate trustee. It has become the most common type of corporate EOT trustee.

3.2.5 Who should be the members of the guarantee company?

If a guarantee company is to be used, and if C is itself a member, this will mean that C cannot then grant rights to subscribe for new shares in C to employees as EMI share options (see **11.4.4**).

Typically, therefore, and for the sake of practical convenience, the articles of association of the guarantee company will provide that the members of the company will be those individuals who are appointed as its directors, and that a director must become a member and *vice versa*. A member who retires as a director must likewise cease to be a member.

The individual members and directors typically comprise:

- one or more directors of C;
- one or more employees of C (or of other members of the group of which C is the principal company – see **2.8.5**), typically selected by the employees themselves;
- (possibly) one or more of the vendors of shares to the EOT; and
- (invariably) at least one or more individuals who are otherwise independent of C.

3.2.6 Directors and employees as trustees or trustee directors

There is no reason why a director or employee of C cannot act as a trustee or director of the trustee company. Again, though, care will be needed to ensure that:

- the terms of the trust deed;
- the articles of the trustee company; and
- the individual's contract of employment or director's service agreement,

all include provisions to allow such an individual to participate in decisions, notwithstanding his or her other obligations and personal conflicts.

A healthy and desirable tension between owners and managers can bring out the best in all concerned, but if individuals have conflicting interests in occupying multiple roles as:

- trustee;
- director or employee of the trading company; and/or
- creditor of the trust,

difficulties can arise. Those individuals may expose themselves to personal liability for:

- a breach of their duties as directors; and/or
- a breach of trust or the misuse of a trust power.

See further, **5.5**.

3.2.7 The need for independent trustee directors

The appointment of independent directors of the trustee company is to avoid the difficulties that would otherwise arise from individual directors also holding office as director and/or employment with C or a subsidiary of C and therefore inevitably having conflicts of interest.

A director has a statutory duty to avoid a situation in which he or she has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. This duty is not infringed if the matter has been authorised by the directors of that company (excluding the director in question from both voting and the quorum), and the articles of association of both C and the trustee company should include provisions to that effect. Nevertheless, an individual who is a director or employee of C, and a trustee director, must always be mindful of which hat he or she is wearing when participating in proceedings of either board.

The inclusion of truly independent directors – i.e. individuals who are not employees or officers of C or a subsidiary and who have no other commercial relationship with C or the group – can assist in resisting accusations of actual or perceived conflict on the part of those directors who owe duties to more than one body.

Typically, the articles of the trustee company will provide that a quorum for a meeting, and for a majority of directors voting in favour of a resolution, would need to include at least one independent director or, if there is more than one, a majority of the independent trustee directors.

Law: CA 2006, s. 175