Understanding Employee Ownership Trusts: A Practical Guide

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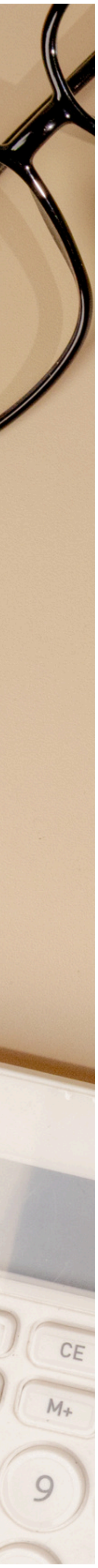
Who this is for: Business owners exploring succession options, professional advisors supporting ownership transitions, and anyone new to the EOT structure.

Why it matters: Canada's $10 million EOT capital gains tax exemption is now permanent, making this the right moment to understand how the structure works and put it into action.



What Makes an EOT Different

An Employee Ownership Trust (EOT) is not a worker cooperative, and employees don't buy shares out of pocket. The EOT is a distinct legal entity - a trust - that separates the benefit of owning something from the responsibility of owning it. Here's what sets it apart:

- **The EOT owns the company:** employees become beneficiaries of the trust, not individual shareholders
- **Transactions are 100% debt-financed:** employees do not buy shares themselves; the company's own future cash flow services the debt over time
- **The EOT must hold the majority:** it must own 51% or more of shares at all times
- All employees are included: there is no carving out a subset; every eligible employee is a beneficiary
- **Employees do not hold Board voting rights or seats:** there is employee voice and representation, but it operates through the trustee structure, not direct board participation

How the Transaction Works

The owner receives fair market value for the company. This is not a gift or a discounted sale. Here's how the money flows:

Closing day
On closing day, a bank (senior lender) typically finances 50–60% of the company's value. That cash goes to the seller immediately. The remaining balance becomes an IOU from the company to the seller, paid out over time as the company generates cash flow.

First repayment
The company repays the bank first, then the seller. Most transactions are fully paid out within 3 to 7 years, though the timeline varies based on how much bank financing is used, the company's cash flow, and what the seller needs upfront. Sellers who take less bank financing upfront often achieve faster overall repayment because the company retains more flexibility.

Is Your Company Eligible?

There are two separate eligibility tests: one for the EOT structure itself, and another for the $10 million capital gains tax exemption. Most operating companies will clear the first hurdle; the second requires more planning.

To qualify as an EOT:

- Must be a Canadian-controlled private corporation (CCPC)
- Must transact at arm's length, an independent process with fair market valuation
- EOT must hold controlling interest (51% or more)
- All employees must be beneficiaries
- More than 50% of assets to be in an active business carried on by the corporation (not passive cash or passive investments)

To qualify for the $10M capital gains tax exemption:

- First time the company is transitioning to an EOT
- Seller must have held shares for at least 24 months
- Active asset test must be met
- Seller must be an individual (not a corporation or non-family trust; though holding companies and family trusts can often be unwound ahead of the transaction and qualify)
- Seller or their spouse must have been actively involved in the business in the last 24 months
- At least 75% of beneficiaries (i.e. employees) must be Canadian residents (residents, not citizens, those on valid work permits qualify)

Important exclusions:

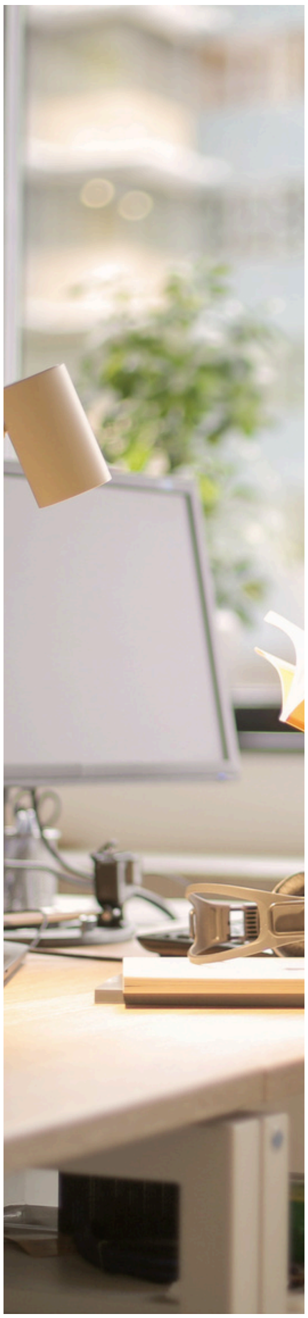
- Doctors, dentists, lawyers, accountants, chiropractors, and veterinarians can form an EOT, but their professional corporations do not qualify for the capital gains tax exemption.

On partial sales:

- If you sell 51% to an EOT now and retain 49%, the capital gains exemption applies to the first sale. When you later sell the remaining shares to the same EOT, the exemption does not apply a second time. If you're planning to sell a company worth more than $10M, it's worth structuring the first transaction to capture the full exemption amount.

The Governance Structure: The ABCs

EOT governance is more traditional than most people expect. It uses a three-level structure.



A: Assembly of Trustees

The trust must own the majority share, but trustees are the humans who act on its behalf. Legislation requires that at least one-third of trustees be employee beneficiaries. Previous shareholders (and their related parties) are capped at 40% of trustee seats. Trustees act in the best interest of beneficiaries, not the company broadly, and are responsible for selecting board directors.

B: Board of Directors

The board sets company strategy, selects the CEO, and makes decisions in the best interest of the company. There is no legislative requirement for employees to sit on the board. Previous majority shareholders are also capped at 40% of board seats. Clear, proactive communication between the board and trustees is essential. Conflict tends to arise when trustees feel frozen out of information, not from fundamental role confusion.

C: C-Suite / Executive Management

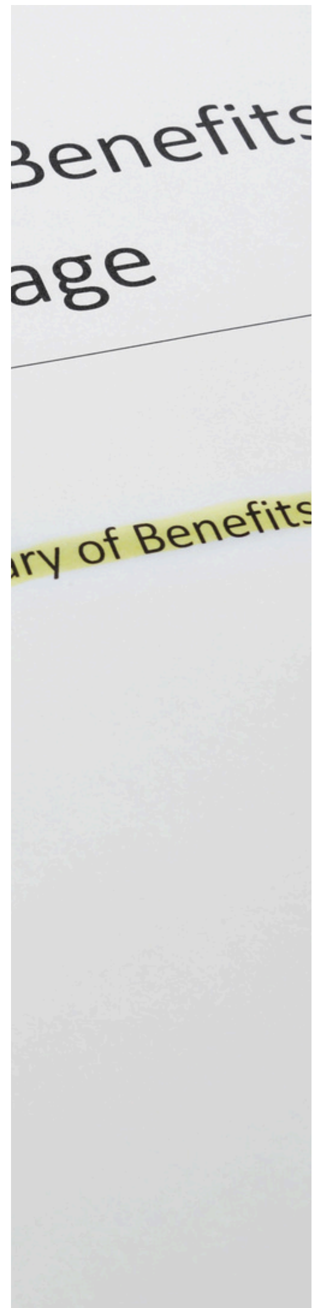
The legislation does not require any changes to executive management. Day-to-day operations remain stable through the transaction. This is one of the structure's most attractive features for founders: cultural and operational continuity is preserved.

How Employees Benefit

Employees benefit from their trust beneficiary status in two primary ways.

Profit distributions:

When the company has profits to distribute, dividends flow through the trust to employees. Employees pay tax on these at dividend rates, not income rates.



Equity allocation:

The monetary value of shares held by the trust can be allocated to employees over time, typically accrued based on tenure. When an employee leaves, the trust buys back the value of their allocated shares. The equity itself never leaves the trust; what transfers is the corresponding monetary value.

Distribution formulas must use one or more of these three criteria (or a combination): total hours worked, total compensation, or total tenure. The formula cannot be designed to widen inequality. Companies have significant flexibility in how they design this, and the design should reflect the organization's values and what it wants to reward.

The Process: What to Expect

Pre-transaction preparation typically takes 2–3 months. The transaction itself takes 5–6 months for an organized company. All in, expect roughly 9 months from initial exploration to close.

Pre-transaction:

A feasibility study assesses whether the company can sustain the debt load required and identifies any operational gaps (e.g., who takes over if the founder steps out of their day-to-day role). If feasible, a roadmapping exercise models 2–4 transaction scenarios to find the structure that works best for the seller, the company, and the employees.

During transaction:

This phase runs simultaneously with governance and benefits design. It involves legal counsel, due diligence, bank solicitation, and project management; similar in scope to a mid-market M&A transaction. A trustee agent (typically a professional with fiduciary expertise) acts as the buyer-side representative before the trust is formally established and helps train incoming trustees.

Post-transaction:

Implementation is critical. Even the best-designed structure fails if employees don't understand it. Trustee training, communication planning, and change management work set the tone for long-term success.

Common Questions

Can I sell only part of my company?
Yes. The EOT only needs to hold 51% or more. The remaining 49% can be structured for key management, retained by the seller, or used for other purposes. EOTs are also frequently paired with ESOPs or management buyout components.

Can I sell multiple companies to the same EOT?
A single company into a single EOT is straightforward. Multiple companies into one EOT, or one company into multiple EOTs, involves more complexity. Consult a tax lawyer before proceeding. Employee Ownership Canada's Service Provider Directory lists several experienced tax lawyers.

What if employees don't want to participate?
There is no opt-out. Employees are beneficiaries, not shareholders; they carry no risk and no liability. Resistance, when it does occur, typically comes from misunderstanding the structure. Clear communication at the time of transition resolves most concerns.

Are trustees personally liable if the company struggles?
No. Trustee responsibility is to ensure benefits flow fairly to beneficiaries. Liability for company performance sits with the board of directors, who can hold directors' liability insurance.

A Note on Professional Advice

The information in this resource is intended as a general educational overview and does not constitute professional advice of any kind, including but not limited to: legal, tax, financial, or valuation advice. Every business transition is different, and the right path forward depends on your specific circumstances, goals, and structure. We strongly encourage you to seek guidance from qualified professionals, including a Chartered Business Valuator, legal counsel, and a transaction advisor with experience in employee ownership before making decisions about your business.

Employee Ownership Canada can help connect you with advisors and resources in our national network. Visit www.employee-ownership.ca to explore our Service Provider Directory, Resource Library and upcoming Events

This resource is based on content from EOC's February 2026 webinar, "EOT Deep Dive." It is intended for general educational purposes and does not constitute legal or tax advice.

This guide is for general informational purposes only. Always seek qualified legal, tax, and financial advice before pursuing any employee ownership structure.