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Employee Ownership Trusts: Frequently Asked EOT Questions From Tax Law & Plan Design Experts

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Based on EOC's June 2026 “Ask the Experts” webinar which featured St. John McCloskey, tax lawyer at Clark Wilson LLP specializing in EOTs and business succession, and Jennifer Williams, Founder of Ownership Design Group which supports clients through EOT transactions from start to finish.

Below are questions and responses which occurred during the event.

Getting Started

How long does it take to set up an EOT?

The process typically starts with a feasibility study, 4 to 6 weeks, that assesses whether your company is financially ready for the transaction and whether your management succession plan is in place. If you proceed, expect the full transaction to take approximately 12 months, assuming a valuation is already underway. Building in 12 to 18 months of runway is advisable.

Why does it take that long?

Three reasons: legal documentation is detailed and must be done carefully; pre-transaction reorganization, particularly for companies with holding company structures, can be complex; and the communication and education work with ownership, management, and employees takes real time. A faster timeline is possible, but giving the transition room to breathe produces better outcomes.

Does it take just as long if we're not pursuing the \$10 million exemption?

The legal complexity is reduced, but the governance setup, employee communication, and management education work remains. The timeline may be somewhat shorter, but plan accordingly.



Valuation

Is an independent valuation required?

Yes. The legislation requires an independent valuation completed by a Certified Business Valuator (CBV).

Can the agreed sale price be above or below the valuation range?

In practice, most transactions use the midpoint of the valuation range. Selling below fair market value is not recommended, it undermines the arm's length nature of the transaction, which is a legal requirement for the structure. Selling above the range would be difficult to justify. If an owner later wishes to forgive part of the vendor note as a gesture to the trust, that is permissible after the fact.

If a transaction takes 14 months to close, is the original valuation still valid?

Not necessarily. If significant time has passed, your valuator can prepare an update (a less intensive process than a full revaluation), to reflect current business performance.



Tax and the Capital Gains Exemption

What are the personal tax implications for the seller in the year of sale?

If you sell for \$10 million or less and meet all eligibility requirements, the full amount is tax-free in the year of sale. If you sell for more than \$10 million, the first \$10 million is exempt and the remainder is taxed as a capital gain in the ordinary way.

The exemption is claimed in the year the transaction occurs. If proceeds are paid out over time via a vendor note, you can spread recognition of the gain over up to 10 years, compared to 5 years in a standard sale. Ideally, your recognition schedule aligns with when you actually receive the money, so you're not paying tax on proceeds you haven't yet collected.

What are the tax implications in years after the sale?

Any gain recognized above and beyond the exemption amount will be taxed as it is recognized each year, on the schedule established at the time of the transaction.



Can a seller claim both the \$10 million EOT exemption and the Lifetime Capital Gains Exemption (LCGE)?

Yes. The \$10 million EOT capital gains tax exemption is shared among owners involved in the transaction, but the LCGE is per individual. If your holding company shares are held in a family trust, distributing them to individual family members before the transaction allows each person to claim their own LCGE, which can meaningfully increase total tax-free proceeds.

How do you protect against CRA clawing back the exemption?

The exemption can be clawed back from the owner in the first two years if the trust ceases to qualify as an EOT, and from the trust itself for 10 years after that. The best protection is ensuring the trust deed, shareholder agreement, and company articles are drafted so that nothing that would disqualify the trust can take effect without appropriate safeguards. This is addressed during setup, not after.

Is interest on a vendor note also covered by the exemption?

No. Interest income from a vendor note is taxed as ordinary income. The exemption applies only to the capital gain on the shares sold to the EOT.

One structuring note: if a holding company within the trust structure borrows money to purchase the shares, the interest on that loan is generally deductible. If the trust borrows directly, deductibility is less certain. This is worth addressing explicitly with your tax lawyer during the setup process.

Holding Company Structures

My company is owned through a holding company. How do I access the \$10 million capital gains tax exemption?

The exemption is available only to individuals selling shares, not to corporations. If your holding company (Holdco) sells the operating company (Opco) shares into the EOT, no individual receives the exemption. The typical approach is for the individual to sell the Holdco shares into the EOT instead. This requires the Holdco to be “purified” first, meaning non-active business assets (excess cash, investments, personal-use property) must be removed before the transaction.

Does purification trigger tax?

It can. Removing assets from a Holdco may result in tax on those assets being removed/ realized. The advice of an accountant is essential here, as the extent of the tax impact depends on your specific asset mix.

Is there a waiting period between purification and the EOT transaction?

If the Holdco has more than 50% non-active assets, a waiting period of approximately two years applies before it qualifies for the LCGE. For smaller amounts of non-active assets, purification and the transaction can be executed in sequence on the same day, as long as documents are signed in the correct order.

Can the Opco shares be moved into a new Holdco as part of purification?

No. Transferring Opco shares into a new Holdco constitutes a disposition and triggers a taxable event before the exemption can apply. The existing Holdco should remain the seller.



Arm's Length

Does the employer-employee relationship mean the transaction isn't arm's length?

No. An employment relationship alone does not make a transaction non-arm's length. For anyone not already deemed non-arm's length under the Income Tax Act (which applies to spouses, children, and certain related parties), arm's length is a factual question: were both parties bargaining independently?

How do you demonstrate arm's length in practice?

The most common approach is to appoint an independent trustee agent, someone who is not a beneficiary and who acts on behalf of the trust before it is formally constituted. Documented evidence of actual negotiation, such as discussions over purchase price, vendor note terms, or due diligence scope, further supports an arm's length position.

What if employees already hold shares in the company?

This can complicate an EOT structure. The structure may still be workable depending on the percentages and who is selling, but it requires careful planning. In some cases, an EOT may not be the right vehicle if shares are already broadly held by employees.

Distributions and Employee Benefits

How are distributions taxed for employees?

Profits typically flow from the company to the trust as dividends, which are then distributed to beneficiaries and taxed at dividend rates. This is more tax-efficient than salary or bonus income.

Can distributions be structured differently for different employee groups?

Partially. The legislation permits differentiation, but only based on three criteria: total hours worked, total compensation, and total tenure, or a combination of these. Distribution formulas cannot be based on job title, department, or role directly. If employees in different roles earn different compensation, that will naturally affect distribution amounts, but the formula itself must be anchored to the three permitted criteria.

Is there a more tax-efficient option than dividend distributions?

The equity component of the Canadian EOT structure (Internal Capital Accounts) is new and its tax treatment is not yet fully settled. There may be future planning opportunities as CRA guidance develops, but for now dividend distributions are the most straightforward and well-understood option. Most companies are currently structured without equity accumulation, sometimes described as "naked in, naked out", meaning employees benefit from distributions but do not accumulate an equity stake in the trust.



What Happens When an Employee Leaves?

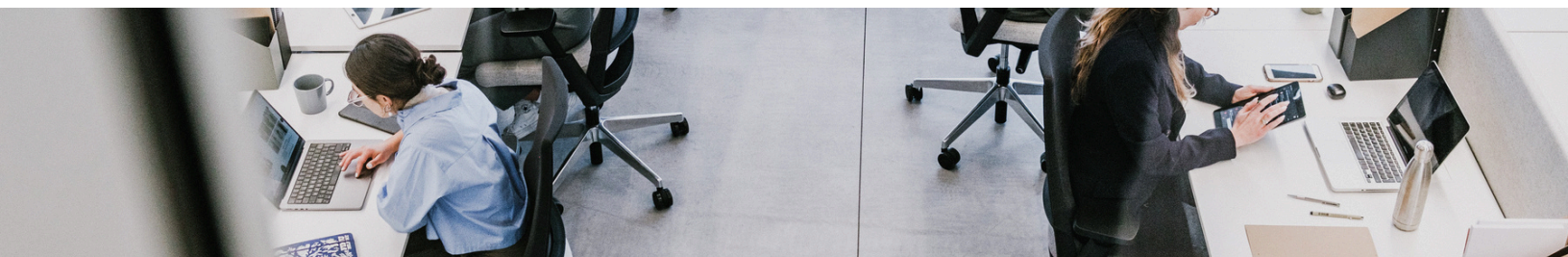
Is a departing employee entitled to a payout from the trust?

That depends on what the trust deed says, not employment law. The trust and the employment relationship are separate. Standard termination entitlements, notice, pay in lieu, apply regardless of EOT status and are unaffected by it.

What happens to a departing employee's trust interest is determined by the trust deed itself. The most common current approach: if an employee is not on payroll on the distribution date, they do not receive that distribution. Because most companies are currently structured without equity accumulation (Internal Capital Accounts), there is typically no equity interest to be valued or bought out.

Should the trust deed address what happens when employees leave?

Yes, explicitly. Scenarios worth addressing include termination, voluntary resignation, retirement, and what happens in the event of a company sale, as these may be treated differently. Working through these questions during the design phase avoids ambiguity when they arise later.





Governance and Employee Voice

Do employee beneficiaries have any formal voting rights?

Under the legislation, beneficiary approval is required for two categories of decisions: mergers, sales, and acquisitions; and actions that would cause more than 25% of beneficiaries to lose their status (such as significant layoffs or hiring decisions that would push the Canadian residency requirement below 75%).

Outside of those areas, day-to-day operational decisions, including hiring and firing of the CEO, remain with the board of directors.

How can employees have a voice without creating decision-making confusion?

Through communication channels and governance design rather than direct operational authority. Best practices include building a strong working relationship between the board of directors and the trustee body, and establishing clear mechanisms for employee concerns to be raised and heard. The trust and board are separate entities with distinct roles; the key is ensuring they communicate well rather than operate in silos.

Can trustees be paid for their role?

Yes. Independent trustees are typically compensated. Employee trustees can also be paid, the legislation does not restrict this.



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Companies with U.S. Operations

Can an EOT own a company that has U.S. employees or a U.S. subsidiary?

Yes, with some caveats. At least 75% of EOT beneficiaries must be Canadian residents to qualify for the \$10 million exemption. If U.S. employees are part of the same Canadian corporation, they would be beneficiaries and could push that percentage below the threshold, something to monitor carefully as the business grows.

If the U.S. operations are held in a separate subsidiary, those employees are not beneficiaries. As long as the subsidiary's value represents less than 10% of the total value held by the trust, the structure can remain eligible.



Do I Need an EOT Specifically, or Are There Other Options?

If I don't qualify for the \$10 million exemption, is an EOT still worth considering?

Yes. The exemption is valuable, but it is not the only reason to structure a transition as an EOT. Companies that don't qualify, including professional corporations and businesses with foreign ownership, may still benefit from the EOT structure for succession, culture, and employee retention purposes.

Should I consider a different kind of trust instead?

Generally, no. Trusts that are not designated EOTs under the Income Tax Act are subject to the 21-year deemed disposition rule, meaning the trust would be taxed as though it had sold its assets at fair market value every 21 years. For a business-owning trust, this is highly problematic. The EOT exemption from this rule is one of its most significant structural advantages, independent of the \$10 million capital gains exemption. Other employee ownership models, such as ESOPs or management buyout structures, may be worth exploring depending on your situation. EOC's Resource Library includes an overview of the different models available.

This resource is intended for general educational purposes only and does not constitute legal, tax, or financial advice. Consult qualified professionals before making decisions specific to your situation. For additional resources, visit employee-ownership.ca/resources.