

Understanding Employee Ownership Trusts: A Practical Guide



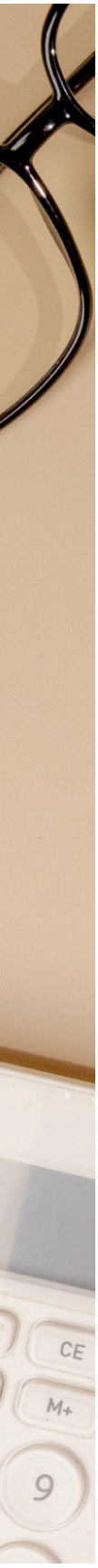
Understanding Employee Ownership Trusts: A Practical Guide

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.

REWRITE CAPITAL ADVISORS

This resource is based on content from EOC's February 2026 webinar, "EOT Deep Dive," presented by Tiara Letourneau (CEO, Rewrite Capital Advisors) and Elizabeth Nolin (Head of Design and Implementation, Rewrite Capital Advisors). It is intended for general educational purposes and does not constitute legal or tax advice.



What Makes an EOT Different

Unlike other employee ownership models where employees buy company shares personally using their own money, an Employee Ownership Trust (EOT) holds the company's shares for the collective benefit of employees at no cost to them personally. One of the great attributes of an EOT is that it separates the *benefit* of owning the company's shares from the *responsibility* of owning them. Here's what sets it apart:

- **The EOT owns the company:** the shares are held in a trust and employees become beneficiaries of that 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 more than 50% of the company's shares at all times
- **All employees are included:** there is no carving out a subset; every eligible employee is a beneficiary (with the exception of an optional 12 month probationary period)
- **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 (a vendor's note), paid out over time using the company's future 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,
- EOT must hold controlling interest (51% or more)
- All employees must be beneficiaries
- Majority active assets, more than 50% of the assets need to be used in an active business carried on by the corporation (not passive cash or passive investments)

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

- Only applies to the initial sale to the EOT
- Seller must have held shares for at least 24 months
- More than 50% of the business's assets must have been used in an active business in Canada
- Seller must be an individual (not a corporation; 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 for a 24 month period
- At least 75% of beneficiaries (i.e. employees) must be Canadian residents (residents for tax purposes, not a question of citizenship)

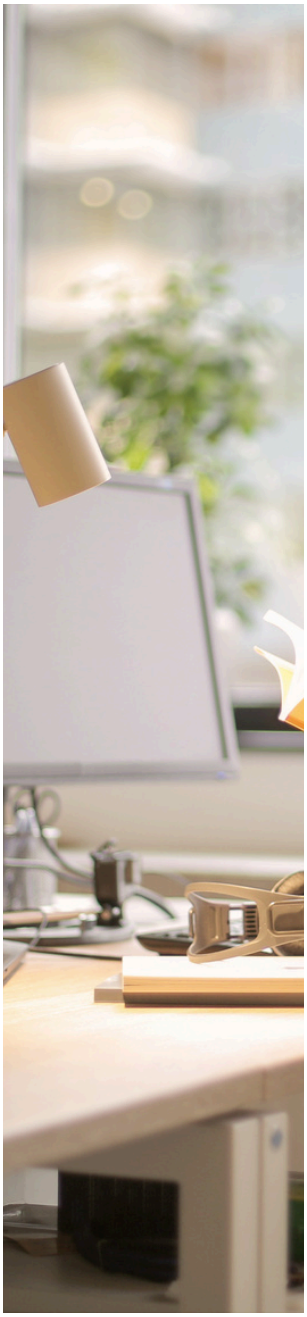
Important exclusions: There are a list of professions defined in the Income Tax Act that are excluded from claiming the EOT tax exemption. These are doctors, dentists, lawyers, accountants, chiropractors, and veterinarians. They can form an EOT, but as professional corporations do not qualify for the capital gains tax exemption.

On partial sales: If you sell 51% to an EOT now and retain 49%, the capital gains exemption only applies to the first sale. If you later sell the remaining shares to the same EOT, the exemption will 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.

Helpful clarification: The EOT capital gains tax exemption applies per business not per person. So an individual with multiple separate companies can claim the exemption for each business they sell so long as they meet the criteria.

The Governance Structure: The ABCs

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



A: Assembly of Trustees

In an EOT, the trust is the legal majority owner of the company, which means that there need to be people to make decisions. Those individuals are called trustees. They act in the best interest of beneficiaries when making shareholder-level decisions like selecting board directors. As shareholders, they do not participate in the management of the business. Legislation requires that at least one-third of trustees be employee beneficiaries. Previous shareholders (and their related parties) are allowed to hold seats at the level of the trust but are capped at 40% of trustee seats.

B: Board of Directors

The board approves company strategy, oversees operations and selects the CEO. They make decisions in the best interest of the company. There is no legislative requirement for employees to sit on the board. Previous majority shareholders (and their related parties) are capped at 40% of board seats. Clear, proactive communication between the board and trustees is essential. Conflict can arise when trustees feel frozen out of information, not from fundamental role confusion.

C: C-Suite / Executive Management

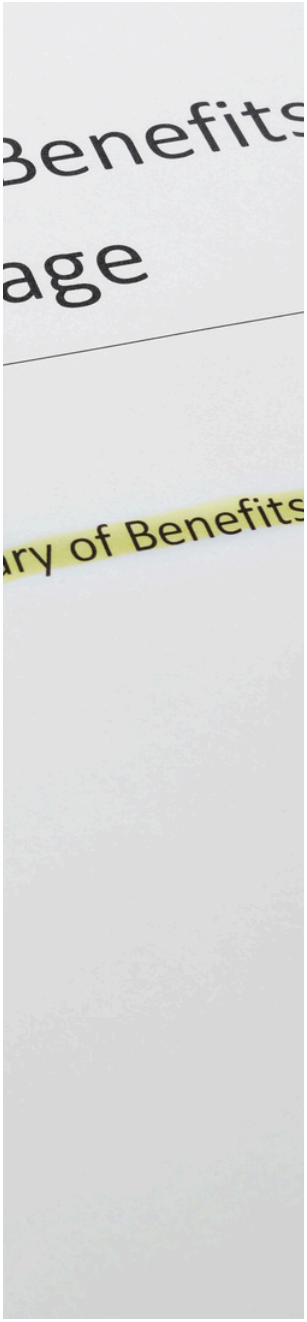
The legislation does not require any changes to executive management. Day-to-day operations remain stable through the transaction. This is one of the structure's most attractive features for founders: cultural and operational continuity is preserved.

How Employees Benefit

Employees can benefit from the trust in two primary ways:

Profit distributions:

When the board decides that the company is in a financial position to distribute dividends, they flow through the trust and are divided among employees based on a formula. 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, again using a formula. 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 at least one of these three criteria (or a combination): hours worked, total wages and other remuneration paid (total compensation), or tenure. 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:

Before starting the process, it is advisable to assess the feasibility of an EOT from two angles: financial and organizational. It is important to know whether the company can sustain the debt load required for the transaction and identify any operational gaps (e.g., who takes over if the founder steps out of their day-to-day role).

During transaction:

In general, the EOT transaction is similar in scope to a mid-market M&A transaction and will involve a number of important parties like legal counsel, the senior lender and your personal tax advisor. In addition to the necessary legal transaction, it is best to work with advisors who can help guide you through the entire process from start to finish, and most importantly beyond to help you design the new EOT governance structure and benefits formula. Considering both the transaction and the transition from a holistic perspective will set you up for success in the long-run.



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 direct share purchase plans.

Can I sell multiple companies to the same EOT?
A single company into a single EOT is straightforward. Multiple companies into one EOT, 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.

****

More resources and information available on our website:
www.employee-ownership.ca