Possible Uptake of Employee Ownership Trusts in Canada: Projections and Complementary Policies

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Recommendation: Include a capital gains tax (CGT) exemption in the creation of employee ownership trusts (EOTs) in the 2022 Fall Economic Statement (FES), along with appropriate education of the advisory community, to ensure rapid uptake and realization of the expected benefits of this possible new trust structure with a view to achieving a cumulative total of between about 505 and 757[1] Canadian EOT conversions over the eight years between 2023 and 2030 with between about 50,000 and 114,000 new employee-owners[2].

Introduction: Making Canadian Employee Ownership Trusts a Reality

- *Budget 2021* introduced the Government's support for "employee ownership trusts" that "encourage employee ownership of a business and facilitate the transition of privately-owned businesses to employees." Employee trusts and similar structures have existed since at least the 1980s[3] in the UK and in the US since 1974 through Employee Stock Ownership Plans (US-ESOPs), which were created under the *Employee Retirement Security Act (ERISA)*.
- April's *Budget 2022* included a proposal to a create a new, dedicated trust structure, the "Employee Ownership Trust" under the *Income Tax Act* (Canada) to support employee ownership of businesses. *Budget 2022* noted that the Government would "continue to engage with stakeholders to finalize the development of rules for the Employee Ownership Trust and to assess remaining barriers to the creation of these trusts."
- This memorandum responds to *Budget 2022*'s interest in stakeholder engagement by looking at lessons from the UK's recent experience with the Employee Ownership Trust model (UK-EOT) that underscore the importance of a CGT exemption incentive to spur the use of a new Canadian EOT structure, along with important guideline documents to make adoption easier for the advisory community.
- We lay out the case for adoption of such an incentive as part of the introduction of a Canadian EOT in the 2022 *FES* and make an initial projection of the possible uptake of a Canadian EOT based on the UK's experience.

[1] This range is based on a central projection of 631 Canadian EOTs over eight years from the inception of the new trust structure based on the UK's experience; the upper and lower bounds of the range reflect a variance of +/- 20% to allow for differences in the distribution of firm sizes, demographics, awareness of employee-ownership structures, and other unidentified differences between the UK and Canada. The remainder of the memo explains in depth our projections.

[2] This range is based on a central projection of an average of 125 employees at possible Canadian EOTs, +/- 20%, which results in a range of about 100–150 employees per Canadian EOT; we then multiplied the higher and lower bounds of this range by the higher and lower ends of the EOT uptake projection range.

[3] "Overview on Use of Employee Benefit Trusts", Croner-I Navigate.

- We note the US experience with the uptake of US-ESOPs following the introduction of CGT exemption incentives and the eventual plateau in their numbers, with some discussion of possible implications for Canadian uptake.
- Finally, we analyze the size of employee-owned companies in the US and UK and the wealth generated for workers at US-ESOPs to project the possible wealth generated for Canadian workers through a successful launch of EOTs in Canada.

<u>Now is the Time: Expected Benefits from Prioritizing EOTs in the *2022 FES*</u>

During prior consultations in 2021 and 2022, Social Capital Partners articulated the principal benefits that would be expected to flow from the creation of Canadian EOTs. These include:

- **More resilient companies.** Employee-owned companies are more resilient in the face of economic shocks and downturns, showing both stronger employment stability and lower likelihood of bankruptcy in recessions than traditional firm structures;[4,5]
- **Creation and retention of jobs in otherwise underserved regions and localities.** Employee owners are much less likely to move a business than external purchasers, who would often live and have businesses in other locations, which would help to keep talent and wealth in specific communities;[6]
- **Higher pay for similar work performed in peer private and public companies.** Employee-owned companies outperform when it comes to employee retention and salaries; recent research has demonstrated this is especially true for women and visible minorities;[7] and
- **Increased employee wealth for a broad cross-section of workers.** Employee ownership has proven to be a powerful wealth building tool for workers at all income levels, with studies showing that median household net wealth tends to be significantly higher for employee owners than employees in traditional firms.[8,9]

<u>UK Experience: Tax Incentives and Public Awareness Drove UK-EOT Adoption</u>

The UK has a long history with employee-owned corporate structures. In the 1970s, governments attempted to popularize worker co-operatives, but interest dwindled by the end of the decade due to high-profile failures of several conversions and the election of governments unfriendly to the model.

Pioneering experiments took place with indirect ownership structures over the subsequent decades, but no form became particularly popular. The Employee Benefit Plan trust (UK-EBP) became the most commonly used structure. It was permitted to borrow money to buy shares in a company on behalf of

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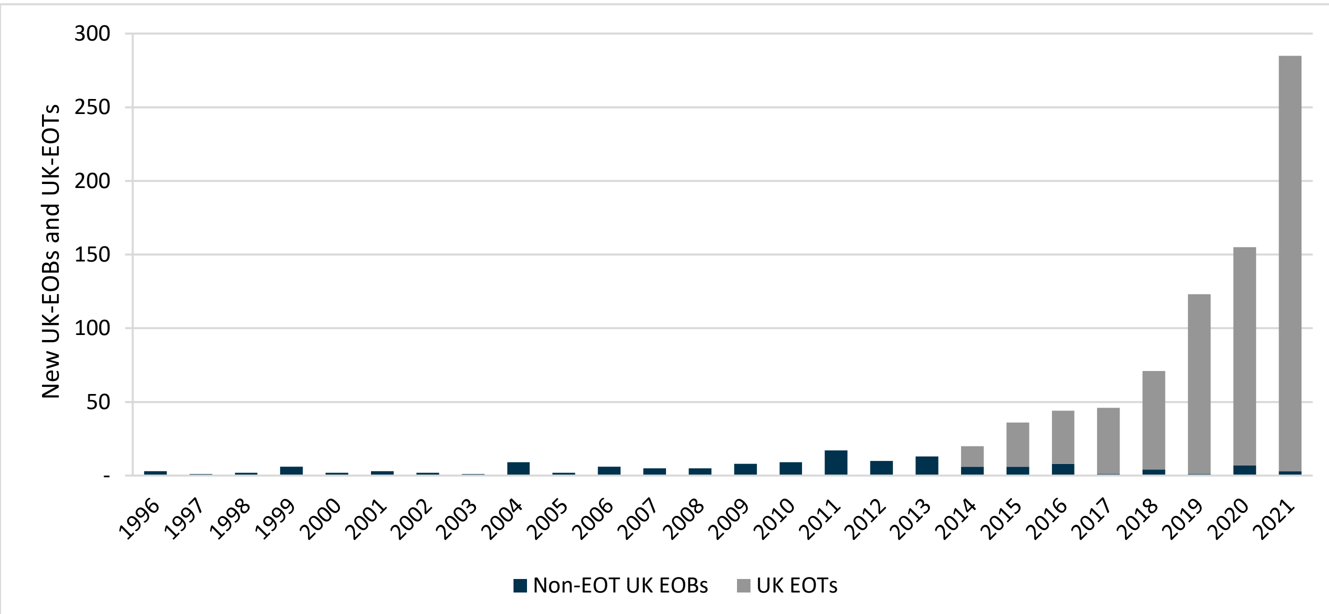
[4] "How Did Employee Ownership Firms Weather the Last Two Recessions?", Fidan Ana Kurtulus and Douglas L. Kruse.
[5] "Employee-Owned Firms in the COVID-19 Pandemic: How Majority-Owned ESOPS & Other Companies Have Responded to the COVID-19 Health and Economic Crises" Rutgers School of Management and Labor Relations.
[6] "Who Should Own Your Business After You?" National Center for Employee Ownership (NCEO).
[7] "Race and Gender Wealth Equity and the Role of Employee Share Ownership" Weissbourd, Conway, Klein et al.
[8] "Employee-Owned Firms in the COVID-19 Pandemic: How Majority-Owned ESOPS & Other Companies Have Responded to the COVID-19 Health and Economic Crises" Rutgers School of Management and Labor Relations.
[9] "Building the Assets of Low and Moderate Income Workers and their Families: The Role of Employee Ownership" Rutgers School of Management and Labor Relations.

the employees of that company, and to hold those shares (with no tax event) for a long period of time. Technically, this trust form is the same as the UK-EOT (and in fact, the UK-EOT is a special from of the EBP). However, data compiled by the UK's White Rose Centre for Employee Ownership (WRCEO)[10] show that only 124 sales of businesses into all forms of employee-owned structures (including the UK-EBP) occurred during 1996 to 2014[11] (chart 1).

Chart 1: Annual Formation of Employee Owned Businesses (UK-EOBs)[12] and UK-EOTs (1996–2021)[13]



The UK's coalition government (2010–15) was aware of the possible benefits of employee ownership: the Minister for Employee Relations commissioned a study in 2012 which confirmed many of the positive attributes of EOBs described above.[14] Frustrated by the lack of success of employee-ownership schemes, the UK government commissioned the *Nuttall Review of Employee Ownership*[15] later that year to identify barriers to employee ownership. It found that employee ownership in the UK suffered from a lack of familiarity among the legal and tax advisory community and no clear dominant model.

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[10] WRCEO is the UK's leading centre for employee ownership research and is a strategic partnership between the Universities of Leeds, Sheffield, and York.

[11] This period includes 2014, in which the UK-EOT was introduced part-way through the year. Of the 20 EOBs formed in 2014, 14 were of the new UK-EOT form.

[12] WRCEO defines EOBs as having an employee stake of at least 25% with no other single majority shareholder. UK EOBs come in three forms: (i) worker cooperatives; (ii) trust-based employee shareholding, i.e., UK-EBPs or UK-EOTs; and, in exceedingly rare cases, (iii) direct employee shareholding with no intermediating trust structure.

[13] Data provided by Professor Andrew Robinson of the WRCEO.

[14] "The Employee Ownership Advantage" The Department of Business Innovation and Skills (2012).

[15] "Sharing Success: The Nuttall Review of Employee Ownership", Independent Review for the Department of Business, Innovation and Skills (2012).

The *Nuttall Review* prompted a series of amendments to the UK's *Finance Act* in 2014 to encourage trust-based employee ownership. This legislation created a definition of the UK-EOT for United Kingdom tax purposes as a special form of the pre-existing UK-EBP trust.

The creation of the UK-EOT vehicle was intended to construct a primary vehicle for employee ownership conversions and added a new major tax incentive to the UK-EBP structure to incentivize owners to sell into a UK-EOT. For owners selling over 50 percent of their company to a UK-EOT, and ensuring (among other things) that the UK-EOT benefitted all employees at no cost[16] and on equal terms, the proceeds to the owner of the sale became exempt from CGT. The legislation also laid out additional tax benefits to employees that were intended to equal existing provisions under the UK's Share Incentive Plan (SIP). The first GBP 3,600 in profits distributed to individual employees participating in a UK-EOT became tax exempt to the employee. The amount matches the upper bound on free shares in a company that employees were eligible to receive under the SIP in order to put the two structures on an equal footing. In practice, few profits are likely to be distributed to employee owners in the early years of a UK-EOT, when most available cash flow would be devoted to paying down debt associated with the purchase of shares in the conversion.

While the UK government did not embark on a public education campaign to raise awareness of the new UK-EOT structure, it did publish some important technical guideline documents for advisors to assist with adoption of the UK-EOT and reinforce it as the new preferred form of employee ownership.[17] Such moves could be replicated and enhanced under the adoption of a Canadian EOT structure.

The introduction in 2014 of a CGT exemption incentive appears to have driven an immediate increase in conversions of businesses to UK-EOBs (chart 1, again), with nearly all (over 95%) of the new marginal employee-owned firms since 2014 being constituted in UK-EOTs, according to WRCEO data. The WRCEO estimated that a total of 730 UK-EOTs were formed during 2015–21, rising from 30 annually in 2015 to 282 in 2021.[18] According to a recent report, the average UK-EOT has 118 employees,[19] so to the end of 2021 we estimate that almost 90,000 employees have become employee owners through

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[16] As discussed in our white paper, *Building an Employee Ownership Economy*, both the UK-EOT and the US-ESOP provide benefits to all employees at no cost and no personal risk. The debt incurred to purchase company shares by the trust in each structure is borne by the company, rather than the employees directly. Importantly, each structure is regulated to ensure that any employment benefits employees accrued prior to the formation of the employee-owned trust must remain in place, and that current and future wages may not be reduced in exchange for benefits provided by either trust. We believe a Canadian EOT must also include these requirements. For more detail please see our white paper.

[17] Two documents in particular were helpful in driving UK-EOT awareness and adoption: a model documentation publication and an accompanying guidance document, published in 2013. Both can be found at Employee ownership: company model documentation - GOV.UK (www.gov.uk).

[18] A high rate of conversions has continued in 2022, as according to the WRCEO an additional 127 UK-EOTs have been formed in the five months to the end of May

[19] "Employee Ownership in the UK", Pendelton, Robinson, Nuttall (2022), forthcoming research paper not yet published, but made available to SCP under embargo.

this structure. We note that these figures are estimates as the UK government does not currently publish comprehensive data sets in accordance with these definitions.[20]

Of course, it is possible that other concurrent tax reforms, regulatory changes, and/or exogenous shocks may have contributed to the increased incidence of business sales into UK-EOTs from 2014 onward. However, having consulted with UK experts on this matter, we are not aware of any such developments that would have plausibly pushed the UK-EOT numbers up in the clear fashion shown in chart 1.

The significance of the CGT exemption incentive likely also piqued the interest of the UK's financial, legal, tax, and succession advisory firms, which led to greater awareness of the advantages of UK-EOTs and created a virtuous circle where the advisory community helped to drive increased interest in and demand for conversions. The *Nuttall Review* noted that the profile of the UK-EBP special trust structure in the advisory community was very low prior to 2012. In contrast, professional services firms' publications on UK-EOTs proliferated in the wake of the 2014 reforms.[21]

The UK's experience before and after 2014 is instructive. Given the lack of legal or tax obstacles to employee-owned structures pre-2014, the data appear to demonstrate just how significant the CGT exemption incentive became in shifting behaviour toward sales into EOBs. As such, it seems reasonable to speculate that if a similar tax incentive and its associated awareness raising effects do not accompany the introduction of a Canadian EOT, Canadian uptake may be more limited than it would otherwise be. The economic and social benefits of the introduction of a Canadian EOT would, therefore be constrained relative to their potential. While there may be an argument for introducing an EOT structure, testing its uptake, and later introducing tax incentives only if necessary, such an approach could also see a new EOT structure treated as irrelevant on arrival and impaired from adoption even if tax incentives are later introduced.

<u>**Expected Uptake in Canada if UK-EOT Policy Lessons are Applied Here**</u>

A simple linear extrapolation of the experience with UK-EOTs to the Canadian economy implies that uptake of a Canadian EOT structure could result in between 141 and 211[22] business conversions annually by year 8 after introduction,[23] for a cumulative total of between 505 and 757 business conversions over the first eight years. In broad terms, the projection scenario in Canada would be analogous to the UK experience from 2015 onward: we assume a new form of employee ownership

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[20] Data was developed by the WRCEO using a variety of research methods and cross-referenced with Companies House, the UK government's registrar of companies.

[21] Links to three such publications: "Why you should now consider selling your business to an Employee Ownership Trust", BDO (2017); "Employee Ownership Trust" Jackson Stephen Accountants/Advisers (2015), and "How an Employee Benefits from an Employee Ownership Trust" DNS Accountants (2018).

[22] Range is based on a projection of 176 Canadian EOTs in year eight post introduction. We varied the result 20% higher and 20% lower to create this range.

[23] The UK is currently in its eighth year since the introduction of the EOT, and 127 EOTs have been formed this calendar year to the end of May, 2022. A linear extrapolation, which is appropriate given the pace of conversions over the past seven years, implies that there will be 305 new EOTs in the UK in 2022, which is an increase from 282 in 2021. Given these data, we've added an eighth year to the Canadian projections, but we have conservatively held this last year in the projection horizon at the same number of new conversions as the seventh year.

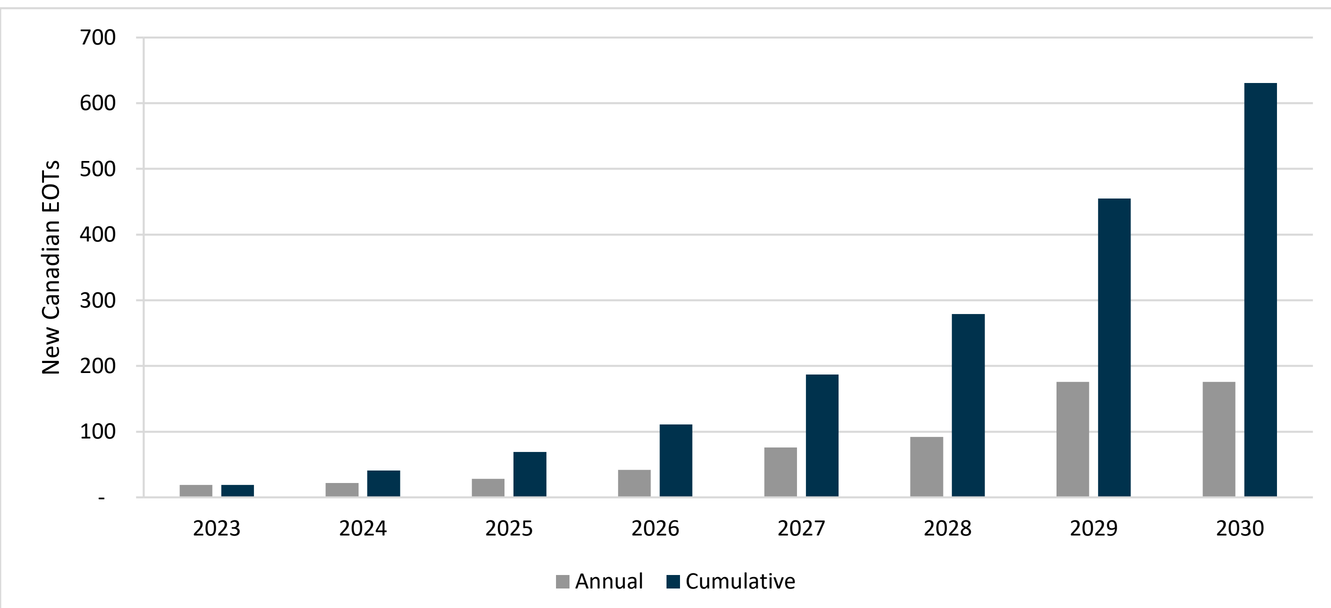
trust would be introduced with similar tax incentives in a setting with very few pre-existing EOBs and a broadly similar socioeconomic context. Our very simple, heuristic projections of possible Canadian EOT uptake were developed as follows.

We start from three priors:

- Real Canadian GDP in 2021 was about 62.5% of UK real GDP in the same year;[24]
- Very few Canadian EOBs exist in Canada, similar to the UK pre-2014;[25] and
- A Canadian EOT structure is assumed to be introduced in 2022 with tax incentives and socialization similar to what accompanied the implementation of the UK-EOT in 2014.

To create a basic projection of Canadian EOT uptake, we assumed that annual Canadian EOT conversions amount to about 62.5% of UK conversions (i.e., annually during 2015–22) in each of the first eight full years of the Canadian trust structure's existence—in line with the relative size of the Canadian economy compared with its UK counterpart. This would imply that annual transformations into EOTs could reach 176 by 2029, with a total of around 631 new Canadian EOTs constituted over the first eight years of the Canadian trust (chart 2).

Chart 2: Canadian EOT Uptake Projections[26]



[24] 2021 GDP data sourced from the World Bank.

[25] There is no organization that tracks employee-owned businesses in Canada as the WRCEO does in the UK and the National Centre for Employee Ownership does in the US. We have searched extensively to find evidence of substantially employee-owned companies in Canada, and have found very few, with companies like EllisDon, PCL and Friesens being relatively rare examples.

[26] Projection based on scaling UK-EOT adoption from 2015-2021 according to the relative size of Canada's GDP as compared to the UK's GDP. Projection is extended for one additional year based on the formation of UK-EOTs in 2022 being on pace to exceed formations in 2021.

Clearly, there are many possible reasons why the scenario that has unfolded in the UK may not be replicated in Canada, even in the presence of a similar set of incentives. Idiosyncratic factors and exogenous shocks in the UK that may not be fully understood may have driven UK businesses to sell into UK-EOTs at greater numbers than would otherwise have been likely. Likewise, Canadian business owners and advisors may, for their own specific reasons, decide that the new trust structure is not appealing, even with similar tax treatments. However, the introduction of the UK-EOT remains the most directly relevant experience on which to project possible EOT uptake in Canada and from which to draw inferences about necessary policy complements.

Canadian uptake could be greater or less than the projections detailed above owing to a number of factors—but we believe the preponderance of risks are to the upside.

Canadian EOT uptake could exceed these ranges on the following grounds.

- **Firm size: A larger share of Canada's universe of private companies falls in the ideal size range for EOT conversions than is the case in the UK.** EOT conversions are most amenable for private companies with between 20 and 500 employees.[27,28] Companies that are smaller than this often find the legal and administrative complexities of EOT conversions and operation challenging: they rarely have the level of management capabilities necessary to take over from a selling owner. The total number of private firms in Canada amounts to about 62% of the similar total in the UK—closely mirroring the relative scale of the Canadian economy versus its UK counterpart (table 1). Canada's total number of private firms with 20–500 employees, however, is 92% of the same number in the UK. This implies substantial potential upside to our simple uptake projections.

Table 1: Comparison of Firm Size Distribution, Canada vs UK[29]

Private Sector Firm Size	Number of Firms		
	Canada	UK	Canada / UK Ratio
5–19 Employees	197,420	368,335	0.54
20–49 Employees	58,170	63,375	0.92
50–99 Employees	19,430	20,530	0.95
100–499 Employees	13,020	14,335	0.91
>500 Employees	2,210	3,515	0.63
Total	**290,250**	**470,090**	**0.62**
EOT Target (20–500 Employees)	**90,620**	**98,240**	**0.92**

- **Demographics: Canada has relatively more people around retirement age than was the case in the UK in 2014 when UK-EOTs were introduced and retirement-age owners are likely to be those most interested in a possible EOT conversion.** Canada's population is equivalent to about 57% of the UK's 2014 populace; however, Canada's population in the 55–64 age range amounts

[27] "How Small is Too Small for an ESOP?", National Center for Employee Ownership (NCEO).

[28] "What the Evidence Tells Us", Employee Ownership Association (UK).

[29] Canadian data sourced from Statistics Canada (Table 33-10-0088-01 Business Dynamics measures, by firm size, per province or territory). UK data sourced from the United Kingdom Statistics Authority (Table 5 of Business Population Estimates for the UK and Regions 2019: https://www.gov.uk/government/statistics/business-population-estimates-2019) and adjusted to remove Education and Health companies to match Canadian data.

to about 71% of UK residents in the same age bracket, while the number of Canadians between 65–74 years old is about 66% of the similar UK total (table 2). Canada's demographics may further skew upward possible EOT adoption in the coming years compared with recent experience in the UK.

Table 2: Comparison of Retirement-Age Population, Canada (2021) vs UK (2014)[30]

Population Age Range	Population (millions)		
	Canada (2021)	UK (2014)	Canada:UK
Ages 55–64	5.2	7.4	71.0%
Ages 65–74	4.1	6.2	65.5%
Total	**37.0**	**64.6**	**57.3%**
Total Ages 55–74	**9.3**	**13.5**	**68.5%**

- **Lending markets: Canadian banks are more likely to provide financing to facilitate EOT conversions than has been the case in the UK.** A recent report by Ownership at Work[31] notes that UK EOBs suffer from a "financing gap" compared with other company structures owing to financial institutions' lack of awareness or understanding of the sector and its characteristics. In contrast, Canadian and US banks operating in Canada are already significant lenders to US-ESOPs and would likely make financing available more readily for Canadian EOT conversions than has been the case in the UK.
- **Advisory services: Many Canadian and US legal, accounting, and consulting firms have operations in both countries, and as such are already well-acquainted with US-ESOP structures.** They would stand ready to serve Canadian business owners interested in structuring an EOT conversion.

In contrast, the only major reason why Canadian uptake of EOTs might skew lower than is implied by a direct extrapolation from the UK-EOT experience since 2014 is rooted in the UK's stronger and longer history of advocacy for employee ownership. The precursor to the UK's Employee Ownership Association (EOA) was founded in 1979, and several trailblazers such as Robert Oakeshott have campaigned for greater employee ownership over decades. While Canada has some large employee-owned companies, such as EllisDon, PCL, and Friesens, none has played an organizing role akin to the efforts of the sector-leading John Lewis Partnership in the UK. As a result, UK employee ownership organizations were better placed to promote the 2014 reforms than would be the case in Canada today. This experience deficit could, however, be quickly mitigated by a concerted effort to raise awareness of the introduction of a Canadian EOT accompanied by significant tax incentives. We would also expect this introduction to result in the rapid development of Canadian organizations similar to the EOA and the WRCEO.

Summing up, Canadian EOT uptake is likely to be higher than the numbers implied by our approach to extrapolating projections from the UK experience. Based principally on differences in firm size and

[30] Canadian 2021 population sourced from Statistics Canada and UK 2014 population data sourced from the Office for National Statistics.
[31] "Capital Partners? Why it's time for finance and employee ownership to talk" Hall and Gorman (2021).

demographics between Canada and the UK, we believe cumulative Canadian EOT adoption could be higher than the range projected by simply applying the proportional difference in GDP between the two countries.

<u>**US-ESOPs: What Uptake in the US Might Imply for Canada**</u>

The American experience with US-ESOPs provides a complicated basis from which to extrapolate possible Canadian EOT uptake projections and we believe the UK-EOTs provide a better reference point. Although the US-ESOP was created in 1974, Rutgers Professor Joseph Blasi, a leading US expert on employee ownerships, contends that government data on them prior to 1999 are unreliable. US-ESOP regulations and incentives have also changed many times. US-ESOP structures were initially designed for public companies: there was little incentive for privately-held firms to sell into US-ESOPs until CGT exemptions were introduced in 1984. Data immediately following the 1984 changes would be instructive, but are unfortunately not available.

Currently, there are almost 6,000 privately-held[32] US-ESOPs covering approximately 1.5 million active workers and 2 million workers overall.[33,34] The total number of privately-held US-ESOPs has plateaued around these levels for the last 20 years: around 250 US-ESOPS are formed each year, but a similar number is terminated annually owing to third-party purchases and wind-downs. This plateau might be instructive for projecting the long-term size of the EOT sector in Canada.

Given that the Canadian economy is about one-twelfth as large as the US economy, if Canada followed the US-ESOP trajectory we might expect Canada to plateau eventually at about 500 Canadian EOTs in operation, similar to, but lower than, our eight-year extrapolation from UK-EOT adoption into the Canadian context. At this steady-state, the annual flow of Canadian EOTs into and out of operation would likely be proportionately smaller than in the US. A "law of small numbers" could more severely limit annual EOT conversions in Canada compared with the US: with a much more modest number of private companies, the odds that any one firm would be a candidate for sale would be proportionately smaller in any one year than in the US. On the other hand, annual EOT termination numbers would also likely be proportionately smaller in Canada than in the US owing to thinner private-equity markets.

US-ESOP numbers hit their 6,000 plateau about 10 years after the introduction of CGT tax incentives in 1984. On this pace, we might expect Canadian EOB adoption to average around 50 per year over the first decade of the structure's existence, although the rate of adoption is unlikely to be linear, and more likely to follow the accelerating shape of UK-EOT adoption.

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[32] The UK-EOT is targeted exclusively at the succession of privately-held companies and the US-ESOP is now almost exclusively used for the succession of privately-held companies, as public companies have other means if providing stock-based incentives to employees in the US and the UK. Our expectation is that a Canadian EOT would similarly apply to privately-held companies exclusively, and thus we have limited our analysis to that group in the US.

[33] [Data from National Center for Employee Ownership (NCEO).]()

[34] In a US-ESOP, an employee is often paid for their shares over time after they leave the company (i.e. over a five-year period). As such, some employees remain participants in the US-ESOP after they are no longer actively employed by the company. Once they are fully paid out, they cease being a participant in the plan. This explains the difference between the number of active and total employees covered by US-ESOPs.

However, there are reasons to believe the US-ESOP plateau is a low benchmark for the eventual cumulative number of Canadian EOT conversions. As has been discussed in previous memos,[35] uptake of the US-ESOP is limited by its designation as a registered retirement plan, which leads to additional complexity and expense; additionally, the CGT incentive's complicated structure, limited to a sub-set of US companies,[36] curbs its appeal to business owners. Annual UK-EOT formations have exceeded the current pace of US-ESOP adoptions since 2017, and are currently being formed about eight times as quickly,[37] possibly as a result of the UK-EOT's simpler structure and accompanying tax incentives. While we have argued strongly for a share-based approach to a Canadian EOT (similar to the US-ESOP), we have made several recommendations that would significantly limit the complexity of a Canadian EOT as compared to a US-ESOP. For example, SCP has previously recommended that a Canadian EOT should not be tied to a retirement plan like the US-ESOP, but should rely on existing trust and corporate law. This would not only reduce the complexity of structuring and administering a Canadian EOT in comparison to a US-ESOP, but it would also make it easier to prevent termination of EOTs due to acquisition by financial buyers or competitors.[38]

Projecting Possible Wealth Generation for Canadian Workers

Using the UK and US experience as a guide, we start by projecting the average number of employees in a Canadian EOT. According to the aforementioned recent UK report, it is estimated that the average UK-EOT has 118 employees,[39] and the average US-ESOP formed over the most recent eight-year period for which data are available (2012–19) has 132 employees.[40] We'd expect this number to increase over time, as the entire cohort of privately-held US-ESOPs has an average of 255 employees,[41] and the average UK-EOT has grown in size from 90[42] to 118 employees over the last two years. However, for the period of study, we project a range of 100–150 for the average number of employees at a Canadian EOT by 2030 by taking the average of the US and UK experiences (125) and varying it higher and lower by 20%. By multiplying the lowest and highest ends of the projected ranges for average employees and uptake for Canadian EOTs, we project a range of about 50,000 to 114,000 new employee-owners at a Canadian EOT within eight years of introducing the new structure.

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[35] Policy Design Objectives, Options and Recommendations (2021-07-20), Governance for Employee Ownership Trusts (2022-01-31).

[36] The CGT incentive for US-ESOPs is limited to C corporations, while the IRS estimates that there are three times more S corporations than C corporations in the US, as noted by the S Corporation Association.

37 The UK Economy is approximately one seventh the size of the US Economy. There were 45 UK-EOTs formed in 2017, which translates to 315 in an economy the size of the US, and there were 282 UK-EOTs formed in 2021, translating to almost 2,000 in an economy the size of the US.

[38] More detail on this recommendation and others that would increase the simplicity of a potential Canadian EOT structure are noted in our "Design Objectives, Options and Recommendations" (2021-07-20) and "Governance for Employee Ownership Trusts" (2022-01-31) memos.

[39] "Employee Ownership in the UK*"* Pendelton, Robinson, Nuttall (2022), forthcoming research paper not yet published but made available to SCP under embargo.

[40] This analysis uses a database of all US-ESOPs that reported on their plans in 2019. Public companies, dormant plans, and some other outliers have been removed from the data set to ensure an appropriately comparable cohort.

[41] Data from National Center for Employee Ownership (NCEO).

[42] *EOT Survey Results 2020*, Employee Ownership Association, John Lewis Partnership, and RM2.

Unfortunately, there are no data on the quantum of profits distributed to employees of UK-EOTs. However, due to US-ESOP reporting requirements[43] and the US-ESOP's share-based structure, where employees' wealth is retained in the trust until they exit the company, the US provides insight into wealth generated for workers in employee-owned companies. In principle, the value of US-ESOP shares owned by employees is equal to the discounted value of future dividend payments plus current retained earnings. As such, the value of US-ESOP share holdings provides an instructive proxy for wealth generation under either a share-based or a profit-sharing EOB structure. Nevertheless, we continue to advocate for a share-based Canadian EOT structure because it is better for employee retention, it creates long-term alignment among all company stakeholders, and it is fairer for employees with different tenures at a company.[44] Also, the wealth-building effects of the US-ESOP's share-based approach are well-documented, while we don't yet know whether the UK-EOT's profit-sharing approach will be as effective at building worker wealth.

Looking in detail at the US data, for US-ESOPs formed in the last eight years, the average employee has USD 65,666 (CAD 84,710)[45] in their share accounts.[46] However, this number includes very recently-formed ESOPs where employees typically do not yet have anything accumulated under their names. Looking at older cohorts, we see share value climbing to an average of USD 86,082 (CAD 111,047) for employees in US-ESOPs formed between 2007 and 2014 and USD 82,487 (CAD 106,409) for US-ESOPs formed between 2002 and 2009.[47]

Using our projections for the number of Canadian EOTs likely to be formed over the next eight years (505–757), the average number of employees per EOT (100–150), and the average wealth generated per employee (CAD 84,710), our projection of total wealth likely to be generated in Canadian EOTs by 2030 is CAD 4.3 billion to CAD 9.6 billion for between about 50,000 and 114,000 Canadian workers.

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[43] US-ESOPs are required to value its shares every year and to report that value to the Internal Revenue Service (Form 5500). When employees leave US-ESOPs they are entitled to the asset value in their US-ESOP account, making this data a reliable source for the wealth generated for workers.

[44] We discuss this topic in more detail in our "Design Objectives, Options and Recommendations" (2021-07-20).

[45] Exchange rate used: 1 USD = 1.29 CAD.

[46] Analysis uses the same database as used for the average number of employees at recent privately-held US-ESOPs. Data used for this analysis is for the period 2012–19, the last eight years for which data are available.

[47] The small decline in value from the 2002–09 cohort to the 2007–14 cohort is not indicative of a secular decline in value over time. The average employee participant of all US-ESOPs has a value of USD 98,386, indicating that US-ESOPs dating from earlier than 2022 have a higher asset value per participant, on average, than the 2002–09 cohort.

Summing Up: Projected Canadian EOT Uptake Targets and Recommended Facilitating Policies

Canadian EOT uptake projections:

- **A total of between around 505 and 757 EOT conversions over the first eight years of Canadian EOT availability.**
- **Uptake may skew toward the top of this range owing to Canadian average firm size and demographics relative to the UK.**
- **This level of uptake would result in a projected CAD 4.3 billion to CAD 9.6 billion in wealth generated for about 50,000–114,000 workers by the eighth year of the Canadian EOT structure's existence.**

Recommended facilitating policies:

- **Capital-gains tax exemption on the proceeds from sales into EOT conversions.**
- **A simpler structure than the US-ESOP (as per previous recommendations).**
- **Technical guidance for the advisory community to reduce barriers to adoption.**