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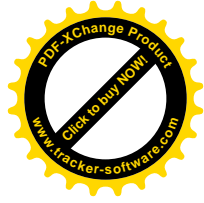
› [Budget 2023 – A Made-in-Canada Plan: Strong Middle Class, Affordable Economy, Healthy...](#)

Employee Ownership Trusts (EOT)

i For transactions which occur after December 31, 2023, Budget 2023 proposed new rules to facilitate the use of an Employee Ownership Trust (EOT) to acquire and hold shares of a qualifying business (QB). The new rules would define the qualifying conditions to be an EOT and facilitate the establishment of EOTs.

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Questions & Answers

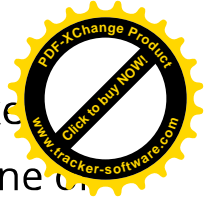
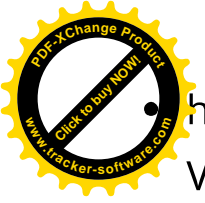
1. What is an EOT?

An EOT is a form of employee ownership where a trust holds shares of a corporation for the benefit of the corporation's employees. EOTs may be used to facilitate the purchase of a business by its employees, without requiring the employees to pay directly to acquire the shares. For business owners, an EOT provides an additional option for succession planning.

2. What are the requirements to be considered an EOT?

To be considered an EOT a trust must be an irrevocable trust that at all times:

- is resident (excluding deemed resident trusts) in Canada,
- is exclusively for the benefit of all individuals described in Q5,
- has trustees that meet the conditions outlined in Q6,
- determines the income and capital interests of each beneficiary of the EOT in the same manner as other current employee beneficiaries or (if applicable) in the same manner as other former employee beneficiaries of a QB controlled by the trust, for more information go to Q7,



has all or substantially all (generally 90% or more) of the Fair Market Value (FMV) of the property of the trust attributable to shares of one or more QBs that the trust controls, and

- requires more than 50% of the employee beneficiaries to approve certain transactions or events prior to their occurrence, for more information go to Q9.

3. What is a QB?

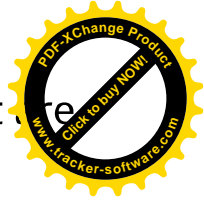
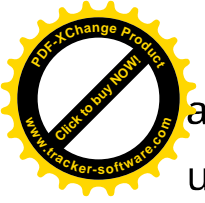
A QB is a corporation controlled by a trust that:

- is a Canadian-controlled private corporation (CCPC),
- no more than 40% of the directors of the corporation are individuals that, immediately before the time the EOT acquired control of the corporation, owned, directly or indirectly, together with any person or partnership that is related to or affiliated with the director, 50% or more of the FMV of the shares of the capital stock or indebtedness of the corporation, and
- deals at arm's length and is not affiliated with any person or partnership that owned, directly or indirectly, 50% or more of the FMV of the shares of the capital stock or indebtedness of the corporation immediately before the time the EOT acquired control of the corporation.

4. What is a qualifying business transfer (QBT)?

A QBT means a disposition by a taxpayer (seller) of shares of a corporation (in this question referred to as the subject corporation) to a trust, or to a CCPC (in this question referred to as the purchaser corporation) that is controlled and wholly-owned by a trust, if:

- immediately before the disposition, all or substantially all (generally 90% or more) the FMV of the assets of the subject corporation are



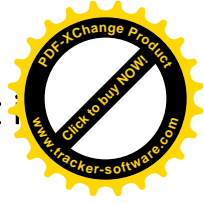
attributable to assets (other than an interest in a partnership) that are used principally (generally more than 50%) in an active business carried on by the subject corporation or a corporation that is controlled and wholly-owned by the subject corporation,

- at the time of the disposition:
 - the seller deals at arm's length with the trust and any purchaser corporation,
 - the trust acquires control of the subject corporation, and
 - the trust is an EOT, the beneficiaries of which are employed in the business.
- at all times after the disposition:
 - the seller deals at arm's length with the subject corporation, the trust and any purchaser corporation, and
 - the seller does not retain any right or influence that, if exercised, would allow the seller (whether alone or together with any person or partnership that is related to or affiliated with the seller) to control, directly or indirectly in any manner whatever, the subject corporation, the trust, or any purchaser corporation.

5. Who can be a beneficiary of an EOT?

Beneficiaries of the trust must consist exclusively of individuals who:

- are employees (current employee beneficiary) or, if the trust allows, former employees (including estates) who were employees, while the trust controlled the QB, of one or more of the QBs controlled by the EOT; other than employees or former employees that did not complete an applicable probation period of no more than 12 months,
- do not own, except through an interest in the trust, shares of a class of a QB controlled by the trust, the value of which is 10% or more of the FMV of the class,



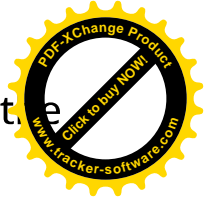
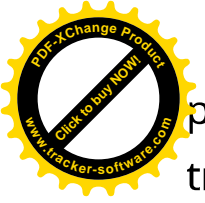
do not own, alone or together with any person or partnership that is related to or affiliated with the individual, shares of a class of a QB controlled by the trust, the value of which is 50% or more of the FMV of the class, and

- immediately before the time of a QBT to the trust, did not own, directly or indirectly, alone or together with any person or partnership that is related to or affiliated with the individual, shares of the capital stock or indebtedness of the QB, the value of which is 50% or more of the FMV of the shares of the capital stock and indebtedness of the QB.

6. What conditions apply to the trustees of the trust?

In order to meet the conditions to be considered an EOT the trustees must:

- not act in the interest of one beneficiary (or group of beneficiaries) to the prejudice of another beneficiary (or group of beneficiaries),
- be either:
 - an individual (other than a trust)
 - a corporation resident in Canada that is licensed or otherwise authorized under the laws of Canada or a province to carry on in Canada the business of offering to the public its services as a trustee,
- each have equal votes,
- ensure that at least one-third of the trustees are current employee beneficiaries of a QB controlled by the EOT (this does not include an employee who has not completed the probationary period, which may not exceed 12 months), and
- ensure that if any trustees are appointed (other than by an election within the last five years by current employee beneficiaries of a QB), at least 60% of all trustees are dealing at arm's length with each person who has sold shares of a QB to the trust (or to any person or



partnership affiliated with the trust) prior to or in connection with the trust acquiring control of the QB.

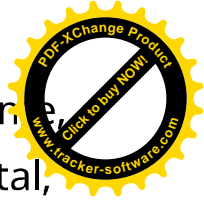
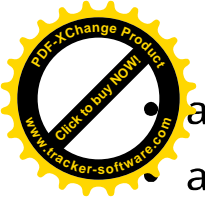
7. How are the capital and income interests of EOT beneficiaries determined?

As noted in Q6, the trustees of the EOT must not act in the interest of one beneficiary (or group of beneficiaries) to the prejudice of another beneficiary (or group of beneficiaries). The capital and income interests of each beneficiary of the EOT must be determined in the same manner as other current employee beneficiaries or (if applicable) in the same manner as other former employee beneficiaries of a QB controlled by the trust. The determination must be based solely on a reasonable and equitable application of any combination of the following criteria:

- total hours of employment service provided by the beneficiary to the QB in respect of a particular time period,
- total salary, wages and other remuneration paid or payable to the beneficiary by the QB in respect of a particular time period, not exceeding, for any calendar year in the particular time period twice the dollar value of the highest personal income tax bracket for the year (prorated based on the number of days in the particular time period),
- total period of employment service the beneficiary has provided to the QB since a particular time.

No other criteria must be taken into account in determining the beneficiaries' income and capital interests in the EOT. A different distribution formula could be used for income vs capital distributions and/or current vs former employees, however, all distribution formulas must include at least one of the above factors.

Where an EOT is set up for the benefit of both current and former employees, it could administer up to four different distribution formulas:



- a formula for current employees in respect of distributions of income,
- a formula for current employees in respect of distributions of capital,
- a formula for former employees in respect of distributions of income,
- a formula for former employees in respect of distributions of capital.

▶ Example – Application of Distribution Criteria

▶ Example – Application of Distribution Criteria with Salary Caps

8. What property can an EOT hold?

All or substantially all of the FMV (generally 90% or more) of the property held by the trust must be attributable to shares of one or more QBs that the trust controls.

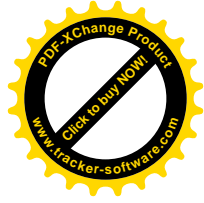
9. When are beneficiaries required to vote in an EOT?

Each current employee beneficiary has an equal vote in the conduct of the affairs of the trust. More than 50% of the current employee beneficiaries of the EOT must approve each of the following transactions or events prior to their occurrence:

- any transaction or event or series of transactions or events that causes at least 25% of the current employee beneficiaries to lose their status as beneficiaries (unless the change in status is in respect of a termination of employment for cause),
- a winding-up, amalgamation or merger of a QB (other than in the course of a transaction or event or a series of transactions or events that involves only persons or partnerships that are affiliated with the QB).



How will EOTs be taxed?



An EOT would be a taxable trust and would generally be subject to the same rules as other personal trusts. Undistributed trust income would be taxed in the EOT at the top personal marginal tax rate, whereas trust income distributed from an EOT to its beneficiaries would not be subject to tax at the trust level but at the beneficiary level.

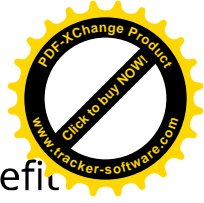
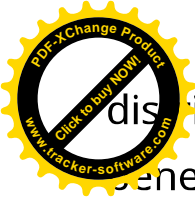
An EOT would be subject to the same filing obligations as other trusts. Generally, a trust has to file an annual income tax (T3) return if the trust has tax payable or it distributes all or part of its income or capital to its beneficiaries. For more information see the [T4013 T3 Trust Guide](#), or the web page [Trust income tax - Canada.ca](#).

For tax years ending on or after December 31, 2023, additional rules apply in respect of the requirement to file a T3 return. A T3 return must be filed if the trust is an express trust (or for civil law purposes a trust other than a trust that is established by law or by judgement) which is resident in Canada and is not a listed trust. For more information on the additional filing requirement see [New trust reporting requirements for T3 returns filed for tax years ending after December 30, 2023 - Canada.ca](#).

11. How do EOTs impact qualifying employees?

Employee beneficiaries of an EOT may have greater participation in the decisions and the growth of the business. In addition, those employee beneficiaries may potentially increase their income as they would share in any profits of the business.

Generally, a trust receives income and pays it to the beneficiaries according to the terms of the trust document. In the case of an EOT the distributions of the income must be in accordance with a reasonable and equitable



distribution formula, see [QZ](#) for more information. The employee beneficiary then has to report the income on their income tax and benefit return.

Income distributed from a trust retains its character, therefore if the EOT distributes dividends received from QBs, those dividends would retain their character when received by beneficiaries and would therefore be eligible for the dividend tax credit.

12. How is the capital gains reserve changing for QBTs?

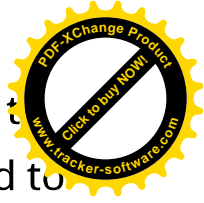
Currently, when taxpayers receive proceeds of a sale of capital property on a deferred basis, they are permitted to defer recognition of the capital gain until the year in which they receive proceeds. A minimum of 20% of the gain must be brought into income each year, creating a maximum five-year deferral period.

Budget 2023 proposed to reduce the minimum capital gain required to be included in income from 20% to 10% for the disposition of shares of a QB to an EOT, or to a CCPC that is controlled by an EOT, pursuant to a QBT. This will create a maximum ten-year deferral period instead of the usual five-year deferral period.

For more information on capital gains reserves, see [Claiming a capital gains reserve - Canada.ca](#)

13. How are the shareholder loan rules changing for EOTs?

Currently, taxpayers who receive a shareholder loan are generally required to include the loaned amount in income in the year the loan is received, unless the loan is repaid within a year. If an EOT were to borrow from a QB



to finance the purchase of shares in a QBT, the EOT would be required to repay borrowed amounts within one year of the QB's taxation year end to avoid paying taxes on the loaned amount.

Budget 2023 proposed to introduce a new exception to extend the repayment period from 1 to 15 years for amounts loaned to the EOT from a QB to purchase shares in a QBT.

Changes are also proposed to provide an exemption to the deemed interest benefit that an indebted shareholder would otherwise be deemed to realize. This exception will apply for up to 15 years where an EOT borrows funds from a QB for the purpose of purchasing the QB pursuant to a QBT.

For more information on the existing rules, see [Loans and employee debt - Canada.ca](https://www.cra.ca/Loans-and-employee-debt-Canada.ca)

14. How is the 21-year deemed disposition rule changing for EOTs?

Currently, to prevent the indefinite deferral of tax on accrued capital gains, certain trusts are deemed to dispose of their capital property at 21-year intervals.

Budget 2023 proposed to exempt EOTs from the 21-year deemed disposition rule. If a trust no longer meets the conditions to be considered an EOT, the 21-year rule would be reinstated as of the date the trust no longer qualified as an EOT until the trust next meets the conditions to be considered an EOT.



15. What is the tax treatment of capital gains realized when a business is sold to an EOT?

The 2023 Fall Economic Statement proposes to exempt the first \$10 million in capital gains realized on the sale of a business to an EOT from taxation, subject to certain conditions.

This incentive would be in effect for the 2024, 2025, and 2026 tax years. Further details will be provided in the coming months.

16. Where can I get more information?

Check online at Canada.ca regularly for updated forms, policies, guidelines, questions and answers, and guidance.

In the meantime, please consult Finance Canada's Budget 2023 documents for details.

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