CASE STUDY

Employee Ownership through Perpetual Trusts

Most conversation about employee ownership in the United States focuses on three vehicles: ESOPs, equity compensation plans, and worker cooperatives. Recently a few company owners have been considering a perpetual trust, an employee ownership model imported from the United Kingdom. The March-April 2016 issue of this newsletter covered the design firm WATG, a U.S. company whose shares are owned by a U.K.-based trust on behalf of employees. This article explores a related approach.

In 2008, Mattias Scheiblehner founded Metis Construction, which does commercial and residential construction. In February 2016, he sold all of the shares to a trust. The sale price was calculated to reflect the time and direct expenses Scheiblehner had invested to establish the company. Metis is based in Seattle, and the trust is a noncharitable purpose trust, a form of trust that exists in many but not all states. The trust is intended to be the permanent owner of the company shares, but state law only allows it to exist for 150 years after the death of the settlor or the final beneficiary. Scheiblehner hopes that when that time comes, the laws of the state of Washington will have changed, but otherwise, the founding documents of the trust instruct it to move to a state with laws that do allow actual perpetuity.

Trust Ownership at Metis Construction

Of the 34 current employees, 18 are employee-owners, or more precisely, beneficiaries of the trust. Another 16 employees are not yet owners, but they are on track to become owners over time if they remain at the company. People who were Metis employees as of six months before the transaction had the chance to become owners immediately. All employees who joined later are automatically given the option of becoming members if they are still employed by Metis at the conclusion of a five-year probationary period.

The trustees of the Metis trust are a subset of Metis employee-owners. Prospective trustees put their names forward and then all employee-owners vote on who will be trustees. In addition, the company has one independent outside trustee.

Scheiblehner sees this structure as simply the right thing to do because "any other organization misses the point of who is doing the work and who is making the profit." He also sees a transformation in the increased responsibility employee-owners are taking on themselves.

Contrast with ESOPs and Co-ops

In an ESOP, participants receive shares or the cash value of shares, generally at retirement, but the financial benefit to Metis employee-owners is that they annually receive a share of company profits. By default, Metis pays 70% of each year's profits as profit sharing, which goes to employees based on hours worked.

Company shares, both at Metis and at ESOP companies, are held by trusts, but the trust that owns Metis shares is dramatically different from an ESOP trust.

- Since the Metis trust does not pay retirement benefits to employees, it is not subject to ERISA. By contrast, ESOPs have requirements for participation, allocation of benefits, fairness to non-highly-compensated employees, distribution, and more.
- The Metis trust is intended to be the owner of the company in perpetuity, but the trustee of an ESOP, by contrast, may find it difficult to resist an offer to buy the shares if the terms are sufficiently favorable. *(See the article on page 4.)*
- ERISA provides standards for the valuation of shares in transactions involving ESOPs, but shares held by the Metis trust are intended never to circulate, so once they enter the trust, the shares do not need to be valued. The valuation standards for determining the price for the sale of shares to the trust depends on state trust law, not on federal ERISA rules.

The tax treatment of ESOP companies, especially S corporation ESOPs, does not apply to Metis. The Metis model has some similarities with worker cooperatives, such as democratic governance and egalitarian treatment of profits. Scheiblehner himself describes the company as a cooperative, although in a traditional cooperative, members own their shares directly, rather than through a trust.

Other Approaches

Metis was an ongoing business that converted to trust ownership, but other models are possible. Equity Atlas, for example, is a mortgage and financial services company that was founded by Brad Hippert in 2016, and its shares have been owned by a perpetual trust since its founding.

Chris Michael of the ICA Group, who worked with both Metis and Equity Atlas, says that two main reasons might lead a business owner to choose employee ownership via perpetual trust. First, the model may be especially attractive to business owners who want to ensure that employee ownership lasts in perpetuity without the risk of an unwanted buyer. Second, the lower cost and increased simplicity of perpetual trusts can make trust ownership a good approach for companies that are too small for ESOPs or that want to avoid the cost and complexity of an ESOP transaction and the ongoing costs of complying with ESOP requirements. ■

Learn more about perpetual trusts at the NCEO annual conference. Chris Michael also has an article about U.S. perpetual trusts in the October 12, 2015, issue of *Tax Notes*.