

Executive Remuneration

The A to Z Employee benefit trusts

August 2009

What is an Employee Benefit Trust?

An Employee Benefit Trust (EBT) is a discretionary trust set up by a company for the benefit of its employees. Assets such as cash or shares in the company are put into the EBT and the trustees are given complete discretion as to which employees benefit and when.

Burges Salmon

Burges Salmon have significant experience of advising on the setting up and running of EBTs in a wide variety of contexts. Being a large commercial law firm our first concern is naturally to adopt a commercial attitude to EBTs. However, unlike many commercial law firms, we maintain one of the largest Tax and Trust units in the country - and are therefore able to advise fully on the complex trust law issues which can arise for EBTs. This combination of commercial and trust capabilities means that we are uniquely placed to advise in this area.

Why set up an EBT?

EBTs can be used in a wide variety of contexts and situations - sometimes with a greater or lesser degree of success.

The aim of this briefing is to give some idea of the situations in which EBTs may be used. We should stress that some of the ideas below are extremely speculative and we include them only because we have occasionally come across misleading advice in this area. Whether or not a particular scheme is appropriate or even effective depends very much upon the circumstances and no-one should undertake such a scheme without taking full advice.

Naturally, the advice given in this briefing is a very broad summary of the issues and reliance should not be placed upon it without consulting professional advisors.

Surely EBTs are now out of fashion?

This briefing is an update of an earlier note we first prepared in December 2001. Since then new legislation and accounting standards have been introduced which curtailed some of the more aggressive uses to which EBTs

were put. Interestingly, however, these new rules have curtailed only two of the twenty-six ideas in our original briefing. Far from being dead, therefore, EBTs are alive and well.

EBTs - The A to Z

Human Resource reasons

- A. To make discretionary payments to employees. The primary reason for using an EBT is to put cash into a fund where it is available to make such payments¹.
- B. To incentivise key employees. The EBT can be coupled with performance criteria setting out when payments will be made.
- C. To handcuff employees. Alternatively, the EBT can be coupled with length-of-service criteria.
- D. To ensure global consistency. For companies with a global workforce, EBTs can be used as part of equalisation packages.

Corporate reasons

- E. To operate as a warehouse for shares. EBTs can hold shares in order to prevent later dilution.
- F. To implement a share scheme. Shares granted under share option schemes will often be held by an EBT in the interim.
- G. To act as a market. Although this cannot be its main purpose, an EBT can buy and sell shares from other shareholders - particularly useful for unquoted companies.
- H. To buy-out a retiring shareholder. Often a tax-advantageous alternative to the company buying-out shares on retirement.
- I. To avoid Financial Assistance. It is normally a criminal offence for a company to offer financial assistance in relation to its own shares. However, there is a specific let-out for EBTs.
- J. To allow circular ownership. The trustee of the EBT

¹ NB If this is not the primary reason for the EBT, many of the other schemes mentioned below will be ineffective.

can be a subsidiary of the company.

- K. To give protection against a hostile takeover. Circular ownership structures may help give the directors greater control in this situation.
- L. To reduce profit and loss (P & L). A donation by a company to an EBT (often returned to the company for the issue of shares) may reduce P & L.
- M. To pay employees without cost! EBTs allow employees to be paid in shares rather than cash - but watch carefully the dilution effect for other shareholders.

Corporate Tax reasons

- N. To defer National Insurance. Donations to an EBT do not attract National Insurance Contributions (NICs) until benefits are designated for particular employees.
- O. Where capital allowances are not available. The EBT could, for instance, hold the company's premises for which the company pays rent.

Personal Tax reasons

- P. To defer Income Tax. Donations to an EBT do not attract Income Tax until benefits are designated for particular employees.
- Q. Timing mismatches for internationally mobile employees. EBTs may have tax advantages for a migratory workforce.
- R. Estate Planning for family companies. Shareholders in family companies might consider putting 51% voting control into an EBT to reduce the size of their estates.
- S. Bonus Waivers. Senior executives may consider waiving bonuses in favour of an EBT to save income tax.

Taxation within the EBT

- T. Inheritance Tax. EBTs will usually escape many of the inheritance tax (IHT) problems traditionally associated with discretionary trusts.
- U. Onshore EBTs suffer income tax and Capital Gains Tax (CGT) at 40%. Offshore EBTs may escape both.

Tax schemes

EBTs are often an important constituent element in a number of tax planning schemes. The following ideas are among the

more speculative in this briefing:

- V. In place of a share option. Certain schemes offer the same advantages of a traditional share option with a much lower tax cost.
- W. In connection with a Funded Unapproved Retirement Benefits Scheme (FURBS). EBTs can potentially be used to route payments to FURBS.
- X. To avoid income tax altogether. EBTs will generally defer income tax (see 18 above). With further planning it may be possible to avoid income tax altogether.

No longer possible

As mentioned earlier, recent legislation and changes in accounting practice have made only two changes:

- Y. It is now very difficult to use EBTs to take assets off balance-sheet.
- Z. A corporation tax deduction is now generally not available until benefits are paid out to employees and income tax is paid.

Conclusion

With the changes in the law over the last few years, many have given up on the idea of using an EBT. This briefing will hopefully have shown that EBTs still have many uses.

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Disclaimer: This briefing gives general information only and is not intended to be an exhaustive statement of the law. Although we have taken care over the information, you should not rely on it as legal advice. We do not accept any liability to anyone who does rely on its content.

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