



## Remuneration Trusts – Providing For Company Employees

Particularly in the present economic climate, companies are looking for more flexible options to incentivise their employees. In addition to the traditional methods of paying salaries, bonuses and dividends, employee incentivisation may also be achieved by way of a Remuneration Trust (**RT**).

Using the conventional forms of employee remuneration can give rise to significant liabilities both for the company and the employee. Taking into account income tax and national insurance contributions, for higher rate tax paying employees, there could be a total income tax charge of 52.5% from this April, rising to 54% in 2011/12. It might be possible to mitigate these significant tax charges by the use of an RT.

For the purposes of this note, a RT is a structure through which profit may be passed from a limited company to an employee in a tax efficient way. The structure is set up by the company using net distributable profits, for the benefit of its employees. This note is primarily interested in two forms of RT: -

- Employee Benefit Trusts (**EBTs**)
- and
- Employer Funded Retirement Benefit Schemes (**EFRBS**)

Although EBTs and EFRBS are technically different, having grown from separate legislative backgrounds, in practice they operate in a similar way.

### **EBTs**

Profit sharing schemes as the fore-runner to EBTs were first introduced in the 1978 Finance Act. EBTs began to be popular prior to the 1980 changes to the corporate buy-back rules, as they could operate as a market for the shares of companies which could not be repurchased by the company. EBTs have therefore been with us for over 30 years.

They take the form of a discretionary trust which is intended to incentivise staff. A company pays sums into an EBT, and in due course benefits would be made available by the trustees to the employees. In order to encourage the use of EBTs, the Government provided generous tax benefits.

### **EFRBS**

An EFRBS is a pension scheme that is unregistered. They replaced the FURBS (Funded Unapproved Retirement Benefit Scheme) and UURBS (Un-funded Unapproved Retirement Benefit Scheme) on A-Day (6 April 2006) when significant changes to the pension rules were introduced.

Unapproved pension schemes were introduced to allow employers to compensate employees, who were subject to the earnings cap in their approved occupational pension scheme, to make pension provision for employees wanting to pay into a pension while working overseas and also non UK tax payers.

Since A-Day, the distinction between approved and unapproved pension schemes has been replaced with a distinction between registered and unregistered schemes.

The main benefit of an EFRBS is that it is not subject to the stringent pensions regime now applying to registered schemes. This means for example, that a contribution to an EFRBS does not count towards an individual's lifetime pension allowance.

### **Outline and Practical Advantages of a RT structure**

- A Company creates a RT and makes a contribution to it from net distributable profits.
- The trustees consider the best way of making provision for the employees. For example, it is possible to create dedicated sub funds, for key employees and then their families after the employee's death.
- If payments are made from an RT while the employee is employed by the company, they are treated as normal taxable benefits in the hands of the employee. However, instead of making payments from the RT, loans may be made to employees at the (current) rate of 4.75% and interest free on the cessation of employment.

There are a number of strong practical reasons why companies consider a RT as part of an employee's overall remuneration package:

- As an incentive / reward.

- To ring fence assets from financial disaster so that they are then not vulnerable to downturns in the company's business. Dividends, for example are more vulnerable to attack in the event of corporate insolvency as almost by definition they are payments for which no valuable consideration has been given to the company.
- They provide greater investment freedom when compared to conventional approved pension arrangements.
- As a retirement fund. For the employee and ultimately as means of support for the employee's family.

### Tax Treatment of RTs

In addition to the practical benefits of using a RT there may also be tax advantages.

- A capital contribution to a RT by a company might be deductible for Corporation Tax or at least enable the deferral of tax for the company. (NB in light of HMRC's published views, endeavouring to obtain a deduction for Corporation Tax would be a higher risk strategy).
- To the extent that the fund remains for key employees, transfers into RTs should not trigger a liability to Inheritance Tax (IHT). The structures are then not subject to ten year or exit charges under the IHT Relevant Property Regime.
- Growth in assets will be outside an employee shareholders' estate. If a dedicated sub fund is created, it can pass IHT free to that employee's family on the employee's death.
- A significant cash surplus in a company may prejudice the availability of Business Property Relief (BPR) from IHT. If a transfer is made to an RT, this will reduce the cash surplus within the company which should reduce the risk of affecting the availability of BPR on the shares.
- If offshore the investments in the RT can be allowed to roll-up without income and capital gains tax arising in the UK.

### HM Revenue & Customs (HMRC) and RTs

With increased pressure to generate tax revenue, the taxation of RTs has come under increased scrutiny by HMRC. Most recently this has resulted in HMRC publishing "Spotlights" 5 and 6, toward the end of 2009. In these publications, HMRC record their approach when reviewing these types of arrangement.

Many tax practitioners feel that the view of HMRC expressed in these publications is just that – a view – and that HMRC's interpretation of the law is not necessarily correct! However, our RT team is conscious of HMRC's approach to RT planning, and will assist your company in the structuring of an RT arrangement that is within the spirit of guidelines set down by HMRC thus endeavouring to ensure that each arrangement is as secure as possible.

As a firm of solicitors, our advice is covered by Legal Professional Privilege. In the event of any future HMRC enquiry into your company's use of RT planning, the advice we give would not be disclosable to HMRC, without a court order, in the event of an enquiry. The advice given by a non-lawyer tax professional does not benefit from this privilege, and therefore makes advice obtained from non-lawyer advisers more vulnerable to scrutiny in the event of a HMRC enquiry.

### Act now!

In the current climate, there is no guarantee that the significant advantages set out in this note will remain. It is widely predicted that HMRC will issue anti-avoidance measures to take effect from 6 April 2010, to restrict future planning using RTs.

Accordingly, if you feel that this type of arrangement will suit your company we strongly recommend you to take action as soon as possible.

We will be pleased to discuss which RT structure best suits your company's requirements. Our experienced RT Team is lead by Jeremy Mills, who also heads our Tax and Trusts Team, which has received consistently high ratings in the Legal 500 and Chambers and Partners.

Please contact **Jeremy Mills** our Remuneration Trust specialist on **(01202) 786186**.

The purpose of this note is to set out the possible benefits of using Remuneration Trust structures and is correct as at January 2010. As this note is framed in general terms, specialist advice should be taken on the specific structure of any RT depending on the specific circumstances of your company and employees.



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