TURCAN CONNELL

Briefing Note

Employee Benefit Trusts

What is an Employee Benefit Trust?

- An Employee Benefit Trust is a trust which can be established either in the UK or offshore and which is set up by a company to hold cash and other assets, for example shares, to provide benefit to employees and their families for the purpose of attracting and retaining quality staff.

- The Trust beneficiaries can include past and present employees of the company and its subsidiaries, and their families and dependants.

- The Trust can hold shares in the establishing company. This allows a market in the company's shares to be created for outgoing shareholders; and also to satisfy share options granted by the company under any share scheme.

- The Trust and the company are separate legal entities, and once the company transfers property into the Trust, the trustees become the legal owners of that property. Similarly, the Trust continues to exist in the event that the company is wound up, liquidated, or has a change of ownership.

- The company is under no obligation to continue to fund the Trust and the employee has no contractual right to benefit from it.

How does an Employee Benefit Trust operate?

- The Trust is established by a trust deed. The company's Board of Directors need to approve the Trust in a formal minute, giving the reasons why the Trust was set up.

- The Trust is run by the trustees who have ultimate control of the Trust property and complete discretion on how to distribute it (subject to their fiduciary duties) although they can, and often do, consult with the company as to what should happen to the Trust property.

- Trustees are independent from the company and can be paid for the service they provide.

How are Employee Benefit Trusts taxed?

- The trustees are subject to the normal rules for taxation of trust income and capital gains. If the Trust is UK resident, the trustees are subject to tax on income at 45% and at 28% on gains arising in the Trust.

- If the Trust is non UK resident, the trustees have no UK income tax liability other than on UK source income and are not liable to UK capital gains tax on disposals.

- Benefits awarded are generally taxed as employment income. Earmarking funds or advancing a loan to an employee will be subject to tax as employment income on the full value of the sum loaned or earmarked. Loans advanced to employees before the rules changed on 9th December 2010 should continue to be taxed under the benefit in kind rules as employment related loans providing they are genuine loans.

- A corporation tax deduction for contributions to the Trust is deferred until a payment is made out of the Trust in a form giving rise to an employee income tax and national insurance liability.

- Discretionary trusts are subject to an inheritance tax charge on every tenth anniversary of the setting up of a trust and also when property leaves a trust. These charges do not apply for trusts for the benefits of employees, provided they meet the criteria of s.86 of the Inheritance Tax Act 1984. (The trust must be for the benefit of all or most of the persons employed by the company).

- Special considerations apply where the company is controlled by five or fewer shareholders (or persons connected to them) or the controlling shareholders are all directors of the company. Depending on the terms of the trust deed, payments to the Trust may be treated as lifetime chargeable transfers for inheritance tax by those shareholders holding 5% or more of the issued share capital of the company. HMRC takes a fairly hard line on the inheritance tax treatment of contributions made by a close company to an Employee Benefit Trust. This further emphasises the need to take specialist advice on the tax implications of establishing Employee Benefit Trusts.

If you would like to discuss the issues involved in setting up, funding and running an Employee Benefit Trust, please contact Donald Simpson on 0131 228 8111 or by email at donald.simpson@turcanconnell.com.

This note is intended as a brief summary of the taxation and legal position of Employee Benefit Trusts as at June 2014. Taxation is subject to change and depends on the individual circumstances of each client. Legislation is also subject to change. Information provided in this document and any opinions expressed are for general use and not personal to your circumstances, nor are they intended to provide specific advice. No responsibility can be accepted for any action taken in reliance of this note and specialist advice should be taken in every case. Turcan Connell would be happy to provide such advice.