

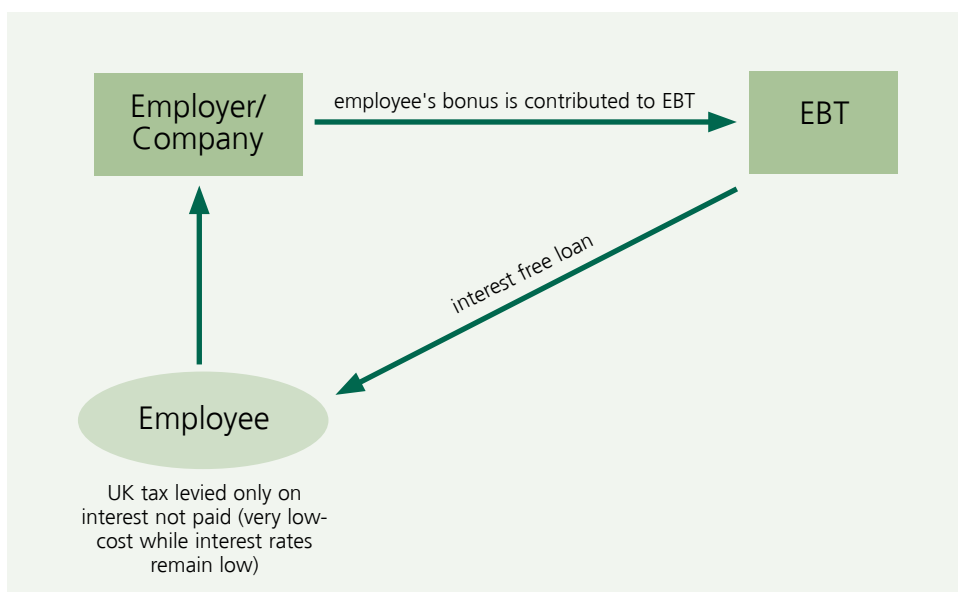
Employee benefit trusts

Deferring UK income tax on salary and bonuses

This year, the UK's Labour Government introduced a top rate of income tax of 50% for high earners, coupled with a new 20% tax on high earners' pension contributions. Both of these will come into effect in April 2010.

As a result, we have had very high levels of demand from our high earning UK clients to advise on ways to reduce their UK income tax and national insurance contributions (NICs) liabilities, especially where they have substantial surplus income in excess of their day to day needs.

Against this background, offshore Employment Benefit Trusts ("EBTs"), while not new, are proving a more useful tax planning tool than ever before, since the increased tax rates mean that the tax savings achieved are now significantly greater and can justify the costs even for relatively small EBTs.



Advantages

- No income tax or NICs on employer's payments to the EBT.
- The payment to the EBT can reduce the employee's income below the threshold for "higher earners", in order to escape the new tax on pension fund contributions.
- No UK CGT payable on gains arising in the EBT.
- Trustees pay UK income tax only on UK source income.
- The employee can take money from the EBT tax-efficiently by taking an interest free loan. He pays tax only on the interest foregone (this is very cheap while interest rates are at historic lows).
- Loans taken by the employee from the EBT are deductible for inheritance tax.
- The assets in the EBT are outside the scope of inheritance tax, so the EBT can be used as a vehicle to transmit assets tax free to children, grandchildren etc.
- Once the employee has left the employment, his family can benefit from the EBT without incurring any tax (but he cannot).
- The EBT's special tax status can be used to support other personal tax planning, e.g. the employee can transfer other assets to the EBT to make use of its tax exemptions.
- The EBT's tax status is enshrined in legislation. This is not "aggressive" tax planning and is unlikely to be challenged by the UK Revenue unless used abusively.

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Structure

An EBT is an offshore trust structure which is set up by an employer company for the benefit of some or all of its employees, typically the senior executives. The employer pays part of the employees' total remuneration (usually some or all of the bonus element) directly to the EBT.

The EBT is divided into separate sub-funds for each employee, and each employee will be able influence how his sub-fund is invested and when it is distributed to him or his family.

The tax advantage for the employee is that he suffers no UK tax on the money his employer pays to the EBT. The employee only suffers tax if and when he receives money from the EBT, enabling him to defer the tax indefinitely.

In some cases, we have advised employees who have escaped UK tax altogether, by leaving the money in the EBT until after they have left both the employment and the UK.

The corollary to the employee benefiting from this tax deferral is that the employer does not get a tax deduction for making the contribution to the EBT.

The employer will get a deduction when the employee himself becomes liable to tax on taking money out of the EBT. This is less of a concern to many employer companies at present, who may have trading losses available and hence do not need the tax deduction.

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