

STRATEGIC TAX PLANNING

International & UK Tax Consultants

23 December 2010

CANCEL THE PARTY: - *DISGUISED REMUNERATION* LEGISLATION HITS EBT'S AND EFURBS HARD!

On December 9th 2010, (just before the latest round of Bonuses in the City) draft legislation dealing with *Disguised Remuneration* was released. This is widely and comprehensively drafted with the clear intention of preventing the 50% income tax rate being sidestepped by the use of Bonuses routed through Employee Benefit Trusts ("EBTs") and Employer Funded Retirement Benefit Scheme ("EFURBS").

These *Solutions* were converting large Bonuses (taxed at 50%) into loans taxed on the Employee at low or no tax rates (depending on whether interest was being charged, or not). They were also popular with Footballers, Entertainers, Computer Contractors and other High Earners, including those running profitable private Companies.

The HMRC projections are that the new rules will bring in about £500 million a year in extra tax but the real loss currently is probably far higher, at closer to £2 Billion. Such was the popularity and frequency that EBTs and EFURBS were being used.

The new rules now bite on any means of *paying or rewarding Employees through Third Parties with rewards or recognition by way of assets or loans; called a "relevant arrangement"*. The rules then attack a *Third Party taking a "relevant step"*. Another key phrase is *"Earmarking" when (however informally) funds are allocated or set aside for the benefit of an Employee or someone "Linked" with them*.

These terms and the scope of the rules (including exclusions which appear to require a whole raft of detailed conditions to be met to qualify!) have already been the subject of much speculative comment and pronouncements as to their scope and meaning. In fact, the reality is that until the consultation period ends and the legislation is sharpened to eliminate some errors and extreme drafting, nobody should take any action going forward.

It does seem fair to conclude that using EBTs and EFURBS in the future will be only for large Companies and a few whose facts and needs fit the new rules. As vehicles for straight income tax avoidance, they will have limited scope.

For many in the City and other High Earners, this will be the *last straw*. With the US extending its low rates of income and capital gains tax for another 2 Calendar years at least; those in the City who can, will now consider moving. Avoiding the UK 50% income tax rate is still possible, but the choices are now very limited and the EBTs and EFURBS solutions which offered near instant access to Bonuses at

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a very low tax cost, has clearly gone. Although alternative *Solutions* may be emerging (in my view prematurely), it is clear that anything that attempts to mirror EBTs and EFURBS will be subject to possible retrospective legislation. The scene is therefore set for a large exodus from the City that only a return to the 40% income tax rate can prevent!

Not wanting to be a Scrooge (in this Season) there is unfortunately more bad news in the December 9th 2010 announcement.

Conventional wisdom on tax schemes (as espoused by tax product sellers) is that the fact there is a cut-off date in the legislation, demonstrates that the scheme works, up till then!

Well for EBTs and EFURBS that may not be the case! In the HMRC documentation there is an overt threat to pre-December 9th 2010 EBTs and EFURBS.

"Some types of transaction which will be chargeable to tax under this measure (including the earmarking of funds held in a discretionary trust) are not accepted by HM Revenue & Customs (HMRC) as effective in avoiding tax under the present law. HMRC will continue to challenge such transactions under the present law, including in litigation where necessary."

Having spoken to HMRC they were keen to mention that this may apply to some Pre-December 9th 2010 EBTs and EFURBS.

HMRC's argument (and they acknowledge there are counter-arguments) is that once funds are placed in any sub-trust or allocated unconditionally for the use and benefit of the Employee, they become income subject to PAYE and NIC's.

They also consider that by analysing any of the steps in an arrangement, if the intention is clear to place money unconditionally in the hands of an Employee, then this falls within the **RAMSAY Principle** as set out in **IRC v Scottish Provident (2005) STC15**. The leading House of Lords decision. They have been buoyed by their recent First Tier Tribunal success in **Aberdeen Asset Management Plc v Revenue & Customs [2010] EWCA Civ 1255**.

This case was argued in the Scottish Tribunal. It dealt with a convoluted scheme "The Discounted Option Scheme" using an EBT and various options and further sub-trusts to award large bonuses to the key Employees at **Aberdeen Asset Management Plc**. Using the **RAMSEY Principle** of purposive construction and analyzing the particular facts, the Tribunal held that the sums in the Scheme were allocated unconditionally for the use of the Employees and therefore subject to Income Tax and National Insurance Contributions.

There were other arguments raised including a Decision on valuation of Company Shares subject to Option (that may have far-reaching consequences to other tax planning).

This contrasts with other previous occasions HMRC argued these points before the **Special Commissioners in the Sempra Metals case** (see my previous article INCOME TAX PLANNING AND

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OSBORNES'S FIRST BUDGET). Their arguments were dismissed on both of the 2 points above. The case was settled before an appeal could be heard in the High Court. **Sempre Metals** was distinguished in the **Aberdeen Asset Management Plc** case because the terms of the sub-trusts and the loans meant the funds were not allocated unconditionally to the Employees.

In the end, it is clear HMRC are going to group together many different types of EBTs and EFURBS (where loans and benefits have been paid pre-December 9th 2010). Many Employees will therefore face a lottery, depending on the exact nature of the way their particular trust was set up and operated. Those who have purchased *Disclosed Schemes* from tax product sellers will be in my view, most at risk! This is highlighted once again by the decision in **Aberdeen Asset Management Plc** where the operation of the Trusts and Companies was felt to be lacking any independence.

CONCLUSION

Once again, tax planning and what is effective has been demonstrated as an uncertain science. Who gives the advice and how it is implemented are now critical to having any chance of success. Any advice must be objective and independent, setting out to the users, both the risks as well as the potential benefits. There may well be restructuring opportunities for some, (if and when) HMRC's approach to particular EBTs and EFURBS becomes clear.

In the meantime, Companies using EBTs and EFURBS users and beneficiaries should consider seeking independent advice.

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