

STRATEGIC TAX PLANNING

International & UK Tax Consultants

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INCOME TAX PLANNING AND OSBORNE'S FIRST BUDGET

George Osborne's first budget has thrown up some interesting developments concerning popular tax strategies that are being heavily promoted as ways around the new 50% income tax rate.

It is clear from both the HMRC and Treasury Budget notes (when read together) that once again the heavy promotion of a tax planning strategy re-packaged as a **tax product**, both accelerates its demise and damages tax planning generally.

The two particular tax planning strategies that are now clearly in HMRC's sights are the following:

1. The use of Trusts to Reward Employees;
2. Geared Growth and Employment Related Securities.

The First is a follow up to a Budget Note issued in Alistair Darling's March budget.

This concerned the use of Trusts as a means of avoiding, deferring or reducing an Employee's or Director's liabilities to income tax and NICs and by-passing restrictions on pensions tax relief.

The assumption by tax product sellers was that this merely referred to Employee Benefit Trusts ("EBTs") and Family Benefit Trusts ("FBTs") (a variation on an EBT where the Employee or Director's family are the main Beneficiaries).

These had already come under HMRC attack in Revenue & Customs Brief 61/09 issued in October 2009.

These tax product sellers were advised that if EBTs and FBTs had the Inheritance Tax problems HMRC claimed, then the simple solution was to use an Employee Funded Retirement Benefit Scheme ("EFURBS") instead!

EFURBS formerly known as Funded Unapproved Retirement Benefit Schemes ("FURBS") before 6th April 2006 are longstanding alternative vehicles to provide high earning individuals with an adequate pension fund.

The changes to their tax treatment from 6th April 2006 meant that Employees were no longer taxed on Employer contributions as a Benefit In Kind. There was also the potential for a Corporate Tax deduction for the Employer when "Relevant Benefits" are paid to the Employee. A potential time delayed tax deduction.

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The Budget note is clear: EFURBS as well as EBTs and FBT will be targeted by the proposed anti-avoidance legislation from April 2011.

The exact form that anti-avoidance legislation will take is unclear. However, HMRC's position is that once funds are allocated unconditionally either to a sub-fund or loaned to Employees or Directors, this is equivalent to an income payment that is subject to PAYE income tax and NICs.

We know this because this was the substance of their argument in *Sempre Metals Ltd –v- Commissioners of HMRC* [2008] STC (SCD) 1062 (SpC698).

HMRC succeeded in preventing a Corporation Tax deduction for payments to an FBT but failed in their argument that loans to Beneficiaries were subject to PAYE income tax and NICs.

Now no doubt, tax product sellers will tell us that since any new anti-avoidance legislation will only come in from April 2011, this presents an opportunity to *buy whilst stocks last!!*

On the other hand, they may gloss over the need for good independent tax advice and a bespoke planning approach. There are, risks that if payments into the EFURBS are to be allocated to individual Employees or loaned back immediately, they may well be treated as income subject to PAYE income tax and NICs. This could create enormous problems for both the individual and the Company that has funded the EFURBS, which then has a large tax liability to fund.

Clients need to be aware of this. Not all EFURBS are equal; there are several different possible variants of EFURBS and making sure that Clients get the right one for them is essential.

Also does the Company pay in or loan money to the EFURBS? Should money be loaned back immediately by EFURBS trustees or invested? Should the entire fund be loaned back? Should the money be allocated to a sub-Fund?

These all have serious tax consequences that need addressing by someone who understands the different tax treatment.

To complicate matters further, a worrying trend has appeared. Tax product sellers are offering either no tax advice (they are a Trust Company IFA etc). Advice at an extra cost or the Client is "confused" by the appearance of a firm of UK Solicitors appearing to endorse the EFURBS but whose contract states they are merely drafting the legal documents.

So, the Client ends up with limited generic guidance and no real tax advice to rely on. In reality, they need bespoke tax advice and planning to create a fall-back position/options if the law changes once they have transferred money to an EFURBS.

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The second Budget Note is aimed at another tax product to reward Employees/Directors in shares subject to Capital Gains Tax, rather than pay income tax at 50%. There are various devices to enable Employees or Directors to acquire shares or share interests in a Company (so called “Geared Growth Schemes”) in a way that they pay or are charged to tax on a small initial value. Say they acquire £10,000 worth of shares but have rights over £100,000 worth of shares. When those shares are sold for say £1m a couple of years later, the Employee will pay Capital Gains Tax at 28% or the increase in value from £100,000, rather than income tax and NICs at 52% (or more).

The growth potential has been “geared” by 10 times. HMRC are consulting this year on “Geared Growth Schemes” with the aim of making sure that such growth is more fairly subject to income tax and NICs. Whether that means subjecting **all** the growth to income tax and NICs or altering the valuation basis to increase the initial amount taxed, is unclear.

Conclusion

EBTs, FBTs and particularly EFURBS have represented genuine tax planning opportunities for many years (often in far more limited circumstances and with far fewer tax savings) than has been claimed by tax product sellers. The same has been the case with some versions of the “Geared Growth Schemes” that have also been added to tax product sellers’ catalogues and hard sold as a solution to the 50% income tax rate.

They may well be appropriate for Clients in the right situation and of course, there are other versions and avenues to reduce or defer income tax that might be more viable.

Before considering any of these, Clients need independent tax advice to determine if any of these tax planning strategies are suitable for them and to understand the tax risks and any alternative planning, that is possible.

Sadly, heavy promotion is likely to have severely limited (and possibly eliminated) the opportunities for using EBTs, FBTs, EFURBS and “Geared Growth Schemes” to avoid the impact of the 50% income tax rate.

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