

MACFARLANES

EMPLOYMENT TAXATION

BRIEFING

BENEFITS PROVIDED BY THIRD PARTIES

The government has recently published draft legislation which imposes tax on various steps which may be taken by the trustee of an employee benefit trust (EBT) (or by any other third party) in connection with arrangements intended to provide benefits to employees, former employees or anyone linked to them (relevant persons). In addition to certain arrangements which HMRC is known to consider unacceptable, the draft legislation appears potentially to catch a number of common situations which are not aimed at avoiding tax.

PROVISIONS WHICH ARE ALREADY IN FORCE

The legislation is still in draft. However there are anti-forestalling provisions which mean that:

- ◆ Any payment of money made from an EBT to a relevant person, including a loan, could now trigger an income tax charge (and a liability to pay National Insurance contributions). This effectively prevents EBTs from providing loans by taxing all such loans as if they were bonuses. Existing loans will not be taxed, although care will be needed if they are to be extended, varied or refinanced.
- ◆ Arguably, a payment from an EBT in consideration for a purchase of shares from an employee or former employee could fall within the scope of the legislation. This would clearly affect the use of EBTs to warehouse leaver shares or operate internal markets and may also catch certain joint share ownership plans. We are expecting clarification from HMRC, which we would hope would confirm that these scenarios are not intended to be caught.
- ◆ Certain other transactions which involve the provision of an asset as security for a loan may also give rise to an immediate tax charge under the new legislation.
- ◆ Certain transactions whereby assets are made available to relevant persons (for example the use of a shared property) could give rise to a tax charge following the cessation of employment.

PROVISIONS COMING INTO FORCE ON 6 APRIL 2011

With effect from 6 April this year, in addition to the transactions referred to above:

- ◆ Any notional allocation or "earmarking" of assets within an EBT for a relevant person will give rise to an immediate "dry" income tax charge, even though the assets at that stage remain within the EBT. This is primarily intended to prevent trust assets being earmarked or allocated to a sub-trust for a particular employee or his family with a view typically to providing benefits out of the resulting trust fund after the employment ends in a manner which

is not subject to tax. However, given the wide drafting of the legislation this could cover, for example, an EBT which holds assets to fund share options or similar awards. Care will also be needed in relation to unallocated equity which is set aside for new members of a management team.

- ◆ Most transfers of assets out of an EBT will be subject to tax. A sale at market value will not trigger a tax charge provided the consideration is paid upfront.
- ◆ Taking a step by virtue of which a relevant person acquires an interest in shares or other securities may trigger a charge.
- ◆ The grant of a lease in excess of 21 years to a relevant person may trigger a charge based on the value of the property.
- ◆ Making an asset available to a relevant person to benefit in a way which is substantially similar to the way in which they would benefit from it if the asset were transferred to them (for example exclusive use of a property) may trigger an immediate tax charge based on the value of the property.

Note that the legislation applies to steps taken by any third parties, not just the trustees of EBTs. It will catch steps taken by group companies and will even catch steps taken by the employer where it is acting as a trustee.

There are a number of exemptions, for example for steps taken under approved share plans and the grant of fully taxable options. There is also an exemption for broadly based employee benefits packages. There are also provisions aimed at avoiding double taxation and reducing the amount subject to UK tax where the step relates to a tax year in which the employee was non-UK resident and is not in respect of UK duties.

Existing arrangements should be reviewed for compliance with the new legislation and may need to be amended or wound down. This should be done as soon as possible, as there may be scope prior to 6 April 2011 to wind arrangements down in a tax-efficient way.

CONTACT DETAILS

If you would like further information or specific advice please contact your usual Macfarlanes contact or:

ROBERT COLLARD
DD: +44 (0)20 7849 2696
robert.collard@macfarlanes.com

DAN PIPE
DD: +44 (0)20 7849 2984
dan.pipe@macfarlanes.com

MACFARLANES LLP
20 CURSITOR STREET LONDON EC4A 1LT

T: +44 (0)20 7831 9222 F: +44 (0)20 7831 9607 DX 138 Chancery Lane www.macfarlanes.com

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