

PRAXIS – EFRBS

EMPLOYER-FINANCED RETIREMENT BENEFITS SCHEMES

INTRODUCTION

The concept of EFRBS was introduced in April 2006 when a lifetime cap (currently £1.8m) was introduced on the funding of UK approved pension schemes. Prior to then, it was possible to top up pensions using FURBS (Funded Unapproved Retirement Benefit Schemes) but FURBS are no longer as tax-efficient. An EFRBS is a highly-flexible alternative to a UK-registered pension scheme. The annual and lifetime allowances on contributions applicable to UK-registered pension schemes do not apply, while the permissible investment choices are much wider.

INCENTIVISATION AND RETENTION

Through using an EFRBS, an employer is able to incentivise and retain key personnel, by providing valuable retirement benefits.

TAX-EFFICIENCY FOR THE EMPLOYEES

An offshore EFRBS can provide an investment fund which is able to grow in a potentially low-tax environment outside of the member's estate for IHT purposes, although the payment of benefits on the member's death will need to be correctly structured. Payment of income tax and NIC is deferred until the beneficiary receives benefits from the EFRBS.

CORPORATE TAX DEDUCTIONS

Unless relevant benefits are paid to retiring employees within nine months of the year end, the UK employer will not be able to claim corporation tax relief at the time when the contributions are made to fund the EFRBS. Instead, corporation tax relief will be deferred until benefits are actually provided to the beneficiaries.

CONTRIBUTIONS

The level of permitted contributions to an EFRBS is not subject to either the annual allowance or lifetime allowance restrictions which affect UK-registered pension schemes. However, the level of contributions made to an EFRBS should take general account of the overall profits of the employer and of the total pool of

remuneration and bonuses payable by the employer. When contributions are made to the EFRBS, the employee should not be subject to income tax, nor should any national insurance contributions (NICs) be payable either by the employer or by the employee.

INVESTMENT OF THE FUND

The fund is able to be invested in a very flexible manner, including but not limited to open-ended and closed-ended mutual funds, equities, bonds etc. Non-UK income and capital gains can accumulate tax-free within an offshore EFRBS, while UK-source income generally suffers UK tax at 40% (50% from 6 April 2010) and UK-source dividends suffer UK tax at 32.5% (42.5% from 6 April 2010). The Scheme Deed can be drafted to be an IHT exempt overseas pension fund, or provide for greater flexibility along the lines of a discretionary trust. The latter version may be subject to the relevant IHT charges, which include the 10 year charge.

ACCESSING THE FUND PRIOR TO RETIREMENT AGE

Prior to retirement, if a member receives a benefit from the EFRBS, including a benefit-in-kind, then he will be liable to income tax and NIC on the value of that benefit in the same way as if he had received that same benefit directly from the employer company even if he has left the employment, or is no longer UK resident, at the time of receipt. However, if the member takes a loan from the EFRBS at a commercial rate of interest equal to or higher than the official HMRC rate of interest (currently 4.75%) then no employment income tax liability would result from such a loan. There are however other tax factors to consider when deciding whether such loans may be made available.

On the member's death, any loan balance outstanding from him to the EFRBS may potentially reduce his taxable estate for IHT purposes, although this will depend on a number of factors. Unlike for UK-approved pension schemes, there is no restriction on making loans to the employer company, however such loans

would need to be on a fully commercial basis as to interest, security and repayment terms.

TAKING RETIREMENT BENEFITS

When certain types of retirement benefits are paid from the EFRBS, such benefits are not subject to either employers' or employees' NIC. The taxation of lump sum benefits will depend on the tax residency of the member when benefits are taken. Likewise, the taxation of pensions or annuities will depend on the member's residency status when such benefits are taken. Generally, if the member is resident in the UK at the relevant time, then all such benefits will be subject to income tax at the beneficiary's marginal rate of tax. There is no obligation to purchase an annuity when taking benefits from an EFRBS.

SUMMARY

An EFRBS can therefore satisfy multiple objectives in a tax-efficient manner, including:

- acting as a top-up pension scheme;
- providing access to a wider spread of investments than is available from approved pension schemes;
- avoiding any purchased annuity obligations;
- protecting assets from future creditors;
- permitting arms-length loans to the member or to the employer company in appropriate circumstances;
- mitigating exposure to NIC for both the employer company and the employee; and
- tax deferral for the employee.

The employer company must carefully consider the impact of the long-term deferral or potential loss of corporation tax relief in respect of the contributions that it makes to an EFRBS. For loss-making companies and/or companies with substantial accumulated losses this factor may be less of an issue.

Particular care must be taken in relation to IHT issues generally, given that an EFRBS may be drafted as a discretionary trust. This particularly applies where EFRBS are established by "close" companies and where it is intended that "employee/shareholders" may benefit from the EFRBS. In such circumstances there are additional IHT and other tax factors to take into account on a case-by-case basis.

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